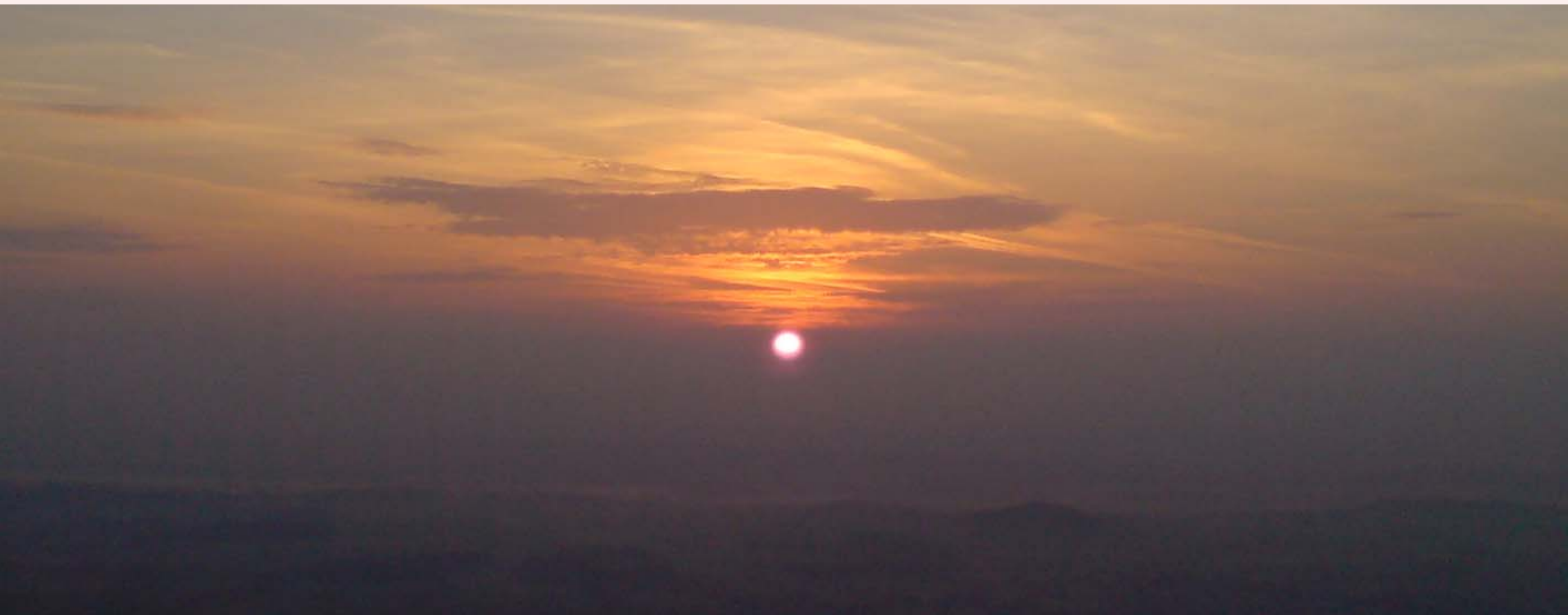

2007 Review and Pension Trends Survey Report

Contents:

ACA Review 2007

Chairman's Introduction 3

Pension Reform: more to be done 4-6

Pension Trends Survey Report 7-10

Insurance: the role consulting actuaries are playing 11

The ACA at work: a brief summary 12-13

ACA Officers and Committee Members 14

Statistical Appendix: 2007 pension trends survey results 15-24

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Chairman's Introduction

Good timing in many areas of life is the key to success . . .

The perfectly struck cover drive from Michael Vaughan or the Tiger Woods iron shot where the ball comes to rest inches from the hole reflect good timing at its best. And in business, identifying the right time to be decisive can be all important. So too, in politics – as election winning Prime Ministers know all too well – good timing is the key to success.

The present Government has a 'good timing' opportunity over the next twelve months.

Defined benefit pension provision, which has under-pinned the growth in retirement income over the last 20 – 30 years, is in a perilous state. Whilst largely unfunded public sector schemes grow in coverage, fewer than 1 million private sector employees are now working for companies with an open scheme. Most schemes are closed to new entrants. Increasingly, future defined benefit accrual for existing employees is also on the wane.

The Government has the opportunity to check this trend. They could add into the *Pensions Bill*, just presented to Parliament on 5 December, changes to defined benefit pension legislation, requiring no extra layer of legislation. This could remove the ban on employers being able to offer 'middle way' conditionally indexed pension schemes; schemes that prosper in The Netherlands, stabilising there the retirement income of millions of people. But will they sense the opportunity or the necessity?

What is clear is that if the opportunity is lost by indecision, or a further fudge delays meaningful reform for another year or so, then frankly it will be too late. The rump of employers prepared to accept the forward liabilities involved with offering open defined benefit pensions under current laws will dwindle to the point where recovering defined benefit provision will become immensely difficult. As one senior actuary recently said to me, "without reforms, more schemes will simply wander off to the elephant graveyard to die". Alarmingly, legislative reforms around defined benefit pensions in recent years have been more concerned with managing decline, rather than finding practical ways to encourage the herd to prosper.

Let us hope the Government will act decisively this time.

This *Review* includes the final report on our *2007 Pension trends survey* including all of the data that lies behind the reports we have published this year. The survey attracted responses from firms with over 2.1 million scheme members and assets exceeding £127 billion. It is one of the largest surveys of its type and, over the years, the series has proved very insightful in identifying both present and emerging trends.

The *Review* looks further at the possibilities available for pension reform, as well as summarising the activities of the ACA and its various committees over the last year or so. It also looks at one of the areas where an increasing number of consulting actuaries are working and finding new roles – Life Insurance – and the reasons behind this trend.

As we move into 2008, I am pleased to report that despite all the challenges facing our profession and our clients, the ACA continues to thrive, with membership at record levels. This growth in membership and in the number of consulting firms shows the adaptability of our members to respond to new challenges and opportunities. As Nelson Rockefeller put it, "wherever we look upon this earth, the opportunities take shape within the problems."

Ian Farr
Chairman

December 2007

Pension Reform:

more to be done . . .

By Ian Farr

Private sector employers are continuing to decommission the defined benefit pension schemes which have historically provided comfort and security in retirement for millions of pensioners. The outcome, changing to provide defined contribution schemes, which transfer all risk to employees, is not in the best interests of the majority of UK employees. It means millions more private sector employees in mid-career, those who change jobs and virtually all new employees now have to grapple with a greater uncertainty over the level of their pension in retirement.

The ACA is extremely concerned that Government appears to believe, aside from personal accounts targeted at the un-pensioned on middle to low incomes, that there are no meaningful measures it can take that will materially change employers' behaviour. The ACA has argued in the long run up to the *2007 Pensions Bill* that by lightening the bureaucratic burden under which defined benefit schemes operate and by changing the law to facilitate risk sharing schemes, the current decommissioning process can be halted and hopefully reversed. We are, therefore, disappointed that the Government has not yet fully seen the merit in extending choice under the current pension regime to remove the ban on employers offering **conditionally indexed pension schemes**.

We support the changes that the Government has proposed to date, following its Deregulatory Review of Private Pensions, namely:

- Reduction in the cap for revaluing deferred rights, as a means of returning the cap to a level which provides a level of protection to members equivalent to pensions in payment;
- Introduction of a statutory override for scheme rules;
- Agreement on some easing in the rules whereby employers can recover surplus;
- A move to principles-based regulation; and
- A change to permit trivial commutation (although some greater vigour is needed to resolve the problems that have been raised by the industry and individuals in a timely manner).

We believe that these are all proportionate changes.

The reduction in the deferred pension revaluation cap will have some impact on costs and so will give some additional incentive to employers to retain existing defined benefit and shared risk schemes, or to establish new ones.

Absence of radical approach

However, much more fundamental changes are needed to reverse the flow of defined benefit scheme closures. Virtually all of the actuarial consulting firms the ACA canvassed in early November say the deregulatory proposals to date are insufficient to encourage the continuing provision of high quality pensions. Virtually all say more freedom is needed in benefit design of occupational schemes than is possible under current legislation. Moving to principles-based regulation is a start, but the scope needs to be significantly wider than legislation affecting disclosures. Changes which merely transfer regulations to compulsory guidance are not helpful. A much more substantive move to simplify and cut back pensions legislation is required, coupled with the need to remove restrictions on employers to offer different types of schemes such as **conditionally indexed pension schemes.**

Government has under-estimated decline of defined benefit schemes

Urgent and convincing reform measures beyond those intimated to date are needed as the *Pensions Bill* progresses through Parliament to address the decline in occupational provision.

These measures need to be implemented ahead of the 2012 introduction of personal accounts, otherwise little good private sector provision will be left open, certainly to younger and mid-career employees.

The ACA, supported by a legal changes paper prepared by the Association of Pension Lawyers, has provided Government with the blue-print of how it can extend good private sector occupational provision by allowing employers to offer **conditionally indexed pension schemes** – risk sharing schemes - that will help close the widening pensions gap between private and public sector provision.

