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Updated actuarial assumptions help the PPF7800

(Frank Eich)

- **At the end of 2009 the net funding position of the 7800 pension schemes captured in the Pension Protection Fund (PPF) 7800 Index stood at -£33bn. The sharp decline in the deficit since mid year was due to rising asset values and falling liabilities, the latter mainly reflecting changed actuarial assumptions.**
- **Reduced liabilities make the cost of securing benefits in the PPF cheaper for schemes though the security of members' benefits will still depend on the funding position of the PPF and any government support should the fund run into financial difficulties.**
- **Since it was set up in 2005 the PPF has paid around £100 million in compensation. In mid January the Conservatives made clear that if they were to win the election they would not bail out the PPF should it ever run into serious financial difficulties. This threat – whether realised or not - might encourage better funded pension schemes to minimise the risk of having to bail out the PPF by seeking alternative solutions to dealing with the legacy of their pension liabilities.**

Defined-benefit private sector pension schemes went through a very rough period in late 2008 and the first half of 2009 but things have generally been on the up again over the last few months. At the end of December the net funding position of the 7800 pension schemes captured in the Pension Protection Fund (PPF) 7800 Index stood at -£33bn, which was the smallest deficit since July 2008 and a far cry from the £242bn deficit recorded in March last year. The shrinking deficit was the result of rising asset values (reaching levels last seen in late 2007) and falling liabilities.

A closer look reveals though that much of the fall in the value of liabilities since the summer has been due to changed actuarial assumptions in October last year. These changes, introduced by the Board of the PPF in accordance with the Pensions Act 2004 and meant to keep the valuation of the PPF 7800 in line with the market, have resulted in a one off reduction in the value of liabilities by more than £70bn. Among the changes made, the PPF Board increased the yields used to discount future payments by 0.1 pp per year in deferment and 0.3 pp in payment, raised expected future longevity increases for males and reduced the assumption for the population who are married or have relevant partners. The reduced discount rate assumption in particular reflects changing bulk annuity prices, which have fallen as a result of the expansion of the insurance-buyout market.

The lower estimated value of liabilities could potentially be good news for members who are entering the PPF as it makes the cost of securing benefits in the PPF cheaper for schemes. However, members should not count their chickens too quickly as the security of their benefits will still depend on the funding position of the PPF and any government support should the fund run into financial difficulties.

The ups and downs of the PPF 7800 Index have been reflected by the Pension Protection Fund itself, which is financed out of levies and used to pay out compensation to members of pension schemes, which are under the wings of the PPF. At the end of December 109 schemes were in the PPF, representing more than 30,000 current or future pensioners. Since 2005, when it was set up, the PPF has paid around £100 million in compensation, a significant amount of money but not enough to destabilise the PPF's funding arrangements quite yet. In mid January the Conservatives made clear that if they were to win the election they would not bail out the PPF should it ever run into serious financial difficulties. While it is by no means certain that the Conservatives would follow through on such an announcement if push comes to shove, this threat itself might encourage better funded pension schemes to minimise the risk of having to bail out the PPF by seeking alternative solutions to dealing with the legacy of their pension liabilities.