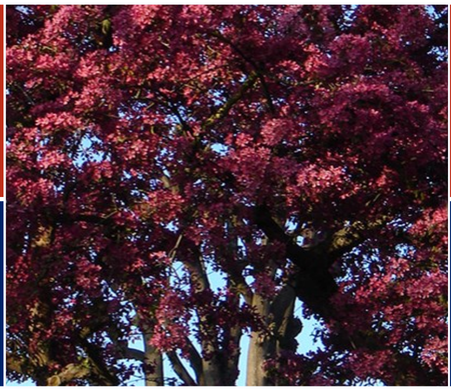
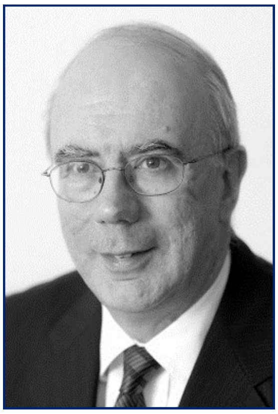
Government Actuary's Department

eNews from GAD

ACTUARIAL ANALYSIS
— FOR THE PUBLIC SECTOR
— FROM THE PUBLIC SECTOR

Issue 15 March 2014





A warm welcome to the latest edition of **eNews from GAD**.

Following recent news from public sector pensions and the UK Budget (see recent announcements below), this edition steps back to look at two important longer term issues:

> Dermot Grenham talks about how insurance can help developing nations manage the risks and impacts of natural disasters and how we are working with DfID in this area

> Bill Rayner discusses the governance structures for UK public service pension schemes.

As you will no doubt have heard, Martin Clarke will succeed me as Government Actuary later this year. Martin is currently Executive Director of Financial Risk at the Pension Protection Fund. His background and expertise in pensions, insurance and financial risk makes him an excellent successor to enable GAD to continue to serve the government, the taxpayer and all our clients.

I hope that you enjoy this issue. As before, previous issues of eNews are available on our website www.gov.uk/gad.

TREVOR LLANWARNE GOVERNMENT ACTUARY

Trevor Llanwarne

NEWS FROM GAD

GAD paper at International Congress

A team at GAD has written a paper Long-Term Financial Management of Unfunded Liabilities for Pensions for Public Service. It explains the method of financing public sector pensions adopted in the UK, how this is monitored and the reforms currently being implemented. The paper will be presented at the 30th International Congress of Actuaries in Washington DC at the end of March.

Head of HR appointment

Paul Vinall will join us during March. Paul is moving to us from FCO Services (a Foreign and Commonwealth Office Trading Fund) where he is currently an Organisational Development Manager. Paul has an extensive career as a HR Business Partner and has managed several HR projects for government departments, a local authority and the Royal Air Force. We welcome him to GAD.

DEVELOPMENTS

Social care

The Department of Health has published a number of reports following a review of the market for products to fund social care. A joint statement of intent with the Association of British Insurers gives a commitment to work together to help people plan and prepare for the costs of their long term care and to work with relevant government departments (including GAD) and the FCA to further explore some of the conclusions of the review.

Uprating report

The 2014 GAD annual report to government on the impact on the National Insurance Fund of the latest orders for benefit and contribution-related up-rating has been published. This estimates the balance in the Fund at 31 March 2014 to be £22.0 billion. By 31 March 2015 this is projected to fall below the Government Actuary's recommended threshold, meaning it may be appropriate to seek additional funds by means of a Treasury Grant.

Recent announcements

> GAD's bulletin provides an overview of key pensions and savings measures set out in the 2014 Budget

> On 13 March the government set out its policy on valuations of the main public service pension schemes and plans for an employer cost cap. GAD's bulletin provides an overview of the announcements.

Review of annuities

A Financial Conduct Authority (FCA) thematic review of annuities in contract-based schemes found that parts of the annuity market are not working well and that the majority of consumers would be better off buying an annuity on the open market. The FCA will now conduct a competition market study looking at the range of products to convert funds to retirement income and whether there are obstacles to competition working more effectively for consumers.

