MERCER

Consulting. Outsourcing. Investments.

MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

23 September 2010

Section 50 Applications
The story so far

Aisling Kennedy

Agenda

- History
- Expected use of section 50
- Pensions Board requirements
- Applications to date
- Case study
- Snapshot of Mercer clients – September 2010
- What next?

History

History

- Section 50 as originally included in Pensions Act:
  - *The Board may…direct the trustees of a scheme…to reduce, in respect of members of the scheme then in relevant employment, the benefits…where*

    (a)the trustees of the scheme fail to submit an actuarial funding certificate within the period specified in section 43, or

    (b)the actuarial funding certificate certifies that the scheme does not satisfy the funding standard and the trustees of the scheme have not submitted a funding proposal.
  - *The reduction in benefits… shall be such that the scheme would, in the opinion of the actuary concerned, satisfy the funding standard…immediately following the reduction.*

A pragmatic provision in the absence of "debt on the employer"

History

- Pensions (Amendment) Act, 1996: amendment to enable a s50 direction to override preservation requirements set out in Schedules 2 and 3 of the Pensions Act
- Social Welfare and Pensions Act, 2007:
  - Circumstances in which a s50 order could be made were extended to include the scheme failing the funding standard and the trustees having made a funding proposal
  - The reduction in benefits could be such as to enable the scheme to satisfy the funding standard either immediately or at the end of the period of a funding proposal

History

- Social Welfare and Pensions Act, 2008:
  - S50 amended to allow changes to benefits for deferred members and removal of future pension increases for pensioner members
  - Additional provision (s50A) added:
    - *The trustees of a scheme may…for the purpose of ensuring that the winding up of the scheme will not be required by reason only of the scheme not having sufficient resources to enable the liabilities of the scheme to be discharged...with the consent of the Board, make such amendments to the scheme as they consider appropriate.*

Burden of a section 50 order need no longer fall on active members alone

Section 50A generally considered a “non-starter”

History

- Occupational Pension Schemes (Preservation of Benefits) (Amendment) Regulations 2010:
  - If NRA is changed pursuant to a s50 direction, impact on preserved benefit does not have to be phased in.

History

- May 2009 - Pensions Board published guidelines for section 50 applications
- November 2009 – Pensions Board published “FAQs” on section 50

