`THE HUNDRED GROUP
Cumbria
School Lane
Seer Green
Beaconsfield
Bucks HP9 2QJ
01494 673479

mortalitydb@thepensionsregulator.gov.uk
Peppi Knott
The Pensions Regulator
Napier House
Trafalgar Place
Brighton
BN1 4DW

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Dear Ms Knott

Response to the Pensions Regulator's Consultation on Good Practice when Choosing Assumptions for Defined Benefit Pension Schemes with a Special Focus on Mortality

I am writing on behalf of the Hundred Group of Finance Directors with regard to the Pensions Regulator's consultation named above. The Hundred Group represents the Finance Directors of the UK's largest companies.

The Hundred Group welcomes the attempt by the Pensions Regulator to provide guidance to the trustees of defined benefit scheme in choosing appropriate mortality assumptions for their valuations. The draft guidance provided by the Pensions Regulator will certainly be a useful source of information for trustees in setting out where scheme specific approaches can be used and in providing guidance on how mortality assumptions should be disclosed.

However, we have serious concerns about the Pensions Regulator's decision to adopt a trigger relating to future mortality improvements:

1. Use of trigger for an individual assumption

We believe that it is inappropriate for the Pensions Regulator to set a trigger for an individual assumption. We accept that the Pensions Regulator has found it useful for its own internal purposes to introduce triggers based on the overall level of technical provisions and length of recovery plans, and that trustees and employers have inevitably taken these triggers into account when agreeing on funding decisions.

However, setting a trigger for an individual assumption (namely future improvements in mortality) would set a worrying precedent. The legislation requires the assumptions for both mortality and the discount rate to be individually prudent (in addition for the requirement for the basis as a whole to be prudent), so there are real concerns that the next step will be to introduce another trigger in relation to the discount rate.

We are concerned that the Pensions Regulator may be using the trigger points as a way of moving away from the principles of scheme specific funding, to a basis that, if not exactly prescribed, is nevertheless firmly recommended.

2. Use of trigger for future mortality improvements

We also have concerns about using a trigger in respect of future mortality improvements in particular. All assumptions made are inherently uncertain and actual experience is likely to diverge from the assumptions. However, this is particularly true of future mortality improvements, where there is a very large range of possible outcomes. The recent consultation issued by the Board for Actuarial Standards states that 'assumptions about future mortality are inevitably subject to high levels of inherently unquantifiable uncertainty'.

We believe that this inherently unquantifiable uncertainty makes it inappropriate to apply a trigger in relation to future mortality improvements.

3. Level of trigger for future mortality improvements

As indicated above, we believe that it is inappropriate for a trigger to be set at all in relation to future mortality improvements. Leaving that aside, however, we would add that the suggested level of the trigger is also wholly inappropriate.

As the Regulator's own figures show, fewer than 0.5% of schemes who have submitted a valuation to date would have met the trigger. Even allowing for changes in mortality assumptions since those figures were collated, we are aware of very few schemes which have adopted both the long cohort projection and a floor to the rate of future improvement. We therefore believe that at least 19 out of every 20 schemes will trigger on this assumption.

We understand that the original thinking behind the Regulator's funding triggers was to enable the Regulator to filter out those schemes adopting assumptions that might potentially cause concern. However, a trigger set at this level cannot be a meaningful filter.

In addition, if schemes do attempt to adopt the filter, it will lead to a significant ratcheting up of liabilities for funding purposes. As the Board for Actuarial Standards notes, the dangers of overestimating longevity are just as significant for pension schemes as those of underestimating longevity. Overestimating future improvements in mortality could lead to employers being increasingly unwilling to continue with defined benefit scheme provision.

4. Power to intervene where trigger not met

We are particularly concerned by this consultation in the light of the additional powers being given to the Pensions Regulator by the Pensions Bill currently going through Parliament, which will enable it to impose its own funding assumptions where it believes that the assumptions used are insufficiently prudent, even if the trustees and employer have agreed on these assumptions after following due process.

The consultation paper indicates that it believes that using assumptions for future mortality improvements which tail off to zero 'can no longer be considered as prudent'. Putting this together with the clause in the Pensions Bill means that the Pensions Regulator will have the power to impose funding assumptions on any scheme that does not use an underpin in its assumptions for future improvements.

We accept that the Pensions Regulator may not intend to use this power very often, however it remains a potent threat and gives the triggers more weight than they have had previously. The triggers define the Regulator's view of prudence, and so determine when these powers may be used.

5. Introduction of these triggers

We also have serious reservations about the proposed timing of the introduction of this trigger, which is to be backdated to valuations with an effective date of March 2007 or later. Many schemes had already reached or nearly reached the end of their funding decision-making at the time when the consultation was published. This retrospective imposition of a trigger has had a potentially destabilising effect on valuations in progress, effectively blighting ongoing funding negotiations.

Conclusion

The Hundred Group has generally been very supportive of the work being done by the Pensions Regulator and we respect the way in which it has consulted openly on so many different areas, as well as its willingness to engage with the Hundred Group's Pensions Working Party on a regular basis.

However, we believe that the proposals contained in its latest consultation are seriously flawed. It is wholly inappropriate to set a trigger for mortality improvements, particularly where the trigger is so specific. Irrespective of the policy area, it is also wrong for any change to be introduced with retrospective effect.

We hope that you will give our concerns serious consideration. Please contact me if you would like any further information on any of the matters discussed in this letter.

Yours sincerely

Eddie Weiss

Edward Weiss
Chairman
Hundred Group Pensions Working Party