Aside from the public sector, where more employees each year (presently over 5 million) are protected by defined benefit occupational pensions, Ministers will be aware that occupational pensions for private sector employees – particularly final salary defined benefit schemes – are covering fewer and fewer employees as each year goes by. That trend has been apparent for a number of years and, amongst other issues, led to the appointment of the Pensions Commission.

In 1995 there were 5 million employees of private sector firms in open defined benefit schemes. By 2004, the number was down to 2 million. **ACA latest figures – collected in November 2007 – show this figure is down to around 900,000.**

The Government has recognised that at the same time as promoting personal accounts aimed at low to middle income groups, it is important to protect and promote the occupational pension schemes offered by many private sector employers.

The Government's Deregulatory Review of Private Pensions was intended to identify means by which good existing occupational pensions could be encouraged by way of deregulatory measures. Unfortunately, the results to date of the review are not likely to be anything like enough to meet the initial objective.

The scale of the problem...

The reality is that few private sector defined benefit occupational schemes are now open to new employees. The ACA surveys conducted earlier this year (see pages 15-24) of employers, and in November of actuarial consulting firms, confirm **fewer than 20% of defined benefit schemes are now open to new entrants.**

Without urgent Government action, the next phase – closure of future pension accruals for existing members (which is already underway, **with now around 20% closed to future accrual,** up from 14% earlier this year) – will occur as employers look to close off the unacceptable costs and forward risks associated with defined benefit provision as it is presently organised under UK legislation.

Much of our occupational pension legislation is serving no better purpose than managing the orderly decline of a once widely applauded British success story. In short, defined benefit legislation is no longer 'fit for today's world'.

At present, employers wishing to cap their pension costs have in the main taken the simple decision – to move their employees into defined contribution schemes – where employees take on 100% of the longevity and investment risks.

A few employers have steered their way around current defined benefit legislation to design hybrid defined benefit / defined contribution schemes. For some types of risk sharing design, however, a view has to be taken about the interpretation of present legislation. Some employers, understandably, have not been prepared to take the risk of finding themselves in Court about some uncertain aspect in the future. In other cases, particularly where the design is not that far off defined contribution in the risk spectrum, employers have not felt the cost of the associated infrastructure has been worthwhile.

What is also clear is that many employees do not want to take on 100% of the investment and longevity risks associated with their pension and, in truth, many are ill-equipped so to do. This is particularly the case for those in lower income groups, but by no means exclusively so, where the volatility of outcomes associated with defined contribution arrangements is a particular concern.

Whilst the number of employees in defined contribution schemes has increased as defined benefit schemes are closed, the overall picture today is that only 44% of employers now offer any kind of pension scheme, down an alarming 8% on the picture just 2 years before (source: DWP Employers' Pension Provision Survey).

There is also increasing evidence of closures of trust-based defined contribution schemes as employers opt for more lightly regulated contract-based arrangements.

So is there an alternative to this picture of decay and levelling-down?

A better way: conditionally indexed schemes

Finding ways around legislation that has become inappropriate to meet current circumstances is no way to proceed. To move ahead on this basis is likely to mean the schemes lost will greatly out-number those where 'manufactured' solutions are arrived at under today's restrictive defined benefit regime.

It is 'pie in the sky' to suggest that a move to principles based regulation would somehow allow a great new freedom to employers to offer a whole new raft of pension arrangements. Principles based regulation is certainly supported by the ACA, but we do not believe that Parliament or the wider public really is prepared to accept a wholesale move to principles based legislation. Yes, by all means, it would be sensible for disclosure requirements to members, but it is unlikely to be acceptable in the arena of scheme design, certainly in the short term.

The ACA has put to Government earlier this year a blue-print to update the defined benefit legislation currently in place to allow employers to provide a new type of risk sharing scheme called a **conditionally indexed scheme.**

The required changes to defined benefit legislation are simple and do not require a new layer or regime, as some have suggested.

Conditionally indexed schemes are the prevalent type of scheme in The Netherlands, where defined benefit provision remains robust and the dominant form of pension provision, ensuring more stable pensions for millions of employees into the future.

For employers, **conditionally indexed schemes** enable costs to be capped reasonably into the future, despite changes in longevity and financial markets. Also, such schemes would result in lower PPF levies and s75 debts than defined benefit schemes with mandatory indexation.

For employees, these schemes offer a pension linked to average career earnings, indexed in deferment and in payment, save on occasions in exceptional circumstances when this is against the long-term financial health of the scheme.

Thereby, unlike defined contribution schemes, where investment and longevity risks are placed squarely on the shoulders of employees, risk is shared instead between employer and employee.

So how do conditionally indexed schemes differ from final salary defined benefit schemes?

First, the similarities: if the legislative amendments were made to allow for **conditionally indexed schemes** to be offered by employers, both types of schemes would fall under the same defined benefit regime we presently have.

They would both be regulated by the Pensions Regulator, would both be required to support past and future benefits including indexation by prudent reserves under the new scheme funding rules and would both offer protections to members in terms of access to the Pension Protection Fund should the sponsoring employer fail.

The principal differences from current final salary defined benefit schemes would be that under a **conditionally indexed scheme:**

- **the level of pension would generally be geared to average career earnings** (already possible under defined benefit legislation), not final salary, and

- **deferred pensions and pensions in payment would be indexed, but with annual increases conditional on the health of a scheme's finances.** Typically, the index chosen would reflect price inflation, capped as at present. These schemes – because they would fall under the existing defined benefit regime – would be required to follow the tough new scheme funding requirements. Future pension increases would be backed by prudent funding reserves.

As new schemes, **conditionally indexed schemes** would also be designed from the outset to adjust the normal pension age to reflect changes in longevity, in the same way the Government has with the State scheme, but subject to actuarial checks that the adjustment was justified.

Importantly, **conditionally indexed schemes** offer the prospect of higher investment returns over the long term, and therefore lower costs, due to fewer constraints on investment strategy.

These **conditionally indexed schemes** are likely to prove particularly popular with employers who have come to the decision to close their final salary schemes to future accrual. At present, the only real alternative being considered is the move to defined contribution. This effectively transfers 100% of the investment and longevity risks from the employer so that these risks are 100% placed on scheme members, irrespective of their financial acumen.

Instead, a **conditionally indexed scheme** would offer a new option to employers, which in many cases might better suit the delicate balance between financial control and human resources policies designed to retain and recruit good employees.

Conditionally indexed schemes would also be attractive to the mounting number of employers who are concerned about the volatility in the pension outcome for lower paid employees from their defined contribution schemes.

The 2007 ACA *Pension trends survey* found **76% of firms employing over 250 employees support the wider promotion of risk sharing schemes.** A recent *Pensions Week* survey found similar levels of support for such schemes, with 81% of firms saying changes in the law were needed to promote these schemes.

So what happens if the Government and Parliament doesn't allow the 'conditionally indexed' option?

Some might have us believe that the tweaks to defined benefit regulation so far proposed via the Deregulatory Review of Private Pensions are enough to turn the tide.

There is absolutely no evidence to support this view. Rather, there is a huge amount of evidence showing that the decline in occupational pension provision is ongoing and extremely serious.

Closure of defined benefit schemes is particularly affecting millions of private sector employees in their early or mid-career and virtually all new employees.

The evidence to date suggests defined contribution schemes that place 100% investment and longevity risks on members are unlikely to fill the gap.

What certainly will be unsustainable as the years go by will be if good defined benefit pension arrangements are almost solely confined to the public sector.

As taxpayers, private sector employees – already on lower average salaries – will react at some time, certainly if tax rates increase. The contrast between the Parliamentary scheme or civil service schemes, for example, and the average scheme now offered in the private sector, is alarming.

A failure by Parliament to grant an option for private sector employers and employees to help bridge the pension gap with the public sector by sharing pension risks would be unforgivable. It would represent a major failure in pension public policy-making.

Doing nothing or not enough will not preserve existing private sector final salary defined benefit schemes – the cost and forward liabilities involved with these schemes (even if the revaluation cap for deferred pensions is reduced) will mean decisions to close will continue, but with these schemes closed off to all but a small minority of older employees.

Yes, there may be some wider pension coverage of employees via defined contribution schemes at some time. But placing 100% of investment and longevity risks on a wider band of lower paid employees will only extend the numbers having to grapple with a greater uncertainty over their level of pension in retirement.

Certainly, at present, the swing to defined contribution is all too often associated with low participation rates, the widespread use of inappropriate default funds by individual members lacking access to financial advice and contribution rates that will generally deliver inadequate pensions. For many on lower incomes, the volatility of outcomes in such arrangements and the level of means-tested benefits in retirement remains a very relevant issue.

Then, at some time, there is the need to buy an annuity, with all of the uncertainties this presents depending on market conditions at the time of retirement.

These are areas Parliament will have to think very carefully about when agreeing the detail of personal accounts in legislation over the coming year and their appropriateness for the target groups.

Time for Government and Parliament to act positively

Aside from deciding the detail of the new personal accounts regime, the ***2008 Pensions Act* needs to do much more than tinker with current legislation through deregulatory measures that are unlikely to have anything more than a minor impact.** Opening up the option for the future for employers to offer good occupational schemes – **conditionally indexed schemes** – that share risks between employers and employees must be of the highest priority.

