

September 2010

Superannuation Arrangements of the University of London

Actuarial Report as at
31 March 2010

MERCER



**MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN**

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London EC3R 5BU

Executive Summary

- This paper is addressed to the Trustee of SAUL. It summarises the results of a financial update (known as an "actuarial report") of SAUL's funding position as at 31 March 2010.
- This report takes place two years after the formal actuarial valuation as at 31 March 2008 which was SAUL's first valuation under the new scheme specific funding regime.
- Based on a methodology and assumptions consistent with the statement of funding principles agreed between the Employer and Trustee, the estimated coverage of SAUL's technical provisions and secondary funding target have deteriorated over the two years since the 31 March 2008 actuarial valuation.
- At 31 March 2010 SAUL was 90% funded on its technical provisions basis and 74% funded against its secondary funding target (100% and 83% respectively at 31 March 2008).
- The calculations contained in this report are approximate. The statement of funding principles agreed as part of the 2008 valuation does not require the Employer contributions to be reviewed at each actuarial report. The information provided in this paper is therefore for information only. The Trustee/Employer should not make any decisions relating to the funding of SAUL without further advice from the Scheme Actuary.

Signature



Scheme Actuary

Christian Hardy

Date of signing

29 September 2010

Qualification

Fellow of the Institute and Faculty of Actuaries

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A. Membership Data

The approximate results in this report have been calculated using the method and assumptions set out in the statement of funding principles agreed as part of the actuarial valuation at 31 March 2008 (updated to reflect changes in market conditions). This report does not contain recommendations of any changes to the method and assumption, contributions or benefit structure. As such, the Board for Actuarial Standards' guidance note GN49 version 1.0 (*Occupational Pension Schemes – Scheme funding matters on which advice of actuary must be obtained*) does not apply, and this report does not need to comply with actuarial guidance note GN9 version 8.1 (*Funding Defined Benefits – Presentation of Actuarial Advice*).

The work has been carried out in accordance with "Technical Actuarial Standard R: Reporting Actuarial Information" and "Technical Actuarial Standard D: Data" issued by the Board for Actuarial Standards and complies with the relevant requirements set out therein. This paper should be read in conjunction with the formal report for the 31 March 2008 actuarial valuation and the actuarial report as at 31 March 2009.

This report is addressed to the Trustee of SAUL. The calculations in the report use methods and assumptions appropriate for the purpose of reviewing the financial position of SAUL. Mercer does not accept liability to any third party in respect of this report; nor does Mercer accept liability to the Trustee if the advice is used for any purpose other than that stated.

This report may be disclosed to Members and others who have a statutory right to see it. It may also be disclosed to any participating employer and, if the Trustee and Mercer consent, it may be disclosed to other parties.

1

Introduction

- 1.1 This report is commissioned by and addressed to the Trustee of SAUL. It summarises the results of a financial update (known as an “actuarial report”) of SAUL’s funding position as at 31 March 2010. It has been prepared to satisfy the requirements of section 224 of the Pensions Act 2004. Under the Pensions Act an actuarial report is mandatory each year, unless an actuarial valuation takes place in that year.
- 1.2 The most recent actuarial valuation was carried out as at 31 March 2008. This was SAUL’s first actuarial valuation under the new scheme specific funding regime.
- 1.3 SAUL covers a number of colleges and employers that have links with higher education. The term “Employer” in this report is used as a collective name for the employers that participate in SAUL.
- 1.4 The results contained in this paper are on a consistent basis with those in the 31 March 2008 actuarial valuation and with the statement of funding principles, having been updated to reflect changes in market conditions and known cashflows over the period to 31 March 2010.
- 1.5 The calculations are approximate and intended to give a broad indication of the trend in SAUL’s financial position over time. The calculations are carried out on a simplified basis that does not fully reflect changes in SAUL’s membership profile, and does not take account of all aspects of SAUL’s experience.
- 1.6 The updated funding position should be included in the next summary funding statement to be issued to Members. This will need to be issued within a reasonable period (generally taken to be 3 months) after 31 March 2011.
- 1.7 The figures calculated for this actuarial report are not as accurate as those that would arise from a full actuarial valuation as some approximations have been made, and individual member data has not been used. As such, they should not be relied upon for decisions relating to SAUL without further advice from the Scheme Actuary.

