

# EXECUTIVE COUNCIL

## CONFIDENTIAL

**Title of Report:** Pensions (Old Scheme) Fund Actuarial Review 2012

**Paper No:** 50/13

**Date of Meeting:** 26 March 2013

**Report of:** Financial Secretary

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### **Purpose**

1. To present the report from the independent actuary on the valuation of the Pensions (Old) Scheme Fund as at 30<sup>th</sup> June 2012 and make recommendations to address the issues raised.

### **Recommendation**

2. Honourable Members are recommended to:
  - a) note the report received from the independent actuary;
  - b) recommend to the Standing Finance Committee and 2013/14 Budget Select Committee that additional provision of £1,011,000 should be inserted in the Estimates in Fund Transfers;
  - c) approve a further review be undertaken by the actuaries to consider the way in which the Pensions (Old Scheme) Fund is used as the annuity provider of last resort.

### **Summary of Financial Implications**

	2012/13	2013/14	2014/15	Full Year
Operating Budget	1,011,000	1,011,000	1,011,000	600,000
Pensions (Old Scheme) Fund	5,000	-	-	-

## **Background**

- 4.1 The POSF was established by Ordinance in 1999 to provide for the payment of retirement benefits to eligible government employees under the provisions of the final salary arrangements of the 1965 and 1979 Pensions Ordinances. The purpose of the POSF has subsequently been expanded to provide for the payment of the following liabilities:
- Retirement benefits under the ex FLH Pension Scheme (ExCo 59/01);
  - Payments under the Voluntary Severance Scheme (VSS) in respect of eligible FIG employee members of the FIPS (ExCo 281/01);
  - Any shortfall required to meet FIG's obligations to pay death-in-service benefits in respect of FIG employee members of the FIPS (ExCo 49/02).
  - Any shortfall required to meet FIG's obligations under the No Worse Off Guarantee (NWOOG) provisions of the FIPS Ordinance (ExCo 103/02);
  - Pensions payable to FIPS members on retirement under the annuity provider of last resort policy (ExCo 103/02 and 48/04);
  - Any shortfall required to meet FIG's obligations to pay ill/health and disability benefits in respect of FIG employee members of the FIPS (ExCo 131/04);
  - Any FIPS Fund Uplift payments applicable to eligible FIG employee members of the FIPS who are made redundant (ExCo 131/04);
  - Any shortfall required to meet FIG's obligations under the Pre-1997 Protection provisions of the FIPS Ordinance (ExCo 69/07).

## **Summary of Triennial Review**

- 5.1 The scheme is required to be subject to an actuarial review by independent actuaries every third year. The last triennial review as at the 30<sup>th</sup> June 2009 was received from GAD in August 2011. In October 2011 ExCo (238/11) approved the policy to change the legislation to allow for independent actuaries to be appointed and the subsequent Bill (ExCo 07/12) was approved by the Legislative Assembly in February 2012. A tender process commenced in April 2012 resulting in the appointment of Punter Southall (in partnership with Callund Consulting) in August 2012.
- 5.2 Nick Silver from Callund Consulting visited the Falklands in November 2012 and presented initial findings to Standing Finance Committee. The final report for the Pensions (Old) Scheme Fund valuation as at 30<sup>th</sup> June 2012 was received in February 2013. The full report is attached as Appendix A.
- 5.3 The 2009 report projected a liability in respect of past service at £3.182M. Standing Finance Committee in April 2012 (SFC 14/12) approved an additional transfer of £3M to cover this deficit. This has substantially benefited the fund which as at 30<sup>th</sup> June 2012 was 94% funded, compared to being only 78% funded as at 30<sup>th</sup> June 2009. The deficit in the Fund has now been calculated at £1.164M a decrease of £2.018M since the 2009 review. There have been a number of movements in liability between 2009 and 2012 as would be expected. However, other than the additional contribution from FIG the major change is a £1M increase in liability relating to guaranteed benefits (under NWOOG or Pre-97).
- 5.4 The report contained the following recommendations for FIG to consider:
- Paying a regular annual or one-off contribution (of £1.2M) to eliminate the deficit;
  - Making some additional contributions towards the expected costs of guarantees;
  - Consider increasing its current contribution towards meeting death in service guarantees of £62,000;

- Consider introducing an equivalent annual contribution towards ill-health and disability guarantee costs, with a recommended level of 3.8% of payroll for the last two items;
- Reviewing the terms of converting members' individual FIPS fund values into pensions paid from the Old Scheme Fund.

## **FIG Treasury review of Punter Southall recommendations**

### **6.1 Deficit reduction payments**

No payments are currently included in the MTFP for deficit reduction. Punter Southall provided the following suggestions for this:

	£000s	Total
One off	£1,164	£1,164
Annual - 3 years	£411	£1,233
Annual - 5 years	£256	£1,280
Annual - 10 years	£141	£1,410

Given the next review is due in three years (as at 30<sup>th</sup> June 2015) it is recommended that annual transfers of £411,000 per annum are made for three years. It is recommended that this is funded from the additional revenues received from oil exploration in a similar way to the £3M transfer in 2012.

### **6.2 Making additional contributions towards the expected cost of guarantees**

This was also raised at the last triennial review and the recommendation to Executive Council at the time was for it to be considered in the 2012 review (due to the late receipt of the report). As detailed in 5.3 these guarantees are the primary reason for the increase in deficit in the period. Punter Southall have calculated that the cost of these guarantees could total £8.033M and have provided the following suggestions for such a contribution:

	£000s	Total
Annual - 3 years	£2,834	£8,502
Annual - 5 years	£1,767	£8,835
Annual - 10 years	£970	£9,700

Punter Southall have also calculated the anticipated cost of guarantees over the next three years (i.e. up to the next review date) as £1.7M. As an alternative to funding all the future guarantees they have suggested the following funding patterns for these guarantees:

	£000s	Total
One off	£1,700	£1,700
Annual - 3 years	£600	£1,800

Given the variables that can change between reviews (retirements, deaths, investment returns) the latter of these is recommended, i.e. an annual contribution for three years of £600,000. As with 6.1 it is recommended these are funded from oil exploration receipts.

### **6.3 Consider increasing the current contribution re death in service, ill-health and disability guarantees**

During the last review GAD made no recommendation of what level of contribution should be considered, therefore given this, and the late receipt of the report, this issue was deferred until the 2012 review. At present £62,000 per annum is paid into the Fund to contribute to death in service guarantees. As detailed above Punter Southall have recommended this be increased to

3.8% of the relevant payroll, £330,000 per annum, and have provided the following suggestions for this:

1. Increase payments to £330,000 per annum to cover all potential liabilities;
2. Increase payments to £200,000 per annum to cover liabilities for death-in-service and either:
  - Fund ill-health and disability as they arise;
  - Do not make payments for ill-health and disability and recognise these as a liability in the fund.
3. Continue to pay £62,000 but recognise this could lead to an increased deficit by 2015;
4. Increase payments somewhere between £62,000 and £200,000.

