FROM THE WORLD OF PENSIONS

Pensions – informed choices

The government has published a paper entitled 'Simplicity, security and choice: Informed choices for working and saving'.

It brings together the government's proposals aimed at breaking down the barriers which it sees as preventing people saving more for retirement. Much of the content is not new, and all of it is very broad, simply setting out another raft of intentions.

The three elements of the government's 'Informed Choice strategy' are:

1 To build on the simplification measures in the green paper to maximise provision and ensure that everyone has access to good choices – recognising the importance of employer-sponsored retirement provision, the government is seeking to establish the best way of increasing pension scheme membership. It will then 'work with employers to promote it'. The options under consideration are:

- requiring new employees to make a decision whether or not to join the scheme;
- asking employees to commit potential future earnings to the pension scheme; and
- automatically including employees in the scheme unless they opt-out.

Also the government will look at whether it would be worthwhile requiring new employees – whose employer only offers them stakeholder access – to make a default contribution.

2 To raise overall levels of financial education and awareness of the need to plan and provide for retirement – the government will work with the Financial Services Authority (FSA), and others, to try to ensure people are equipped to understand the information they are provided with. Some of the measures set out in the paper are:

- finance education to be included in the National Curriculum;
- Department for Work and Pensions (DWP) to set up an integrated retirement planning service;
- government to work with the Employer Task Force and Association of British Insurers (ABI) to develop ways to encourage employers to support employees in their retirement choices; and
- powers to be included in the Pensions Bill to require employers to ensure their employees have access to a decent standard of pensions information.

3 To ensure all people of working age have access to personalised information so they can understand how the choices available relate to their own retirement prospects – the paper sets out what the government has already done to improve the provision of tailored information – such as starting to issue automatic state pension forecasts. Also:

- it plans to make 'what if' pension forecasts available showing the effect of deferring state pension (to be available in 2005);
- as previously set out in the green paper, defined benefit schemes will be required to provide annual benefit statements from April 2005;
- also as previously set out in the green paper, reserve powers will be included in the Pensions Bill enabling the government to compel schemes to provide combined pension forecasts in the future, if necessary; and
- it plans to develop a web-based retirement planner to go live in spring 2006.

Annex 2 of the paper contains a timetable for the Informed Choice agenda. This includes a reference to the expected Budget announcement on the tax simplification proposals. The wording in the timetable suggests that both the increase in minimum pension age and the flexibility to work and draw an occupational pension at the same time will be introduced regardless of whether the whole tax simplification package is taken forward. This is welcome.

The timetable also confirms that the government intends to introduce an age discrimination bill into Parliament by the end of 2004.

But conspicuous by its absence from the timetable is any reference to the Pensions Bill… (See also p14.)

Opra reporting

Following the publication of a revised version of Opra Note 1 for advisers, Opra has published new guidance on when it expects trustees to report late payment of contributions. Opra Update 5 reflects Opra's new approach to reporting, focusing on breaches that could constitute a significant risk to members' security.

Opra does not want trustees to report:

- isolated late payments, where the matter has been put right and action taken to prevent recurrence;
- a temporary failure to pay the correct contributions when due, where the contributions were paid promptly when the failure was found, and the administrative failure has been, or is being, corrected in an effective and timely way; or
- short periods of lateness of small amounts of contributions resulting from, for example, changes in pensionable pay, or new members joining, where the contributions have subsequently been corrected.

Where a late payment raises concerns about the conduct of the employer, Opra wants to receive a report. For example, trustees should report if an employer:

- is using the contributions to alleviate cashflow difficulties; or
- does not have arrangements in place to ensure the normal correct and timely payment of contributions due.

Where the breach may pose a significant risk to members' interests, trustees should report immediately, putting the breach in context and outlining any other concerns.

From now on, Opra only expects trustees to report when contributions remain outstanding 90 days or more after their due date. However, trustees must nonetheless notify scheme members when contributions are paid 60 days, or more, late. They must do this within 90 days of the due date.

Latest ACA pension trends survey

The Association of Consulting Actuaries (ACA) has issued preliminary results from its 2003 survey of smaller firms' (firms with 250 or fewer employees) pension trends.

Key findings include:

- the prevalence of group personal pensions (44% of respondents, with average combined employee/employer contributions of 8.6% of earnings);
- only 36% of defined benefit schemes are still open to new members (average combined employee/employer contributions of 21% of earnings, up 2.1% from last year);
- of firms offering a pension, 60% record greater member interest as a result of recent 'bad press';
- 58% of firms support the Pensions Protection Fund (but, for most, that support will depend on the level of the levies); and
- 64% of firms oppose trustees having the unilateral power to wind up a scheme.