REGULAR NEWS BULLETIN FROM GAD

ISSUE 15 MARCH 2014

INSURING AGAINST NATURAL DISASTERS

Dermot Grenham

All countries are at risk from extreme weather events and natural disasters. In the face of the risk of disasters, countries try to put in place mitigation and adaptation plans in order to reduce their effect. Insurance has a role to play, at both the private and public levels. Risk analysis and insurance knowledge are important to ensure it is implemented effectively. GAD has been working with the Department for International Development (DfID) on a number of their insurance development projects.

Extreme weather has been familiar in recent news. In recent weeks parts of the UK have suffered the effects of severe floods and winds. The USA has similarly been suffering from unprecedented cold weather while over the past few years disasters such as earthquakes, tsunamis and typhoons have affected, for example, the Philippines, New Zealand, Japan, Chile, Italy and Haiti, and drought is a pressing challenge for many African countries. Typical mitigation and adaptation plans include improving flood defences and dealing with the aftermath of the occurrence of a disaster.

The role of insurance

One element in the mitigation and plans that needs to be considered is the role of insurance, at both the private and public levels. Insurance is essentially a way of spreading the costs of disasters across time and a whole population. Individuals and businesses can insure themselves, to a greater or lesser extent, against risks to their lives and property from unexpected events. Similarly, governments can also insure themselves in situations where they consider that this makes economic sense, ie where the cost of taking out insurance is lower than the cost of paying future claims. In the UK, HM Treasury generally considers that it is not economically efficient for central government to take out insurance and generally only does so where this is a legal requirement. There are though situations where the public and private sectors come together to ensure that appropriate insurance is available. Examples of this include Pool Re which provides terrorism cover and, potentially, Flood Re, which will enable households in areas at a high risk of flooding to get insurance. Actuaries at GAD have provided advice on both of these. We have also been working with the Department for International Development (DfID) on a number of their projects to help with the development of insurance in low and middle income countries.

'Governments can also insure themselves in situations where… this makes economic sense.'

Photo: Anne Wanjié

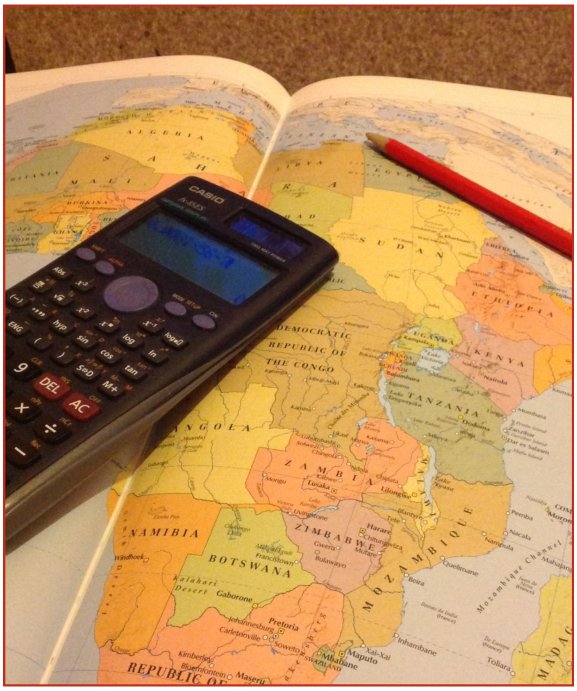
African Risk Capacity

One of these projects is with the African Risk Capacity (ARC). The problem ARC seeks to address is that, in the event of a drought in an African country, it can take some time for government resources and aid to be mobilised. This delay can have serious consequences for the health and livelihoods of those affected.

A lack of sufficient and suitable food for young children can lead to physical and cognitive impairment. Farmers may need to sell productive assets, such as cattle, in order to purchase food and this can reduce their livelihoods for years to come.

INSURING AGAINST NATURAL DISASTERS (continued)

To overcome this, ARC aims to make payments to governments almost as soon as a drought is expected to occur so that food and other forms of aid can be bought and distributed before the worst effects of the drought are felt and therefore provide support to livelihoods until larger volumes of aid arrive from other government resources and the international community.



