

Merchant Navy Officers Pension Fund

Statement of Funding Principles

Status of this document

This Statement of Funding Principles sets out a written statement of the Trustee's policy in relation to scheme funding and other related matters. It has been prepared by MNOPF Trustees Limited, the Trustee of the Merchant Navy Officers Pension Fund ("the Fund") to satisfy the requirements of Section 223 of the Pensions Act 2004, after obtaining the advice of Mr C P Burbidge, the Scheme Actuary appointed by the Trustee.

The contents of this Statement of Funding Principles have been discussed with the participating employers in the Fund. This document is dated March 2016 and is to be taken into account in the actuarial valuation of the Fund as at the effective date of 31 March 2015.

Policy for securing that the Statutory Funding Objective is met

In common with most UK occupational pension schemes, the Fund is subject to the legislative requirement (referred to in the Pensions Act 2004 as the *statutory funding objective*) that it must have sufficient and appropriate assets to cover its *technical provisions* – these being generally interpreted as the amount required to be set aside in order to pay benefits from the Fund as and when they become due.

In order to meet these requirements under the Pensions Act 2004, the Trustee has established a long-term funding strategy. Regular actuarial valuations will be obtained to check the Fund's financial position compared to its *statutory funding objective*, the results of which will then form the basis for decisions concerning both the level of contributions paid into the Fund and the level of discretionary increases granted to members' benefits.

Method and assumptions used in calculating the technical provisions

The actuarial method to be used in the calculation of the *technical provisions* is the Projected Unit method, under which the salary increases assumed for each active member are projected until that member is assumed to leave active service by retirement, death or withdrawal from service.

In line with the legislative requirements, assumptions will be chosen to be sufficiently prudent, both for pensions already in payment and for future beneficiaries, to allow benefits to continue to be paid as they fall due. The assumptions have been chosen on the basis that the Fund should not expect to require its sponsors to make any future contributions over the life of the Fund. It is intended that the assumptions adopted for the calculation of the *technical provisions* will, where considered appropriate, include a suitable margin for adverse deviation. In particular:

- The assumed rate of return on investment for funding purposes will be based on the Fund's current and anticipated future investment strategy. It will have regard to the Fund's liability profile by allowing for different investment returns before and after retirement:
 - The assumed investment return prior to retirement will be derived having regard to a prudent estimate of future returns from equities and any other return seeking asset classes held by the Fund.
 - Returns post-retirement will be based on a closed fund approach, taking into account the Fund's expected long-term investment strategy in respect of its pensioner liabilities, having regard to the yields obtained on gilts and high quality corporate bonds.
- Mortality assumptions will have regard to information published by the UK actuarial profession's Continuous Mortality Investigation (the CMI). It is accepted however that actual Fund mortality may

be different to that modelled by the 'standard' mortality tables. For this reason, the mortality assumptions adopted for funding purposes will, to the extent possible, take into account the membership's actual experience (as reviewed from time to time), and may have regard to the experience in other similar schemes. An allowance will be made in the assumptions for future improvements in longevity.

- Future Retail Price Inflation (RPI) (on which pension increases under the Fund Rules are based) will be assessed having regard to the redemption yields available on long-term index-linked and fixed-interest UK Government bonds at the valuation date. Reference may also be made to other relevant information and data published by the Bank of England, where considered appropriate. Consumer Price Inflation (CPI) is derived with reference to RPI, taking account of the views of the Office for Budget Responsibility and the Trustee.
- Other assumptions will be adopted after considering actuarial advice, and taking into account the experience of the Fund.

Consistent with the Pensions Regulator's guidance, it is intended that individual assumptions will be chosen with a level of prudence such that, when taken together, the Trustee has an appropriate level of confidence that the resultant funding target will prove adequate to pay benefits as they fall due. In making this assessment, the Trustee will consider both the Fund's estimated solvency position and the relative strength of the participating employers' covenant to the Fund.

Details of the principal assumptions to be used in the calculation of the *technical provisions* as at 31 March 2015 are set out in the Appendix.

Policy on discretionary increases and funding strategy

The Fund has no recent practice of making discretionary increases to benefits and the Fund's funding policy does not include any advance provision for the granting of such discretionary benefit increases.

In the event that any individual augmentations to benefits within the Fund requested by an employer are granted, it is expected that an appropriate special employer contribution equal to the associated increase in the Fund's *technical provisions* will be paid at the time that the augmentation is awarded.

However, where changes to benefit or contribution provisions affecting a group of members are being considered, for example through the formal amendment of the Fund Rules, the specific funding arrangements in relation to any change in liabilities associated with these amendments will be decided by the Trustee at that time.