The survey attracted responses from 459 firms, selected on a random basis. Smaller firms, as defined for the survey, employ 55.6% of the UK working population.

Watson Wyatt is 125

Watson Wyatt has celebrated its 125-year history with the publication of *The Story of Watsons*.

R Watson & Sons was established in 1878 by Reuben Watson, undertaking pioneering actuarial work with friendly societies. Today Watson Wyatt is a global consulting firm specialising in employee benefits, human capital strategies, and insurance and financial services. Paul Thornton, senior partner at Watson Wyatt, said: 'The firm has grown from small beginnings in the specialist field of friendly societies to a prominent position as an adviser on a range of issues to major corporations and financial institutions. The actuarial core has developed into a wide range of professional consultants.'

Watson Wyatt advises nearly half of the UK's 100 largest corporate pension schemes, and has been named a Top 100 employer in the *Sunday Times* '100 best companies to work for' survey in each of the past three years. The firm employs over 1,800 associates throughout the UK and 6,200 globally.

One of the firm's first clients was Manchester Unity in 1879, followed by Royal Liver in 1892. Both organisations remain clients today. By 1910, the firm was the leading adviser to the government on social insurance schemes. The firm left London for Reigate in 1938 and has remained a prominent local employer ever since. In 1995 Watsons formed a strategic alliance with US-based Wyatt & Company and became Watson Wyatt Worldwide.

Paul Thornton

Reuben Watson 1821–1902

Sir Alfred Watson (grandson of Reuben), first government actuary

Samuel Watson (son of Reuben)

Reigate in 1938

Early computer room

Watson House, Reigate

Stop press: Pensions Bill

A massive yawn greeted the publication of the long-foreshadowed Pensions Bill last month. Prior to publication, employer organisations had warned that the Bill could destroy pensions provision by requiring cross-subsidy from healthy firms and schemes to those which are less healthy. Department for Work and Pensions secretary Andrew Smith sought to defuse this criticism by committing to moving to a risk-based contribution rate basis to the new Pensions Protection Fund as soon as possible.

This failed to allay completely fears which owed something to the disclosure of a record deficit by the equivalent US body – the Pensions Benefit Guaranty Corporation. All of the NAPF, PMI, and ACA also criticised the length and complexity of the draft Bill, which appeared to run counter to the government's professed aspiration for simplification. While all agreed that the bill was well intentioned, this faint praise was accompanied by criticism of the apparent vacuum in government policy on pensions.

Of course, the challenges of pension provision in uncertain financial markets and against a background of uncertain retirement patterns and life expectancies are not simple. We hope to carry more considered digestion of the implications of the new Bill in the next issue of *The Actuary*.

FRS17 deficits again

Rival consultants were united in questioning the optimistic tone of our report last month suggesting that the pensions 'black hole' had been significantly reduced by improvements in equity markets during 2003. Consultants expressed concern that clients may take an unrealistically optimistic view and delay necessary remedial action on funding required to restore schemes to health.

Pending company results announcements which should give a clearer picture, many actuaries suggested that the Hewitt Bacon & Woodrow report had not sufficiently allowed for the offsetting impact of corporate bond yield levels on the gains achieved in equity markets. Results are likely also to be influenced by the mix of assets in schemes.

Indeed Aon Consulting pointed out the scale of the probable deterioration in scheme finances as a result of greater pensioner longevity. 'We calculate that if the life expectancy figures which FTSE 100

companies use to calculate their pension provision are underestimated by just one year, this is likely to understate liabilities on balance sheets by £10bn. Further underestimation of the effects of mortality improvements would lead to even bigger shortfalls. Our advice to companies is to check – on an ongoing basis – that the assumptions they base their pension provision on are in line with the latest expectations as well as the experience of their scheme', said the Aon spokesman.

We may return to this theme, but the message from most pensions actuaries is that there is no basis for complacency regarding the employer contributions likely to be required to meet promised benefits.

Penrose awaited

By the time this issue of *The Actuary* is with readers we hope that UK life offices and their actuaries will have had ample time to digest the expected 818 pages of Lord Penrose's long-awaited report on the recent difficulties of Equitable Life. 'What Lord Hutton did for the BBC, Penrose will do for life offices and their actuaries' was the fear of more than one senior actuary.

Many were surprised when the Treasury appeared to raise the stakes by referring elements of the report to the Senior Fraud Office for unspecified reasons. Former Equitable chief executive Chris Headdon suggested that this departed from the non-judgemental spirit which had previously characterised Lord Penrose's work.