ARC is an insurance company which aims to insure a number of African countries, starting with around six and, over a number of years, rising to around 18. ARC will use the results of the African Risk View (ARV) drought disaster model to set premiums, on a country by country level, to cover the impact of droughts which have a greater than one in five year chance of occurring, with a maximum pay-out of no more than $30 million. The same model will be used to measure on an on-going basis whether, given specific levels of rainfall in a year, a drought severe enough to trigger a claim is expected to occur. If it is, then a payment is made to the country or countries affected. In order to be insured, countries need to have agreed credible plans with ARC of how they will disburse the claims payments received. In the event that they get a claim payment, their use of the funds received will be audited to ensure that it was in line with their plans. ARC will initially start with capital provided by donors, but over time expects to generate its own capital from profits from the premiums such that the original capital can be repaid.

GAD's contribution

GAD has been working with DfID to review the model used by ARC to demonstrate the financial robustness of their business plan and, in particular, the level of risk that ARC will not have the financial resources in, say, 20 years' time to repay the original donors. We applied our insurance and actuarial skills and experience to help DfID understand the implications of supporting the project. In particular we examined:

- how the results from ARV's model translated into projected revenue accounts and balance sheets,
- how much capital is likely to be required by ARC, and
- how likely it is that this capital will be needed to support claim payments and therefore not be returnable to donors in, say, 20 years.

'We applied our … skills and experience to help DfID understand the implications of supporting the project.'

We also reviewed the level and structure of ARC's proposed reinsurance arrangements and the extent of stress and scenario testing that was carried out. If DfID decides to financially support this project then GAD will continue to be involved in the regular valuation of DfID's investment.

Other projects

GAD is also assisting DfID in its work with the Political Champions for Disaster Resilience, an informal grouping of senior representatives and political leaders that advocates for greater emphasis on and investment in disaster risk reduction, and with its joint project with the World Bank on Sovereign Disaster Risk Finance and Insurance.

Our website details the full range of insurance and other services we can offer. If you would like to discuss these further please contact Dermot Grenham.

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REGULAR NEWS BULLETIN FROM GAD ISSUE 15 MARCH 2014

PUBLIC SERVICE PENSIONS REFORM: DON'T FORGET GOVERNANCE CHALLENGES

Our Senior Chief Actuary, Bill Rayner, has been on the governance board of the Royal Mail Statutory Pension Scheme as a proxy for HM Treasury for two years and has 20 years' past experience of delivery and governance of pension administration. As the commencement of reformed UK public service pension schemes is rapidly approaching, we asked him to offer some personal thoughts about the governance challenges that will arise out of the changes.

Bill Rayner

Most reformed schemes will start on 1 April 2015, with the new LGPS starting on 1 April 2014. For each scheme being reformed the list of tasks needed to implement the new benefit arrangements could well be formidable and includes:

- comply with policy and regulation
- updating administration systems
- member communication, and
- calculation by the actuaries of the employer contribution rate and cost cap.

Additionally, there is the issue of implementing new governance arrangements. While this should admittedly not be as extensive or time-consuming as the items listed above, it is an issue meriting careful forethought, planning and engagement with stakeholders.

The reforms are to be implemented according to the Public Service Pensions Act 2013. This legislation specifies that each scheme should have:

- A Scheme Manager: the person (or the authority) responsible for managing or administering the scheme, or part of the scheme, or any connected statutory scheme
- A Pension Board: to assist the Scheme Manager with compliance by the Scheme with relevant regulations, and with compliance requirements imposed by the Pensions Regulator (tPR)
- A Scheme Advisory Board: responsible for providing advice to the responsible authority, at the authority's request, on the desirability of changes to the scheme.

In essence, the Pension Board's function is to provide stewardship, while the Scheme Advisory Board focuses on any future scheme transformation.

The legislation mandates that no one who serves on either of the two Boards should have a conflict between their role as a board member and any of their other interests. The Pension Board must have representatives of the employer and the members.

'...An issue meriting careful forethought.'

Therefore, when setting up either of these bodies, consider including the following:

- how to manage any conflicts of interest, real or apparent
- process of appointment (and removal) of Board members
- terms of reference.

These questions take little or no time to pose, but typically much longer to answer. Establishing a shadow board in advance of the actual Board may be a good idea. This would give all involved time to familiarise themselves with the nuances of how the new requirements will work in practice, before the reformed schemes go live.

Getting the implementation of governance structures right will support the effective management of the new scheme, lay the foundations for engagement with members and other stakeholders (including tPR).

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For details of our management team and office address please visit:

https://www.gov.uk/government/organisations/government-actuarys-department#people