Death in service – The cost of these guarantees is difficult to quantify as it depends on the pension fund accrued by the employee at the time of their death. Over the timeframe of the review there have been three such deaths with an average lump sum paid of £100,000. The remaining funds in the individuals fund would have allowed only 4 – 7.5 years pension to be paid to the dependent. As detailed in the actuarial report the impact on the fund over the three year period has been £200,000. Given the uncertainty and the level already paid in (ie £186,000 over three years) option 3 of continuing to pay £62,000 per annum is recommended. However, this should be carefully considered at each review point.

Ill-health and disability – The cost to the scheme over the period of review has been on average £10,000 per annum. Given the level of this is not high compared to the overall Fund balance it is not proposed to increase the contribution at this time though it must be recognised that the risk is therefore borne by the Fund.

#### **6.4 Terms of converting members' individual FIPS funds to be paid from the Old Scheme Fund**

In 2002 (103/02) ExCo approved that the Old Scheme Fund be used as an annuity provider of last resort for FIPS and implementation of this commenced from 2004 (48/04). At present the Pensions department requests quotes from insurance companies through the administrator Capita. When this policy was approved it was agreed that this process should be monitored. No review has been undertaken since that time. The actuaries have highlighted that changes to UK rules in December 2012 will result in gender neutral quotes being used. This could impact on the pensions received in some cases (anticipated to be negatively for females and positively for males).

Annuity factors received from insurance companies will also contain a profit margin from the insurer. Therefore setting rates internally (with actuarial advice) could result in higher pensions for individuals. However, as noted in ExCo 48/04 using annuity rates from insurers will automatically provide the Old Scheme Fund with some mitigation of the risk taken on from FIPS by the Fund.

At this point FIG has insufficient knowledge of the pros and cons of making such a change. Also given that ten years have elapsed since the original recommendation it is considered an appropriate time to undertake such a review. Therefore it is recommended that Punter Southall be contracted to undertake a review in this area and provide advice on the way forward. The anticipated cost of this is between £3,000 - £5,000 which would be met by the Pensions (Old) Scheme Fund.

## **Financial Implications**

- 7.1 The current transfer payment budget for 2013/14 – 2017/18 includes a transfer of £62,000 per annum into the POSF to contribute to the provision of death benefits out of the Fund. No other transfers are currently made.
- 7.2 The following additional transfers from the Oil Development Reserve are recommended to be referred to the Standing Finance Committee and 2013/14 Budget Select Committee:

Para		2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
6.1	Deficit	411,000	411,000	411,000	-	-	-
6.2	Guarantees	600,000	600,000	600,000	600,000*	600,000*	600,000*
6.3	Death in service	-	-	-	-	-	-
	<b>Additional</b>	<b>1,011,000</b>	<b>1,011,000</b>	<b>1,011,000</b>	<b>600,000</b>	<b>600,000</b>	<b>600,000</b>

\* Whilst it is recognised that the recommendation in 6.2 is for payments over a three year period it is recommended that for planning purposes this is inserted in the Estimates for all future years given that the three year period does not fund the full guarantee liability in the scheme and further liabilities are anticipated to arise in future years.

- 7.3 Total transfers to the scheme will therefore amount to the following from 2012/13 onwards.

Para		2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
6.1	Deficit	411,000	411,000	411,000	-	-	-
6.2	Guarantees	600,000	600,000	600,000	600,000*	600,000*	600,000*
6.3	Death in service	62,000	62,000	62,000	62,000	62,000	62,000
	<b>Total</b>	<b>1,073,000</b>	<b>1,073,000</b>	<b>1,073,000</b>	<b>662,000</b>	<b>662,000</b>	<b>662,000</b>

- 7.4 Although the recommended Fund Transfers will have an impact on the operating budget, they will have a neutral impact on FIG's consolidated Balance Sheet as funds would be transferred from the Consolidated Fund to the Pensions (Old Scheme) Fund.
- 7.5 The cost of undertaking a review of the process of providing annuity factors for FIPS (paragraph 6.4) would amount to between £3,000 - £5,000 to be met from the Pensions (Old Scheme) Fund.

## **Legal Implications**

- 8.1 None.

## **Human Resource Implications**

- 9.1 None.



Punter Southall  
CONSULTING ACTUARIES



# Falkland Islands Government Old Scheme Fund

Report on the actuarial valuation as at  
30 June 2012

14 February 2013



## Executive summary

An actuarial valuation of the Falkland Islands Government Old Scheme Fund (the “Fund”) was carried out with an effective date of 30 June 2012.

The Fund was established by the Pensions (Old Scheme) Fund Ordinance 1999 and was set up to pay benefits for:

- pensioners as at 31 December 1996 whose pensions were then being paid by the Falkland Islands Government;
- employees as at 31 December 1996 who did not transfer to the Falkland Islands Pension Scheme (“FIPS”) when it was set up on 1 January 1997;
- former members of the Falkland Landholdings Pension Scheme (through the FLH guarantee); and
- FIPS members entitled to death in service, ill-health and disability benefits, the No Worse Off Guarantee (“NWOG”), Pre-97 protection, the Voluntary Service Severance scheme (“VSS”), and the FIPS Fund Uplift (“FFU”).

The Fund also acts as annuity provider of last resort to members of the FIPS on retirement.

The scope of the actuarial valuation of the Fund as at 30 June 2012 includes all of the benefit categories outlined above. However, I have assumed that where the Fund acts as annuity provider of last resort to members of the FIPS, there is no gain or loss to the Fund on exercise of the option to convert the FIPS fund within the Old Scheme Fund. In reality, this is unlikely to be the case and may act as a further source of deficit to the Fund.

The main findings of the actuarial valuation of the Fund as at 30 June 2012 (the “2012 valuation”) were as follows:

- The Fund was 93.9% funded on the assumptions used to calculate the liabilities at 30 June 2012. The assets were therefore £1,164,000 lower than the liabilities at the valuation date.
- Over the period since the last valuation of the Fund as at 30 June 2009, the funding level has improved. The main reason for this was higher than expected investment returns and contributions being paid towards the deficit over the period, which were partially offset by additional liabilities arising due to the retirement of the FIPS members who were entitled to a guarantee from the Fund, and by changes in market conditions used to calculate the liabilities.
- On the assumptions used to calculate the liabilities, the contribution rate needed to meet the cost of the potential strain on the Fund due to death in service, ill-health and disability benefits (the “risk benefits”) was 3.80% per annum of total payroll.
- The potential strain to the Fund arising from members exercising their rights to the NWOG or the Pre-97 protection remains volatile due to the heavy reliance on both members’ individual FIPS fund values and members’ individual choices at retirement. It is expected, however, that the potential future costs of the NWOG will be eliminated from 2019; and the Pre-97 protection could cause the Fund potential costs until 2033.

