

**Health Professions Council
Finance and Resources Committee 21st June 2007**

FINANCIAL IMPLICATIONS OF HPC PENSION SCHEME

Executive Summary and Recommendations

Introduction

The purpose of this paper is to provide background information as to the overall value of a final salary scheme (Flexiplan) in comparison with a stakeholder scheme (Friends Provident).

Decision

The Committee is requested to note the document. No decision is required.

Background information

Nil

Resource implications

Nil

Financial implications

Nil

Appendices

Nil

Date of paper

4th June 2007

Finance and Resources Committee 21st June 2007
FINANCIAL IMPLICATIONS OF HPC PENSION SCHEME

1. Friends Provident Scheme

Until 1st May 2007, a final salary scheme was offered at HPC through Capita pension scheme. The stakeholder pension scheme offered now through Friends Provident will result in employees receiving significantly less on retirement than with the previous Capita scheme that they had anticipated. Details of the potential impact of this are detailed below. It should be noted that the reason for the change in pension provider was the extremely poor performance of the Capita pension scheme. Although the Finance and Resources Committee was not under any obligation to do so, they decided to change that scheme for this reason.

2. Final Salary Pension Scheme Information

Barnett Waddingham were asked to provide an analysis of the potential differences to employees and the information which they have provided is outlined below with the graphs they have produced:

Barnett Waddingham stated that the information which is provided is a graphical comparison of the projected pensions from the new stakeholder plan (defined contribution – DC plan) with the final salary pensions that the Capita Flexiplan used to be aiming to provide (defined benefit – DB plan).

It is worth noting that DC projections are extremely sensitive to the assumptions used. Barnett Waddingham have shown on the graph the effect of changing the assumed future investment returns by +/- 1% per annum. However, the variations could be much greater than this and there will also be variations around the other assumptions as well, so that the actual DC pensions could differ very materially from the amounts which they have shown on the graph. Nevertheless, it is hoped this comparison is useful for the Committee's purposes.

Further explanatory comments follow:

The first graph shows the projected DB pension on retirement at age sixty five, assuming the member joined at age X (from age twenty to sixty five) and stays in pensionable service until age sixty five when they retire and draw their pension. The red line shows the DC pension, again assuming that the member joined at age X and stays in pensionable service until age sixty five when they retire and use their accumulated fund to buy a pension from an insurance company (an annuity).

Barnett Waddingham have used a current market price for this annuity of 31.5 (i.e. £1 per annum pension costs £31.50 to buy, or putting another way a fund of £100,000 would buy an annuity of £3,175 per annum). This annuity price is based on the assumption that the member is a non-smoking male or female aged sixty, and that the annuity has an allowance to increase each year with Retail Price Inflation, and 50% of the annuity will be paid to the member's spouse on the member's death (with a 5 year guarantee period). This is equivalent to the type of DB pension that the Flexiplan was targeting to provide. This is not a guaranteed annuity price and it is of course impossible to know what annuities will cost in the future.

It can be seen that at all ages the future pension that can be earned would be expected to be greater in the DB scheme rather than the DC scheme where the contribution is 19.5% of pensionable salary in total.

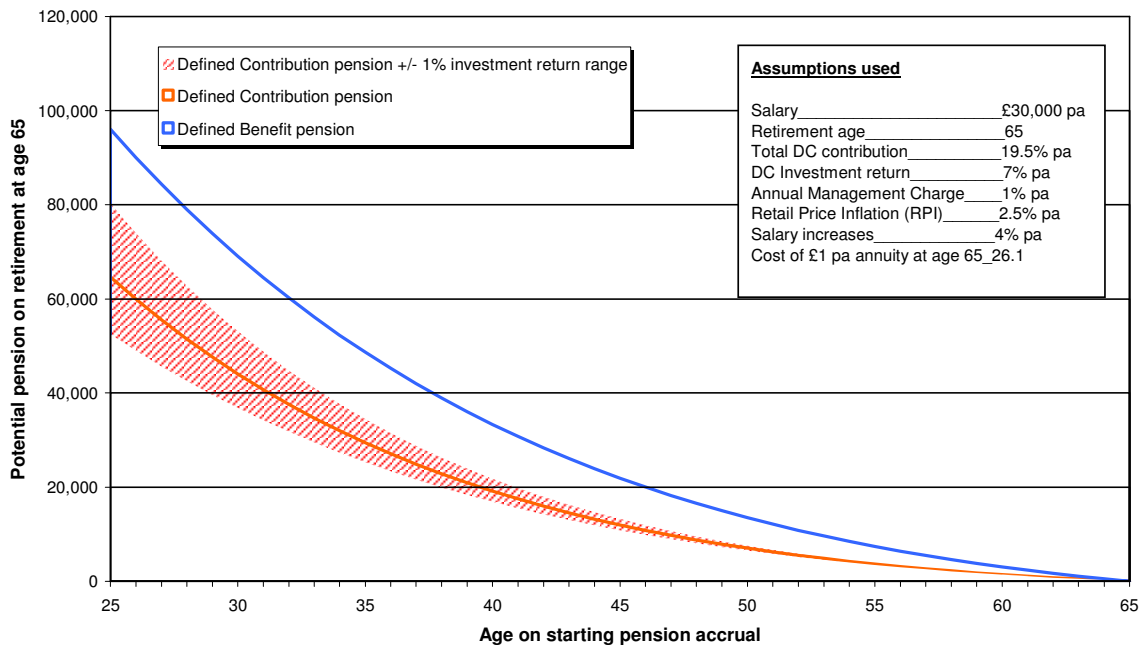
The second graph illustrates the difference between the DB and DC pensions directly, showing the size of the future DC pension compared to the DB pension, when the member reaches age sixty five. For example, a member joining the DC scheme at age thirty and staying in pensionable service until age sixty five would (on our assumptions) be expected to earn a pension that is just over 50% of the pension amount that he or she would have got had he or she joined the DB scheme instead.

That is: by joining the DC rather than the DB scheme a thirty year old can expect their potential pension to be halved.

The shaded area on each graph shows the effect of varying the assumption for investment return earned on DC contributions by plus or minus 1% per year. Clearly the actual investment return each year could be greater than or less than 1%.

It is important to note that the graphs are sensitive to the assumptions used. For example, Barnett Waddingham have assumed that a member will stay in pensionable service until retirement at age sixty five. If it was instead assumed that the members' stop accruing pension after three years, the DC pension on the assumptions at the younger ages would be higher than the DB pension. This would be reflected in the slope of the line in graph two, which would be much steeper, starting at over 100% (the line would end up in the same place, just under 40%, at age sixty five though).

Estimated future pension earned in the HPC DB or DC pension arrangements



Estimated DC pension on retirement at age 65 compared to estimated DB Pension

