



Merchant Navy Officers Pension Fund

Annual funding update as at 31 March 2010

CP Burbidge
Paul Burbidge

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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 2010 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 2010 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 2010, long dated yields fell by around 0.4% pa for index-linked bonds, whereas fixed interest gilt yields rose by around 0.6% pa. Corporate bond yields have fallen by 1.2% and this reduced margin between gilts and corporate bonds has been partially reflected in the discount rates. Expectations of long term retail price inflation also rose by about 0.75% 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 2010.

Changes to financial assumptions

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

- The increase in assumed ongoing basis investment returns 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 increase in assumed discontinuance basis investment returns is consistent with changes in fixed interest gilt yields.

Ongoing Valuation Results

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

* Includes £500m in respect of the buy-in (£475m recapture premium and £25m deferred premium as at 31 March 2010). 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 deficit has changed to a surplus of £20m over the year to 31 March 2010 as a result of:

- Change in market conditions reducing the value of liabilities: +£8m
- Investment returns and other miscellaneous items: +£143m

We have not taken into account the further £100m buy-in undertaken in May 2010. This would not have had a material impact on the funding level.

Discontinuance Results

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

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

The discontinuance funding level has improved because the increase in the value of assets held has not been offset by the change 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.

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
	% pa	% pa
Retail Prices Inflation	3.0	3.75
Section 148 increases	4.5	5.25
Pension increases		
- pre 97 (non-GMP)	nil	nil
- post 97	3.0	3.75
Ongoing basis investment return:		
- pre retirement	7.25	7.25
- post-retirement	4.75	5.0
Discontinuance basis investment return:		
- non-pensioners	3.5	3.9
- pensioners	4.0	4.4

- The increase to the Retail Prices Inflation assumption reflects market expectations, consistent with the widening of the gap between yields on fixed interest and index-linked gilts.
- The ongoing basis investment return has not changed pre-retirement as return expectations for the Section's return-seeking assets have not changed. The increase in assumed ongoing basis post-retirement investment returns reflects changes in index yields for fixed interest gilts and corporate bonds.
- The increase in assumed discontinuance basis investment returns is consistent with changes in fixed interest gilt yields.

Ongoing Valuation Results

	31 March 2009	31 March 2010
	£m	£m
Liabilities in respect of benefits accrued to date	2,252	2,321
Reserve for expenses	35	35
Total Liabilities	2,287	2,356
Assets	1,547	1,842
Gross* Surplus/(Deficit)	(740)	(514)
Gross* Funding Level	68%	78%
Value of outstanding 2003 and 2006 deficit contributions	183	153
Net Surplus/(Deficit)	(557)	(361)

*Gross of the value of the deficit contributions from the 2003 and 2006 valuations to be paid after the effective date

The ongoing gross deficit has reduced by £226m as a result of:

- Deficit contributions paid: +£43m
- Change in market conditions increasing the value of the liabilities: -£19m
- Investment returns and other miscellaneous items: +£202m

Recovery plan

- Following the 31 March 2009 valuation, a recovery plan was prepared.
- The Trustee has agreed that contributions with a present value of £402 million as at 30 September 2010 (in addition to the contributions agreed following the 2003 and 2006 valuations) will be paid by the participating employers over the period to 30 September 2022.
- These additional contributions have allowed for an additional 12% return on the assets (above the average return assumed on the technical provisions) over the period from 31 March 2009 to 31 December 2009 and are expected to eliminate the shortfall by 30 September 2022.
- The present value as at 31 March 2010 of the 2009 deficit contributions due (about £387 million) is slightly greater than the net deficit as at 31 March 2010 of £361 million. Therefore the deficit contributions are currently expected to eliminate the shortfall before 30 September 2022, depending on future experience. However, it would not be appropriate to revisit the current recovery plan at the present time. There is still a discontinuance deficit of over £1 billion, the ongoing funding position would have weakened since 31 March 2010, because of movements in investment markets, and the Trustee may not collect all of the 2009 deficit contributions due, as a result of corporate failures.

Discontinuance Results

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

The discontinuance funding level has improved because the increase in the value of assets held has not been offset by the change 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 MNOFF, and others should not rely on it or take action based on it without seeking their own independent advice.
- As this document sets out the results of the annual update, it does not comply with the contents of the actuarial guidance note GN9. Its purpose is to illustrate the considerations involved in financing the Fund.
- 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.
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Paul Burbidge
Towers Watson Limited
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