The Actuarial Profession
making financial sense of the future

Current issues in pensions: spring 2013:

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Liability management: de-risking opportunities

How do pension schemes manage risk?

Introduction

- Current financial market conditions impacting de-risking
- Low gilt yields have increased the cost in most areas
- Legislation / guidance to outline good practice
- Increased use of technology to set and monitor triggers.

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Types of risk

There are many types of pension scheme risk

The ultimate risk materialises if there are insufficient assets in a Scheme and the sponsoring employer is unable to provide the additional funds needed

Liability
- Interest rate
- Inflation
- Life expectancy

Asset
- Equity risk
- Credit risk
- Liquidity risk

Sponsor
- Financial strength
- Covenant
- Avoidance

Regulatory
- Legislative
- The Regulator
- Governance

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Approach to de-risking and options

Stage 1
Set objectives
'Get ready'

Stage 2
Investment strategy

Stage 3
Liability management

Risk reduction method	Usually initiated by
Enhanced transfer value	Company
Pension increase exchange	Trustee/Company
Flexible retirement	Trustee/Company
Buy-in	Trustee
Buy-out	Company

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Incentive exercises - guidance

A new code of good practice was issued in June 2012, with revised tPR guidance in July 2012

Code of good practice 7 principles

1. No cash
2. Member advice
3. Maintain records
4. Clear communication
5. No undue pressure
6. No vulnerable clients
7. Be aware of roles & act in good faith

Trustees' role

1. Engage in the process to ensure members are properly informed
2. Administer the resulting benefits
3. Manage conflicts
4. Manage data protection duties
5. Consider funding impact

The Pension Regulator's 5 principles

1. Clear, fair and not misleading
2. Open and transparent
3. Manage conflicts of interest
4. Trustee consultation
5. Independent financial advice

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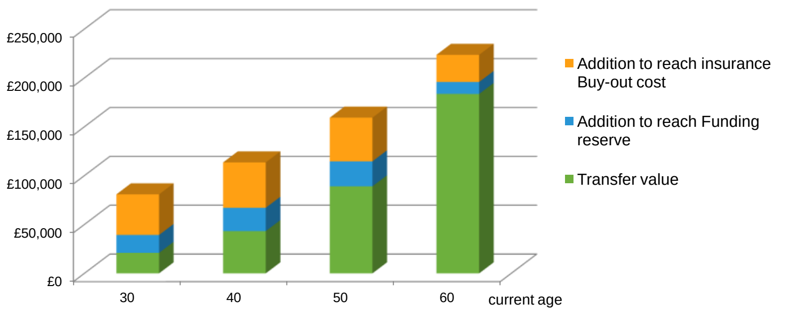
Impact of code of practice

- Almost universal adopting of the Code
  - has given clarity to all parties
  - Key changes – no cash as part of ETVs, advice for PIEs
- Incentive Exercises Monitoring Board
  - 3 sub-groups: communications, compliance, practicioners
  - First substantive data in second half of 2013
- Grey area of “routine retirement procedures”
- Fewer enhanced transfer value exercises
  - also connected to credit yield gap so this may reverse

Enhanced Transfer Values (ETVs)

- Deferred members are offered an incentive to transfer out
- Members receive independent financial advice on decision
- Objective: find an offer attractive both members/employer.

Approximate values at various ages of a deferred pension of £10,000 pa payable at age 65



Why provide an ETV?

- Deferred members are the..
  - largest component of most schemes
  - longest term liabilities
  - largest source of financial volatility
- Insurance of deferred members is very expensive
- Investment risk can be matched (at a price)
- Solutions are not available to match the longevity risk
- Very few deferred members transfer out normally
- There are a number of reasons why a member may choose to take a transfer value.

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Where are ETVs now after the Code?

- Too demonised by some previous bad examples
  - no need to demonise a good well run exercise
- Is it right that cash is banned as part of offer?
  - right or not it's not likely to change
- More exercises are targeted
- The deferred members haven't gone away
- Financial markets and the economy were an equal impact in 2012.

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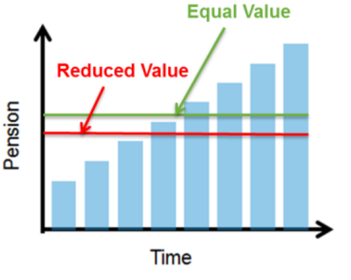
Pension Increase Exchange (PIEs)

- A PIE exercise offers a choice for members to exchange future pension increases in payment for a higher pension without such increases
- Only non-statutory pension increases can be exchanged.
- This can be at the time of, after, or before Scheme retirement.