SAUL's Funding Principles

- 1.8 SAUL has historically maintained prudent margins within its assumptions to accommodate short-term fluctuations in investment markets in order to maintain contribution stability.
- 1.9 Given market conditions at the date of the last valuation, and, in particular, the very low level of real yields, the Trustee took the view that it was reasonable to release some of the prudent margins held against adverse experience, thus allowing SAUL to disclose a fully funded position on its technical provisions basis.
- 1.10 As a result, the Trustee agreed two funding objectives with the Employer at the last valuation, described in detail in SAUL's statement of funding principles dated 20 May 2009. In summary, the Trustee agreed:
- a *technical provisions basis* (that takes account of both the strength of the Employer covenant and the expected long-term return on SAUL's assets), and
 - a stronger, *secondary funding objective* (which retained the margins previously held and will continue to be used by the Trustee for key strategic decisions).
- 1.11 While the Trustee agreed to remove some of the prudent margins in SAUL's assumptions in order to disclose a fully funded position. It was also agreed that an improvement in SAUL's financial position should be clearly evident at March 2011 if SAUL wishes to continue to operate at current contribution and benefit levels and maintain the margins it has held in the past.

Developments since the 2008 Valuation

- 1.12 Asset values fell significantly over the year following the valuation date and SAUL's last actuarial report as at 31 March 2009 showed that the required improvement in SAUL's funding position had not yet materialised. Projections at that time continued to show SAUL with a sizeable shortfall at the next valuation on both a technical provisions and secondary funding target basis (unless there are significant market changes).
- 1.13 In summary the 31 March 2009 funding review revealed that:
- SAUL's funding level had deteriorated to 79% and 65% on its technical provisions basis and secondary funding target respectively (compared to 100% and 83% at the 31 March 2008 formal valuation).
 - Were SAUL to have wound up at 31 March 2009, we estimated that its assets would have covered 55% of its liabilities when calculated using indicative deferred and immediate annuity rates (compared to 80% at the 31 March 2008 formal valuation).
 - SAUL's PPF funding level at 31 March 2009 was 72% compared to 107% at the formal valuation.

- Based on long-term assumptions, current contribution levels, and SAUL's current benefit (and investment) structure, it was expected to take almost 20 years for SAUL to be fully funded against its secondary funding target and 10 years to be fully funded on its technical provisions basis.
- The cost of future benefits was 24.0% of Salaries (calculated on the average real yield basis). This compares to total Member and Employer contributions of 19% of Salaries (i.e. a contribution shortfall of 5% of Salaries at 31 March 2009). SAUL therefore relies on additional returns from its assets to justify the status quo.
- It was also noted that the Trustee currently makes no allowance for improvements in life expectancy beyond those included within the medium cohort projections. In particular, there is no provision at present for a minimum improvement in life expectancy (known as an "underpin").

2

Background

Membership Data

- 2.1 We would like to register our thanks to STC for once again providing us with data in the format we requested. Details of the data received and some commentary is included in Appendix A.
- 2.2 During the last year SAUL has welcomed the Royal College of Art ("RCA") as a new Employer. The transfer of RCA members to SAUL has contributed to the above average level of growth in SAUL's membership over the year. SAUL's total membership increased by approximately 5% over the year (including 2% from RCA). SAUL's membership stood at 29,993 at 31 March 2010, having been 28,490 at 31 March 2009 and 27,571 at 31 March 2008.

SAUL's Investment Strategy

- 2.3 SAUL's assets fit into a continuum ranging from those that are "risk-reducing" to those that are "return-enhancing". SAUL's long-term strategic asset allocation strategy is to invest 35% of the portfolio in risk-reducing assets, such as bonds, with the remaining 65% invested in return-seeking assets: 40% in equities and 25% in absolute return assets.
- 2.4 The actual asset allocation will differ from the strategic allocation from time-to-time due to market movements and short-term deviations by individual managers within permitted ranges. At 31 March 2010 the risk-reducing / return enhancing split was approximately 34% / 66%.

Economic Background

- 2.5 The recession in the UK economy deepened over the second and third quarters of 2009, though the rate of decline was significantly less than the 2.5% drop in the first quarter of the year. On an annual basis GDP decreased by 5.2% by the end of September, the deepest recession since comparable records began and definitely since the Great Depression of the 1930s.

- 2.6 The UK finally emerged from recession in the fourth quarter of 2009, expanding by 0.4% quarter-on-quarter. This was with the assistance of historically low interest rates, quantitative easing totalling £200bn, and counter-cyclical government expenditure.
- 2.7 In advance of the May election, debate centred on the timing of spending cuts with the budget deficit close to 12% of GDP or £149bn. The subsequent Coalition Budget resulted in IMF growth forecasts being revised downwards from 1.2% to 1.1% for 2010 and 2.5% to 2.1% for 2011. The OECD predicted unemployment would remain at 8% until the end of 2011 as a result of the measures announced.