Expected use of section 50

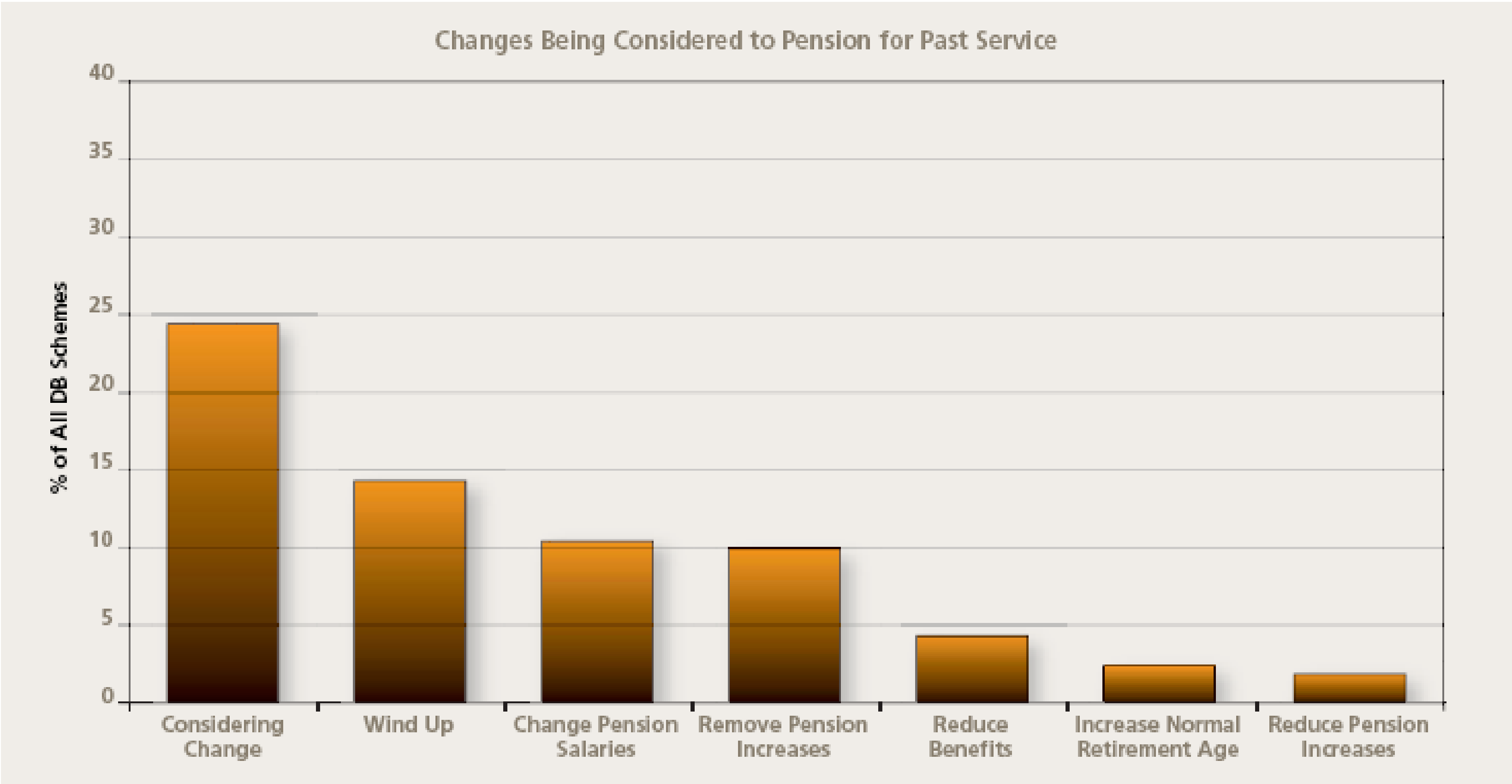
Expected use of section 50

- IAPF Survey October 2009 (101 schemes)

Reduce past benefit levels (section 50)	
In process	2%
Considering likely	12%
Considering but unlikely	12%

Expected use of section 50

- Mercer survey February 2010 (270 schemes)



Pensions Board requirements

Pensions Board requirements

- *"The Board will consent to an application only where it is satisfied that the proposed future operation of the scheme is robust enough to make any further application unlikely."*
- Trustees must first engage in a comprehensive review of the scheme.
- The nature and amount of the reduction in benefits is a matter for the trustees.
- Trustees should obtain legal advice:
  - This should include advice as to the duties and powers of the trustees and the obligations of the employer to make contributions to the scheme.
- Information must be provided to members before an application is made.
- The trustees must confirm that they have considered all options to address the scheme deficit and that they are of the view that the application is in the best interests of the members.

Factors taken into account by the Pensions Board

- The Board will consider
  - the proposed contribution rate
  - the ability of the scheme to withstand investment losses, given the proposed investment strategy
  - the proposed responses to short and long-term risks
  - any other relevant factors which the trustees bring to the attention of the Board.
- The maximum term of a funding proposal associated with a s50 application is 10 years *from the proposed effective date of the section 50 direction*
  - unless there are legally enforceable remedies available to the scheme trustees in the event of the proposal going off-track.

Contribution rate

- The application must include the long-term contribution rate for the scheme calculated on the basis of long term bond yields
  - i.e. 4.5% p.a. or up to 5% *“if the scheme actuary is satisfied that such an adjustment is appropriate”*
- Board’s view is that any lower contribution rate is *“unlikely to support the robust operation of the scheme unless other factors are or will be in place”.*
  - e.g. a binding commitment from the sponsoring employer or the use of contingent assets

Stress test

- If the s50 application is not combined with an application for a funding proposal of more than three years duration:
  - ability to withstand an immediate fall in equity values of 15% and a simultaneous reduction in interest rates (applied to both assets and liabilities) of ½%
- If the s50 application is combined with an application for a funding proposal of more than three years duration:
  - similar test as at the end of the funding proposal period
  - assuming an investment return in line with long term bond yields
- The asset allocation used for the stress test can be based on the scheme's proposed investment strategy three years after the submission of the application rather than the current strategy, to allow the trustees time to realign their investments

Stress test

- May be differences in how the mechanics of the stress test are interpreted
- The cap on future assumed investment returns reduces the incentive to hold risky assets
- The effect of the stress test is that substantial derisking is likely to produce a lower contribution requirement – because a lower investment mismatching reserve is then required

Applications to date

Applications to date

- Only a small number of applications have been received by the Pensions Board to date
- Perhaps 4 – 6 approved
- Others under consideration or pushed back to the trustees for further explanation or because criteria were not met