In light of the deficit of the Fund as at 30 June 2012, the Falkland Islands Government may wish to consider some or all of the following options:

- paying a regular annual or one-off contribution (of £1.2m) to eliminate the deficit at 30 June 2012;
- making some additional contributions or advanced funding towards the expected costs of the guarantees arising in future years;
- increasing the regular contributions that are payable towards the expected costs of the death in service, ill-health and disability benefits of up to 3.80% per annum of total payroll; and



- reviewing the terms for converting members' individual FIPS fund values into a pension paid through the Fund.

The Government should also consider their longer term plans for the future of the Old Scheme Fund and whether to continue underwriting the death in service and retirement benefits for members of the FIPS.

I would be pleased to discuss any of these results and recommendations further with the Falkland Islands Government if required.

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# 1. Introduction

This is my report on the actuarial valuation of the Old Scheme Fund (the “Fund”) as at 30 June 2012 (the “2012 valuation”), as required under Section 5 of the Pensions (Old Scheme) Fund Ordinance 1999 and the Pension Funds (Actuarial Reviews) Ordinance 2012.

I am providing this report in my capacity as the Actuary to the Fund. This report is commissioned by and addressed to the Financial Secretary and the Executive Council of the Falkland Islands Government and it is for their exclusive use as noted in Appendix D.

The previous actuarial valuation of the Fund was carried out by Trevor Llanwarne of the Government Actuary’s Department (“GAD”) as at 30 June 2009 (the “2009 valuation”).

The main purposes of the valuation are to:

- review the financial condition of the Fund; and
- aid decisions about the funding of the Fund and the contributions to be paid into the Fund by the Falkland Islands Government over the three years until the next valuation, due as at 30 June 2015.

The actuarial valuation of the Old Scheme Fund excludes some benefits for members of the Falkland Islands Pension Scheme (“FIPS”) who are entitled to guaranteed benefits from the Old Scheme Fund but where current practice is for these guarantees to be funded on a pay as you go basis. However, I have considered the impact of the potential liabilities arising due to members of the FIPS choosing the No Worse Off Guarantee (“NWOOG”) or Pre-97 protection (the “guarantees”), which is covered in Appendix A.

My advice is not required to be compliant with the Technical Actuarial Standards (“TAS”) applicable in the UK. However, I consider that my advice complies with the spirit of the TAS and we have followed the principles of the TAS where appropriate. Further details are included in Appendix D.

Throughout this report there are a number of pensions terms used. Definitions for these terms, which may be useful when reading this document, can be found in the glossary (Appendix E).

## 2. The actuarial valuation

### 2.1 Background

The Old Scheme Fund was established by the Pensions (Old Scheme) Fund Ordinance 1999 and was set up to pay benefits for:

- pensioners as at 31 December 1996 whose pensions were then being paid by the Falkland Islands Government;
- employees as at 31 December 1996 who did not transfer to the FIPS when it was set up on 1 January 1997;
- former members of the Falkland Landholdings Pension Scheme (through the FLH guarantee); and
- FIPS members entitled to death in service, ill-health and disability benefits, the No Worse Off Guarantee (“NWOOG”), Pre-97 protection, the Voluntary Service Severance scheme (“VSS”), and the FIPS Fund Uplift (“FFU”).

The Fund also acts as annuity provider of last resort to members of the FIPS on retirement.

In line with the 2009 valuation, the main results of the 2012 valuation do not include any allowance for the NWOOG or Pre-97 protection. However, I have considered the impact of the potential liabilities arising due to members of the FIPS choosing these guarantees on retirement in Appendix A.

Furthermore, I have assumed that where the Fund acts as annuity provider of last resort to members of the FIPS, there is no gain or loss to the Fund on exercise of the option to convert the FIPS fund within the Old Scheme Fund.

Further details of the various benefits and membership categories can be found in Appendix B.

### 2.2 Assumptions

I provided advice to the Falkland Islands Government on the assumptions to use for the 2012 valuation of the Fund in my paper entitled “Advice on method and assumptions for the actuarial review as at 30 June 2012” dated 23 October 2012 (“my assumptions report”). We discussed my advice and proposed assumptions set out in that paper on a conference call dated 31 October 2012 where the Government agreed to the proposed assumptions. Please refer to my assumptions report for further details.

I have set out a summary of the key assumptions used in Appendix C.

### 2.3 Actuarial funding method

This section explains the approach we have taken to place a value on the liabilities of the Fund.

#### Past service liabilities

I have carried out the 2012 valuation of the Fund using a “cashflow valuation” approach which involves projecting forwards the expected cashflows from the Fund and discounting them back to the valuation date to obtain a capitalised or net present value of the liabilities of the Fund.

The size and timing of the future cash flows paid from the Fund are based on:

- the membership data provided by the Government’s Pension Officer, a summary of which is shown in Appendix B;

- the assumptions outlined in Appendix C; and
- members' benefits being paid in line with the relevant Ordinances of the Fund and supplementary documents.

### **Voluntary Severance Scheme (“VSS”)**

I have estimated the liability associated with the potential future VSS payments to eligible members by using assumptions about the probability of the eligible members leaving service early between the valuation date and date of retirement. The probability of members leaving service before retirement is referred to as the “withdrawal” assumption, further details of which are set out in Appendix C.

### **FIPS Fund Uplift (“FFU”)**

In my calculations, I have not made allowance for the FFU, apart from those uplifts which have already been applied to deferred members of the Fund as advised by the Government Pensions Officer. I understand that these payments are granted only by the consent of the employer and are not expected to be significant going forward. This practice is consistent with that used for the 2009 valuation.

### **Death in service, ill-health and disability benefits (the “risk benefits”)**

When death in service, ill-health and disability benefits are payable to FIPS employees, the Fund bears the cost of benefits in excess of the Government contributions which have accumulated in the individual FIPS accounts.

For the purpose of the 2012 valuation, in order to place a value on the death in service benefits, I have multiplied the estimated amount payable in the year following the valuation on the death of each eligible member by the probability of death based on each member's age. This is summarised as a percentage of the total salaries of eligible employees.

In order to place a value on the ill-health and disability benefits, I have multiplied the estimated amount payable in the year following the valuation on the ill-health or disability of each eligible member by the probability of the event occurring based on each member's age. This is summarised as a percentage of the total salaries of eligible employees.

### **NWOG and Pre-97 protection (the “guarantees”)**

There are a number of members of the FIPS for whom guarantees may be payable from the Fund if the member is entitled to such a guarantee and exercises this option at retirement. I understand that these guarantees are not funded for in advance and that in practice, the FIPS fund values are transferred to the Old Scheme Fund on retirement. Any strain on the Fund as a result of the costs of the guarantees exceeding the FIPS fund values arising on retirements over the three year period since the last valuation are essentially picked up at each valuation and consequently, FIPS members retiring with guarantees over the inter-valuation period may increase the deficit to some extent.

No allowance for the guarantees is made in the main results of this report. However, I have looked at the potential liabilities arising as a result of these guarantees under different scenarios in Appendix A.

### **Annuities**

I understand that the Old Scheme Fund acts as annuity provider of last resort to FIPS members on retirement (i.e. where FIPS members cannot obtain an annuity from an insurance provider). We have not made any allowance for any gains or strains on the Fund which may arise in respect of future FIPS retirements where the FIPS fund value is used to provide a pension through the Fund.

Furthermore, I understand that the terms for conversion of the FIPS fund values to pension within the Fund are set by obtaining insurance quotations for each individual on retirement. We suggest that the Government should consider whether this approach remains appropriate going forward.

The main alternative to this approach would be for the Government to set market-related factors (based on actuarial advice) for the purpose of converting FIPS fund values to pension within the Fund and update these on a monthly basis to take account of changing market conditions. This is likely to increase annuity rates to some extent (and, therefore, provide a higher pension to members) as insurers usually include loadings for profits, expenses and solvency margins which would not necessarily be required within the Fund.

It is also worth drawing the Government's attention to the recent prohibition in the UK of using gender as a rating factor in life insurance contracts, with all contracts entered into after 21 December 2012 based on gender neutral rates. Therefore, this will feed through to the conversion rates used by the Government if current practice continues.

I would be pleased to advise the Government further on these points if required and review the process used in practice for obtaining insurance quotations and using these to convert pensions within the Fund.

## 2.4 Asset valuation

The value of the Fund's assets used in this valuation is equal to the [unaudited] market value as at 30 June 2012. This is consistent and compatible with the assumptions used to value the liabilities at 30 June 2012 as they were determined from market-related data. A summary of the assets as at 30 June 2012 is included in Appendix B.

## 2.5 Funding valuation

I have assessed the financial condition of the Fund as at 30 June 2012 and the results are summarised in the table below, with the results as at 30 June 2009 for comparison. Both the Fund assets and liabilities shown below exclude AVCs.

	As at 30 June 2009 £000s	As at 30 June 2012 £000s
Past service liabilities for:		
• In-service members	172	0
• Deferred members	18	26
• Pensions in payment	12,806	17,975
• Pre-98 guarantee for ex- FLH members	149	181
• Projected VSS payments	1,046	759
<b>Total past service liabilities (A)</b>	<b>14,191</b>	<b>18,941</b>
<b>Total value of assets (B)</b>	<b>11,009</b>	<b>17,777</b>
<b>(Deficit) [B - A]</b>	<b>(3,182)</b>	<b>(1,164)</b>
<b>Funding level [B / A]</b>	<b>77.6%</b>	<b>93.9%</b>

## 2.6 Experience analysis since the previous valuation

The previous valuation showed a deficit of £3,182,000. The valuation carried out as at 30 June 2012 shows a deficit of £1,164,000, indicating an overall gain of £2,018,000 over the inter-valuation period.

An explanation of the change in the position between these two dates is as follows:

Impact of items of experience on overall gain/loss	£m
<b>(Deficit) on 2009 valuation</b>	<b>(3.2)</b>
▪ Interest on the deficit	(0.4)
▪ Investment returns higher than expected	2.7
▪ Contributions to address the deficit	3.2
▪ Liabilities accepted as a result of the guarantees net of FIPS	(1.0)
▪ Liabilities accepted as a result of death in service spouses pensions	(0.2)
▪ Deaths in retirement and other miscellaneous	0.2
▪ Effect of changes in market conditions	(2.5)
<b>(Deficit) on current valuation</b>	<b>(1.2)</b>

Some commentary on the more significant of the items set out in the above table is set out below:

- The Falkland Islands Government made a one-off payment of £3m in June 2012 towards the deficit as well as some smaller contribution payments in 2010 and 2011.
- The Fund achieved a nominal investment return of approximately 11% per annum since the previous valuation. This compares with the assumed nominal rate of 4% per annum for the 2009 valuation. The investment return experienced was therefore, significantly higher than assumed at the previous valuation.
- Many FIPS members entitled to guaranteed benefits retired over the period and chose either the NWOOG or Pre-97 protection. The cost of these guarantees in excess of the FIPS fund values transferred to the Fund amounted to approximately £1.0m.
- A few Government employees who were also members of the FIPS scheme died in service over the period. The cost of providing the death in service spouses' pensions in excess of the FIPS fund values transferred to the Fund plus the annual contribution of £62,000 being paid by the Government to cover the expected cost of these benefits amounted to approximately £0.2m.
- Some pensioner members died over the period with no attaching spouses' pensions coming into payment and therefore there was a small gain as a result of this.

## 2.7 Results for future service

There are no remaining active members in the Fund and therefore the future service results relate to the risk benefits only. The estimated cost of the risk benefits payable in respect of FIPS employees on death, ill-health or disability is shown below.

Estimated contribution rate	As at 30 June 2009	As at 30 June 2012
Death benefits	2.00%	2.30%
Ill-health and disability	1.40%	1.50%
<b>Total</b>	<b>3.40%</b>	<b>3.80%</b>

I am aware that the Falkland Islands Government currently pays £62,000 a year towards the cost of meeting the death in service guarantee. However, over the inter-valuation period, there was a strain to the Fund as a result of the cost of the death in service benefits arising exceeding this contribution to the amount of approximately £0.2m. Consequently, the Government may wish to consider increasing the annual contribution payable.

Based on a total payroll for eligible FIPS employees of around £8.7m as at 30 June 2012, the annual contribution payable for both death benefits plus ill-health and disability benefits would be substantial at around £0.33m per year. I understand that no ill-health and disability cases arose over the inter-valuation period and therefore, the Government may prefer to continue to fund for these on a pay as you go basis as and when they arise given their infrequency. Therefore, an alternative would be to fund for the expected cost of the death benefits only, amounting to approximately £0.20m a year based on a payroll of £8.7m at 30 June 2012.

## 2.8 Recommendations

In light of the deficit of the Fund as at 30 June 2012, the Falkland Islands Government may wish to consider some or all of the following options:

- paying a regular annual or one-off contribution (of £1.2m) to eliminate the deficit at 30 June 2012<sup>(1)</sup>;
- making some additional contributions or advanced funding towards the expected costs of the guarantees arising in future years (this is discussed further in Appendix A)<sup>(2)</sup>;
- increasing the regular contributions that are currently payable towards the expected costs of the death in service, ill-health and disability benefits of up to 3.80% per annum of total payroll<sup>(3)</sup>; and
- reviewing the terms for converting members' individual FIPS fund values into a pension paid through the Fund.

Suggestions for regular contribution amounts which the Government could pay under the first three bullet points above are detailed below.