Pension Trends Survey Report

ACA 2007 pension trends survey finds employers have little confidence in Government reform measures to date…

THE survey results suggest the Government has little option but to pursue radical reforms if it is not to let down millions of private sector employees.
The biennial survey of pension trends conducted by the ACA this year has highlighted the scale of the closure of private sector defined benefit occupational pension schemes to new entrants and their replacement – generally – by lower-cost defined contribution schemes. The ACA survey found 81% of defined benefit schemes are now closed to new entrants (up from 68% two years ago). Earlier this year, over 330 employers responded to the survey covering over 2.1 million members with total scheme assets of £127 billion.

The survey also identified an emerging trend of employers closing their trust-based defined contribution schemes and levelling-down to contract based schemes, which it is argued are less onerous to run than trust-based arrangements.

personal accounts (designed to extend basic provision to far more employees), the Department for Work and Pensions has set up a Deregulatory Review of Private Pensions to come forward with recommendations as to how regulation could be eased for existing schemes. Following consultations and recommendations from two external reviewers, the Government gave its response in October 2007 supporting a number of deregulatory measures (see page 4 of this Review), consulting further on a few others and ruling out a number of possible reforms, such as the removal of mandatory limited price indexation.

Elsewhere we ask whether this response is sufficient to restore employer confidence in providing good private schemes. Certainly, the ACA 2007 survey results suggest the reforms, including the establishment of a new regime of personal accounts, are unlikely to be enough, with:

68% of employers saying the Government's pension reforms will lead to a general levelling-down of pension contributions per employee, and
76% saying there will be an increase in the number of scheme closures of existing better (than personal accounts) schemes.

Figure 1: What type of pension arrangement do firms offer and what is the total value of scheme assets?

Type of pension scheme (Figures in brackets are 2005 survey results)	% of firms with such schemes	% Closed to new entrants only	% Closed to new entrants and new accruals/ contributions	Total Asset Values (£bn)
Defined benefit scheme	68% (71%)	67% (58%)	14% (10%)	£116.4
Defined contribution	38% (39%)	12% (5%)	4% (2%)	£5.2
Mixed DB / DC	9% (14%)	-	-	£3.8
Group Personal Pension	21% (16%)	5%	-	NK
Stakeholder	24% (22%)	-	-	NK
Industry-wide	2% (2%)	50%	-	£2.1
All Schemes	-	-	-	£127.5

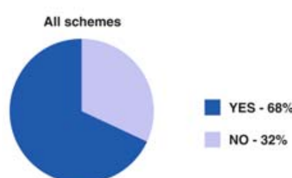
A recent update of trends in scheme design undertaken by the ACA in early November 2007 suggests that there has been a sharp increase in defined benefit schemes closing to future accrual (now around 20% compared to 14% earlier in the year). This latest survey also found only around 900,000 active members of open defined benefit schemes in the private sector, down from 2 million in 2004 and over 5 million in 1995.

But, current Government reforms could worsen position

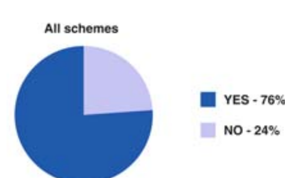
To a degree the Government has accepted the case that something needs to be done to preserve and encourage good pension schemes in the private sector. Alongside its commitment to a new regime of

Figure 2: The government's pension reforms will lead to:

A: a general levelling-down of pension contributions per employee by organisations presently offering better pension schemes



B: An increase in the number of closures of existing better schemes



A clear concern coming through in the responses to the survey is that the mandatory auto-enrolment of employees into either a company scheme or, if this is not available to certain employees, into personal accounts is likely to spur smaller firms into reviewing their existing schemes to ensure there is not a big jump in costs in 2012 and beyond.

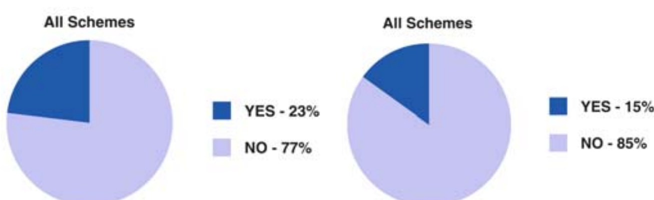
Whilst opt-out rates from personal accounts of 40% plus are viewed as being likely amongst smaller firms, the potential for extra employer costs (arising from the mandatory 3% of earnings employer contribution, where employees do not opt out) means, amongst smaller firms of 250 or fewer employees that:

- **36% say they may abandon their existing pension scheme in favour of personal accounts, and**
- **36% say they are likely to revise the benefits they offer to mitigate the extra costs of personal accounts.**

These are worryingly high levels and it is noteworthy that amongst larger companies, the respective percentages are as high as 10% and 20% - also by no means insignificant.

Figure 3: If you decide to operate auto-enrolment into your scheme, are you likely to revise the benefits offered to reduce costs?

Will auto-enrolment into a pension scheme (occupational or the personal accounts regime) lead you to consider abandoning your present occupational pension scheme(s) in favour of personal accounts for all employees?



Close to **a third of employers (and over 40% of smaller firms) also say that they will restrict auto-enrolment entry into their company scheme from 2012 to hold down pension costs,** meaning many employees henceforth will only be offered basic personal accounts.

Whilst since the survey was undertaken the Government has decided to cap contributions into personal accounts at £3,600 per annum (although through indexation, the actual level will be nearer £5,000 by 2012, when personal accounts are launched) and confirmed that transfers in and out of personal accounts will not be permitted, certainly for a number of years, it is not clear that the Government's reforms have yet addressed levelling-down other than to contest that it will happen! However, the survey results from this and other surveys shows ample evidence that levelling-down has been happening for some time and is predicted to continue apace by those who run private sector firms and schemes.

Scheme design issues

We have detailed above the findings of the 2007 survey that now eight out of ten defined benefit schemes are closed to new entrants and a growing tide (14%) to future accruals. The survey provides, if it were needed, ample reasons as to why this has happened. **Average combined employer and employee contributions into defined benefit schemes are now 29% of earnings, not far short of double the level of 5 years ago. Employer contributions have risen quickest, doubling to, on average, 23% of earnings.**

In contrast, contributions into defined contribution schemes – which face the same longevity and lower investment return issues as defined benefit – have increased only marginally over the same period. **DC contributions stand, on average, at a third of the contributions going into defined benefit schemes.** To some degree the higher defined benefit contributions reflect deficit repayments, life assurance and ill health costs and the expenses of running legacy members.

Figure 4: Average of contributions paid into schemes (as a percentage of total earnings)

Average employer contributions into:							
	2002	2003	2004	2005	2006	2007	Long-term expected
Defined benefit scheme	11.5%	13.1%	15.1%	16.5%	21.0%	22.6%	17.0%
Defined contribution	5.1%	5.2%	5.8%	5.9%	6.0%	6.2%	7.4%
Group Personal Pension	5.6%	5.6%	5.8%	6.1%	5.8%	6.0%	7.2%
Stakeholder	5.0%	5.2%	4.3%	4.5%	4.0%	4.1%	6.0%

Average employee contributions into:							
	2002	2003	2004	2005	2006	2007	Long-term expected
Defined benefit scheme	4.3%	4.5%	4.9%	5.5%	5.8%	6.1%	6.5%
Defined contribution	3.4%	3.5%	4.0%	4.1%	4.1%	4.1%	5.0%
Group Personal Pension	3.6%	3.8%	3.6%	3.8%	4.0%	3.9%	4.3%
Stakeholder	3.3%	3.5%	3.7%	3.8%	4.1%	4.1%	5.3%

Figure 4: Continued

Average combined employer and employee contributions into:							
	2002	2003	2004	2005	2006	2007	Long-term expected
Defined benefit scheme	15.8%	17.6%	20.0%	22.0%	26.8%	28.7%	23.5%
Defined contribution	8.5%	8.7%	9.8%	10.0%	10.1%	10.3%	12.4%
Group Personal Pension	9.2%	9.4%	9.4%	9.9%	9.8%	9.9%	11.5%
Stakeholder	8.3%	8.7%	8.0%	8.3%	8.1%	8.2%	11.3%

It is difficult to draw a conclusion other than that the pensions these defined contribution schemes will deliver will be modest, at best, and seriously inadequate, at worst.

In part, the higher defined benefit contributions can be accounted for in terms of companies wanting to reduce past service funding deficits through increases in regular payments. **Past service deficits have also been reduced by dint of additional regular or annual contributions (by 34% of schemes) and significant lump sum contributions (by another 31% of schemes).**

The ACA survey found that **86% of schemes were in deficit as ongoing entities** (as reported to the survey as at February 2007) – slightly fewer than 2 years ago. **Overall the average funding level has improved to 87% but with a marked reduction in those reporting 75% funding or less (10% as opposed to 18%).** As a result, **71% of schemes expect to remove their funding deficit in 10 years or less,** compared to just 56% two years ago.