Investment Experience

- 2.8 Equity markets produced very strong returns in both sterling and local terms over the year to 31 March 2010, rising across all markets. In the UK, the FTSE all share index was up 52.3%% over the year.
- 2.9 Bond markets largely produced strong positive returns over the year, with sterling non-gilts performing particularly well. The exception to this was long-dated fixed interest gilts which produced marginally negative returns. Property and commodities also produced good positive returns over the year
- 2.10 The unaudited market value of SAUL's assets was £1,391m at 31 March 2010 compared to £1,039m at 31 March 2009. SAUL's investment return over the year to 31 March 2010 has been 30% (before investment management fees):

Gilt yields

- 2.11 The financial assumptions used for valuing SAUL's liabilities are derived from the yields on fixed interest and index-linked gilts.
- 2.12 Short dated fixed-interest gilt yields remained generally unchanged over the year, whilst medium and long dated yields rose during the period.
- 2.13 As SAUL's benefits are linked to inflation, its liabilities are sensitive to changes in the index-linked yield (also referred to as the "real yield"). Paragraph 3.2 of this report shows that the index-linked gilt yield used to value SAUL's liabilities fell by 30 basis points per annum (0.3% per annum) over the year. This has (all other factors being equal) led to an increase in the calculated value of SAUL's liabilities.

Summary

- 2.14 In summary, strong investment performance has resulted in an improvement in SAUL's funding position over the last year. However, continuing low real yields have taken some of the shine off this strong asset growth and SAUL remains in deficit against both its secondary funding target and technical provisions.

3

Method and Assumptions

- 3.1 The financial and demographic assumptions used to assess the technical provisions, the normal cost of benefit accrual and the secondary funding objective are set out in SAUL's statement of funding principles dated 20 May 2009.

Market Yields

- 3.2 The table below sets out a summary of the market yields at 31 March 2010, together with the yields at the date of the last actuarial report and the 2008 formal valuation (all figures are rounded to the nearest 0.1%):

	31 March 2008	31 March 2009	31 March 2010
Long-dated gilt yield	4.3% p.a.	4.4% p.a.	4.6% p.a.
Long-dated index-linked gilt yield	0.7% p.a.	0.9% p.a.	0.6% p.a.
Market implied inflation (long-term)	3.6% p.a.	3.5% p.a.	3.9% p.a.

- 3.3 As set out in SAUL's statement of funding principles, the gilt yields and market implied inflation assumptions referred to in the above table are derived from estimates of the yield available on notional portfolios of conventional and index-linked Government bonds whose cashflows approximately match SAUL's estimated cashflows.
- 3.4 The index-linked gilt yield has fallen by 30 basis points per annum (0.3% per annum) over the year. This has (all other factors being equal) led to an increase in the calculated value of SAUL's liabilities.

Past Service Assumptions

3.5 The table below shows the financial assumptions implied by market conditions at 31 March 2010, with those used for the last actuarial report and the 2008 formal valuation shown for comparison.

	31 March 2008		31 March 2009		31 March 2010	
	Technical Provisions	Secondary Funding Objective	Technical Provisions	Secondary Funding Objective	Technical Provisions	Secondary Funding Objective
Investment return pre-retirement	6.90% p.a.	5.30% p.a.	7.00% p.a.	5.40% p.a.	7.20% p.a.	5.60% p.a.
Investment return post-retirement	4.80% p.a.	4.30% p.a.	4.90% p.a.	4.40% p.a.	5.10% p.a.	4.60% p.a.
Salary increases*	4.85% p.a.	4.85% p.a.	4.75% p.a.	4.75% p.a.	5.15% p.a.	5.15% p.a.
Price Inflation	3.35% p.a.	3.35% p.a.	3.25% p.a.	3.25% p.a.	3.65% p.a.	3.65% p.a.

*An additional allowance is made for future promotional increases.

Inflation Expectations

- 3.6 Market implied inflation at 31 March 2010 was 3.9% per annum, this being the difference between fixed and index-linked gilt yields of appropriate duration. This represents an increase of 40 basis points per annum (0.4% per annum) compared to the 31 March 2009 actuarial report.
- 3.7 As set out in SAUL's statement of funding principles, we continue to make a deduction of 0.25% per annum to reflect lower longer term inflation expectations.