Future service contributions

In order to determine the ongoing contributions in respect of future service, the Trustee's objective is to maintain the statutory funding objective.

Failure to meet the Statutory Funding Objective

If the assets of the Fund are less than the *technical provisions* at the effective date of any actuarial valuation, a Recovery Plan will be put in place, which may require additional contributions from the employers.

The level and period over which these additional contributions are to be paid will usually be decided by the Trustee after consultation with the participating employers. In determining the recovery period that will apply at each valuation, the Trustee will have regard to the size of the funding shortfall and the employers' financial circumstances. In making this latter assessment, the Trustee may take account of external market information concerning the participating employers or obtain specialist financial accounting advice.

The assumptions used to determine the amount of deficit recovery contributions will be consistent with those used to determine the *technical provisions*, unless the Trustee decides otherwise.

Future contributions if the Statutory Funding Objective is met

If the Statutory Funding Objective is met, the Trustee will have regard to the size of the surplus, the employers' financial circumstances and the discontinuance position in determining the required contributions.

Arrangements for other companies to contribute to the Fund

There are a number of associated and non-associated employers participating in the Fund. Apart from this, there are no arrangements in place for any other corporate entity to contribute to the Fund. The Trustee may accept guarantees relating to the payment of contributions by a participating employer from any corporate entity it determines.

Frequency of valuations and circumstances for extra valuations

The Fund's actuarial valuation under Part 3 of the Pensions Act 2004 is being carried out as at 31 March 2015. Subsequent valuations will, in normal circumstances, be carried out every three years. An actuarial report on developments affecting the Fund's *technical provisions* and funding level will be obtained annually.

The Trustee may bring forward the date of the next valuation if it feels it is appropriate in light of events affecting the Fund, for example significant adverse investment market changes or a significant change in the employers' financial circumstances.

Payments to the Employers

As a matter of regulation, there may be circumstances where it may be possible to pay surplus assets to the employers, if the assets of the Fund exceed the Scheme Actuary's estimate of the cost of buying out the benefits from an insurance company (although the Trustee does not foresee such circumstances arising). However, in order to do so the Trustee must comply with the requirements of Section 37 of the Pensions Act 1995. These include actuarial certification of the maximum amount that may be paid to the employers and a requirement that the Trustee is satisfied that it is in the interests of Fund members for such a payment to be made. The Trustee must also give notice of any such proposal to the Fund members.

Policy concerning payment of cash equivalent transfer values

Cash equivalent transfer values are currently intended to represent the expected cost to the Fund of providing the member's benefits, and are calculated having regard to investment market conditions at the time of the calculation. No allowance is made in the calculation for future salary increases or discretionary increases in pension payments.

UK legislation permits the Trustee to reduce cash equivalents below their normal level, subject to certain specific conditions being met, where the assets held by the Fund are considered insufficient to pay full cash equivalent transfer values in respect of all of the membership. No such reduction is currently applied to transfer values paid from the Fund.

Dates of review of this Statement

This Statement of Funding Principles will be reviewed by the Trustee no later than 15 months after the effective date of each actuarial valuation, due every three years.

This Statement of Funding Principles, dated March 2016 has been agreed by the Trustee of the Merchant Navy Officers Pension Fund.

Signed on behalf of the Trustee of the Merchant Navy Officers Pension Fund



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Name Rory Murphy
Trustee Chairman

Date: 22nd March 2016

Merchant Navy Officers Pension Fund

Appendix to Statement of Funding Principles

Details of the principal assumptions to be used in the calculation of the *technical provisions* in the funding valuation as at 31 March 2015 are set out below.

Financial assumptions for the Technical Provisions

The rationale behind the financial assumptions used to determine the Fund's *technical provisions* can be summarised as follows:

Discount rate

Pre-retirement:

The pre-retirement discount rate will be based on a prudent assessment of the expected return from equities and any other return seeking asset classes held by the Fund, having regard to market conditions at the valuation date. The assumption adopted as at 31 March 2015 is 4.75% per annum.

Post-retirement:

The post-retirement discount rate will be based on returns expected from gilts and high quality corporate bonds. Reference will again be made to market conditions at the valuation date and, in the case of bond-related investments, to redemption yields on appropriate market indices. An appropriate margin of prudence may be included within the expected asset return, in order to allow for possible reinvestment risk. As at 31 March 2015, this assumption has been taken to be 2.6% per annum.

Section 148 increases

This assumption will typically be set having regard to historic experience. The assumption adopted as at 31 March 2015 is 4.1% per annum.

Salary increases

This assumption has only a limited impact on the level of a member's pension and has been set at the same level as the Section 148 increases assumption, at 4.1% per annum.