Figure 5: Bands of ongoing funding level (as reported to survey in February 2007)

Funding Level	Percentage of schemes
+ 100%	14% (11%)
+95 – 100%	9% (6%)
+85 – 95%	44% (40%)
+75% - 85%	23% (25%)
Below 75%	10% (18%)
Average ongoing funding level	87% (85%)

(Figures in brackets are 2005 ACA Pension trends survey results)

Figure 6: Period over which firms say scheme deficits are expected to be removed?

0 – 5 years	15% (23%)
6 – 10 years	56% (33%)
11 – 15 years	20% (39%)
+15 years	9% (5%)

(Figures in brackets are 2005 ACA Pension trends survey results)

It is noteworthy that **two-thirds of companies with defined benefit schemes have increased employer contributions to meet future service benefits due to changes in longevity and expectations of lower investment returns into the future.** This need, coupled with requirements to index benefits on a mandatory basis for future service, has underscored the forward risks involved in providing such schemes under the current defined benefit pensions regime.

The rapid demise of existing defined benefit schemes means hardly any new entrants to the private sector labour market or job changers are now offered anything other than a defined contribution scheme. The survey results allied to the modest deregulatory changes proposed to date by Government suggests this situation will not improve. Elsewhere in this review we have referred to ways in which good private sector occupational schemes could continue to be offered by employers if they were given new freedoms to offer risk sharing arrangements – schemes where, for example, indexation of benefits is conditional upon the financial health of the scheme from year to year.

The ACA survey found that **76% of larger employers (250 employees or more) favoured the Government promoting a new risk-sharing pension regime** that provides a more stable benefit platform than defined contribution.

Figure 7: Do you support the transfer of risk to the individual that is inherent in the move to defined contribution pensions or do you feel that public policy should promote a new pension regime that combines better cost control for employers and a more stable benefit platform for employees through risk sharing between employers and employees?

Investment issues

The survey found that amongst defined benefit schemes there has been a general shift away from equities – which still remain the dominant investment – compared to two years ago. There has been a swing by funds to investing in overseas equities as opposed to UK equities and whilst there has also been a move to greater investment in bonds, the overall picture is just as coloured by changes in the breadth of asset classes used with funds moving into private equity, hedge funds, infrastructure and commodities.

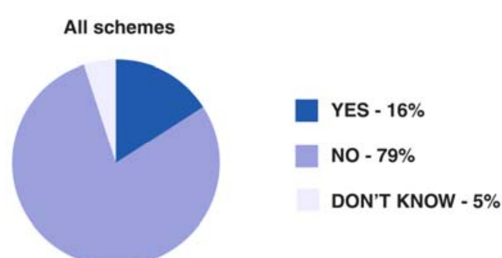
Figure 8: Current split of defined benefit scheme assets between equities, bonds and alternative assets such as property, private equity and hedge funds. Within the next year expectation of how this will change.

		Change expected in next year		
	Present	Increase	Decrease	No change
UK Equities	37%	6%	26%	68%
Overseas Equities	25%	11%	28%	61%
Gilts: Fixed Interest	8%	16%	7%	77%
Gilts: Index linked	5%	14%	7%	79%
Corporate bonds	10%	15%	14%	71%
Property	5%	18%	13%	69%
Private Equity	2%	6%	8%	86%
Hedge Funds	2%	5%	5%	90%
Cash / deposit	1%	5%	4%	91%
Active currency	1%	18%	-	82%
Commodities	2%	12%	-	88%
Infrastructure	1%	17%	-	83%
Tactical Asset Allocation	1%	16%	-	84%

Whilst only a minority of schemes reporting to the survey were involved in buying into these wider asset classes, some were far more active than others in so doing, and with significant holdings.

However, only a minority of the schemes reporting to the survey have moved to a Liability Driven Investment strategy – 16%. This strategy usually involves some use of swaps and derivatives to hedge out the risks faced by pension funds as changes in inflation and interest rates eat into a scheme's ability to meet its liabilities. The survey found that amongst respondents the most prevalent hedging technique used is LDI pooled funds, used by 45% of those surveyed with an LDI strategy. Pooled funds overcome the difficulty some schemes have in setting up bespoke swap arrangements with investment banks, which can require a large governance budget. The percentage of liabilities hedged varied enormously between respondents from 10% through to 80% of liabilities using a dedicated matching gilts portfolio.

Figure 9: Are defined benefit scheme assets, or any part of them, specifically structured to hedge some of the interest rate and/or inflation risk in the associated liabilities (commonly referred to as a 'Liability Driven Investment' strategy)?



Another evident trend over the last two-years, is that **31% of defined benefit schemes (up from 21%) now report that they use upwards of five investment managers,** reflecting in all probability the trend towards the use of more specialised managers to manage diversified asset classes as opposed to balanced managers.

A minority of managers are passive managers, but overall they manage 40% of the assets under management, slightly less (by 3%) than was the case 2 years ago.

Whilst the number of defined contribution schemes covered by the survey with default funds has risen to 79% (up 5% on two years ago), with the majority lifestyle based, **the number of schemes offering with-profit funds has reduced from 54% to 47%** over the period.

A recent study by the Pensions Institute at Cass Business School has found that whilst 90% of DC members opt for the default fund, most default funds do not match members' needs adequately in terms of asset allocation and risk profile. With many of those who take up personal accounts – perhaps as many as 8 million – likely to opt for the default fund, a considerable degree of thought and development is needed as to how these funds can better match members' needs.

Generally, and perhaps surprisingly, there has been no great change in the number of fund options offered to DC members, with around a quarter still offered 5 or fewer options, but there has been a change in the fund manager market servicing the sector. Here, over the last 2 years, there has been both **an increase in the number of schemes with just one manager** (58% as against 51%, two years ago) **and those with over 10 managers** (10% as opposed to 2%).

All of the data behind the ACA 2007 pension trends analysis above can be found in the tables in the appendix to this review – see pages 15 to 24.

Insurance:

the role consulting actuaries are playing…

By Philip Simpson

It will probably seem self-serving for an actuarial consultant to laud the virtues of actuarial consultants. But since actuarial consultants only work in certain contexts – with the largest of insurers, or with small companies that do not have a full-time actuary on their staff – those who stand to benefit the most from an actuarial consultant may not even know it. Many insurance organisations simply do not work with actuarial consultants, and organisations in many other industries may not even know why they would need an actuarial consultant.

The need for actuarial consulting is growing, and with good cause. The very nature of how insurers and other financial organisations view risk is changing, thanks to sophisticated analysis made possible by modern financial economics and a new generation of actuarial modelling. The traditional, formulaic approaches to modelling risk that have been used for decades are giving way to more sophisticated approaches. A frontier of new information has begun to emerge, and companies that work with consultants will be in the best position to stake their claim and gain competitive advantage.

The new risk aversion

UK insurers do not need a reminder – they are already quite cognizant of how even the most venerable of insurance institutions can be waylaid by today's volatile risk environment. Recent years have seen unexpectedly high increases in longevity and massive natural and man-made catastrophes together with significant fluctuations in inflation, interest rates and markets. The interconnected nature of today's risks may confound even the savviest of financial types; witness the sub-prime crisis in the US and how it has carried over to European markets as only the most recent example. An insular approach to management is not helpful – or feasible – in today's interconnected financial world.

This environment demands a more precise way of understanding risk, and actuaries are providing just that. Called *stochastic* – from the Greek for conjecture – this analysis can model the complex nature of risk and its probabilistic (or even random) permutations. Stochastic modelling allows us to turn away from the formulaic approaches to capital, pricing and reserving that have long served us well and move toward more sophisticated risk modelling.

The arrival of stochastic modelling is well timed because consumers of financial products have become more risk averse. Insurance products with guarantees – essentially, hedges on investments – have grown quite attractive.

There is also pressure from regulators. European insurers will be pressed to follow in the footsteps of Basel II and value their liabilities in a way similar to the banks. Solvency II may not be as imminent as was initially expected, but it remains on the near horizon, with 2012 now flagged as the likely implementation date. The kind of internal models allowed by stochastic analysis will help companies better manage their risks and price their liabilities and satisfy Solvency II when it does arrive.

Other regulatory forces, such as the convergence of international accounting standards, will provide further challenges. Under this regime, the value of an insurance contract will be based on its *current exit price* – in other words, the price you could sell an insurance contract for on the open market, assuming the buyer was an informed third party who had made allowances for risk and profit. Calculating the exit price for illiquid liabilities, such as insurance liabilities, has become a hot topic in recent weeks as markets become more risk averse.