- (1) Regular contributions to reduce the deficit of the fund (£1.164m) over various terms:

Term	3 years	5 years	10 years
<b>Annual contributions</b>	£411,000	£256,000	£141,000

- (2) Regular additional contributions to fund in advance for the expected cost of the guarantees (£8.033m) over various terms:

Term	3 years	5 years	10 years
<b>Annual contributions</b>	£2,834,000	£1,767,000	£970,000

These figures are based on the results of the "with commutation" scenario and an assumed average rate of investment return on members' FIPS funds of 4.50% per annum (as discussed in



Appendix A). This essentially assumes the Government brings the total guarantees into the scope of the Old Scheme Fund triennial valuations and funds for them in advance as is the case for the normal Old Scheme Fund benefits. Alternatively, the Government could fund for the expected liabilities arising over the period until the next valuation by a one-of lump sum of £1.7m or an annual contribution as follows:

<b>Term</b>	<b>3 years</b>
<b>Annual contributions</b>	<b>£600,000</b>

- (3) To fund for the expected cost of death in service, ill-health and disability benefits, the Government could consider one of the following payment options:
- Increase payments to £0.33m per year, based on the total expected death in service and ill-health benefits arising.
  - Increase payments to £0.20m per year for the expected cost of death in service benefits only *and* either pay for the cost of ill-health and disability benefits (over and above the FIPS fund values) as and when they arise given they are infrequent *or* do not make any payments as and when such cases arise but accept that this will result in a strain to the Fund which will materialise as a source of additional deficit at the next valuation.
  - Continue to pay £62,000 per year as per previous practice, but accept that this could lead to an increase in the deficit of the Fund at the 2015 valuation.
  - Increase payments to somewhere between £62,000 and £0.2m per year.

The Government should also consider their longer term plans for the future of the Old Scheme Fund and whether to continue underwriting the death in service and retirement benefits for members of the FIPS.

The majority of the Old Scheme Fund members are now pensioners, and with no further benefits accruing this membership will continue to age and decline over the next, say, 40 to 50 years until the last pensioner dies.

However, with the Fund also taking on liabilities of FIPS members when they die in service or retire, the remaining lifetime of the Fund could potentially be much longer than 40 to 50 years (as the FIPS is still open to new members). As such, as it currently stands, the long-term future of the Fund is that it will effectively become an insurance company, existing purely for the purpose of underwriting the benefits for FIPS members who die in service or choose to convert their FIPS fund values within the Fund on retirement.

The Falkland Islands Government should consider whether this is their intention for the Fund in the long-term or whether they wish to look for an alternative arrangement for the FIPS members.

I would be pleased to discuss any of these results and recommendations further with the Falkland Islands Government if required.

### 3. Sensitivity and risk

#### 3.1 Sensitivity of results to changes in assumptions

When agreeing the assumptions to use in the 2012 valuation, the Falkland Islands Government should give consideration to the sensitivity of the funding of the Fund to changes in the key assumptions. The funding position of the Fund is particularly sensitive to the discount rate and the mortality assumptions.

The following table shows the approximate effect of changing some of the key assumptions in isolation. The changes are given relative to the scheme funding results in section 2, i.e. a deficit of £1,164,000 (for example, number 1 means that changing the discount rate to 3.5% per annum would reduce the deficit of £1.2m by £1.1m to £0.1m).

Assumption	Impact on deficit
1. Discount rate of 3.5% per annum	- £1.1m
2. Discount rate of 4.0% per annum	- £2.1m
3. Mortality long-term rate of improvement + 0.25%	+ £0.3m
4. Mortality long-term rate of improvement – 0.25%	- £0.2m

The discount rate sensitivities provided above only show the effect on the deficit as a result of the liabilities changing. If it is expected that gilt yields will revert to something higher than 3% per annum (the central discount rate used in the proposed 2012 basis) at some stage in the future then we should also take account of the corresponding fall in gilt-based assets as yields rise. This would reduce the impact of the fall in deficit outlined above.

#### 3.2 Risks

The question as to whether the Fund is able to meet all of its obligations in full will depend upon future events rather than the assumptions made. Actual experience will be different from many of the assumptions made, so there is no guarantee that the benefits will always be paid in full.

The Government should consider the following risks faced by the Fund:

- actual experience is different from the assumptions used to calculate the Fund's liabilities leading to a larger deficit than expected;
- the returns available from the investment of future income may differ from the returns available at the date of the calculations;
- falls in asset values will not be matched by similar falls in the values of liabilities;
- the potential exercise of options and guarantees (e.g. early retirement, cash commutation, NWOOG and Pre-97 protection) against the Fund; and
- the relatively small number of Fund members is likely to lead to particular volatility in the funding level and the contribution rate as the future demographic experience of such a group is more uncertain than would be the case for a larger group.

Each of the above risks could affect the Fund's funding level, the stability of the contribution rates or the scope for paying any discretionary benefits or granting other enhancements.

## 4. Conclusion

### 4.1 Advice relating to the valuation

The Falkland Islands Government has considered various pieces of advice as part of the valuation process, as follows:

- my paper “Advice on method and assumptions for the actuarial valuation as at 30 June 2012”, dated 23 October 2012;
- my preliminary results presentation “Preliminary results of the Actuarial Valuation as at 30 June 2012”, dated November 2012; and
- various conference calls between the Government and Punter Southall, including a video conference on 20 November 2012 where we presented the preliminary results of the 2012 valuation.

The Government has considered this advice in reaching decisions concerning the method and assumptions to be used for the valuation, the results of which are recorded in this report.

### 4.2 Main findings of the valuation

The main findings of the actuarial valuation of the Fund as at 30 June 2012 were as follows:

- Over the period since the last valuation of the Fund, the funding level had improved. The main reason for this was the additional contributions paid by the Government to address the deficit of the Fund, and higher than expected investment returns. This was partly offset by additional liabilities arising due to the retirement of the FIPS members who were entitled to a guarantee from the Fund and by changes in market conditions over the period since the last actuarial valuation.
- The Fund was 93.9% funded on the assumptions used to calculate the liabilities at 30 June 2012. The assets were £1,164,000 lower than the liabilities at the valuation date.
- On the assumptions used to calculate the liabilities, the contribution rate needed to meet the cost of the potential strain on the Fund due to death in service, ill-health and disability benefits (the “risk benefits”) was 3.80% per annum of total payroll.

### 4.3 Recommendations

In light of the deficit of the Fund as at 30 June 2012, the Falkland Islands Government may wish to consider some or all of the following options:

- paying a regular annual or one-off contribution (of £1.2m) to eliminate the deficit at 30 June 2012;
- making some additional contributions or advanced funding towards the expected costs of the guarantees arising in future years (this is discussed further in Appendix A);
- increasing the regular contributions that are currently payable towards the expected costs of the death in service, ill-health and disability benefits of up to 3.80% per annum of total payroll; and
- reviewing the terms for converting members’ individual FIPS fund values into a pension paid through the Fund.