Demographic Assumptions

- 3.8 As a result of an analysis of SAUL's experience, the mortality assumption, the assumed proportion of members that are married and the assumed withdrawal assumption were all updated at the 2008 valuation, to more closely reflect SAUL's experience.
- 3.9 Data for this actuarial report is provided largely in grouped format. The limited analysis that we have performed on membership movements (this being an interim review) does not provide any evidence to justify a change to the demographic assumptions made at the 2008 formal valuation.

Future Service Assumptions

3.10 The table below shows the change to the investment return assumptions used for calculating the future service cost. All other assumptions are the same as the past service assumptions.

	31 March 2008		31 March 2009		31 March 2010	
	Average real yield basis	Spot rate basis	Average real yield basis	Spot rate basis	Average real yield basis	Spot rate basis
Investment return pre-retirement	7.00% p.a.	6.30% p.a.	7.10% p.a.	6.40% p.a.	7.30% p.a.	6.60% p.a.
Investment return post-retirement	5.00% p.a.	4.30% p.a.	5.10% p.a.	4.40% p.a.	5.30% p.a.	4.60% p.a.

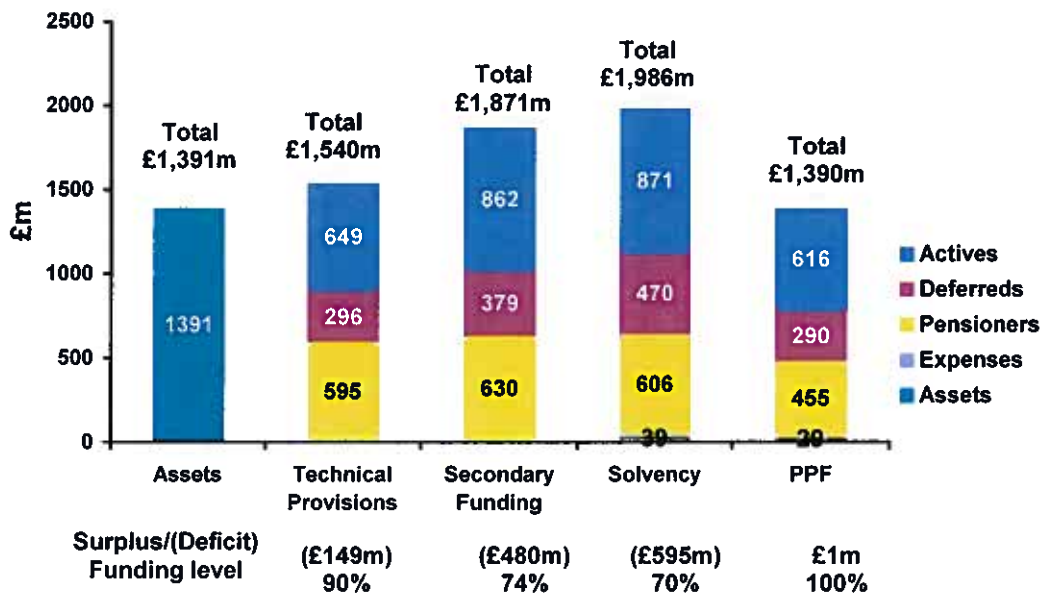
4

Results

Summary of Past Service Results

4.1 At the last actuarial report as at 31 March 2009, the value of SAUL's assets was £1,039 million and value of ongoing liabilities on the technical provisions basis was £1,307 million: a deficit of £268 million. Against its secondary funding objective target SAUL was 65% funded at 31 March 2009 (a shortfall of £549m).

4.2 The market value of SAUL's assets at 31 March 2010 is compared below with the value of the accrued benefits on each of the bases considered in this report.



4.3 The results of this actuarial report show SAUL to be 90% funded on its technical provisions basis (a deficit of £149m) and 74% funded on its secondary funding objective basis (a deficit of £480m).

Wind-up Funding Level (“Buy-out”)

- 4.4 The ultimate test of SAUL’s financial security (as for any other pension scheme) is its ability to be able to secure all accrued liabilities with an insurance company (a total transfer of financial and longevity risk).
- 4.5 We have once again estimated SAUL’s wind-up position based on indicative rates. SAUL’s assets represent approximately 70% of those required to secure the liabilities. This has improved from the position at the 2009 actuarial report of 55% due to the strong investment performance achieved over the year.

Other Valuation Results

- 4.6 We estimate SAUL’s funding level based on PPF benefits and assumptions (a Section 179 valuation) to be 100% at 31 March 2010 (this was 72% as at 31 March 2009).