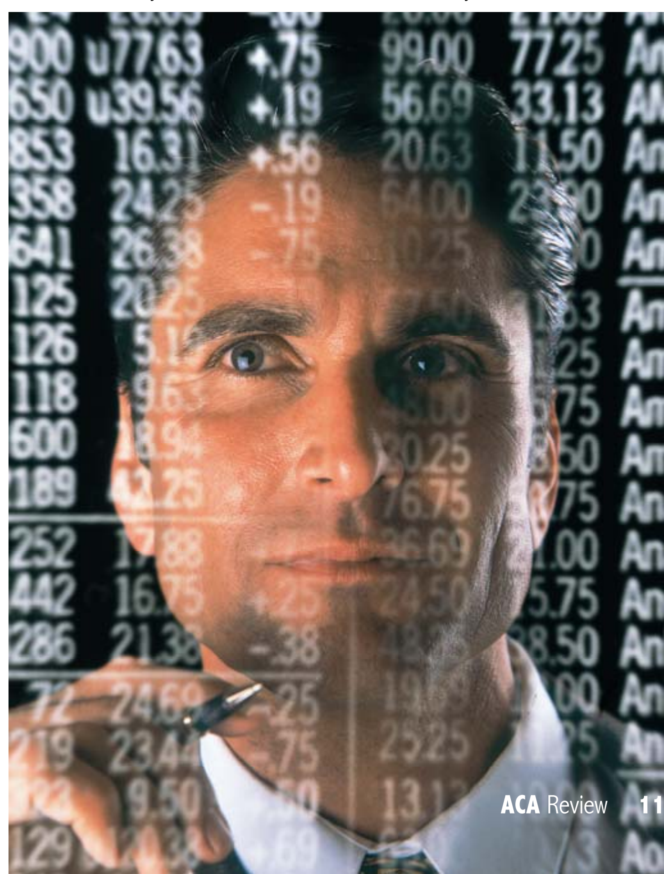
The need for consultants

Driven by regulatory, consumer, and economic factors, this environment is easier to navigate with the help of experienced, independent opinions. That is where consultants can be helpful. Actuarial consultants come in contact with different organisations and see the problems of the day played out in any number of ways, which puts them in a better position to diagnose and solve problems.

But the need goes beyond a diverse perspective. Accessing the new risk frontier is difficult, requiring intensive computing and complicated multivariate analysis. While this kind of rigor is unlikely to exist in a lone consultant's basement, it can be found within actuarial consulting firms, which have the resources and expertise to help companies set up a more risk-conscious organisation that capitalizes on better information.

Armed with deeper comprehension of the real value of risk and an understanding of modern economic theory, actuarial consultants can help insurers price guarantees and options and understand how their liabilities would be valued in the capital market and help them understand the implications of these guarantees and options when markets turn.

All told, actuarial consultants are in a perfect position to accompany insurers as they venture forth into the 21st century.



The ACA at work:

a brief summary

During the course of the last 2 years, the principal campaign the ACA has run has been that of trying to persuade Government to establish a reformed pension regime for the future in which 'good schemes' – schemes better than the minimum – can prosper. Regular written and face to face representations to both Ministers and Officials have been made on how that might best be achieved. Detailed representations have also been made to the external reviewers to the Deregulatory Review of Private Pensions established by the Government and those views have also been discussed with the pension spokespersons of the Official Opposition.

The key points the ACA has made on pension reform are summarised in this report on pages 15 – 24. In pursuing our objectives, the ACA has worked alongside other like-minded pension bodies as well as seeking broader appeal for them from organisations such as the CBI.

Aside from this campaigning work, the ACA continues to offer a wide range of other activities for our 1700 members – a figure that continues to rise from year to year. Monthly sessional meetings in London have again attracted attendances of up to 270 members and have been supported by two series of regional meetings during the year. The 2006 and 2007 annual dinners were held at The Drapers' Hall and were sell-outs addressed by Sir John Sunderland, then CBI President, in 2006 and Michael O'Brien MP, the Pensions Reform Minister, in 2007. The ACA Charity Golf Days again raised funds for the sports charity for disabled children, *Get Kids Going!*

Over 340 members attended the Members' Conference at Gatwick which included 23 technical seminars and a session on US pension trends, run in association with the Conference of Consulting Actuaries (CCA). Later in the year, ACA speakers addressed the CCA's Annual Meeting in San Antonio, Texas.

No summary of the ACA's activities would be complete without including a thumb-nail sketch of the work undertaken – all on a voluntary basis – by ACA members through its various specialist Committees.

The **Accounting Committee** met during the year to consider a number of issues including the FASB Exposure Draft to amend Statements 87, 88, 106 and 132(R) (became FASB 158) and the IASB/ASB consultations on changes to IFRS2/FRS 20 respectively, where the Committee agreed and subsequently submitted a response. A response was also made to the International Public Sector Accounting Standards Board proposal for a public sector equivalent of IAS.

Later in the year the Committee agreed a response to the ASB's proposal to amend FRS 17 and introduce a new Reporting Statement and to the IFRIC's Draft Interpretation D19 (*IAS 19 - The Asset Ceiling: Availability of Economic Benefits and Minimum Funding Requirements*).

The **International Committee** considered issues arising from the Portability Directive as well as leading a session on International Pension issues at the ACA Members' Conference in Gatwick. This covered international pension plans picking up on design trends, solvency and regulation in a number of different locations. In addition, at the sessional meeting conducted by Chris Daykin, the then Government Actuary, on International Pensions the Committee provided support on the panel.

Over the period covered by the report, the **Investment Committee** organised a number of events, including the sessional meeting at which Marcus Schueler from Deutsche Bank gave an update on credit market derivatives, Daniel Agostino gave a presentation on using infrastructure in pension fund investment and Jon Exley gave a presentation on the use of options, swaps and swaptions in DB benefit pension plans. Neil Record also spoke to a sessional meeting on developments in currency risk management.

The Committee also held a series of meeting where it reviewed offers from some leading investment banks including the use of swaps options and CPPI (Constant Proportion Portfolio Insurance) and their adaptability to the UK pension scheme investment environment. A comprehensive response to the NAPF consultation document *Institutional investment in the UK six years on* was also drafted by the Committee on behalf of the ACA.

The **Life Insurance Committee** considered developments in relation to matters impacting the life industry, including issues discussed by the Profession's Life Board and output from Board of Actuarial Standards (BAS) and the Financial Services Authority (FSA). Its programme of work included meeting with Claire Spottiswoode, Aviva's Policyholder Advocate to discuss views on issues relevant to her role and in particular, TCF.

In April 2007 there was a parallel ACA life meeting alongside the main ACA sessional meeting. Nigel Silby and Brian Purves spoke on the roles of the reviewing actuary and the external actuarial function holder. The meeting was well attended and was the first of what it is hoped will be a regular feature of the ACA year.

It was another busy year for the **Local Government Committee** as a result of ongoing activity regarding changes to the Local Government Pension Scheme (LGPS).

The early part of the year was dominated by the consultation exercise in respect of the proposed new benefit structure of the LGPS to be applicable from 1 April 2008.

Committee members were also consulted on the principles and terms that should underlie transfer payments between LGPS Funds in respect of transfers of individuals or small groups of members.

Throughout the year, in addition to coming together at meetings organised by Government, the Committee examined the adoption of a common approach regarding the wind up of Family Service Units, the adoption of a common approach to dealing with compensation payments and augmentations, progress on the multiple bulk transfers of magistrates courts staff to the Civil Service Pension Scheme, approach to FRS17 calculations and liaison with the Audit Commission and Cipfa.

The **Pension Schemes Committee** had rather a quiet period over the last year or so! It only provided written responses to some 20 consultations during a 9 month period! Committee members attended at least five consultation meetings with the DWP, and the Chairman also participated in Occupational Pension Scheme Joint Working Group meetings through the year.

With legislation still to the fore, as well as the outcome from the Sweeney/Lewin Deregulatory Review, the Committee continues to have a heavy workload. The Committee's focus is on encouraging fair and proportionate pension regulation, cutting away unnecessary legislation that can only lead to the decline in work-based pension provision.

The **Pensions Taxation Committee** had a very active year dominated by "snagging" problems emerging with operating the new tax regime introduced by Finance Act 2004.

Members of the Committee have attended various informal meetings with HMRC with a view to promoting items to be taken forward into changes in primary legislation. The Committee made representations - many successful – to HMRC on several issues during the year, including the interpretation of Finance Act 2004 and regulations, changes being made by Finance Act 2006, matters to appear in Finance Act 2007 and 2008 and regulations, opinions given by HMRC on interpreting the law and inclusion in RPSM (with Committee assistance) of better clarifying examples.

Following an initial presentation on how HMRC would roll out the consultation areas announced in the Pre Budget Report, formal consultation meetings were held on a number of topics including BCE3 (Pension increases), dependent scheme pensions and ASP (working with the ACA Small Schemes Committee). Formal responses were submitted by the Committee on the first two.

A "discussion" meeting was held by HMRC on Trivial Commutation as it operates under the new regime, which the Chair attended and then authored a letter for the JWG highlighting the problems arising. We hope that the next stage will be to consider solutions acceptable to HMRC and all industry bodies.

The **Public Relations Committee** regularly reviewed at its meetings the topical issues of the day affecting Members across pensions and insurance areas.

During the year, the main area of activity has been in the area of pension reform. This has been against a back-cloth of reform proposals from Government in terms of State reforms, the introduction of personal accounts and the Deregulatory Review of Private Pensions.

The ACA continues to act as the Secretariat to the All-Party Parliamentary Group on Occupational Pensions. There were three formal meetings of the Group in the last year, including a lunch addressed by James Purnell MP, the then Pensions Minister, which was well attended by MPs, other trade bodies and ACA representatives, at which the ACA launched its shared risk initiative. Another meeting considered the FAS compensation offer and its shortcomings (addressed by Ros Altmann) and was again a very well-attended meeting.