Rather as the calm before a great storm, the actuarial profession awaits a dissection of the apparent failings in professional standards and supervision which are alleged to have taken place prior to the adverse House of Lords judgment in *Equitable v Hyman*. The only certainty is that life will never be the same again.

Wealth management back on the agenda

According to a new study, IT investment by financial companies in western Europe shows increased dynamism in the wealth management arena, as companies launch new initiatives after the capital market slump.

To understand how wealth management business will evolve in Europe, IDC has evaluated how financial institutions are setting up new services to adapt to the new market requirements. This analysis aims to identify key drivers for IT spending on wealth management solutions over the next year.

They found the following:

- The wealth management business offers new opportunities due to a more positive market trend. The European countries with the biggest opportunities include Spain, Germany, and the UK.
- Customer relationship management, risk management, and portfolio management solutions will still be a priority over the coming year. Also, profitability management solutions are increasingly critical because financial companies need to evaluate the real added value that wealth managers can offer.
- 2004 will be a very important year in terms of regulation changes. The new rules related to risk management, anti-money laundering, and UCITS funds will alter the competitive landscape.
- In an increasingly competitive environment, it will be important for IT companies to evaluate new IT requirements of wealth managers in order to maintain and enhance their positions in the market, which is seeing the first signs of recovery.

To find out more about how to obtain study detail, see *www.idc.com*.

The feeling's not mutual

Last month the Financial Services Authority (FSA) published a letter from chief executive John Tiner to Dr Vincent Cable MP who had expressed concern that FSA action had made the demutualisation of Standard Life inevitable. 'We have no view one way or the other about the merits of a mutual structure compared to a proprietary structure involving shareholders' said the FSA.

Some felt that the FSA was being a little disingenuous in that it is difficult to visualise the economics of a new mutual life office in today's environment of realistic solvency and risk-based capital. Historically, mutual offices were able to recycle capital contributed either temporarily or permanently by their owner-members. The requirement to have sufficient capital to sustain solvency with very high levels of confidence make shareholder capital almost an essential requirement.

This in turn may lead some individuals with higher risk tolerances to take the view that the FSA's requirements are overly burdensome so far as their own life assurance and pension arrangements are

Mesothelioma – light at the end of a long tunnel?

Actuaries involved in general insurance will be very aware of the lingering effects of exposure to asbestos, and in particular the likely escalation in deaths from the mesothelioma cancer over the early decades of this 21st century. We heard of both bad and good news this month.

Actuaries at Tillinghast confirmed in response to an article in the *British Medical Journal* (BMJ) that as many as 100,000 are likely to die from this dreadful condition in coming years. Actuary Darren Michaels, said that these figures were 'broadly in line' with estimates from previous studies of mesothelioma.

Nevertheless, the *BMJ* paper is a stark reminder of the levels of mesothelioma, one of several different asbestos-related diseases and the most fatal of them, expected to hit developed countries. The paper asserts that one in every hundred men born in the 1940s will die from mesothelioma, and with a lag time between exposure and development of 25 years to more than 50 years, the death rate is continuing to increase.

Current mortality rates in the UK are 1,800 deaths per year, and this is expected to rise to 2,000 per year in the peak years of 2015 to 2002. The paper further suggests that the situation is similar in Europe, as well as Australia, which had the highest asbestos usage in the world. By contrast, the US mortality rates have probably peaked now, states the paper, because of 'earlier awareness and action on asbestos imports'.

There may, however, be hope in that London's Bart's Hospital is an important centre for research into the causes and treatment of mesothelioma, run by doctors Robin Rudd and Jeremy Steele. We were privileged to attend a discussion organised by the Association of Run-off Companies (ARC) at which Dr Steele reminded us of the dramatic impact of research on other forms of disease such as leukaemia in children.

The programme of research in mesothelioma at Bart's is funded entirely from charitable donations. meeting a current cost of £50,000 a year for the programme of clinical trials. This is an excellent cause deserving of support from insurers and actuaries, and readers can make a difference by making donations either at *jeremy.steele @bartsandthelondon.nhs.uk* or by post to the Bart's Mesothelioma Research Fund, King George V Building, West Smithfield, London EC1A 7BE.

concerned. These individuals could band together in a new form of mutual firm, whereby they took the risk of shortfall themselves. It could just be Dr Cable has a point – that the FSA's safety first approach to treating customers fairly could lead to either the end of mutuality or to its rebirth in a new form.