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Why provide a PIE option?

- Improves risk profile of plan liabilities
- Ultimate buy-out costs could be less
- Can be structured to lead to a funding actuarial gain
- No immediate cash is required from the employer
- Provides a good voluntary option for members

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Where are PIEs now after the Code?

- Dilemma between “100 per cent balanced deal” or not
- Trustees more comfortable with PIEs post the Code
  - a good option for members?
- Member advice is the transformative change
- Code issues to decide for future “normal routine retirements”

Flexible retirements: Total Pension Increase Exchange (TPIE)

- The member (aged over 55) takes a transfer value to buy an immediate annuity
- Two types of exercises:
  - Bulk Exercise
  - Future ‘at retirements’
- For employers and members this can be a good option:

Member	Employer
Choice / flexibility of pension enhanced annuity option Potential higher cash lump sum Income Drawdown opportunity	Risk reduction: Fewer future pensioners Discharge at a good price

Where are TPIEs now after the Code?

- Had only just started before the code
- Full member advice as per transfers (no change)
- Therefore, Code has limited impact
- The issues are the practicalities – not the Code of Practice
- Code issues to decide for future "normal routine retirements"

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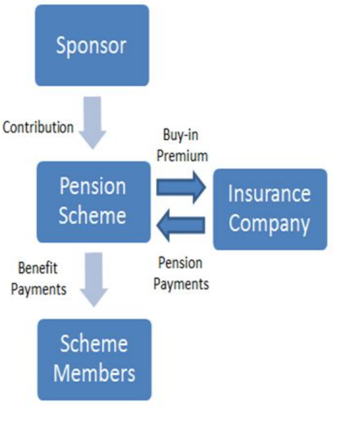
Buy-ins / Buy-outs

- £4.5 Bn of buy-in/out from 166 deals in 2012
- Corporate spreads produced favourable terms
- Trustees 'swapped' gilts for a pensioner buy-in contract
- Options to balance cost and risk removal (e.g. deflation)
- Use of delayed payment options and enhanced annuities.



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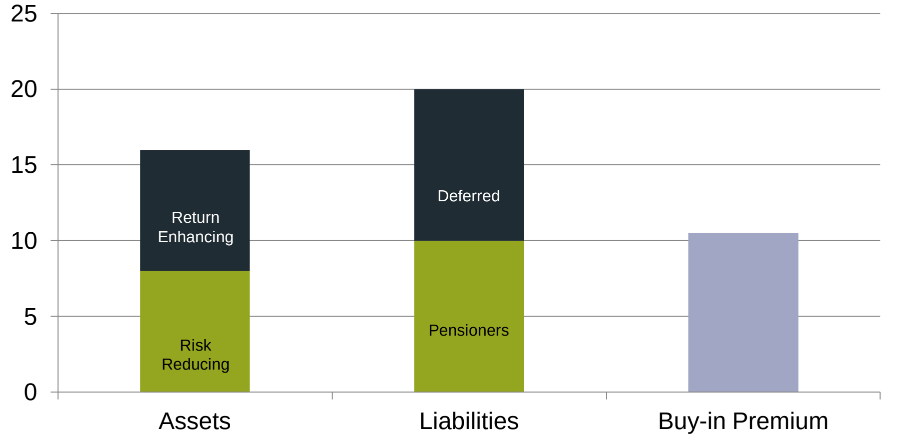
What makes a buy-in good value?



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Enhanced buy-ins

- First deals now complete
- 4 providers currently in the market
- Solutions for small schemes (< 300 pensioners)
- Covers all members - medical underwriting varies.

Basis	Estimated costs	Difference	Saving
£7,500 single life pension, Male age 65	£209,000	-	-
Mild lifestyle condition (e.g. overweight)	£177,000	£32,000	15%
Smoker	£170,100	£38,900	18%
Mild impaired (e.g. diabetes)	£158,800	£50,200	24%

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Summary

- A range of de-risking options available
- Market conditions may impact choice of exercise
- Use of different options for membership segments
- Trustees and sponsors can work together on a plan.

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Questions

- Is there still a market for ETVs?
  - What would make them attractive?
- What proportion of members may find a transfer to an insured annuity attractive at retirement?
- How attractive are such retirement transfers to employers
- What should trustees make of incentive exercises?
- What are the largest practical hurdles?

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Questions or comments?

Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

The views expressed in this presentation are those of the presenter.