During the year the ACA continued to gain good media coverage for its views. Regular contact with the press is maintained and a *Media Card* is published annually to alert journalists to ACA spokespersons in specialist areas.

As well as coverage for submissions to Government and the Pensions Commission, the articles following on from the publication of the *2006 Smaller Firms Pension survey* and *2007 Pension trends survey* were excellent, including most of the nationals and extensive coverage in the trade and regional press. The ACA also provides a monthly column in *Pensions Age* magazine and has contributed articles during the year to *Pensions World, Pensions Management, Pensions Week* and *Professional Pensions*.

During the year, work on the re-design and archiving material on the ACA website (www.aca.org.uk) was completed, with the revised site launched in late-March 2007.

The main item of interest to the **Small Schemes Committee** was the tax simplification changes at A-day. SSAS providers seem to have experienced very little adverse impact on their business from the cessation of mandatory triennial valuations and pensioneer trusteeship. Indeed, most seem to be busier than ever.

The Committee monitored the debate on ASP during the Summer of 2006 and wrote to Ed Balls, the then Treasury Minister responsible, on this topic. Unfortunately, this was not enough to prevent the Government's u-turn on ASP, as announced in the Pre-Budget report. There is now a general lack of trust amongst Small Scheme providers in Government pensions policy and the stability of the new pensions taxation regime. Also, practitioners have some concerns that the penal rates of taxation on ASP residual funds may now create an industry of tax avoidance.

Other issues which the Committee discussed included accounting year end dates for tax return purposes, protected rights for SIPPs and FSA regulation for SIPP operators from 6 April 2007.

The **Smaller Firms Committee** organised a session for smaller firms of consulting actuaries, which was again held at the ACA Members' Conference in Gatwick and was attended by 50 actuaries from 30 different firms.

2007 Pension trends survey report…1

Views on pension reform:
Pension apartheid and levelling-down of scheme contributions poses real threat

UK 2007 Pension trends survey report…2

Sharp rise in defined benefit scheme costs and closures foreshadows widespread move to lower-cost pensions

pension trends survey: changes in scheme provision, contributions, defined benefit scheme deficits and recovery plans

This year's *Pension trends survey* has achieved widespread coverage

ACA Officers and Committee Members:

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Chairman:	**I A Farr**	**Watson Wyatt**
Immediate Past Chairman:	**R A J Waddingham**	**Barnett Waddingham**
Treasurer:	**S M Southall**	**Punter Southall**
Secretary:	**K Barton**	**Hewitt**

Committee:	**J R Dell**	**Lane Clark & Peacock**
	M W Duke	**Towers Perrin**
	D Duval	**Aon Consulting**
	D Fairs	**KPMG**
	M D Harris	**PricewaterhouseCoopers**
	C Taylor	**Hymans Robertson**
	A Vaughan	**Mercer**
	P Wadsworth	**Jardine Lloyd Thompson**

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Committee:	A W Claringbold	Aon Consulting
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	A J Homer	Jardine Lloyd Thompson
	J M Lowes	Hewitt
	S R Robinson	KPMG
	C Rodgers	Watson Wyatt
	W G Singer	Mercer
	S P Southern	Lane Clark & Peacock
	S J D Taylor	HSBC

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Chairman:	J O'Neill	MAZARS
Committee:	C J W Czapiewski	Colin Czapiewski Consulting
	S Malde	Ernst & Young

International

Chairman:	M Sullivan	Mercer
Committee:	A P Cunningham	Lane Clark & Peacock
	I J Hinton	Hewitt
	G P Middleton	KPMG
	E M J Steedman	Watson Wyatt

Investment

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Committee:	R S Chapman	Hymans Robertson
	D Fogarty	Mercer
	P J A Gibney	Lane Clark & Peacock
	Miss M T Kerrigan	Watson Wyatt
	C D Richardson	Barnett Waddingham
	R Riddaway	Hewitt

Life Insurance

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Committee:	S H Bell	Milliman
	C B Golding	Golding Smith
	S Grout	Mercer
	T A D Jones	KPMG
	P A Leandro	Barnett Waddingham
	N F Silby	Watson Wyatt
	S Thompson	Towers Perrin/Tillinghast

Local Government

Chairman:	T Lunn	Hewitt
Committee:	C Hull	Mercer
	G D Muir	Barnett Waddingham
	Mrs A J Murray	Hymans Robertson

Pension Schemes

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Deputy Chairman:	D Everett	Lane Clark & Peacock
Committee:	Ms E J Beverley	Punter Southall
	S B Bowman	Watson Wyatt
	M I Carson	Jardine Lloyd Thompson
	T P Connor	Aon Consulting
	N Dodd	Mercer
	G P Everness	Watson Wyatt
	P M Greenwood	Foresight Trustees
	S F Lee	HSBC
	G McClushion	Towers Perrin/Tillinghast
	W G C Sharp	Gissings
	P J Williams	Hewitt

Pensions Taxation

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Committee:	S Clayson	Watson Wyatt
	R Crowhurst	Hymans Robertson
	C F B Dallard	Hewitt
	A Dodd	Punter Southall
	Mrs J S Pegrum	Aon Consulting
	Ms K Phillips	Mercer
	T S Sexton	PricewaterhouseCoopers

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	G S Boyd	Watson Wyatt
	Ms M de Valois	HSBC
	M L Cranfield	Lane Clark & Peacock
	S M Leake	Punter Southall
	P McGlone	Aon Consulting
	P H Simpson	Milliman

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Committee:	W D B Anderson	Hymans Robertson
	Mrs B J Hall	Watson Wyatt
	S P Humphrys	Hewitt
	D Keeler	Mercer
	J R Prior	Punter Southall

Small Schemes

Chairman:	M A J Howard	Barnett Waddingham
Committee:	B Buddhdev	Barnett Waddingham
	D O Downie	James Hay
	M J Field	Michael J Field
	N S Sloam	Nigel Sloam

Smaller Firms Committee

Chairman:	M L Owen	M L Owen
	J A Jolliffe	J A Jolliffe
	S J O'Grady	EB Consultants
	N H Taylor	N H Taylor
	Ms R M A Walkling	Arnoldact Rose

As at December 2007

Statistical Appendix:
2007 pension trends survey results

Pensions Reform:

2006 Pensions Bill, Personal Accounts and Occupational Scheme reforms

Respondents: 336 schemes with 2.1 million members and assets of £127 billion.

Figures in (brackets) are where comparable 2005 figures are available.

Table 1

Overall, do you believe that the State pension reforms proposed in the *2006 Pensions Bill* will provide a stable State pension platform upon which private pension savings can be built?

Yes	No
59%	41%

Table 2

Contracting-out is due to be abolished for DC schemes. Do you think the restrictions on existing protected rights funds (which have been built up from NI rebates) should be removed so they are treated like any other pension rights?

Yes	No
89%	11%

Table 3

The Pensions Bill contains measures to allow schemes to convert Guaranteed Minimum Pensions (GMPs) to normal pension rights. Do you think many schemes will take advantage of this?

Yes	No
58%	42%

Table 4

Over time, the State Second Pension will move to be a flat rate top-up and it can be expected that the rebates received by contracted-out DB schemes will be reduced accordingly. Do you think this will lead to:

Some DB schemes reducing benefits	Some DB schemes closing altogether
64%	36%

Table 5

Do you currently operate auto-enrolment into your occupational pension scheme (i.e. employees are automatically enrolled in your scheme on joining your organisation)?

	Yes	No
Up to 250 employees	6%	94%
250 employees and above	20%	80%
All schemes	**18%**	**82%**

Table 5 Continued

If 'no' are you likely to decide to auto-enrol all eligible employees into your scheme from 2012 or are you likely to continue to restrict entry into the scheme, introducing auto-enrolment into personal accounts for those not offered the occupational scheme?

	We are likely to auto-enrol all employees into the occupational scheme	We are likely to restrict occupational scheme entry, auto-enrolling the balance of employees into personal accounts	Neither
Up to 250 employees	31%	42%	27%
250 employees and above	58%	29%	13%
All schemes	**54%**	**31%**	**15%**

Table 6

If you decide to operate auto-enrolment into your scheme, are you likely to revise the benefits offered to reduce costs?

	Yes	No
Up to 250 employees	36%	64%
250 employees and above	20%	80%
All schemes	**23%**	**77%**

Table 7

Will auto-enrolment into a pension scheme (occupational or the personal accounts regime) lead you to considering abandoning your present occupational pension scheme(s) in favour of personal accounts for all employees?

	Yes	No
Up to 250 employees	36%	64%
250 employees and above	10%	90%
All schemes	**15%**	**85%**

Table 8

Based on your company's experience, how many employees (as a percentage) do you think will continue to opt out of either the occupational scheme or personal accounts from 2012?

