# Scheme-specific funding - nice idea but...

Francis Fernandes

Financial Markets Advisory, 30th November 2004

ABN·AMRO

***Disclaimer***

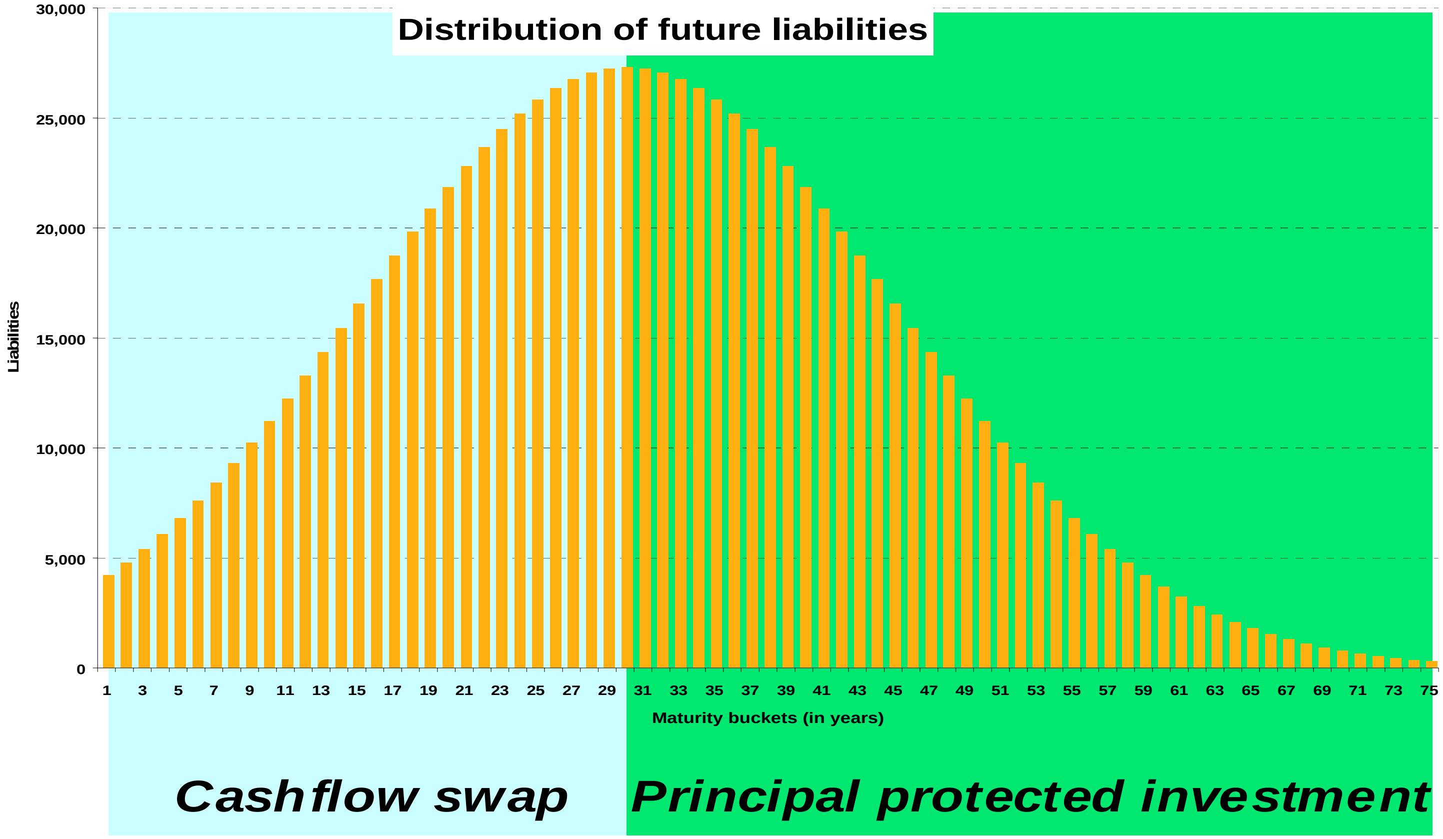
This presentation was prepared by ABN AMRO exclusively for the benefit of those attending the Actuarial Profession’s seminar on the “Impact of the Pensions Bill” held on 30th November 2004. This presentation is incomplete without reference to, and should be viewed solely in conjunction with, the oral briefing provided by ABN AMRO. The presentation is proprietary to ABN AMRO and may not be disclosed to any third party or used for any other purpose without the prior written consent of ABN AMRO.

The information in this presentation reflects prevailing conditions and our views as of this date, which are accordingly subject to change. In preparing this presentation, we have relied upon and assumed, without independent verification, the accuracy and completeness of all information available from public sources or which was provided to us by or on behalf of the Company or which was otherwise reviewed by us. In addition, our analyses are not and do not purport to be appraisals of the assets, stock or business of the Company. Even when this presentation contains a kind of appraisal, it should be considered preliminary, suitable only for the purpose described herein and not be disclosed or otherwise used without the prior written consent of ABN AMRO. The information in this presentation does not take into account the effects of a possible transaction or transactions involving an actual or potential change of control, which may have significant valuation and other effects.

# Agenda

- Statutory funding objective (SFO)
- Statement of funding principles (SFP)
- Valuation reporting
- Failure to reach agreement
- Future funding discussions
- Issues for trustees and employers

# EU Directive - scheme liabilities




ABN·AMRO

# Statutory funding objective (SFO)

- **Shortfall = assets - technical provisions**
- **Assets are sufficient and *appropriate***
- **Technical provisions (TP) calculated in accordance with any “prescribed methods and assumptions”**
- **Actuarial certification within reasonable period**
- **Methods & assumptions for TP require agreement of employer**

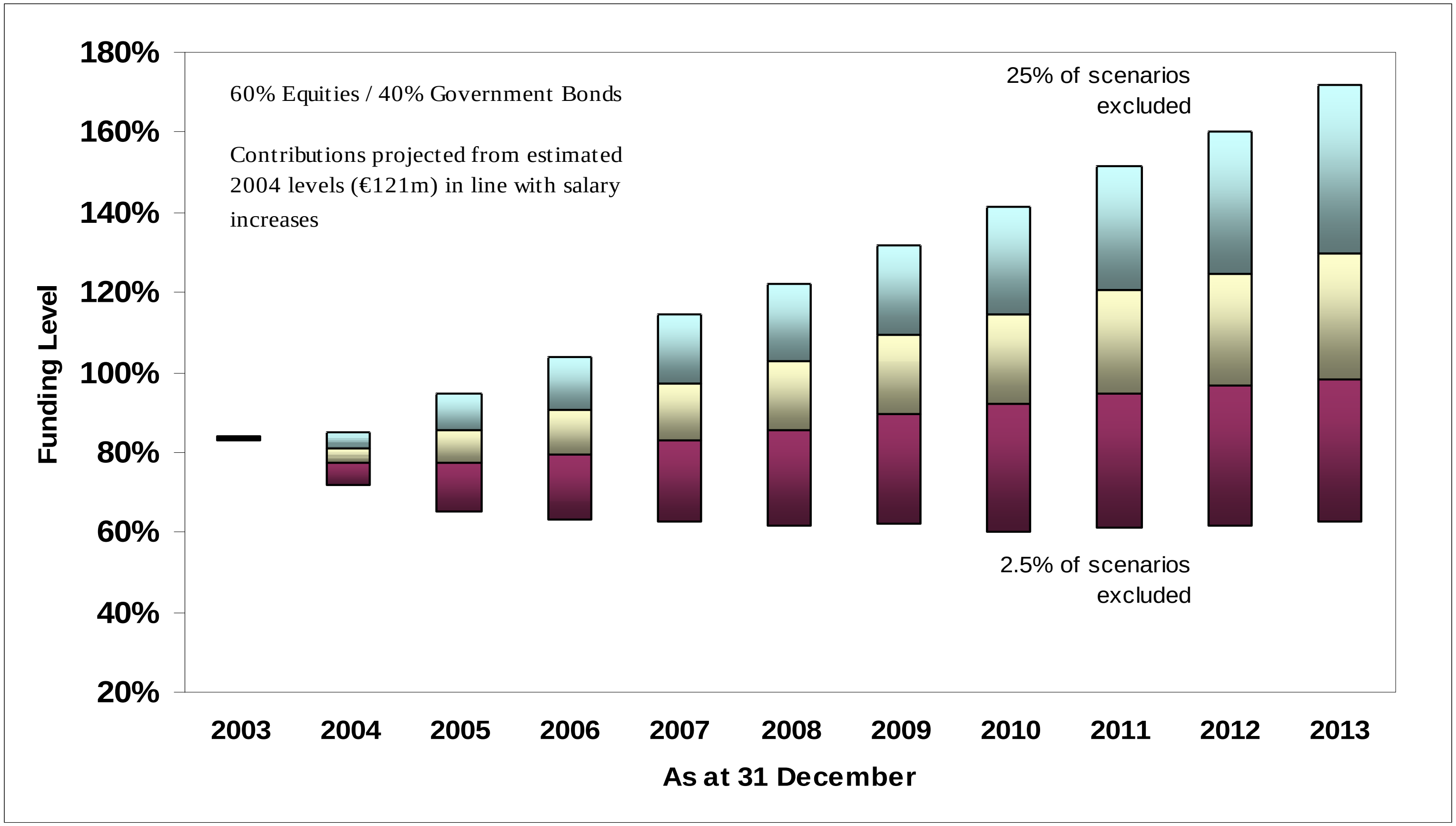
# Statement of funding principles (SFP)