Case study

Snapshot of Mercer clients

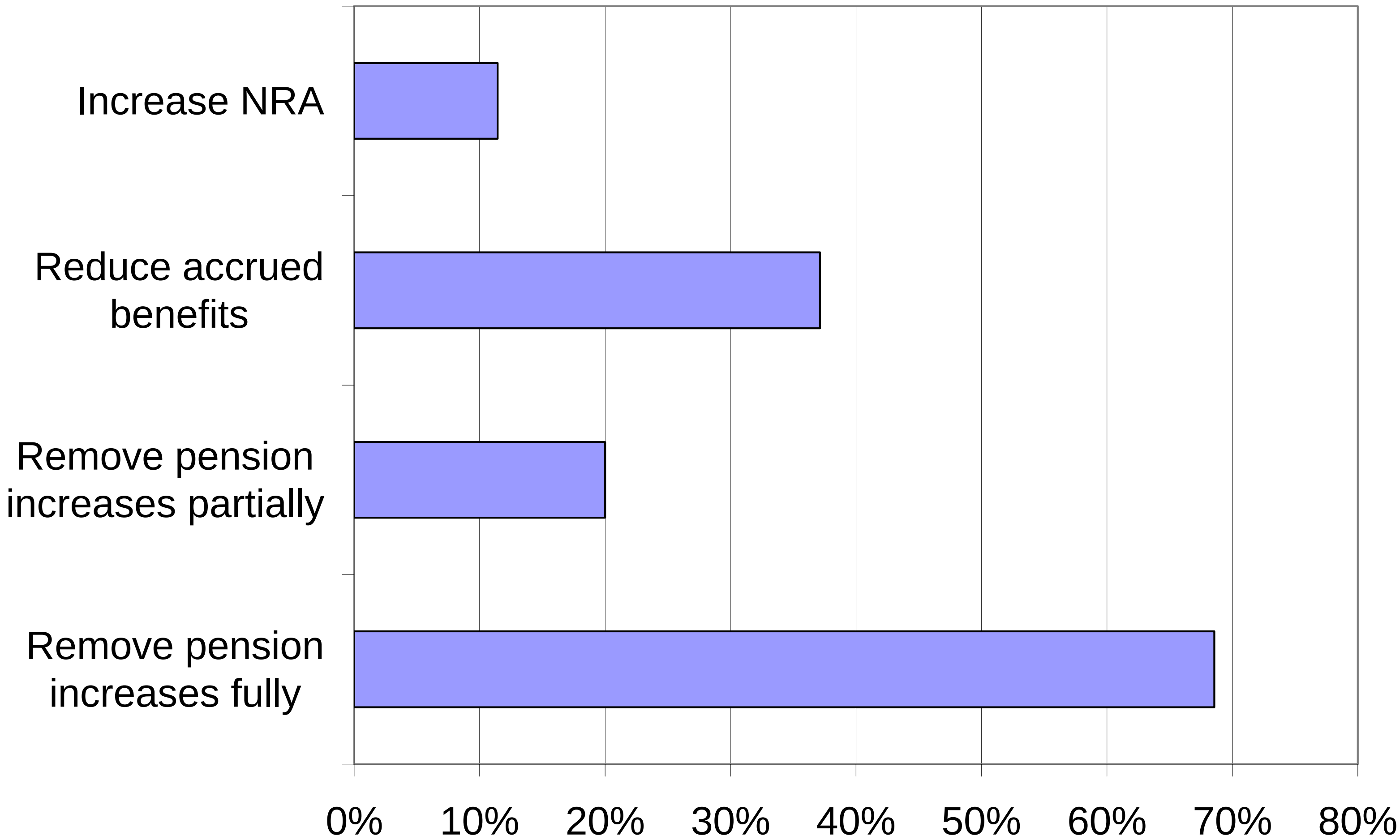
September 2010

Snapshot of Mercer clients – September 2010

- Proportion pursuing section 50 lower than earlier survey indications

	% of clients pursuing section 50
Application approved	7%
Application made	5%
Member consultation in train	40%
Options still being considered	48%