	Occupational scheme	Personal accounts
Median opt out: up to 250 employees	30%	40%
Median opt out: 250 employees and above	20%	20%
Median opt out: all schemes	**20%**	**25%**
Range	0 → 85%	0 → 100%

Table 9

Organisations offering DB schemes will be exempt from offering personal accounts where employers auto-enrol all employees aged 22 or over into either a contracted-out occupational scheme that passes the Reference Scheme Test or a contracted-in scheme offering a minimum accrual of 1/120ths. Do you agree with this proposal?

Yes	No
97%	3%

Table 10

Organisations offering DC schemes: the exemption test for defined contribution schemes (with 8% as the total default contribution) would require auto-enrolment of all employees aged 22 or over, that the scheme offers a default investment option and that it allows an employee to actively opt for a lower contribution than 4% of earnings, provided the employer contribution is not below 3%. Do you agree with this proposal?

	Yes	No
Up to 250 employees	88%	12%
250 employees and above	71%	29%
All schemes	**74%**	**26%**

Table 11

The Personal accounts White Paper says there will be further consultations as to whether exempt schemes should be allowed to have a three or six month 'waiting period' before employees (aged 22 or over) join the occupational scheme. Which of the following do you support?

In ranked order:

1	3 month waiting period
2	6 month waiting period
3	No waiting period

Table 12

The White Paper proposes that changes required of exempt schemes should be phased in over 3 years, mirroring the phasing in of personal accounts over this period. Do you think that phasing for exempt schemes should be by phasing the minimum contribution requirement (i.e. gradually increasing contributions up to the default levels) or by phasing the target groups (e.g. offer scheme first to new entrants, then later to those not offered scheme access before, then to those who have previously rejected the company scheme)?

	Phasing by contribution	Phasing by groups
Up to 250 employees	68%	32%
250 employees and above	50%	50%
All schemes	**53%**	**47%**

Table 13

The White Paper proposes that to protect existing schemes there should be a cap on personal account contributions of £5,000 pa (up from £3,000 recommended by the Pensions Commission) and that certainly until 2020 there should be no transfers in (from other schemes) or transfers out (to other schemes) from personal accounts. What is your view?

	Should be no cap	Support £5,000 cap	Cap should be different
Up to 250 employees	56%	36%	8%
250 employees and above	45%	25%	30%
All schemes	**47%**	**27%**	**26%**

Personal accounts should be able to:

	Support	Oppose
Accept transfer payments from other pension arrangements	87%	13%
Move transfer payments to other pension arrangements	84%	16%

Table 14

A cap of £5,000pa on personal account contributions could mean some employees might save well over 4% of their earnings. Do you believe that savings above the default employee contributions should require regulated investment advice?

	Yes	No
There should be no requirement for regulated investment advice provided contributions are within the cap (£5,000pa)	65%	35%

(40% of respondents said regulated investment advice should be required if employee contributions exceed 10% (median level) of earnings)

Table 15

A number of proposals have been floated to reduce the financial pressures on existing defined benefit pension schemes. Which of the following proposals do employers support?

	Support	Oppose
Remove for the future mandatory annual limited price indexation of pensions in payment	46%	54%
Reduce maximum revaluation of deferred pensions from 5% to 2.5% per annum for future leavers	72%	28%
Allow schemes to increase Normal Retirement Ages for future service benefits	80%	20%
Allow schemes to increase Normal Retirement Age for past service benefits	29%	71%
Trustees to be required to obtain agreement of employer to material change in investment strategy and management	33%	67%
Allow employers to recover at least some of the surplus where a scheme's ongoing funding level exceeds the statutory funding target set by trustees	59%	41%

Table 16

Which of the following do you agree or disagree with:

The government's pension reforms will lead to a general levelling-down of pension contributions per employee by organisations presently offering better pension schemes

	Yes	No
Up to 250 employees	74%	26%
250 employees and above	67%	33%
All schemes	**68%**	**32%**

The Government's pension reforms will lead to an increase in the number of employees covered by pension schemes with little or no adverse effect on existing schemes

	Yes	No
Up to 250 employees	48%	52%
250 employees and above	42%	58%
All schemes	**43%**	**57%**

The Government's pension reforms will lead to an increase in the number of closures of existing better schemes

	Yes	No
Up to 250 employees	71%	29%
250 employees and above	77%	23%
All schemes	**76%**	**24%**

Overall, is the Government's stated policy of promoting occupational pensions moving in the correct direction?

	Yes	No
Up to 250 employees	29%	71%
250 employees and above	40%	60%
All schemes	**38% (32%)**	**62% (68%)**

Table 16 Continued

What should the Government's most important pension policy priorities be (in ranked order):

1	Reduced regulation/increased simplification
2	Better financial incentives to encourage pension saving
3	Remove over-regulation of good quality schemes
4	Reduce means-testing
5	Improve Basic State Pension

Table 17

Do you support the transfer of risk to the individual that is inherent in the move to defined contribution pensions or do you feel that public policy should promote a new pension regime that combines better cost control for employers and a more stable benefit platform for employees through risk sharing between employers and employees?

	Support 100% risk transfer to individuals	Support promoting new risk sharing schemes
Up to 250 employees	46%	54%
250 employees and above	24%	76%
All schemes	**28% (31%)**	**72% (69%)**

Table 18

For organisations not presently offering an occupational scheme: if, as a result of forthcoming personal accounts legislation, your organisation is required by legislation from 2012 to pay a 3% (of earnings) employer pension contribution for all employees over and above NI contributions, perhaps phased in over 3 years, how will your organisation meet the extra cost?

	Yes
Employer would meet cost (i.e. owner/shareholders)	37%
Customers would have to meet cost (i.e. increased	26%
Staff would have to meet cost	5%
Combination of all three above	32%

Table 19
What issues are most likely to have an influence on pension thinking in the longer term?

In ranked order

	Very concerned	Quite concerned	Not concerned
The impact of legislation on benefits and funding costs	51% (49%)	43% (49%)	6% (2%)
Increasing burden on management time due to greater scheme complexity	45% (41%)	53% (47%)	2% (12%)
Poor annuity returns	42%	35%	23%
The increasing public profile of pensions will lead to more costly/complex pension related communications	25% (18%)	63% (64%)	12% (18%)
Performance of investment markets	22% (47%)	68% (47%)	10% (6%)
Further pension reforms introducing, for example, personal accounts	22% (29%)	64% (49%)	14% (22%)
Impact of accountancy requirements	22% (25%)	54% (48%)	24% (27%)
Increasing cost of private pensions	14%	49%	37%
Competition for staff will lead to a need to improve firms' pension arrangements	4% (3%)	31% (29%)	65% (68%)

Pension Scheme Design

Table 20
What type of pension arrangement do firms offer and what is the total value of scheme assets?

Type of pension scheme	% of firms with such schemes	% Closed to new entrants only	% Closed to new entrants and new accruals/ contributions	Total Asset Values (£bn)
Defined benefit scheme	68% (71%)	67% (58%)	14% (10%)	£116.4
Defined contribution	38% (39%)	12% (5%)	4% (2%)	£5.2
Mixed DB / DC	9% (14%)	-	-	£3.8
Group Personal Pension	21% (16%)	5%	-	NK
Stakeholder	24% (22%)	-	-	NK
Industry-wide	2% (2%)	50%	-	£2.1
All Schemes	-	-	-	£127.5

(*NB: the majority of respondents did not disclose or were unaware of total assets held)*

Percentage of schemes contracted-out of SERPS / S2P

	Percentage contracted-out
Defined benefit	92% (93%)
Defined contribution	14% (17%)

Table 21

Size of firms responding to survey

Employees:	0-250	251-999	1000+
Defined benefit scheme only	2%	21%	34%
Defined benefit + contribution	12%	59%	61%
Defined contribution only	86%	20%	5%
Total sample of firms	**17%**	**21%**	**62%**

What is the distribution of membership of schemes?

	Active	Deferred	Pensioners
Defined benefit	31%	40%	29%
Defined contribution	76%	20%	4%
All schemes	**34%**	**38%**	**28%**

Table 22

Why do firms provide employees with pension arrangements (in ranked order)?