- Trustees' written policy for ensuring SFO is met
- Agreement of employer and advice of actuary
- SFP includes methods & assumptions for technical provisions and correction period
- Recovery plan - action to meet SFO in the event of shortfall and period for correction
- Schedules of contribution consistent with SFP - certified by actuary

# Valuation reporting

- Actuarial valuations – at least every 3 years provided there are annual “actuarial reports”
- Actuarial reports - developments in technical provisions since last valuation
- Valuations against PPF as well…will impact risk-based levies
- More focus on solvency

# More focus on solvency




ABN·AMRO

# Failure to reach agreement

- Basis for PPF – buy-out
- Regulator: minimise calls on PPF
- Regulator power to set SFO and conts
- Consider new scheme…then extend
- Regulator sees recovery plans
- How tough will new regulator be?

# An Illustration of the hit

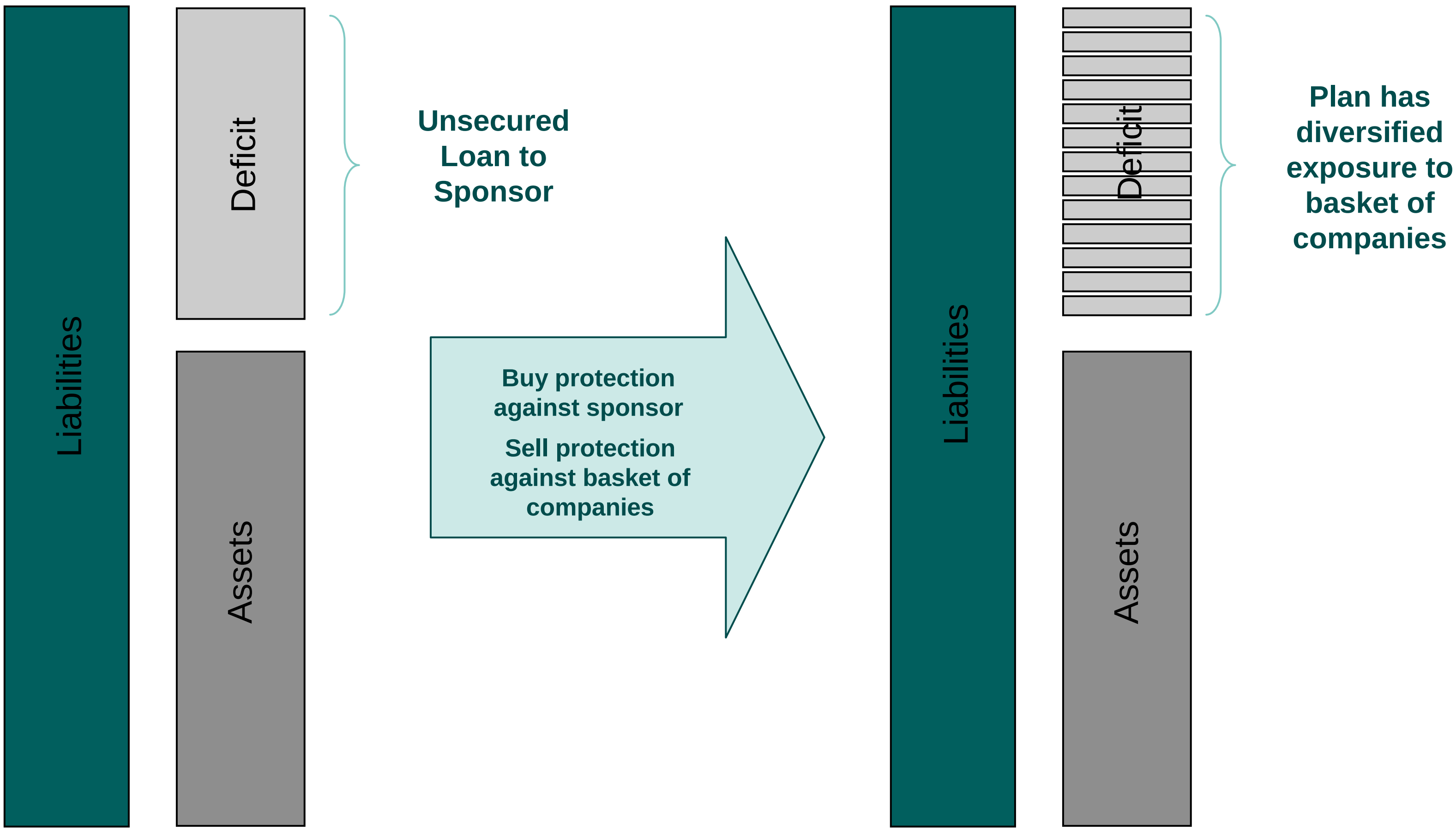
## Assets £1.7bn and payroll £500m

| | Typical Funding basis | Buyout Basis |
|---|---|---|
| Technical Provisions | **£1.9bn** | **£3.1bn** |
| Future service rate | **10%** | **25%** |
| Deficit funding (pa) | **£14m** | **£100m** |
| Contribution rate (pa) | **£64m** | **£225m** |

# Possible view of new regulator

- Initially, pension schemes likely to be in deficit against SFO
- Trustees making large unsecured loans back to the sponsor
- While contributions by the sponsor may have increased, it is unlikely that the deficit will be removed in the **near** future
