



Merchant Navy Officers Pension Fund

Annual funding update as at 31 March 2011

CP Burbidge
Paul Burbidge

October 2011

Background

- An annual funding update is required under the Pensions Act 2004 in the years in which a full actuarial valuation is not undertaken.
- This is not a full actuarial valuation, but a roll forward of the 31 March 2009 valuation results, taking into account actual cashflows. The asset value as at 31 March 2011 has been taken from the Fund's Annual Report.
- The same methodology as that used for the 2009 valuation has been used to derive the financial assumptions, but based on 31 March 2011 market conditions. It is a requirement to follow the methodology adopted for the most recent full actuarial valuation. No adjustment has been made for any change in the strength of the employers' covenant.
- The statistical (or demographic) assumptions used are the 2009 assumptions. They will be reviewed at the next formal valuation in 2012, with particular focus on the mortality assumptions (base tables and future rates of improvement).
- Over the year to 31 March 2011, long dated yields have remained relatively unchanged for index-linked bonds and corporate bond yields, whereas fixed interest gilt yields fell by around 0.2% pa. Expectations of long term retail price inflation also fell by about 0.15% pa.
- The funding position is subject to considerable volatility, and can change significantly from month to month. Thus the current position could be materially different from that disclosed as at 31 March 2011.

Changes to financial assumptions

	31 March 2009	31 March 2010	31 March 2011
	% pa	% pa	% pa
Pension increases	nil	nil	nil
Ongoing basis investment return	4.5	4.6	4.5
Discontinuance basis investment return:			
- non-pensioners	3.5	3.9	3.75
- pensioners	4.0	4.4	4.25

- The decrease in assumed ongoing basis investment return over the year to 31 March 2011 is consistent with changes in return expectations for the assets held, which are mainly based on index yields for fixed interest gilts and corporate bonds.
- The decrease in assumed discontinuance basis investment returns is broadly consistent with changes in fixed interest gilt yields.

Ongoing Valuation Results

	31 March 2009	31 March 2010	31 March 2011
	£m	£m	£m
Liabilities in respect of benefits accrued to date	1,219	1,221	1,219
Reserve for expenses	25	25	25
Total Liabilities	1,244	1,246*	1,244**
Assets	1,113	1,266*	1,255**
(Deficit)/Surplus	(131)	20	11
Funding Level	89%	102%	101%

* Includes £500m in respect of the buy-in (£475m recapture premium and £25m deferred premium) as at 31 March 2010.

** Includes £590m in respect of the buy-in (£574m recapture premium and £16m deferred premium) as at 31 March 2011.

The recapture premium is calculated by Lucida as the amount that an insurer would charge to provide the benefits covered by the policy. The deferred premium is the value of the remaining assets to be transferred to Lucida.

The ongoing surplus of £20m as at 31 March 2010 has reduced to a surplus of £11m over the year to 31 March 2011 as a result of:

- Change in market conditions increasing the value of liabilities: -£7m
- Investment returns and other miscellaneous items: -£2m

Discontinuance Results

	31 March 2009	31 March 2010	31 March 2011
	£m	£m	£m
Liabilities in respect of benefits accrued to date	1,319	1,261	1,262
Reserve for expenses	30	30	30
Total Liabilities	1,349	1,291*	1,292**
Assets	1,113	1,266*	1,255**
(Deficit)	(236)	(25)	(37)
Funding Level	83%	98%	97%

* Includes £500m in respect of the buy-in (£475m recapture premium and £25m deferred premium as at 31 March 2010).

** Includes £590m in respect of the buy-in (£574m recapture premium and £16m deferred premium) as at 31 March 2011.

The discontinuance funding level has deteriorated slightly because the value of the assets has decreased but the value of liabilities has stayed relatively constant. The value of liabilities under this basis is linked directly to the yields on gilts.

This is only an estimate of the buy-out cost; the true position can only be determined by completing a buy-out and recent experience indicates that different terms might apply in practice.

Old Section data allowance in liabilities for unclaimed benefits

- Some benefits due to members are unclaimed: members are above normal retirement age, but the Trustee has no knowledge of their whereabouts.
- For the 2009 funding valuation, a reasonable provision of around £60m for this feature was made by assuming that payments due to such members in the past will not be paid, but all future payments due would be paid.
- For the Journey Plan, an additional allowance of £30m (above the provision in the 2009 funding valuation) is included in the liability in respect of these members.
- Before the next funding valuation, consideration should be given to:
 - the appropriate level of data allowance to be included; and
 - what further actions (if any) should be taken to reduce the number of members who are not in contact with the Fund.