The Government should also consider their longer term plans for the future of the Old Scheme Fund and whether to continue underwriting the death in service and retirement benefits for members of the FIPS.



**Andrew MacRae**

Fellow of the Institute and Faculty of Actuaries

**14 February 2013**

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## Appendix A – NWOOG and Pre-97 protection

There are a number of members of the FIPS for whom the NWOOG and Pre-97 protection guarantees may be payable from the Fund if the member is entitled to such a guarantee and exercises this option at retirement. Current practice is that these guarantees are not funded for in advance; when a member retires, the FIPS fund values are simply transferred to the Old Scheme Fund and the pension is paid from the Fund until the member dies. Consequently, any strain on the Fund as a result of the costs of the guarantees exceeding the FIPS fund values arising on retirements over the three year period since the last valuation will be picked up at each subsequent valuation.

The potential costs of the guarantees are subject to considerable uncertainty as they are dependent on:

- whether or not a member chooses to opt for the guaranteed benefit at retirement (this choice, in itself, will very much depend on many things including the level of pension and tax free cash available under the guarantees versus that available from converting the FIPS fund value to pension and cash), and
- the level of the FIPS fund value at retirement (which will be used to offset the cost of the guarantee).

Consequently, for illustration purposes, I have set out below the potential additional costs (in capitalised net present value terms) arising from the guarantees assuming all eligible members opt for the guaranteed benefits at retirement. The results from the 2009 valuation are also shown for comparison.

As for the 2009 valuation, I have shown three scenarios:

- Scenario 1 assumes that members do not commute any pension for cash.
- Scenario 2 assumes that all members take the maximum tax free cash available to them.
- Scenario 3 assumes that members will only opt for the guarantee if the cash sum available to them under the guarantee option is higher than that available from the FIPS fund values.

In addition, I have shown each of the three scenarios assuming three different investment growth rates for the FIPS fund values (of 3.0%, 4.5% and 6.0% a year).

Assumed average rate of investment return on members' FIPS funds	Scenario 1: No commutation £000s	Scenario 2: With commutation £000s	Scenario 3: Low take up £000s
GAD's results as at 2009 at 5.00% a year	12,903	10,433	1,301
3.00% a year	10,060	8,381	7,022
4.50% a year	9,711	8,033	6,666
6.00% a year	9,317	7,646	6,261

Overall, the potential costs have reduced since the 2009 valuation. The main reason for this is that a number of FIPS members who were eligible for the guarantees in 2009 have retired over the period since the 2009 valuation (and therefore, the costs of the guarantees have transferred into the Old Scheme Fund) or have died.

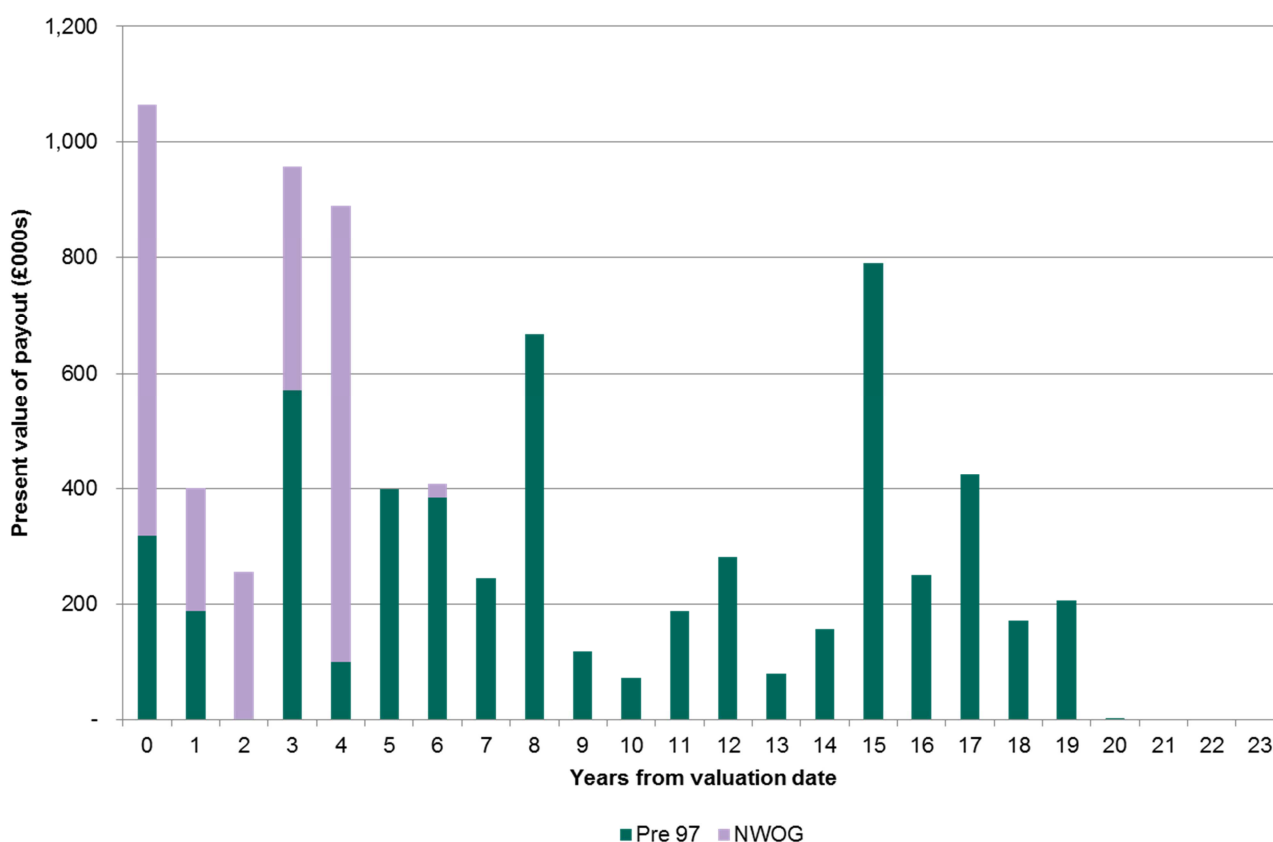
The higher the assumed investment returns on members' FIPS funds, the lower the projected costs are under NWOOG. Further, if members opt to commute some of their pension for cash, this reduces the cost of the NWOOG and Pre-97 protection. Our calculations show that the guarantees tend to provide the highest cash in the majority of cases, and thus the low take up scenario does not significantly reduce the cost of the guarantees. This latter result differs to that shown in the 2009 valuation however we do not have access to last time's data and so are unable to perform a reconciliation of the differences.

Overall, the results show that the potential costs of the guarantees are still significant and could impose significant additional liabilities on the Old Scheme Fund in the future.

As the Fund does not currently fund in advance for the potential liabilities arising from these guarantees, it is important for the Government to consider the timings of when the future liabilities may arise and hence, when there could be strain to the Fund.