Retail Price Inflation (RPI):

This has been assessed having regard to the yield curve reflecting the inflation expectations implicit in UK Government bond prices as published by the Bank of England, and the average weighted duration of the Fund's accrued liabilities. The assumption adopted is 3.1% as at 31 March 2015.

Consumer Price Inflation (CPI):

This has been assessed relative to the RPI assumption reflecting a view at the valuation date of expected CPI relative to RPI over the long term. The Trustee also has regard to the inflation target given to the MPC of the Bank of England by the government. The assumption adopted is 2.1% as at 31 March 2015.

Pension increases:

These assumptions have been set reflecting the guaranteed level of increases under the Fund Rules and having regard to the central price inflation assumptions and the expected variation in inflation around the central assumption.

Post 97 pensions are guaranteed to increase each year by the lower of 5% or RPI. For the actuarial valuation as at 31 March 2015, it will be assumed that this increase will be at 2.9% per annum.

Post 88 GMP pensions are guaranteed to increase each year by the lower of 3% or CPI. For the actuarial valuation as at 31 March 2015, it will be assumed that this increase will be at 1.8% per annum.

No allowance has been made for discretionary pension increases.

Statistical/demographic assumptions for the Technical Provisions

The demographic assumptions concern the likelihood of events (for example, death) taking place at different ages. They also cover family statistics, such as the proportion of deaths giving rise to dependants' benefits and the ages of those dependants.

To ensure that the assumptions adopted remain appropriate, an analysis of the Fund's individual experience will typically be carried out every three years. It is expected that the next detailed analysis of the Fund's experience will be carried out as part of the 31 March 2018 valuation.

The various demographic assumptions used to calculate the *technical provisions* as at 31 March 2015 are summarised below.

Mortality:	"Heavy" Normal Health SAPS 2 amounts table projected to 2015 with CMI 2014 core projections with a long term rate of future improvements of 1.8% pa. Multipliers of 85% for normal members and male spouses, 105% for ill-health pensioners and 110% for female spouses are applied.
Mortality future improvements:	CMI 2014 core projections with a long term rate of future improvements of 1.8% pa.
Retirements:	Members are assumed to retire at their Normal Pension Age with no allowance for early retirement except on grounds of ill-health, as shown below.
Withdrawals:	Allowance has been made for withdrawals from service, as shown below.
New Entrants:	No allowance for new entrants has been made.
Commutation:	An allowance for 50% of the maximum lump sum taken at retirement has been made.
Family details:	Husbands are assumed to be three years older than their wives and 80% of males and 60% of females will be or were married at Normal Pension Age or have eligible dependants.
Transfer values:	No allowance is made for transfers out of the Fund.

The tables on the next page illustrate the allowances that are to be made for mortality, withdrawals from service and retirement at various ages.

Men

Current age	Number leaving the Fund in the next year as a result of:		
	Death before retirement (per 100 members)	Withdrawal from service (per 100 members)	Ill-health Retirement (per 100 members)
20	0.0	9.0	0.0
30	0.1	8.8	0.0
40	0.1	5.6	0.5
50	0.3	2.9	1.5
60	1.0	0.0	2.4

Women

Current age	Number leaving the Fund in the next year as a result of:		
	Death before retirement (per 100 members)	Withdrawal from service (per 100 members)	Ill-health Retirement (per 100 members)
20	0.0	9.0	0.0
30	0.0	8.8	0.0
40	0.1	5.6	0.5
50	0.2	2.9	1.5
60	0.4	0.0	2.4

Expenses

An expense allowance of £50m (past service) and 1.0% of Pensionable Salary (future service) has been included to meet ongoing administration expenses plus the cost of the Pension Protection Fund levies.

Allowance for investment out-performance in the Recovery Plan

The Trustees has decided to make an allowance for additional returns in excess of the average discount rates underlying the Technical Provisions of 0.1% per annum from 31 March 2015.

Discontinuance

The actuarial assumptions will be the same as those used to calculate the *technical provisions*, except where indicated below:

Discount rate: The real return net of pension increases before and after retirement will be based on Bank of England gilt yield curve at the valuation date, at a duration which has regard to the mean term of the liabilities. This yield will be adjusted to allow for investment and mortality risks. The assumptions adopted as at 31 March 2015 are a discount rate of 1.65% per annum for non-pensioners, and 2.05% per annum for pensioners.

**Consumer Price
Inflation (CPI):**

Pricing in the insurance market for CPI is more prudent than that used for the technical provisions. The assumption adopted is 2.8% at 31 March 2015.

Commutation

No allowance for commutation at retirement has been made.

Expenses:

An allowance of £60m has been made to meet the expenses of winding-up.