



Reasons for Increased Employer Debt on Withdrawal for the Growth Plan between March and September 2005

- **Changes in interest rate:**

As part of the valuation the Scheme Actuary calculates the amount of money needed to provide the benefits promised to members from their Normal Retirement Date.

He then calculates the amount of money that is needed as at the valuation date to make sure that the benefits can be paid when due. The result of this calculation is the value of the liabilities at the valuation date.

To work out the liabilities the Scheme Actuary makes an assumption about the expected rate of return on investments (the interest rate). He then discounts back the amount of money needed to provide the benefits at Normal Retirement Date by this interest rate to arrive at the amount of money that is needed now to pay the benefits when they are due.

When calculating the level of funding on the buy-out basis the interest rate is based upon the assumed rate of return that will be achieved on gilts because if the benefits were to be bought out with an insurance company the assets backing the liabilities would be invested in gilts.

The interest rate assumption in March 2005 was 4.01%. Due to falls in gilt yields between March 2005 and September 2005 the Scheme Actuary revised his assumed interest rate to 3.3% for non pensioners and 3.8% for pensioners.

A reduction in the interest rate increases liabilities as it assumes less return on assets and therefore a greater amount of money is required at the valuation date to meet the targeted benefits.

- **Mortality:**

Since the figures were produced for March 2005 updated mortality tables have been introduced by insurance companies which take account of the fact that people are living to a greater age. This means that their pensions will have to be paid for longer and this again increases the liabilities for the Growth Plan.

The above 2 factors have together produced an increase in liabilities of 19.6%.



- **Orphan Liability:**

Prior to 2 September 2005, when the basis for calculating the Employer Debt on withdrawal changed from the Minimum Funding Requirement (MFR) to the full buy out, there would not have been a statutory debt due from a withdrawing Employer because the Plan had always been fully funded on the MFR basis. Now, as from September 2005, where an employer withdraws, that employer is liable for a debt which includes its pro-rata share of what is known as orphan liabilities. Orphan liabilities are deferred and pensioner liabilities in respect of ex-employees of employers that ceased to participate in the Growth Plan before the new regulations came into force. Currently the orphan liabilities represent about 16% of the total liabilities.

With the new regulations coming into force as at September 2005, we now have a statutory obligation to pursue and recover employer debts, including the relevant proportion of orphan liability. If we did not do this it would be grossly unfair to the remaining participating employers.

There is no deficit in respect of Growth Plan Series 3 liabilities at present and new money invested in Growth Plan Series 3 should not increase the overall deficit. Accordingly, the Board has decided on actuarial advice not to apportion any share of the deficit to Growth Plan Series 3 and consequently the employer debt should not increase if new members join Growth Plan Series 3. However, I must add the caveat that the Board may need to re-visit this decision if its actuarial and legal advice should change.

- **The Gearing Effect:**

Whilst liabilities for the Growth Plan, on the buy-out basis, grew by 19.6%, assets grew by 10.5% from March 2005 to September 2005. This has a "gearing effect" as when two large figures move independently; the effect on the difference between them is much more dramatic (in percentage terms).

In total, the balance sheets moved as follows (excluding the Series 3 Assets and liabilities):-

	Estimate as at March 2005 (£m)	Valuation as at September 2005 (£m)	%increase
Assets	469.5	519.0	10.5
Liabilities	<u>622.0</u>	<u>744.2</u>	19.6
Deficit	(152.5)	(225.0)	47.5

As such, the increase in the size of the deficit (and hence the debt) in percentage terms is exacerbated.



- **Estimated position as at 30 April 2006:**

In light of the disappointing results as at 30 September 2005, we asked the actuary to estimate how the position would have changed as at 30 April 2006.

Due to improvements in gilt yields since 30 September 2005, the funding level on the buy-out basis for the Growth Plan would have improved from 75% at September 2005 to 83% at 30 April 2006. This means that the employer debt on the buy out basis under the Growth Plan has decreased by around £70m, and your organisation's debt figure will also have decreased accordingly.

Employer debt figures will always be highly susceptible to market conditions as at the date of calculation. Please always bear this mind when receiving the future annual updates on employer debt.