



# Technical Seminar of the ISSA Technical Commission of Statistical, Actuarial and Financial Studies

Limassol, Cyprus. – 30-31 October 2008

## *Optimal financing of social security pension schemes*

### **Experience of the United Kingdom**

**Chris Daykin**

**Independent Consultant and Actuary, UK**



# Overview of UK Social Security Provision

- Basic Pension (flat-rate)
- State Second Pension (career average)
- contracting out of S2P
  - defined benefit occupational plan
  - defined contribution occupational plan
  - Appropriate Personal Pension
  - Stakeholder Pension
- other occupational and personal pensions

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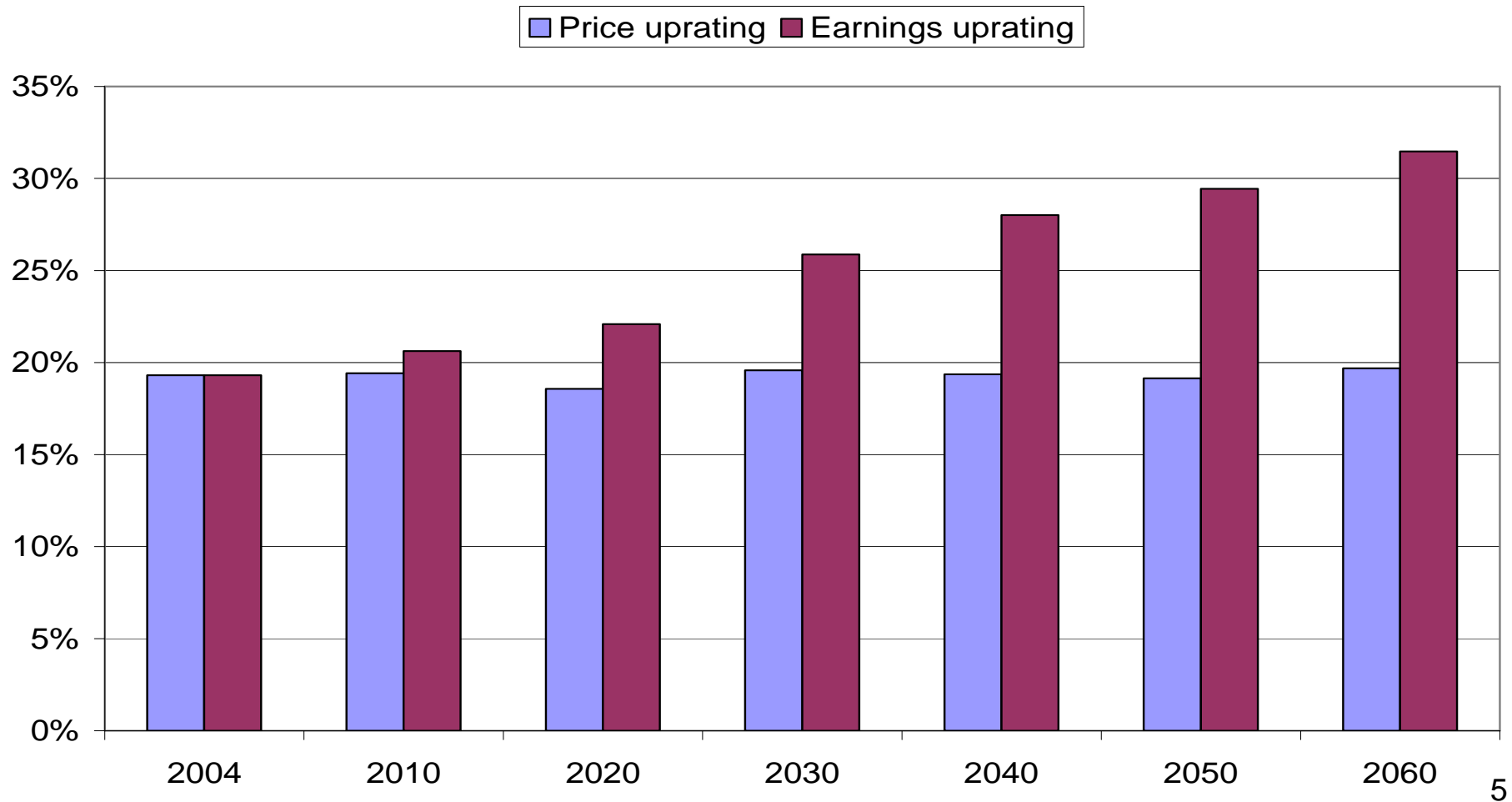
# Financing of Social Security