Life in Europe will not be easy

The European life insurance industry must make some very tough decisions or have them made for it, and quickly, if it is to take advantage of the huge growth opportunities offered by economic growth, financial deepening, and demographic changes in the region. Life companies must face up to a capital shortfall of up to €100bn (£70bn) between the statutory minimum and what is economically required, and find ways of eradicating it. They must tackle this funding gap by raising fresh capital, derisking their businesses, and, above all, consolidating and restructuring. The alternative is a sustained period of stagnation and long-term decline for the sector and a deepening of Europe's growing long-term savings and pensions conundrum.

These are some of the key conclusions of a report published this month by Mercer Consulting entitled 'Life at the end of the tunnel? The capital crisis in the European life sector'. Mercer continues to be very positive about the future prospects of the life sector. 'The growth prospects of life insurance are still extremely strong. A combination of continued economic growth, financial deepening and demographic changes is likely to lead to above-GDP growth rates for the life insurance markets, even without taking into account the potential effects of pension deregulation,' states the report.

The consulting firm forecasts that between 2004 and 2020 medium and long-term savings markets, including individual life and pensions and occupational pensions, will grow at an annual rate of some 7.5%. This is 4% higher than the predicted annual growth in flows into cash and bank deposits. Hoped-for pension reform in France, Italy, and Germany could provide an extra 2% boost to annual growth. 'This suggests there are enormous growth opportunities for life insurers that are able to tap into this source of assets,' states the report. But the big question, according to Mercer, is whether the currently battered and bruised group of European life companies are up to the challenge, and whether they can raise profitability and provide the capital to support that potential growth. The consulting firm says it does not have a chance if it does not tackle the capital issue and remove the €100bn gap that currently exists. Mercer's gap is essentially the difference between the solvency capital that is required by the regulators and economic capital.

Insurers fight back against fraudsters

High-profile cases such as the conviction of Major Charles Ingram for insurance fraud in November last year are indicative of a rising trend of spurious and fraudulent claims which insurers have previously been sluggish to counteract with watertight claims processes. However, a new report from independent market analyst Datamonitor reveals that insurers in the UK are now in the process of what promises to be the strictest crackdown on fraudulent claims that the industry has ever seen. 'The insurance industry has always been viewed as a soft touch on fraud in comparison to other financial service providers such as banks, primarily because they lag behind these institutions in terms of financial muscle. However, another factor behind this is insurers' historical unwillingness to co-operate with their competitors and share information. At last, it seems as if insurers are waking up to the sheer scale of the problem and realising just how hard it is hitting them in the pocket', comments James Greenwell, author of the report.

With the total cost of claims in the motor sector approaching £8bn in 2002, claims on property costing insurers a further £3.6bn, and with investment income hit hard by the stockmarket slump, insurers are waking up to the importance high-quality claims management processes in maintaining profitable business.

In early 2003, when certain major insurers raised their intention of monitoring claimants' voices when reporting a claim over the telephone, in an effort to identify suspicious claimants, there was a tangible sense of public outrage. The controversy surrounding the so-called 'lie detector' technology, or voice stress analysis (VSA), has subsided somewhat, and uptake of the new software is expected to take off rapidly in 2004. Despite initial misgivings, many major insurers believe the vast majority of their honest customers are prepared to live with VSA, providing the anti-fraud technology is successful at weeding out fraudsters and reducing future premiums. Pilot schemes have proven remarkably successful, with one insurer reporting that 25% of motor theft claims had been withdrawn since it had begun using the software.

The introduction of VSA is complemented by other similar measures typifying the sweeping changes seen by insurance industry in terms of claims process. A new scheme implemented in 2003, the Motor Insurance Database, is an effort to record and track multiple claimants, enabling insurers not only to pick out problematic policyholders who have dubious claims histories, but also to deter anyone thinking of engaging in such behaviour in the future.

'These anti-fraud measures, combined with a fresh outlook on other ways that they can save money, have led to a sea change in the way insurers look at their operational responsibilities. Indeed, claims management is now viewed less as a tiresome necessary evil but as a science that represents a real opportunity to not only improve service standards, but also save money for themselves and their policyholders', concludes Mr Greenwell.

Check your spreadsheet!

Further to our story last month ('Spreadsheet risks and control', p16), we refer you to the latest edition of Louise Pryor's monthly letter (*www.louisepryor.com*). In it she discusses problems with Excel 2003, which, Louise says, has bugs and is being touted as having an improved random number generator:

The RAND function doesn't work in Excel 2003. It's meant to return a random number between 0 and 1, but in fact it sometimes returns negative numbers. Microsoft has released a 'hotfix' (its term) that it claims fixes the problem. It also claims that it fixes several other problems, a number of which they had not previously mentioned.

There is no indication in these cases that anything is awry. If you use Excel 2003, your spreadsheets may not show the correct results. The hotfix is not downloadable. You have to contact Microsoft and convince them that you need it.