Changes to financial assumptions

	31 March 2009	31 March 2010	31 March 2011
	% pa	% pa	% pa
Retail Prices Inflation (RPI)	3.0	3.75	3.6
Consumer Prices Inflation (CPI)	-	-	2.6
Section 148 increases	4.5	5.25	5.1
Pension increases			
- pre 97 (non-GMP)	nil	nil	nil
- post 97	3.0	3.75	3.6
Ongoing basis investment return:			
- pre retirement	7.25	7.25	7.0
- post-retirement	4.75	5.0	4.9
Discontinuance basis investment return:			
- non-pensioners	3.5	3.9	3.75
- pensioners	4.0	4.4	4.25

- The decrease to the RPI assumption reflects market expectations, consistent with the narrowing of the gap between yields on fixed interest and index-linked gilts. The difference between RPI and CPI (for the ongoing basis) is based on our current best estimate of the long-term difference between the indices.
- The ongoing basis investment return has reduced pre-retirement as return expectations for the Section's return-seeking assets have reduced. The decrease in assumed ongoing basis post-retirement investment returns reflects changes in index yields for fixed interest gilts and corporate bonds.
- The decrease in assumed discontinuance basis investment returns is consistent with changes in fixed interest gilt yields.

Ongoing Valuation Results

	31 March 2009	31 March 2010	31 March 2011
	£m	£m	£m
Liabilities in respect of benefits accrued to date	2,252	2,321	2,347
Reserve for expenses	35	35	35
Total Liabilities	2,287	2,356	2,382
Assets	1,547	1,842	2,051
(Gross* Deficit)	(740)	(514)	(331)
Gross* Funding Level	68%	78%	86%

*Gross of the value of the deficit contributions from the 2003, 2006 and 2009 valuations to be paid after the effective date. See next slide for further information regarding the deficit contributions payable.

The ongoing gross deficit has reduced by £183m over the year to 31 March 2011 as a result of:

- 2003, 2006 and 2009 deficit contributions paid: £187m gain
- Decrease in liabilities due to change in statutory pension increases from RPI to CPI: £40m gain
- Change in market conditions increasing the value of the liabilities: £37m loss
- Investment returns and other miscellaneous items: £7m loss

2009 valuation recovery plan

- The present value as at 31 March 2009 of 2003 and 2006 deficit contributions due after that date was £183 million, leaving £557 million to be met by a new recovery plan.
- Positive investment returns (an additional 12% above the average return assumed on the technical provisions) and allowance for interest from the valuation date to 31 December 2009 reduced the net deficit to £379 million. Allowing for interest to 30 September 2010 increased this to a deficit of £402 million.
- The Trustee agreed that contributions with a present value of £408 million as at 30 September 2010 (in addition to the contributions agreed following the 2003 and 2006 valuations) would be paid by the participating employers over the period to 30 September 2022. This includes £6 million in respect of active member contributions from 31 March 2009.
- The present value as at 31 March 2011 of the 2003, 2006 and 2009 deficit contributions due after that date was £383 million. This is slightly greater than the gross deficit as at 31 March 2011 of £331 million. Therefore based on the conditions at 31 March 2011 and depending on future experience the deficit contributions would have been expected to eliminate the shortfall before 30 September 2022. However, market conditions since 31 March 2011 have been very volatile and generally unfavourable and it would not be appropriate to revisit the current recovery plan at the present time. There is still a discontinuance deficit of around £1 billion, and the Trustee may not collect all of the deficit contributions due, as a result of corporate failures. The deficit contributions payable will be considered as part of the 31 March 2012 valuation.

Discontinuance Results

	31 March 2009	31 March 2010	31 March 2011
	£m	£m	£m
Liabilities in respect of benefits accrued to date	2,884	2,856	2,922
Reserve for expenses	50	50	50
Total Liabilities	2,934	2,906	2,972
Assets	1,547	1,842	2,051
(Deficit)	(1,387)	(1,064)	(921)
Funding Level	53%	63%	69%

The discontinuance funding level has improved because the increase in the value of assets held has not been fully offset by the increase in the value of liabilities, which under this basis is linked directly to the yields on gilts.

This is only an estimate of the buy-out cost; the true position can only be determined by completing a buy-out and recent experience indicates that different terms might apply in practice.

Limitations of reliance

- This presentation is prepared for the Trustee of the MNOPF, and others should not rely on it or take action based on it without seeking their own independent advice.
- The written comments included in this presentation should be considered in conjunction with the supporting and amplifying oral comments and background provided by Towers Watson prior to any actions or decisions being taken.
- The content of this presentation was based on our understanding of the Pensions Act 2004, Regulations, Codes of Practice, Guidance and other relevant information available at the time of preparation. This presentation may not reflect the position at any future date.
- This presentation should not be disclosed to any third party other than in accordance with the terms of engagement agreed with you or with our specific consent. Unless otherwise specifically agreed in writing we assume no responsibility, duty of care or liability to any third party who may gain access to a copy of this document.
- The assumptions made about future economic and demographic conditions are precisely that; they are assumptions, and not predictions or guarantees. They provide, we believe, a reasonable basis on which the Trustee can formulate their policy, but they must be aware that there are uncertainties and risks involved in any course of action. There is no guarantee that the assumptions made will be borne out in practice, and the expectation is that in actuality the Fund's experience will, from time to time, be better or worse than that assumed.

Paul Burbidge
Towers Watson Limited
October 2011