- pay-as-you-go financing of Basic and S2P
- benefits increased each April
- contributions set for coming fiscal year
- report to Parliament by Government Actuary
  - projected income and expenditure
  - focuses on current year and the next one
  - shows estimates for 5 years ahead

# Long-term financing

- Government Actuary's Quinquennial Review
  - projections of future income and expenditure
  - future balancing contribution rate
  - impact of recent and proposed changes in law
  - sensitivity analysis
  - description of methodology and assumptions
    - eg real earnings growth of 1½% and 2% a year
    - latest national population projections

# Projected joint contribution rate required from members/employers\*



\*Assumed 1½% real earnings growth

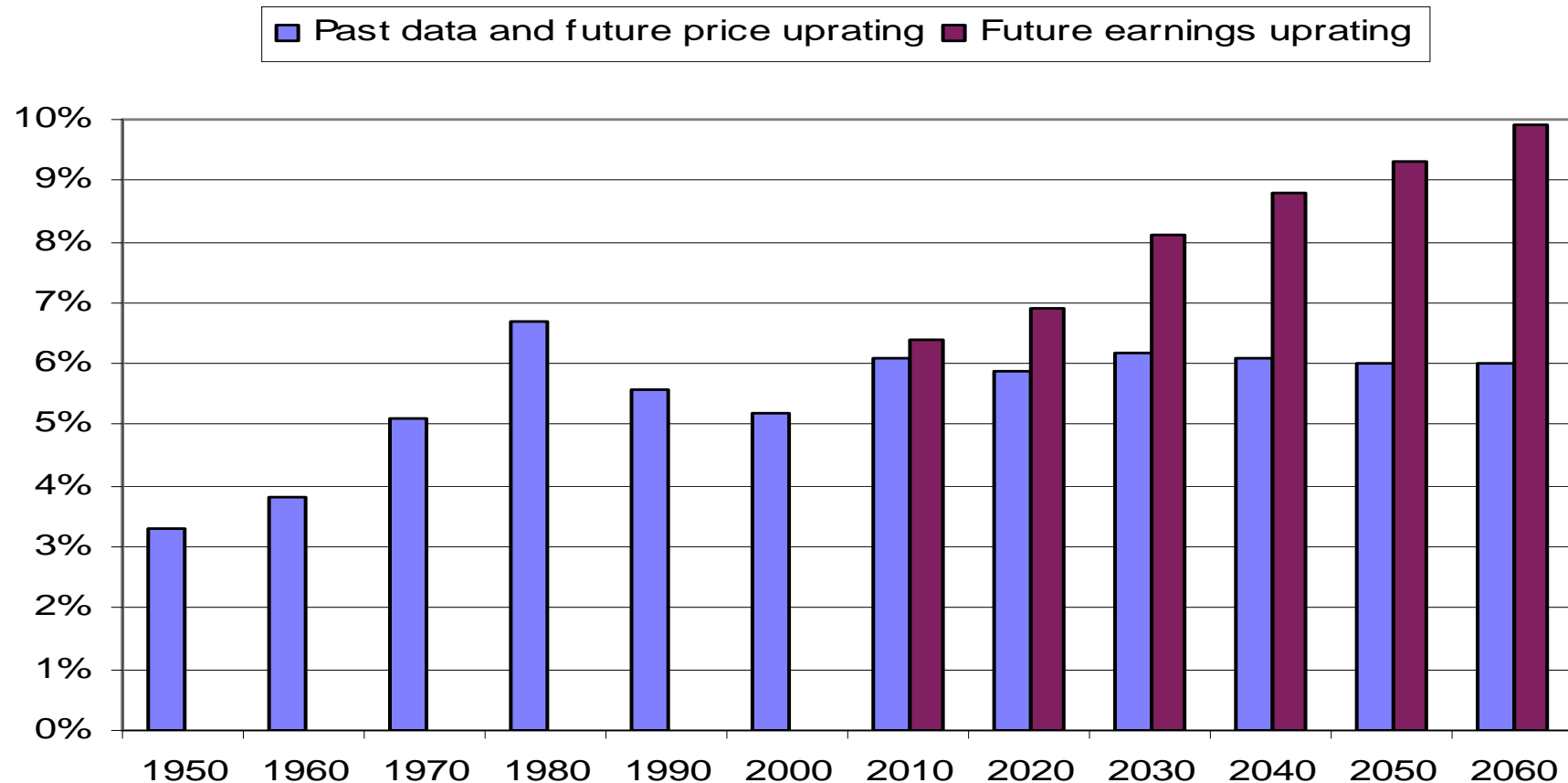


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# Expenditure from National Insurance Fund as % of GDP\*



# Changes on the way

- increasing pension age
  - equalising at 65 for men and women 2010-2020
  - up from 65 to 66 between 2024 and 2026
  - up from 66 to 67 between 2034 and 2036
  - up from 67 to 68 between 2044 and 2046
- earnings up-ratings from 2012 (or so)
- only 30 years' contributions for full pension
- weekly home responsibilities credits

# Other social security benefits

- Pension Credit/Savings Credit (means-tested)
- housing benefit (means-tested)
- attendance allowance (non-contributory)
  
- not subject to same actuarial discipline...
- ...or long-term projections

# Occupational Pension Schemes

- tradition of final salary occupational plans
- intended to be fully funded for accrued rights
- overfunded in early 1980s...
- ...leading to taxation of surplus and
- ...encouragement of contribution holidays
- now generally significantly underfunded
- majority are closed to new entrants...
- ...and many to further accrual

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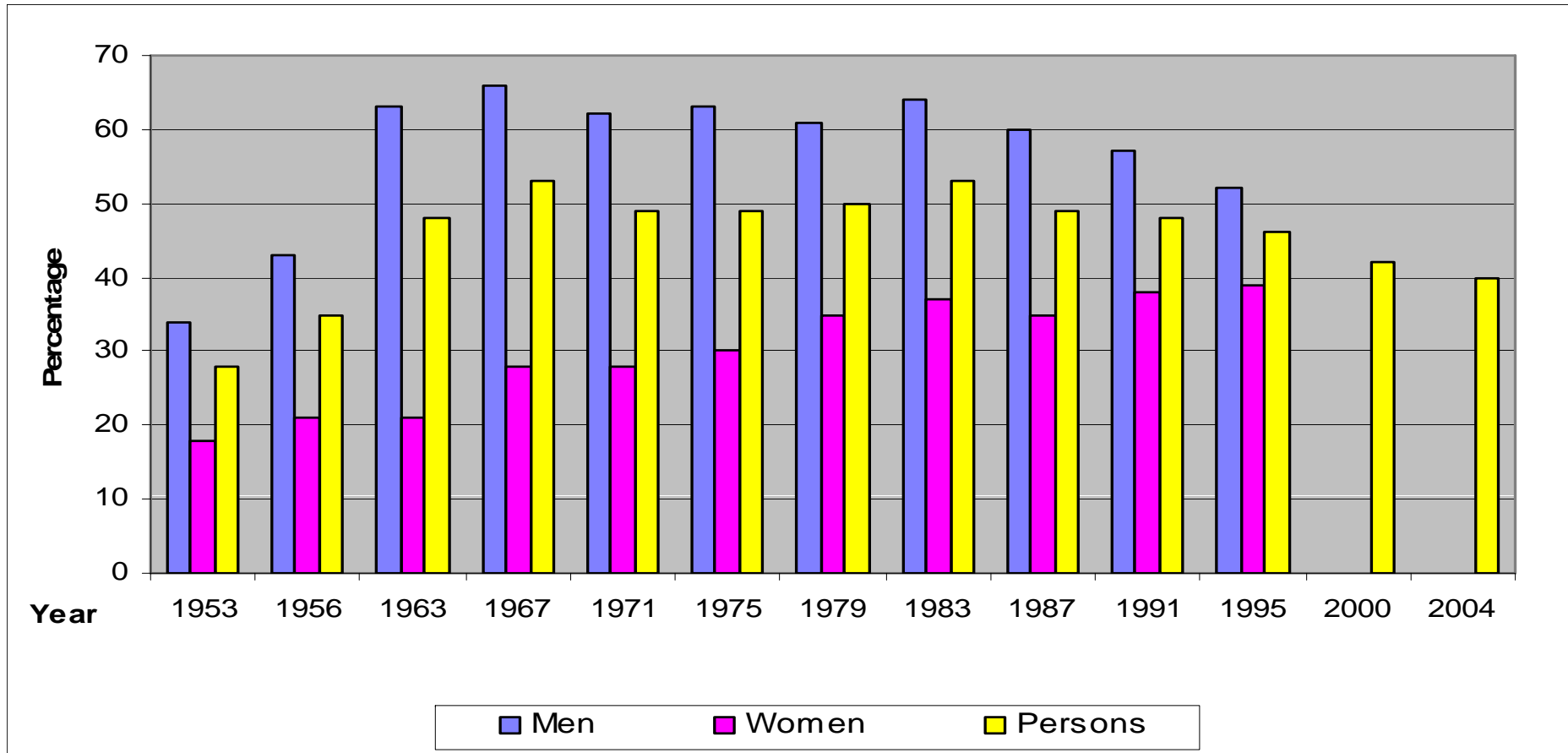


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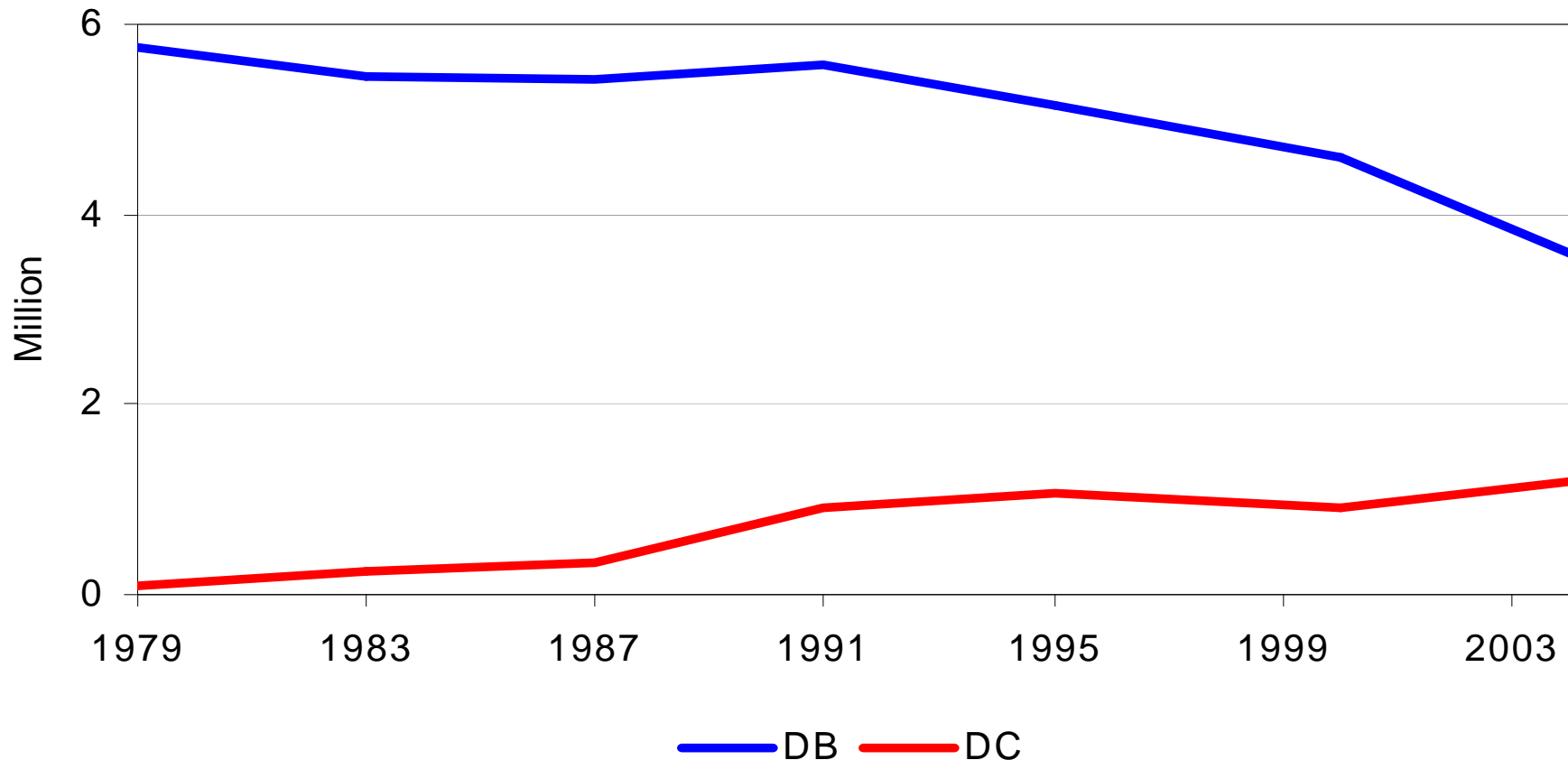
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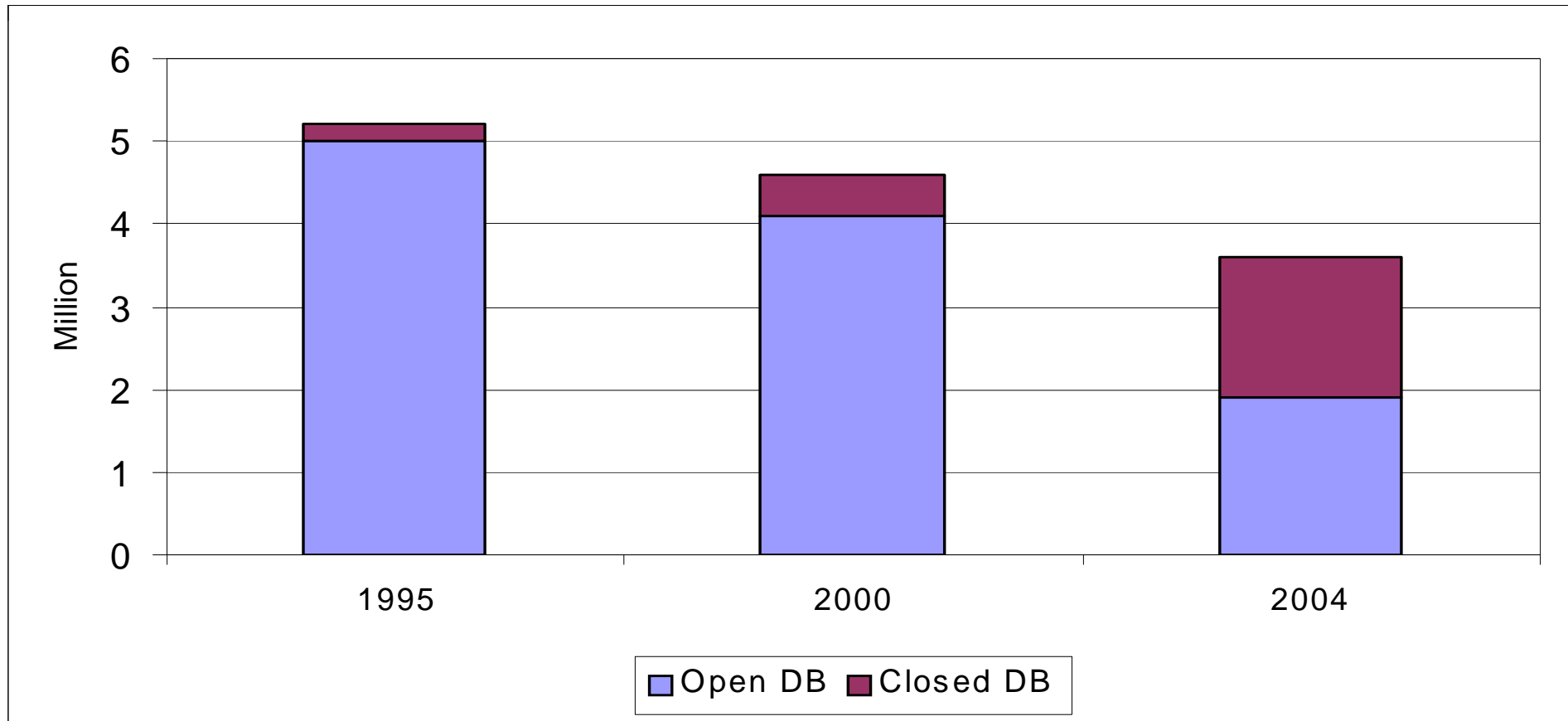
# Occupational pension scheme membership (as % of employed persons)



# Active members of private sector occupational plans



# Active members of private sector DB schemes



# **Funding of defined benefit occupational pension schemes**

- new stronger pensions regulator (tPR)
- the Pensions Protection Fund (PPF)
- ...and the Financial Assistance Scheme
- emphasis on improving funding levels
- perceived privilege of public sector workers

# Regulation of DB occupational schemes

- assets taken at market value
- liabilities on projected accrued benefit method
- ...known as 'technical provisions'
- statutory funding objective:
  - assets > technical provisions
- if not, recovery plan to be set in place
  - agreed between trustees and employer
  - recovery period as short as possible and not >10yrs

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# Funding of DC plans

- DC plans are fully funded
- value of pension depends on value of assets
- some DC plans may be contracted-out of S2P
- ...but DC contracting out to end shortly
- compulsory annuitisation from age 75
- DC under stress with market collapse

# Personal Accounts

- auto-enrolment into individual savings accounts
- contributions on £5,000 to £30,000 pa earnings:
  - 4% from employees
  - 3% from employers
  - 1% from tax relief
- contributions collected with National Insurance
- investment mechanisms still to be decided...
- expected to involve wholesale investment of funds
- ...rather than retail pension products
- provision for opting out

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