Future Service Costs

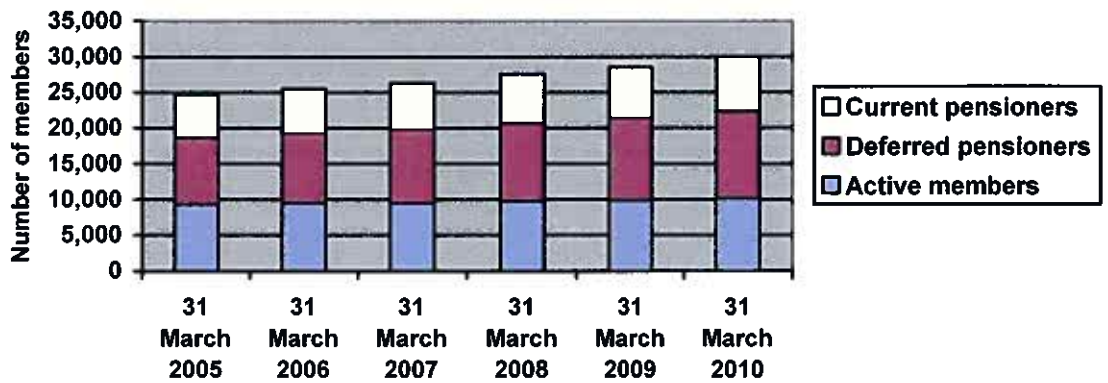
- 4.7 The future service costs have been estimated using a method and assumptions consistent with those used at the last valuation. They are shown for information only. Any further discussion of these will require further advice from the Scheme Actuary.
- 4.8 The table below shows the cost of accrual based on conditions at the actuarial report date. We have included the cost calculated using the “spot rate” approach (which is consistent with SAUL’s traditional funding approach) and the “smoothed yield” basis, which averages market yields (in response to the relative low yields by historic standards).

	31 March 2008		31 March 2009		31 March 2010	
	Average Real Yield	Spot rate	Average Real Yield	Spot rate	Average Real Yield	Spot rate
Normal contribution rate for:						
▪ pension benefits	23.4%	28.4%	22.0 %	26.6%	23.8%	29.0%
▪ insured lump sum death benefits	0.6%	0.6%	0.6%	0.6%	0.6%	0.6%
▪ administrative expenses	1.4%	1.4%	1.4%	1.4%	1.4%	1.4%
Total normal contribution rate	25.4%	30.4%	24.0%	28.6%	25.8%	31.0%
Member contribution rate*	(6.0%)	(6.0%)	(6.0%)	(6.0%)	(6.0%)	(6.0%)
Employer normal contribution	19.4%	24.4%	18.0%	22.6%	19.8%	25.0%

Appendix A

Membership Data

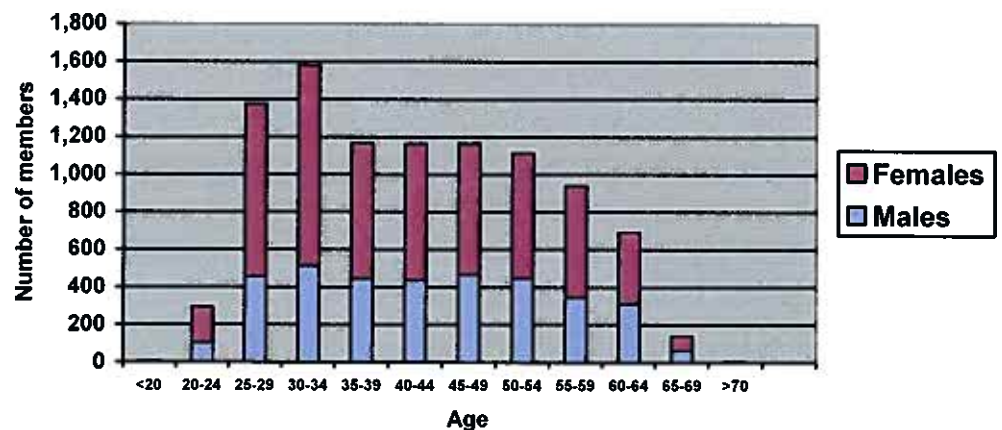
- A.1 The data for the funding review was received as for previous funding reviews, in line with our requests and in age grouped format.
- A.2 As shown on the chart below, SAUL's membership continues to increase steadily. The total membership at 31 March 2010 is 29,993 compared to 28,490 at 31 March 2009 and 27,571 at the 31 March 2008 formal valuation. During the year since the 2009 funding review, SAUL has welcomed a new employer, the Royal College of Arts, which has contributed to the rise in membership.