The below graph illustrates the additional capitalised liabilities projected to arise from the NWO and Pre-97 protection under the “with commutation” scenario and based on a FIPS fund growth of 4.5% per annum. It is expected that the potential future costs of the NWO will be eliminated from 2019; however the Pre-97 protection could still cause the Fund potential costs until 2033.

#### Illustration of potential future additional liabilities arising from the NWO and Pre-97 protection (“with commutation” scenario)



The Government should consider whether the current practice of not funding for the guarantees in advance is appropriate or whether they wish to move to some form of funding such as paying a regular contribution in respect of the potential guarantees (i.e. essentially bringing them into the scope of the actuarial valuation of the Fund where the potential liabilities are included alongside the other Old Scheme Fund liabilities every three years) or paying an additional capital injection into the Fund every time a member retires with a guaranteed benefit.

If there is no change to the current practice (and all assumptions are borne out in practice), the potential increase in deficit in the Old Scheme Fund over the three year period to the next valuation is in the region of £1.7m (i.e. the sum of the first three bars in the graph above).

I would be happy to discuss these results further with the Treasury if required.

## Appendix B - Fund benefits and data

### 1. Fund benefits

The Fund benefits and the different guarantees that have been valued in the actuarial valuation are described in the 1965 Ordinance and 1979 Ordinance of the Fund, subsequent amending deeds and announcements, and GAD's benefits and data note dated 5 November 2010. I see no benefit in replicating such a summary of the various benefits ourselves and have simply used GAD's summary, together with the answers to GAD's questions in that note provided by the Falkland Islands Government, to carry out my calculations for the Fund. I have verified this against our understanding of the benefits from the relevant legislation.

### 2. Membership data

My valuation relies upon the accuracy of the information provided by the Falkland Islands Government. The membership data was supplied by Nigel Dodd as Pensions Officer of the Government. A summary of the data provided is given below. I have carried out a number of reasonableness checks on the data supplied and confirm that I am satisfied that the data is of adequate quality for the purpose of this valuation as outlined in section 1 of the main report.

I do not have access to full data from the 2009 valuation and therefore have been unable to carry out a full membership reconciliation. However, the Pensions Officer provided some information on membership movements and I am satisfied that the membership numbers in 2012 are consistent with those stated for the 2009 valuation.

I would be pleased to advise the Government on some ways to potentially improve record keeping and therefore aid the membership reconciliation and checks that will need to be performed at each future valuation.

#### 2.1 Benefits in respect of Old Scheme Fund members (funded)

##### 2.1.1 In-service members

	Number	Average accrued pension	Average age (weighted by liability)
30 June 2012	0	n/a	n/a
30 June 2009	1	£6,487	Not given

##### 2.1.2 Deferred pensioners

	Number	Average deferred pension <sup>1</sup>	Average age (weighted by liability)
30 June 2012	2	£771	58
30 June 2009	2	£771	Not given

1. I understand that deferred pensions are not revalued between date of leaving and date of retirement.

## 2.1.3 Current pensioners

	Number	Average pension	Average age (weighted by liability)
30 June 2012	180	£5,061	67
30 June 2009	168	£4,520	Not given

## 2.1.4 Former FLH members with a guarantee for their pre 1 July 1998 service

	Number	Average pension <sup>1</sup>	Average age (weighted by liability)
30 June 2012	8	£1,559	57
30 June 2009	8	£1,604	Not given

1. There is a small discrepancy in the data provided as the total pensions in 2009 are higher than those in 2012. This is not material to the results.

## 2.1.5 Members eligible for the Voluntary Severance Scheme

	Number	Average Pay	Average age (weighted by liability)
30 June 2012	67	£28,903	47
30 June 2009	87	£27,939	Not given

## 2.2 FIPS members eligible for the Pre 97 protection and/or the No Worse Off Guarantee (unfunded)

## 2.2.1 Members eligible for NWOOG

Members eligible for NWOOG	Number	Total accumulated FIPS fund	Average pension	Average age (weighted by pension)
30 June 2012	46	£6,499,000	£9,429	60
30 June 2009	64	£7,282,000	£7,832	Not given

## 2.2.2 Members eligible for Pre97 protection but not NWOOG

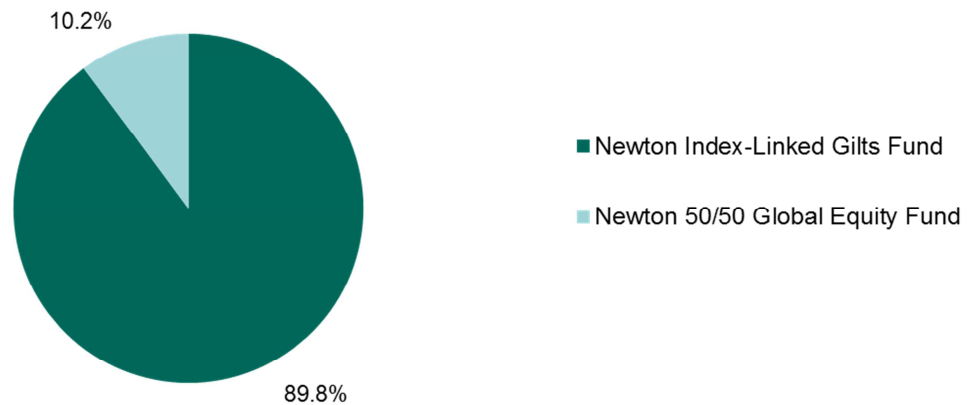
	Number	Total Pre 97 accumulated FIPS fund	Average pension	Average age (weighted by pension)
30 June 2012	91 <sup>1</sup>	£1,626,000	£2,957	54
30 June 2009	94	£1,153,000	£2,924	Not given

1. This includes one member who is on long term unpaid sick leave but has been valued as if they were still active.



### 3. Financial data

The audited accounts of the Old Scheme Fund as at 30 June 2012 showed the total market value of the Fund's assets as £17,777,000. This is made up of £71,000 net current assets, and invested assets of £17,706,000 excluding AVCs. The invested assets are broken down as follows:



I have had to rely on information in the accounts in carrying out this actuarial valuation and must therefore caveat this report to the extent that if the information in the accounts is found to be incorrect then the Government cannot rely on the results and advice provided in this report.