	All Schemes
We consider it is our responsibility as a good employer to make adequate arrangements for our employees retirement	**1** (1)
The scheme helps us to build our image as a caring employer, motivating and encouraging loyalty from employees	**2=** (2)
The scheme helps us to compete in the labour market for skilled staff	**2=** (3)
The scheme enables us to retire employees on reasonable pensions in an orderly way to suit our business	**4** (4)
The scheme has been in existence for many years and could not easily be discontinued	**5** (5)
We were required to introduce a scheme under the Stakeholder rules	**6** (6)

Table 23

Changes in pension arrangements over last few years

	In last year	In last 5 years
Closed defined benefit scheme to new entrants	5%	41%
Closed defined benefit scheme to future accruals	5%	8%
Introduced defined contribution scheme to some or all employees	8%	22%
Converted existing defined benefit to mixed DB/DC scheme	2%	-
Set up a career average scheme	1%	3%
Reduced percentage of employees covered by firm's scheme	-	4%
Placed one or more schemes in wind-up	4%	4%
Established a flexible benefits package with wider benefits option	1%	6%
Introduced access to group benefits largely paid for by employees	1%	3%
Contracted some or all of members back into State Second Pension	8%	6%

Table 24

Average of contributions paid into pension schemes (as a percentage of total earnings)

Average employer contributions into:	2002	2003	2004	2005	2006	2007	Long-term expected
Defined benefit scheme	11.5%	13.1%	15.1%	16.5%	21.0%	22.6%	17.0%
Defined contribution	5.1%	5.2%	5.8%	5.9%	6.0%	6.2%	7.4%
Group Personal Pension	5.6%	5.6%	5.8%	6.1%	5.8%	6.0%	7.2%
Stakeholder (see note)	5.0%	5.2%	4.3%	4.5%	4.0%	4.1%	6.0%

Average employee contributions into:	2002	2003	2004	2005	2006	2007	Long-term expected
Defined benefit scheme	4.3%	4.5%	4.9%	5.5%	5.8%	6.1%	6.5%
Defined contribution	3.4%	3.5%	4.0%	4.1%	4.1%	4.1%	5.0%
Group Personal Pension	3.6%	3.8%	3.6%	3.8%	4.0%	3.9%	4.3%
Stakeholder	3.3%	3.5%	3.7%	3.8%	4.1%	4.1%	5.3%

Average combined employer and employee contributions into:	2002	2003	2004	2005	2006	2007	Long-term expected
Defined benefit scheme	15.8%	17.6%	20.0%	22.0%	26.8%	28.7%	23.5%
Defined contribution	8.5%	8.7%	9.8%	10.0%	10.1%	10.3%	12.4%
Group Personal Pension	9.2%	9.4%	9.4%	9.9%	9.8%	9.9%	11.5%
Stakeholder (see note)	8.3%	8.7%	8.0%	8.3%	8.1%	8.2%	11.3%

(Source: ACA 2003, 2005 and 2007 Pension Trends Surveys)
Note: figures exclude nil employer contributions made into 28% of Stakeholder schemes.

Table 25

Current range of employer contributions

<table>
<tr><th>Contribution as % of earnings</th><th colspan="2">Defined Benefit</th><th>Defined Contribution</th><th>GPP</th><th>Stakeholder</th></tr>
<tr><td>0%</td><td colspan="2">-</td><td>-</td><td>-</td><td>28% (30%)</td></tr>
<tr><td>Up to 3%</td><td colspan="2">- (1%)</td><td>2% (4%)</td><td>12% (4%)</td><td>11% (11%)</td></tr>
<tr><td>Over 3 – 6%</td><td colspan="2">1% (1%)</td><td>53% (48%)</td><td>42% (41%)</td><td>43% (28%)</td></tr>
<tr><td>Over 6 – 9%</td><td colspan="2">4% (7%)</td><td>23% (26%)</td><td>35% (44%)</td><td>11% (21%)</td></tr>
<tr><td>Over 9 – 12%</td><td colspan="2">14% (11%)</td><td>19% (18%)</td><td>7% (11%)</td><td>7% (7%)</td></tr>
<tr><td>Over 12 – 15%</td><td colspan="2">14% (30%)</td><td>3% (4%)</td><td>4% (-)</td><td>- (3%)</td></tr>
<tr><td>Over 15 – 20% (18%)</td><td colspan="2">18% (c20%)</td><td>-</td><td>-</td><td>-</td></tr>
<tr><td>Over 20 - 25% (Over 18%)</td><td>15%</td><td rowspan="2">(30%)</td><td>-</td><td>-</td><td>-</td></tr>
<tr><td>Over 25%</td><td>34%</td><td></td><td></td><td></td></tr>
</table>

Table 25 Continued

Current range of employee contributions

Contribution as % of earnings	Defined Benefit	Defined Contribution	GPP	Stakeholder
0%	6% (5%)	- (5%)	-	- (5%)
Up to 2%	- (2%)	6% (4%)	7% (5%)	9% (5%)
Over 2 – 4%	10% (15 %)	51% (42%)	50% (53%)	42% (61%)
Over 4 – 6%	42% (36%)	33% (39%)	38% (37%)	46% (26%)
Over 6 – 8%	32% (38%)	10% (6%)	5% (5%)	3% (3%)
Over 8%	10% (4%)	- (4%)	-	-

Table 26

How frequently do you undertake formal actuarial valuations?

Every 3 years	Other
96% (93%)	4% (7%)

Do you obtain informal updates between these?

Yes	No
91% (88%)	9% (12%)

Frequency?

Annually	Quarterly	Other / As required
72% (69%)	20% (10%)	8% (21%)

Table 27

Number of defined benefit schemes advised by their actuaries that their scheme is in deficit when considering it as an ongoing entity

In deficit	Not in deficit
86% (89%)	14% (11%)

Bands of ongoing funding level as a percentage of liabilities at the last actuarial assessment

Funding Level	Percentage of firms
+ 100%	14% (11%)
+95 – 100%	9% (6%)
+85 – 95%	44% (40%)
+75% - 85%	23% (25%)
Below 75%	10% (18%)
Average ongoing funding level	**87% (85%)**

If in deficit, have scheme actuaries recommended an increase in contributions?

Yes	No
91% (88%)	9% (12%)

Change in employer defined benefit contribution rates

Employer contribution rate increases	Percentage of firms
+10% of earnings	8%
+5% - 10%	20%
+3% - 5%	56%
0 – 3%	16%

Alternatively, have additional employer contributions been made expressed as fixed monthly amounts or significant lump sums?

	Yes
Additional contributions expressed as fixed annual/ monthly amounts	34% (23%)
Significant lump sum contributions	31% (27%)

Period over which firms say scheme deficits are expected to be removed

0 – 5 years	15% (23%)
6 – 10 years	56% (33%)
11 – 15 years	20% (39%)
+15 years	9% (5%)

Have employer contributions been increased to meet future service benefits?

Yes	No
65%	35%

Table 28

Number of schemes reporting increase (or future increase) in defined benefit employee contribution rates

Increase	No increase
45% (44%)	55% (56%)

Change in employee contribution rates

Employee contribution rate increases	Percentage of firms
+2% of earnings	15%
+1% - 2%	74%
0 – 1%	11%

Change in the accrual rate of benefits in the last year or so

Moved from 60ths to 80ths	1%
Moved from better than 60ths to 60ths	3%
Moved from 60ths to between 60ths to 80ths	3%
Moved from better than 60ths to between 60ths to 80ths	-

Investment Issues - Defined Benefit Schemes

Table 29

Schemes reporting change in investment strategy to a greater proportion in bonds and lower proportion in equities

Yes	No
44%	56%

Table 30

Current split of scheme assets between equities, bonds and alternative assets such as property, private equity and hedge funds. Within the next year expectation of how this will change

		Change expected in next year		
	Present	Increase	Decrease	No change
UK Equities	37%	6%	26%	68%
Overseas Equities	25%	11%	28%	61%
Gilts: Fixed Interest	8%	16%	7%	77%
Gilts: Index linked	5%	14%	7%	79%
Corporate bonds	10%	15%	14%	71%
Property	5%	18%	13%	69%
Private Equity	2%	6%	8%	86%
Hedge Funds	2%	5%	5%	90%
Cash / deposit	1%	5%	4%	91%
Active currency	1%	18%	-	82%
Commodities	2%	12%	-	88%
Infrastructure	1%	17%	-	83%
Tactical Asset Allocation	1%	16%	-	84%

Table 31
How many fund managers do schemes use?

	Percentage
One	31% (39%)
2 to 4	38% (40%)
5 to 10	25% (15%)
More than 10	6% (6%)
Median	4 managers

How many of these are passive managers and what percentage of assets do they manage?

Percentage that are passive managers	Average percentage of assets managed
15% (17%)	40% (43%)

Table 32
Are scheme assets, or any part them, specifically structured to hedge some of the interest rate and/or inflation risk in the associated liabilities (commonly referred to as a 'Liability Driven Investment' strategy

Yes	No	Don't know
16%	79%	5%

Investment Issues - Defined Contribution

Table 33
Investment choices offered by DC schemes

	Percentage Offering
UK Equity	94%
Overseas Equity	86%
Global (UK & Overseas) Equity	98%
Gilts: Fixed interest	82%
Gilts: Indexed linked	86%
Corporate bonds	74%
Cash / deposit	84%
With profits	47%
Mixed managed fund	76%
Life-style / default	79%
Other	8%

Number offering a default fund

Yes	No
79% (74%)	21% (26%)

Table 34
Fund options offered to members

	Percentage
Under 5	28% (25%)
6 - 10	31% (33%)
Over 10	41% (42%)

Table 34 Continued
Number of fund managers offered

	Percentage
Only one	58% (51%)
2 - 10	32% (47%)
Over 10	10% (2%)

Schemes offering a with-profits fund

Yes	No
47% (54%)	53% (46%)

Percentage of members invested in the with-profits fund

	Percentage
Average percentage of members invested in with-profits (where offered)	24% (27%)

Table 35
Percentage of firms facilitating financial advice / retirement counselling services to members / employees

Yes	No
68%	32%

If 'yes', percentage where cost fully met by employer

Yes	No
56%	44%

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