Actives

- A.3 The number of members in active service has increased from 9,830 at 31 March 2009 to 10,168 at 31 March 2010.
- A.4 The total salary roll of active members has increased by just over 3% over the year since the 2009 actuarial report. This increase is a result of the Royal College of Arts ("RCA") joining SAUL as a new Employer. The total salary roll excluding RCA is broadly unchanged from 31 March 2009.
- A.5 The average salary of active members has increased from £25,094 per annum to £25,486 per annum over the year since the 2009 actuarial report..

- A.6 Increases in average salaries do not provide full information on general increases as they are distorted by the salaries of younger new entrants (who generally earn less) and leavers during the year. Over the two years since the 2008 valuation, salary experience has been broadly in line with assumptions.
- A.7 While the active membership has increased since the 2009 funding review (at a rate of 3.4% over the year) total membership numbers have continued to increase at a higher rate: 5.3% over the year.
- A.8 The proportion of the membership relating to active members has been gradually declining over the last 10 years and now stands at 34% compared to 35% in 2008, 37% in 2005, 41% in 2002 and 46% in 1999.
- A.9 The chart below shows the distribution of male and female active members by age at 31 March 2010. Amongst active members the proportion of female members has remained constant at 62%.

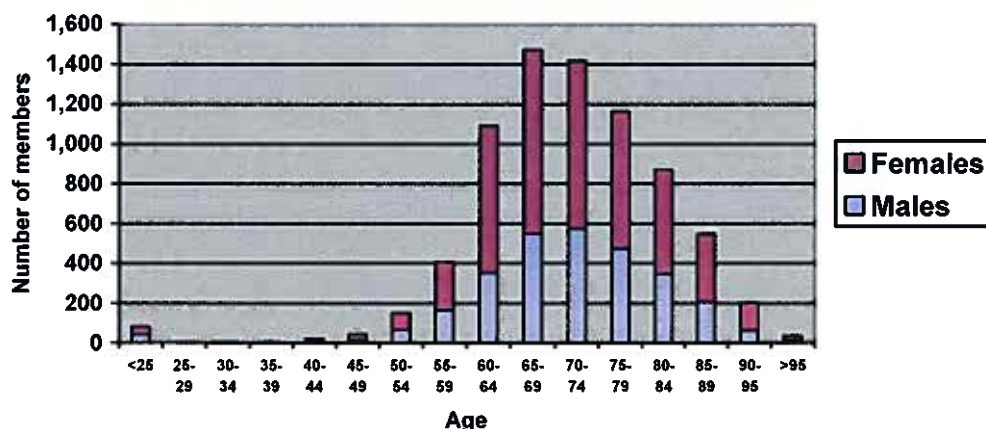


Deferreds

- A.10 The number of deferred pensioners has increased by approximately 5.7% over the year. The proportion of the membership relating to deferred members has remained at the 41% level quoted in the 31 March 2009 actuarial report. This compares to 40% in 2008, 38% in 2005, 35% in 2002 and 29% in 1999.
- A.11 Amongst deferred members the proportion of female members has remained constant at 68%.

Pensioners

- A.12 The chart below shows the distribution of male and female pensioner members by age at 31 March 2010. Amongst pensioner members the proportion of female members has remained constant 62%.



- A.13 The total pensioner payroll has increased by almost 10%, which includes a 7% rise in the total number of pensioners.

Summary

- A.14 The membership data is summarised below, with the figures at the 2009 actuarial report and the 2008 formal valuation shown for comparison:

	31 March 2008	31 March 2009	31 March 2010
Active Members			
Number	9,764	9,830	10,168
Total Salaries (£000s p.a.)	223,974	243,996	251,647
Salary Weighted Average Age ¹	42.0	43.1	43.1
Deferred Pensioners			
Number	10,940	11,570	12,231
Current Pensioners			
Number ²	6,867	7,090	7,594
Total Pensions (£000s p.a.)	29,116	31,032	34,119

¹ 2009 and 2010 average ages are estimated from grouped data.

² All figures include children and widows. At 31 March 2010 there were 78 children in receipt of pensions, compared to 81 in 2009 and 78 in 2008.

MERCER



MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

Mercer Limited
Four Brindleyplace
Birmingham B1 2JQ

