eNews from GAD

Actuarial analysis from the public sector

Issue 17, October 2014

Welcome to eNews – GAD's regular newsletter. In this first edition under my tenure as Government Actuary, we focus on the modelling of National Insurance payments and contributions and the Quinquennial Review (QR) of the National Insurance Fund that my predecessor Trevor Llanwarne recently completed.

Understanding and reporting on the complex dynamics of long-term financial and demographic trends is a specialism of actuaries that has applications in several areas of government expenditure. I was attracted to the possibility of becoming the 9th Government Actuary by the potential for actuarial analysis and advice to support decision-making at the highest levels in government. I am passionate about the capacity and versatility of actuaries to do this with added value.

For me, much of this depends on our ability to communicate effectively the uncertainty of outcomes and to express the sensitivity of the outcomes to material and key assumptions. This is manifestly the case with the National Insurance Fund that is the accumulated difference between the aggregate contributions and benefit payments stretching out many years ahead. Long-term demographic, economic and labour market experience are the principal drivers of outcomes to the Fund and our QR explores at length the sensitivity of the income and outflows to variant assumptions to our base case in all these three areas.

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

Martin Clarke
Government Actuary

NEWS FROM GAD

Chief Actuary promotions

As of the start of August, Matt Wood has been promoted to Chief Actuary of the Teachers and Police team and Ian Rogers has been promoted to Chief Actuary of the Insurance, Risk and Modelling team. We wish both Matt and Ian all the best in their new roles.

Annual Report

The GAD 2013/14 Annual Report is now available on our website. This sets out our aims, service commitments and values and provides details of our achievements during 2013/14.

DEVELOPMENTS

State pension deferral

In a Written Ministerial Statement, Steve Webb, Minister for Pensions, confirmed a proposed new rate of 1/9th of 1% for each week's deferral of State Pension after State Pension Age (SPA) for those reaching SPA from 6 April 2016. The decision follows a GAD report commissioned to provide an update on an actuarially fair rate. Draft regulations to implement the changes are due to be published later in the year.

Definition of money purchase benefits

Following the 2011 High Court decision in the 'Bridge case' (see our June 2011 eNews for more details), a revised definition of money purchase benefits came into force on 24 July 2014 (with retrospective effect from 1 January 1997). As the impact is very scheme specific, the Pensions Regulator issued a statement which set out its expectations of schemes. The Pension Protection Fund also consulted on consequential effects on s179 valuations.

Solvency II consultations

In advance of its transposition into UK law, two consultations relating to UK implementation have been published on Solvency II. HM Treasury's recent consultation related to two policy issues and the Prudential Regulation Authority's consultation sets out proposed changes to their rules.

The Pensions Regulator (tPR): DB Code of Practice

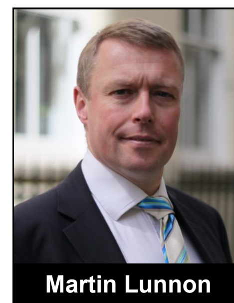
TPR's revised code of practice on Funding Defined Benefits came into force on 29 July. The code now allows for tPR's new objective introduced by the Pensions Act 2014 'to minimise any adverse impact on the sustainable growth of an employer'.

Defined Contribution pension reform

The government has set out further details on the implementation of the flexibilities to Defined Contribution pension savings announced at Budget 2014. Draft legislation and accompanying guidance were also published for technical consultation during August.

TAKING A LONG-TERM PERSPECTIVE: THE REVIEW OF THE NATIONAL INSURANCE FUND

GAD's skill in taking a long-term view of costs and understanding trends is integral to the service we can deliver to our clients. Martin Lunnon explains why this is relevant for the recently published Government Actuary's Quinquennial Review of the National Insurance Fund as at April 2010 (QR), how this has been implemented in practice, and some initial conclusions.



Martin Lunnon

Why have a National Insurance Fund and a Quinquennial Review?

In Great Britain, most working people pay National Insurance contributions into the National Insurance Fund which supports a range of state benefits. The most significant of these is the State Pension. Benefits in the year are paid from the National Insurance contributions received in the year. (A small amount of contributions is given to the NHS.) Any excess of contributions goes into the Fund and any deficit made up from the Fund, or if it is insufficient, from wider public finances. Thus, although the Fund acts mainly as a working balance, it is appropriate to review it periodically.

An individual's State Pension is built up and paid out over a long timeframe. So to review what might happen to the Fund it is important to understand the impact over a long period of recent policy changes and the lasting effects of current economic conditions. With knowledge of economic and demographic trends, actuaries have the right skills to do this. The Government Actuary has a statutory responsibility to review the NI Fund every five years.

