



NEWS RELEASE

Actuaries speaking at the NAPF conference say despite reduced scheme deficits, a second wave of final salary scheme closures to future service accrual is coming...

RISK SHARING SCHEMES ARE THE FUTURE OF GOOD PENSIONS

25 May 2007: Speaking at the NAPF Conference in Manchester, two senior actuaries have warned that a second wave of final salary pension scheme closures to future service accrual is on the way – over 70% of schemes are already closed to new entrants. Despite recent reductions in scheme deficits, many employers are unwilling to continue with pension arrangements that have the potential to damage the financial performance of their core business. However, the solution is not the wholesale adoption of defined contribution schemes – many employers want to do more and employees want greater security than these schemes offer. The real answer is legislative changes, as part of the Government's reform plans, designed to encourage the introduction of many more *shared risk* schemes.

This was the message from **Ian Farr, Chairman of the Association of Consulting Actuaries (ACA)** and **Richard Mulcahy of Hewitt** in a presentation to the **2007 National Association of Pension Funds (NAPF)** conference in Manchester today (25 May 2007).

Whilst the presentation accepted that many employers – particularly smaller firms – were unlikely to offer anything other than defined contribution schemes in the future, evidence suggested that many middle sized to larger employers wanted to do more, provided the financial risk involved was reduced. In the *ACA 2007 Pension trends survey*, to be published next week, 72% of the participating employers favoured Government pension policy promoting risk sharing schemes rather than policies that place 100% investment and longevity risk on members by way of defined contribution schemes.

“Risk sharing schemes can offer the ‘safety valve’ to provide the degree of cost and benefit predictability that employers need, whilst providing members with a more stable pension than defined contribution, with this pension continuing to be indexed pre and post retirement,” said **Ian Farr**.

Outlining how future shared risk scheme might look, **Richard Mulcahy**, said typical schemes might have the following features:

- Contracted-in to provide a guaranteed layer of defined benefit
- The employer would determine the accrual rate based on pay in the year
- The employer would contribute at least the expected cost of future service accrual using prudent assumptions as required by the new scheme funding requirements
- The expected cost of accrual would include a targeted rate of increase, pre and post-retirement
- Targeted increases would be granted each year provided the scheme was not in deficit
- Targeted pension increases not granted would have first call on any future surplus emerging
- Past service benefits of these new schemes could be cut back if the actuary certifies that life expectancy has increased (this would be spelt out in the scheme documentation), but with protection for those close to retirement

“The pensions delivered under these shared risk schemes would be better and more stable than that likely from the vast majority of defined contribution schemes. Importantly, employers will be able to control contributions, better control their potential s75 debt - which would exclude targeted increases – and there should be lower PPF levies and more flexible pension accounting rules,” noted **Mulcahy**.

Farr and **Mulcahy** said the outcome of the Government’s Deregulatory Review offers the opportunity to implement the legal changes necessary to encourage many more shared risk schemes to develop – at present their development is restricted as most have to be set up under the defined benefit pension regime. This does not allow the flexibility needed to run shared risk schemes and, such are its burdens, this regime is increasingly regulating only closed schemes. The ACA has sought advice on the legal changes needed to establish a simple shared risk scheme category, which have been submitted to Government during the consultation process of the Deregulatory Review. The results of the Review are eagerly awaited.

“If we get the legal reforms needed in a Bill in the 2007/08 session of Parliament, then I would expect shared risk schemes will be used for future service benefits by many employers, with many of those considering closure of their final salary scheme to future accrual going the shared risk way, rather than jumping – as at present – straight to defined contribution. Later on, we may then see some defined contribution schemes, as their weaknesses unfold, being up-graded by their sponsors to shared risk.”

“This isn’t ‘pie in the sky’ – shared risk type schemes are prospering in The Netherlands, where occupational defined contribution schemes are much less common as a result. And what’s the alternative – the managed decline of a once excellent and growing private pension system? Our generation will never be forgiven by today’s and future generations if we simply fiddle around whilst Rome burns. There are clear challenges to address that require bold and innovative solutions,” concluded **Ian Farr**.

A paper on *Shared Risk* schemes and a *Questions & Answers* briefing are available on the ACA website at www.aca.org.uk (see ‘Policy Statements’)

For further comment:

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Notes for Editors

[About the Association of Consulting Actuaries \(ACA\)](#)

The **Association of Consulting Actuaries (ACA)** is the representative body for consulting actuaries, whilst the Faculty and Institute of Actuaries are the professional bodies. The ACA has over 1500 members working in around 80 firms. ACA Members are all qualified actuaries and are subject to the code of professional conduct of the Faculty and the Institute of Actuaries. Advice given to clients is independent and impartial. The ACA forms the largest national grouping of consulting actuaries in Europe.