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Statement on the assumptions underpinning the Galbraith Tables and current market conditions

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Background

Version 1.0 of the Galbraith Tables, being Mathieson Consulting Limited's proprietary tables for use in valuing pension rights upon divorce, were published in March 2022 and reflected prevailing market conditions as at that time. Since then, we have encountered an unprecedented degree of economic and indeed political instability over a period of a few months, and some thought needs to be given as to whether the tables as presently constituted remain fit for purpose.

In particular, the UK is at present experiencing levels of price inflation that have not been seen for over 20 years, with the September to September measure used for indexing pension benefits in the following April being 10.1% for the 2023 increase, compared to just 3.1% and 0.5% for the prior two years. In response to the above, the Bank of England has increased the base interest rate to 2.25%, being the highest level since the 2008/9 credit crunch. It is generally accepted that such a change might be expected to increase the nominal rate of return expected through holding other investments besides cash e.g. equity, bonds etc.

These factors all have an impact upon how one might value pension rights: higher expectations of future inflation made index linkage a more valuable benefit, and in turn the costs associated with securing such a pension promise increases. However, this will be offset by the fact that higher future investment returns will drive down the monies that need be set aside today to cover a future benefit promise. Anecdotally, we have seen improvements in annuity rates provided by the market i.e. less monies are now needed up-front to secure a notional £1,000 pa income in retirement.

It remains to be seen whether such changes as have occurred in recent months reflect a mere blip, with reversion to a longer-term mean expected hereafter, or if instead they constitute some kind of "paradigm shift" where existing preconceptions and rules of thumb need be discarded in favour of something else. Moreover, it is not clear whether further changes might be expected to emerge in the months that follow, in particular with regards to energy prices, the Ukraine situation and both the fiscal and political environments that apply at present in the UK.

Possible impact upon the Galbraith Tables

The Galbraith Table multipliers (i.e. the actual tables of factors) depend upon both financial and demographic assumptions. The "user manual" to the Galbraith Tables sets out all of the assumptions upon which the tables are based, and provides details of the process that was used to alight upon each assumption.

Furthermore, the assumptions that underpin the tables are meant to be long term in nature, rather than being the subject of frequent updates. In the first instance, we note that no revisions in respect of demographic assumptions (those pertaining to life expectancy) are mooted, as no evidence has emerged to cause us to reconsider what was adopted in version 1.0

In terms of what the current economic circumstances mean for the Galbraith Tables, we make the following observations:

- In the first instance, short-term volatility in economic conditions should not give rise to any revisions to the tables. As to whether any long-term "paradigm shift" has occurred, it is perhaps too early to tell, with more months of data being required before any meaningful conclusions may be drawn in respect of this.

- *"Nothing ages faster than a vision of the future"*, with it being remembered that attempts made by economists to predict the future have seldom been successful e.g. "market expectations" over c. 2010–15 that the Bank of England would raise base rates from the then historic low of 0.50%, something that never happened.

- Any change to be made to the assumptions that underpin the tables must be rational, considered and supported by data: it should neither be "knee-jerk reaction" or a revision that fails to take account of all that has changed. Conversely, the value of such a resource to practitioners is depleted where frequent revisions are made i.e. which are the "correct" factors to use if a new version is about to be published?

- Given that the Galbraith Tables are used to value index-linked pension incomes, the factors depend more upon the real future investment return (i.e. that over inflation) than the nominal investment return and future assumed rate of inflation as separate variables. To this extent, rising rates of price inflation and rising base rates (which feed through to investment returns) may be said to offset each other, at least in part.

- The Galbraith Tables explicitly rejected the use of open market annuity rates to capitalise pension rights once they come into payment. This was on the grounds that such rates are reliant upon factors that are not readily modelled and reflect the vagaries of insurer pricing which may depend upon factors beyond current market rates. To this end, the "appropriate reaction" to current conditions for insurers and for us (in setting the assumptions for the Galbraith Tables) may not necessarily coincide.

- Notwithstanding all of the above, the Galbraith Tables are intended to be used with *current* pension amounts, and not those *per annum* pension promises in defined benefit schemes that have been expressed in earlier leaving service terms. Any attempt to update historic pension rights to today prior to their valuation should be expected to take account of the higher-than-average inflationary increase that is expected to be made next year.

Other influences over the Galbraith Tables assumptions

The "user guide" that accompanies version 1.0 of the Galbraith Tables makes clear the source of the assumptions that are used in their construction. To this end, it is helpful to consider whether any changes in assumptions made by others ought to feed through to the tables. We make the following observations in respect thereof:

- The pre-retirement investment return assumption makes reference to the rates used by pension providers in preparing Statutory Money Purchase Illustrations (SMPIs) under actuarial standard TM1. It is noted that TM1 has been revised, but only to take effect from October 2023, and on this basis we suggest that any revisions that we might make in light thereof are considered closer to October 2023.

- Despite recent higher-than-average rates of inflation as have been experienced in the UK, the Bank of England target for CPI remains at 2.00% pa. On this basis, we make no revisions to our underlying inflation assumption.

- Finally, the life expectancy figures used in the construction of the tables are based upon the mortality assumptions set by the Pension Protection Fund (PPF). The current assumptions document for a section 179 valuation as is required by the PPF is dated May 2021 and as such no changes have been made that ought to be reflected in the tables.

Conclusions drawn and policy adopted

In light of the above, we have decided that **no action should be taken at present to revise the assumptions that underpin version 1.0 of the Galbraith Tables**. This is on the grounds that it is at present too early to say whether any long-term changes in financial markets—and the associated pricing of pension rights—have emerged, and it is therefore impossible to determine the level of change that ought to be made (if indeed any need be made at all) in light of the events of 2022.

Once again, the Galbraith Tables are intended to serve as a robust but nonetheless broad-brush guide to the expected cost today of meeting future pension rights, and they make long-term assumptions upon such matters. We are of the opinion that further evidence may yet give rise to our seeking to revise the Galbraith Tables assumptions at some point in the future, but that this has yet to manifest itself. Meanwhile, we stand by version 1.0 of the Galbraith Tables as published in the Financial Remedies Journal and as are shown at https://mcact.co.uk/wp-2020/wp-content/uploads/2022/04/The-Galbraith-Tables.pdf.

However, we propose that a more thorough review of the Galbraith Tables be performed in the coming months—most likely in spring 2023—to determine whether more certainty exists around the long-term outlook for financial conditions, and also whether the revisions to TM1 give rise to any revision to our pre-retirement investment return assumptions.

Further thoughts

It is recognised that other Pension on Divorce Experts (PODEs) may have hitherto made different assumptions upon such matters as those set out in the Galbraith Tables, and that such individuals / organisations may take a different view upon by how much assumptions should change to take account of the events of 2022. This is understood and accepted, and the publication of the Galbraith Tables does not constrain others from forming their own legitimate views upon such matters.

Nonetheless, however, it is noted that no other such bespoke resource for the valuation of pension rights upon divorce exists at present, and it is again hoped that the Galbraith Tables may prove to be of use to practitioners in this field. Absent the use of such tables, the only other options available to place values thereupon are i) to use the Cash Equivalent Transfer Values (CETVs) of such pension benefits; or ii) to commission detailed such analysis from a PODE. The dangers of using CETVs for this purpose are well-documented, and to this end we continue to believe that the Galbraith Tables remain the best available resource for practitioners to seek to value pension rights in the absence of more detailed and bespoke actuarial analysis.

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