How was the Review conducted?

To investigate the future of the Fund long-term financial projections are needed for a range of scenarios. In the QR, we project the Fund up to the year 2075 for a base case as well as some variant scenarios. The principal start date for the QR projections was end March 2010, though more recent available information, including the Fund's accounts up to 2012-13, was also used. Publishing in 2014 meant that we could include the impact of some relevant recent legislation: the Pensions Act 2014.

Most of the projections reflect the current situation of the Fund: that the basic and new State Pension will be uprated in line with the 'triple lock', that is, the largest of increases in earnings, increases in the consumer price index and 2.5% a year, and that the current level of National Insurance contribution rates will continue. We made no allowance for additional payments from wider public finances.

The base case projection is based on an economic and demographic outlook consistent with that used by the Office for Budget Responsibility (OBR). As long-term demographic, economic and labour market experience are the principal drivers of outcomes to the Fund, our QR explores at length the sensitivity of the cashflows to variant assumptions in all of these three areas.

> 'With knowledge of economic and demographic trends, actuaries have the right skills.'

What does the Review show?

Unlike the previous QR, which projected that the Fund would remain with a positive balance at least up to 2070, the current QR projects that, in the absence of the Pensions Act 2014 reforms, the Fund would be exhausted in 2027 and with the reforms it would be exhausted in 2035.

Economic conditions mean that the balance in the Fund has declined in recent years as a result of the slowdown. The prolonged period of low growth in earnings means that actual contribution receipts have been less than previously projected. As benefit payments are less affected by economic conditions this has led to the Fund being in a weaker financial position now than five years ago.

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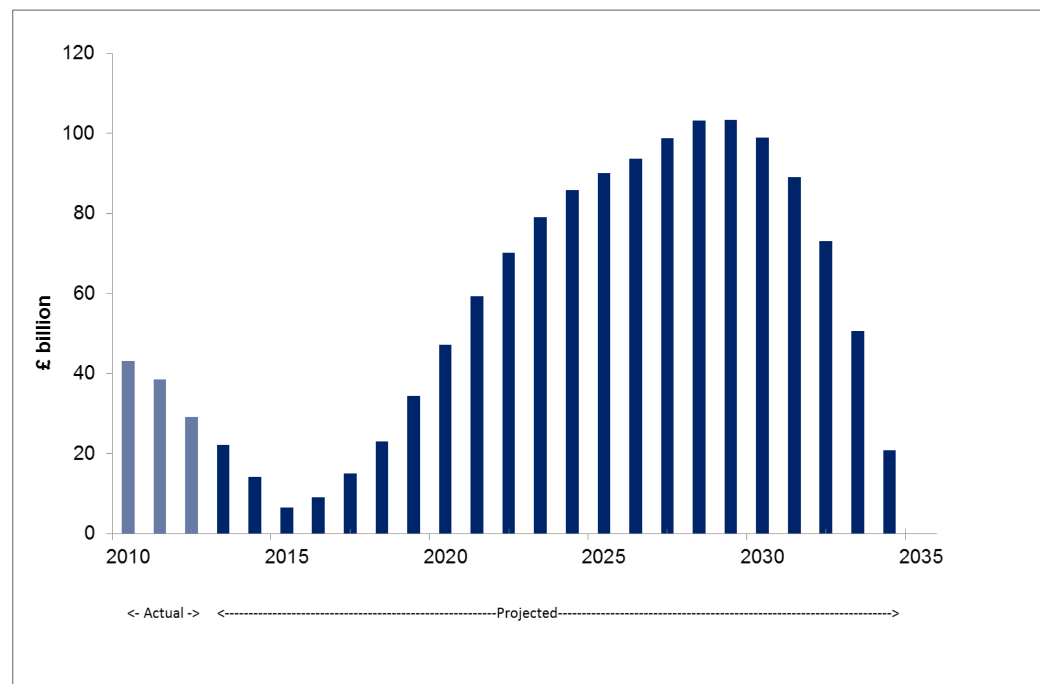
TAKING A LONG-TERM PERSPECTIVE: THE REVIEW OF THE NATIONAL INSURANCE FUND (continued)

Projected National Insurance Fund allowing for Pensions Act 2014



'It is instructive to understand the long-term dynamics that shape the future.'

Policy changes in the Pension Act 2014 are expected to affect the Fund:

- The main impact is the increase in contribution income from 2016 as a result of the ending of contracting out.
- The Fund will also be affected by the increase in the number of years required for a full pension from 30 to 35 and the bringing forward of increase in State Pension age to 67 to between 2026 and 2028.