## Appendix C – Assumptions

**Change in key financial indicators affecting the financial assumptions between 30 June 2009 and 30 June 2012:**

	30 June 2009 (per annum)	30 June 2012 (per annum)
UK Over 15 year fixed interest gilt yield	4.39%	2.94%
UK Over 15 year index-linked yield (assuming 2.5% inflation)	0.85%	0.02%
UK Implied inflation (geometric difference between fixed interest and index linked gilt yields)	3.51%	2.92%

Other information on historic inflation (RPI):

Annualised rate of RPI in the UK over the 10 years to 30 June 2012: 3.00%

Annualised rate of RPI in the Falkland Islands over the 10 years to 30 June 2012: 3.50%

**A summary of the key assumptions used to determine the liabilities is as follows:**

	30 June 2009	30 June 2012
Financial assumptions	per annum	per annum
Discount rate	4.00%	3.00%
Price inflation	3.00%	3.00%
Earnings growth		
- To value DIS, Ill-health ad pre 97 guarantee benefits	4.50%	4.00%
- To value NWOOG notional benefits	3.00%	3.00%
Pension increases		
- Fixed 3%	3.00%	3.00%
- Discretionary	2.00%	2.00%
Investment return on FIPS funds (NWOOG and Pre-97 protection)	3%, 5%, 7%	3%, 4.5%, 6%
Demographic assumptions		
Mortality post-retirement		
- Base table	S1PA and a 1+year age rating	S1PA and a 1+year age rating
- Future projections	2008-based UK principal	CMI 2011 projection model

	population projections													
- Minimum/long term improvements	N/A	1.50% per annum long term rate for males and 1.25% for females												
Mortality pre-retirement	Assume all members live until retirement													
Commutation	Nil allowance for deferreds in the Old Scheme Fund													
Proportion married	Actual marital status for pensioners and 80% married for non-pensioners													
	Males 3 years older than females													
Withdrawal assumption (for the purpose of assessing the VSS)	Numbers per thousand employees at sample ages: <table> <thead> <tr> <th>Age</th><th>Male</th><th>Female</th></tr> </thead> <tbody> <tr> <td>35</td><td>33</td><td>48</td></tr> <tr> <td>45</td><td>74</td><td>106</td></tr> <tr> <td>55</td><td>34</td><td>49</td></tr> </tbody> </table>		Age	Male	Female	35	33	48	45	74	106	55	34	49
Age	Male	Female												
35	33	48												
45	74	106												
55	34	49												

A description of all the assumptions made, together with a description of the derivation of these assumptions can be found in my note on actuarial assumptions, dated 23 October 2012. All other assumptions are as per the 2009 valuation.

## Appendix D – Legal and compliance notices

### 1. Addressee of this report

This report has been commissioned by and is addressed to the Financial Secretary and the Executive Council of the Falkland Islands Government and it is for their exclusive use. Its purpose is to satisfy the legislative requirement to report on the results of an actuarial valuation.

I am providing this report in my capacity as Actuary to the Fund. This report has been prepared for the benefit of our client only. It may not be shared with any other party without my prior written consent, except to comply with statutory requirements. No other parties may rely on or make decisions based on this document (whether they receive it with or without consent). Punter Southall Limited and its employees acknowledge no liability to other parties. Any advice has no wider applicability. It is not necessarily the advice that would be given to another client or third party whose objectives or requirements may be different.

### 2. Legal requirements

This valuation of the actuarial valuation of the Fund as at 30 June 2012 is required under Section 5 of the Pensions (Old Scheme) Fund Ordinance 1999 and the Pension Funds (Actuarial Reviews) Ordinance 2012.

### 3. Technical Actuarial Standards compliance

My advice is not subject to and is therefore not required to be compliant with the Technical Actuarial Standards, however this report and the work undertaken to produce it follows the spirit of the Pensions Technical Actuarial Standard ("Pensions TAS"), and the Data, Modelling and Reporting Technical Actuarial Standards ("TAS D", "TAS M" and "TAS R", respectively), set by the Financial Reporting Council and current at the date of signing this report, where appropriate.

My liability calculations consider the future benefit payments from the Fund, which are then discounted to the valuation date. In carrying out my calculations, I have to make some prudent approximations as it is not feasible to precisely reflect every single benefit entitlement and the probability of that entitlement giving rise to a cash flow under the Fund's rules and documentation. I consider the significance of these approximations against the results emerging and the purpose of our advice, and I am comfortable that our representation of the Fund is appropriate for the purpose the valuation, in terms of its relevance and completeness.

## Appendix E – Glossary

### A

**actuarial assumptions:** A set of figures and estimates that are used by the actuary as part of an actuarial valuation to predict the timing and amount of pension benefits. The assumptions can include how long people are expected to live, inflation, increases in salaries and earnings on investments.

**actuarial valuation:** An assessment carried out by an actuary, usually every three years, of the assets and liabilities of a pension scheme. The purpose is usually to work out how much money needs to be put into a scheme to make sure pensions can be paid in the future.

**additional voluntary contributions (AVCs):** Contributions that a member can choose to pay, on top of the normal level of contributions, to increase their pension benefits.

### C

**commutation:** The option to take a lump sum on retirement, in exchange for a smaller pension.

### D

**deferred pensioner:** A member who has left a scheme but will get benefits from it when they retire.

**deficit:** The amount by which a scheme's liabilities exceed its assets at a particular date.

**discretionary increase/discretionary benefits:** An increase in benefits, or payment of a benefit, that only happens on a discretionary basis, that is, on the instructions of a scheme's trustees and/or the employer.

### F

**funding level:** The scheme's assets divided by its liabilities, expressed as a percentage. A funding level of over 100% means that there is a surplus, whilst a funding level of under 100% means that there is a deficit.

**funding method:** The method used to calculate a scheme's actuarial liability. Different funding methods make different allowances for the benefits for in-service members.

### I

**in-service member:** A member of a pension scheme who is building up pension benefits in that scheme as a result of their on-going employment.

### L

**liabilities:** The commitments made by a pension scheme to pay pensions or other benefits now and in the future. It is an estimate, using actuarial methods and assumptions, of the assets needed to cover benefits accrued.

**life expectancy:** The length of time a person is expected to live. Life expectancy can be measured from birth, or from a particular age or point in time, for example life expectancy from age 65.

**longevity:** General reference to how long members are expected to live for.

### M

**market value:** The price at which an asset might reasonably be expected to be bought or sold in an open market.

**mortality rates:** The probability, or chance, of dying in a certain period, usually one year. For example, a mortality rate of 0.01 means that a person has a 1%, or 1 in 100, chance of dying over the year in question.

## P

**present value:** The value at the current time of future payments. This value is worked out by taking off an amount for interest and allowing for the chances of the payments actually being made.

**preserved benefits:** The benefits that a member is entitled to receive at retirement on ceasing to be an in-service member of an occupational scheme.

## R

**Retail Prices Index (“RPI”):** A measure of inflation, published each month. It measures the change in the cost of a specified list of goods and services.

**revaluation:** The process of applying increases to preserved benefits before they come into payment.

## S

**surplus:** The amount by which a scheme’s assets exceed its liabilities at a particular date.

## V

**valuation exercise:** An exercise which involves estimating an amount for use in a transaction, for example calculating a transfer value, or for recording in a formal document such as accounts.

## Y

**yield:** The total interest earned on an investment over the period until it matures. It includes both income and any capital growth, and is usually expressed as an annual percentage.

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