- So new regulator's powers could include forcing protection against some of the deficit as well as increased contributions
- Trustees can buy protection using credit default swaps (CDS)
  - Can be linked to the deficit at the time of insolvency or stress-test
- Might have some appeal for the sponsor
  - Potential reduction in the risk-based levy to the PPF
  - more flexibility over future funding

# Buying protection against solvency deficits




ABN·AMRO

# Letter of credit

- Alternative approach is arranging a Letter of Credit facility
- Sponsor gets bank(s) to underwrite deficit in the event of employer insolvency
  - Actuary calculates the deficit on the solvency basis
  - Sponsor pays bank(s) to meet this deficit on certain “trigger” events
  - Position could be reviewed following each formal actuarial valuation
- Enables sponsor to continue to fund with flexibility on an “ongoing basis”
- Depends on size of deficit - but could weigh up contributions vs extent of protection
- Not a perfect match - but easier for trustees to understand than CDS
- Reduced risk-levy to PPF?

# Issues for trustees and employers

- Need detail urgently
- More focus on solvency
- How tough will regulator be?
- Future discussions on funding…new ideas?
- More bad news for DB schemes…have you warned clients?

# Scheme-specific funding
# - nice idea but...

Francis Fernandes

Financial Markets Advisory, 30th November 2004

ABN·AMRO