There are other changes made by the Pensions Act which affect the amounts that pensioners may receive but do not greatly affect the Fund, for example the new State Pension is to be set at or above the basic level of means-tested support and so reduce the amount of means-tested benefits paid. The financial effects of this are not reflected within the Fund itself but elsewhere within government accounts.

Our projections illustrate how much certain policies, for example triple lock, cost and how they are only partially offset by the changes brought in by the Pensions Act 2014.

What can be done to improve the balance of the Fund?

National Insurance contributions and the benefits payable from the Fund are a subset, albeit a substantial one, of the government's income and expenditure account. The health of the Fund should, therefore, be considered in a much wider context. Nevertheless, it is instructive to understand the long-term dynamics that shape the future experience of the Fund. In this respect, the report describes some options which could be introduced to avoid the Fund being exhausted before 2060.

For example:

- If the main, Class 1, contribution rates were increased from the current rate of 21.85% to 23.5% (both net of the allocation to the NHS) by 2020 this is projected to keep the Fund positive until at least 2060. Alternatively, contribution rates are projected to need to increase gradually from their current level to over 30% by 2060 to balance income and expenditure.
- An alternative option would be to reduce the annual rate of increase in the basic or new State Pension from triple lock to below earnings growth. This would, however, require a change in legislation, as there is currently a statutory requirement for these pensions to increase at least in line with earnings.

Over the longer term, further increases in State Pension age, beyond those of the Pensions Act 2014, would help the finances of the Fund but they are unlikely to be introduced soon enough to prevent the Fund becoming exhausted by the mid-2030s.

However, before any decisions about the future of the Fund are even considered, further investigations and projections are suggested. As well as examining possible future outcomes in more depth, issues such as public expectations and intergenerational fairness would need to be considered.

GAD's ability to make long term financial projections and to provide tailored advice to decision makers can be applied to a wide range of long-term uncertain financial issues. Our website details the full range of service we can offer. If you would like to discuss any of the above please get in touch.

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PUBLIC SERVICE PENSION REFORM: SUPPORT FOR MEETING GOVERNANCE REQUIREMENTS

Sophie Dennett

1 April 2015 is fast approaching, when many of the reformed public service pension schemes go live. These schemes will be subject to governance requirements under the Public Service Pensions Act 2013 (or equivalent Northern Ireland legislation). Appropriate frameworks need to be put in place and operational in time for next April. Sophie Dennett looks at some of the information and support available to those involved with public service pension schemes.

What are the new requirements?

The Pensions Regulator (tPR) has a statutory role to provide regulatory oversight of the new schemes. TPR is developing a code of practice setting out the standards of governance and administration expected of those running public service schemes. The draft code has been subject to consultation, including a separate consultation in Northern Ireland. A consolidated code for the United Kingdom is expected to be put for parliamentary approval later in the autumn.

As Bill Rayner's March eNews article set out, legislation specifies that each scheme should have a scheme manager, a pension board and a scheme advisory board. The role of the pension board is to assist the scheme manager, for example helping to ensure compliance with relevant regulations and other requirements imposed by tPR.

Information available from tPR

To help support schemes in meeting these requirements, tPR recently published brief guides on public service pension boards and on being a pension board member. These are available on a new public service section of tPR's website.

The pension board guide provides an overview of the scheme manager's roles and responsibilities, which include governance and administrative issues. One of the key responsibilities identified for the scheme manager is to manage risks and ensure there are adequate internal controls. Whilst noting that scheme regulations or scheme-specific guidance may provide further detail, the guide also considers some operational aspects such as the composition of the pension board.

Other support available

Pension board members are required by law to have knowledge and understanding of relevant pensions law and to have a working knowledge of their scheme's regulations and documentation. TPR will be developing a free online learning programme to assist with this. Whilst there are parallels between the role of pension board members and trustees in a trust-based pension scheme, tPR's guide notes the importance of being aware of the differences, as not all information aimed at trustees may be relevant in the public service setting.

'Pension board members are required by law to have relevant knowledge and understanding.'

All of the above highlights some new territory for how many public service pension schemes will need to be governed. GAD has worked with a range of organisations on the identification and mitigation of many types of risk and has worked alongside policymakers throughout the scheme reform process. Please get in touch with your usual GAD contact if you would like to discuss how GAD may be able to assist as your scheme puts in place a framework to meet the new governance requirements.

GAD contacts

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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

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