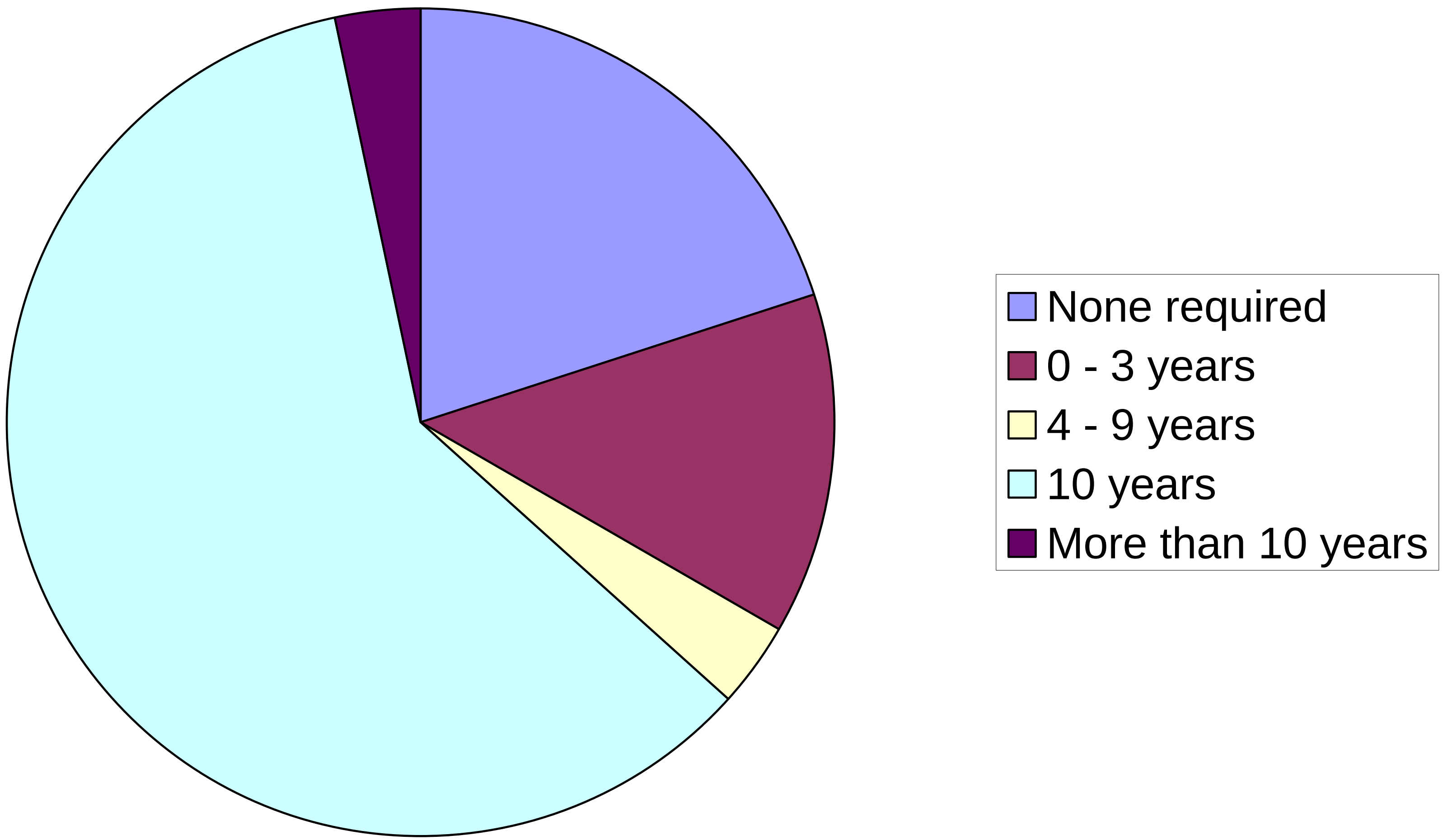
Proposed benefit changes



Issues

- Removing or curtailing future pension increases is by far the most common change
  - Impacts all member categories but perceived by other member categories to mostly impact current pensioners
  - Little push back in current market conditions but inflation may return
- Raising NRA not a mainstream option in spite of proposed increase in State retirement age
  - May not require a Section 50 order in any event (other than to counteract preservation requirements)
- A number of schemes are reducing accrued benefits by freezing pensionable salaries, but there is no facility to withhold statutory revaluation

Duration of accompanying funding proposal



Future investment strategy

- Evidence that most schemes pursuing section 50 plan to substantially or wholly de-risk over a relatively short timeframe

What next?

What next?

- Increase in annuity prices over the course of the summer has impacted planned section 50 and funding proposal applications
- “Sovereign annuity” proposal still on the table
- Deadlines fast approaching – potential action by the Board if these are missed:
  - *“In the event of schemes not submitting…applications by the deadline, the Board will be obliged to consider using its statutory powers… These include the power under Section 50 to unilaterally direct the scheme trustees to reduce benefits…”*

MERCER

MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN