THE IRISH INSTITUTE OF PENSIONS MANAGEMENT

De-risk the Defined Benefit Pensions – Collaboration of all stakeholders

Defined benefit pension is a top issue for management

FINANCIAL CRISIS

INCREASING REGULATION

NEED FOR GREATER CONTROL AND UNDERSTANDING

3

Pension risks are important and need to be managed jointly

REGULATION

INTEREST RATE

LONGEVITY

DESIGN

FINANCIAL MARKET

CURRENCY

REPUTATION

INFLATION

OPERATION

THE IRISH INSTITUTE OF PENSIONS MANAGEMENT

Opportunity for HR and Finance to work together

COMMON OBJECTIVE

Operational risk

People risk

Compliance risk

HR to design the benefits

- Retain
- Attract
- Motivate

Finance to fund the benefits

- Cost
- Effectiveness
- Efficiency

Financial risk

Market risk

Strategic risk

Pension de-risking process is dynamic

Finance, Risk Management and HR need to utilize a spectrum of solutions to de-risk the risk exposure of corporate defined benefit pension benefits

Design Solutions

HR driven pension plan design changes to reduce future exposures

Investment Solutions

Finance driven investment solutions acquired to manage the investment risk exposures

Insurance Solutions

Risk management and finance driven insurance solutions utilised to mitigate the longevity or entire risk exposures

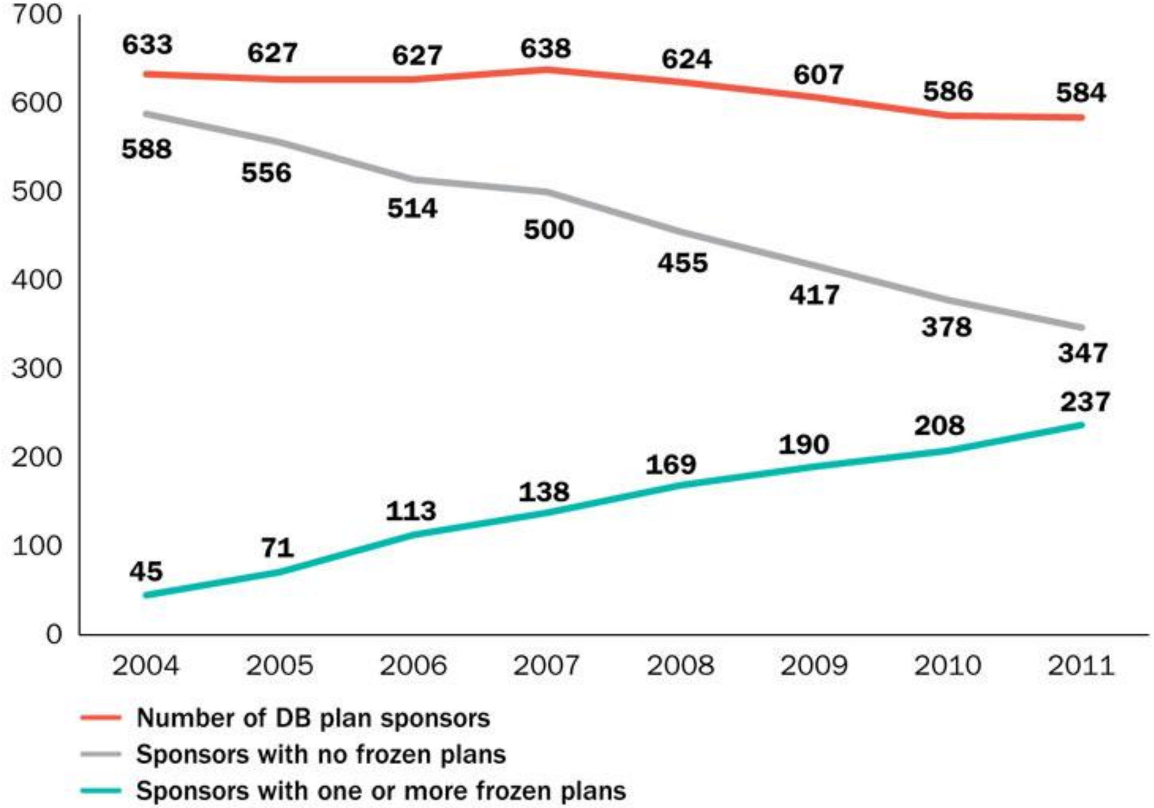
- Pension plan redesigned to reduce future accruals of risk exposures
- Freeze / close pension plans to reduce / eliminate future accruals
- Cash out participants to reduce the already accrued risk exposure

- Increase fixed income allocation to reduce interest rate risk exposure
- Increase fixed income duration to better hedge interest rate exposure
- Utilising derivatives to fully hedge the interest rate risk

- Purchase pension bulk annuities as buy-out / buy-in contracts to transfer risk exposures
- Utilising company's captive insurance company to centralize pension financing
- Utilising longevity swaps / insurance to mitigate longevity risk

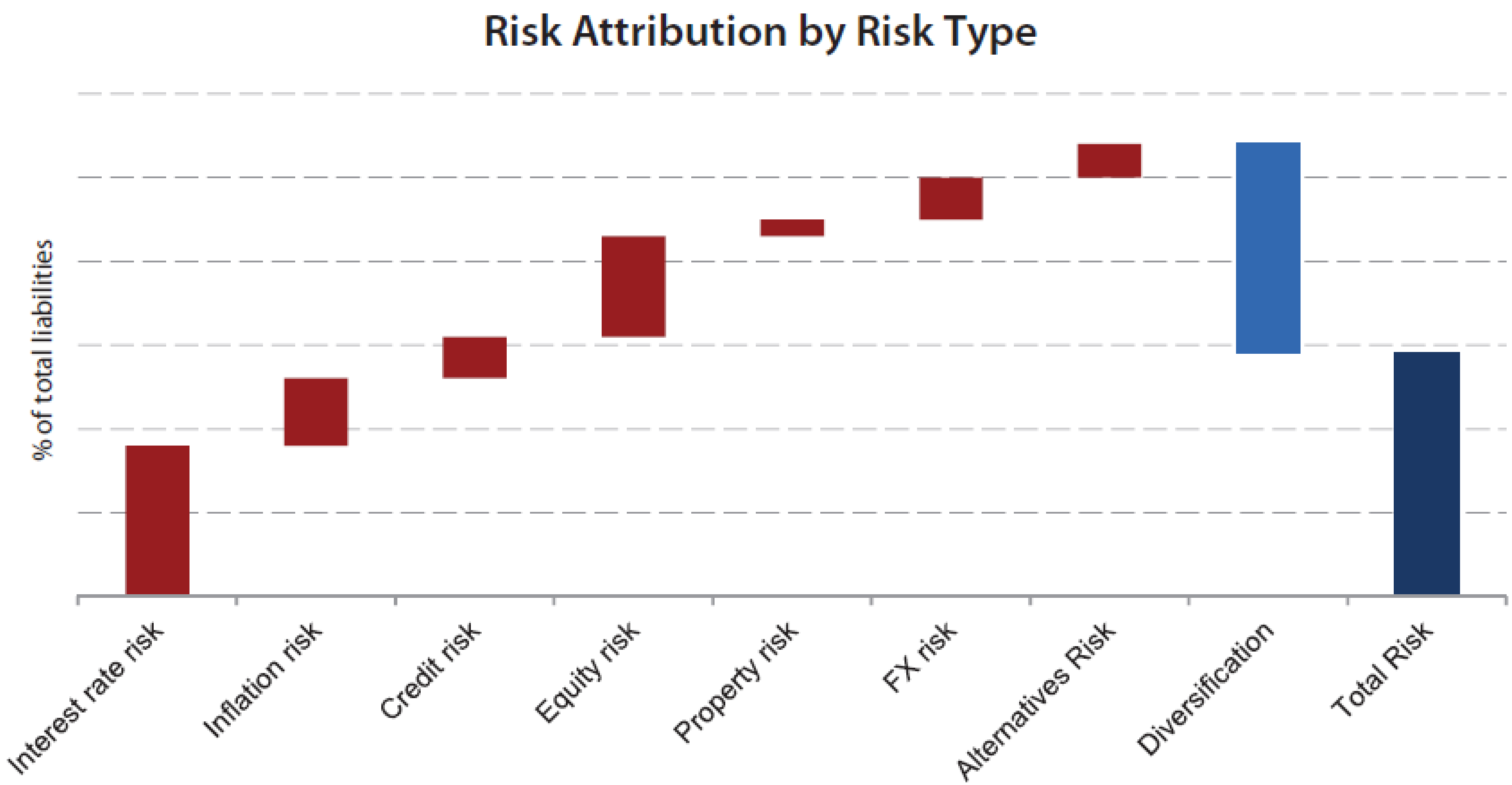
De-risking Trends

Figure 1. DB plan sponsorship among the *Fortune* 1000, 2004–2011

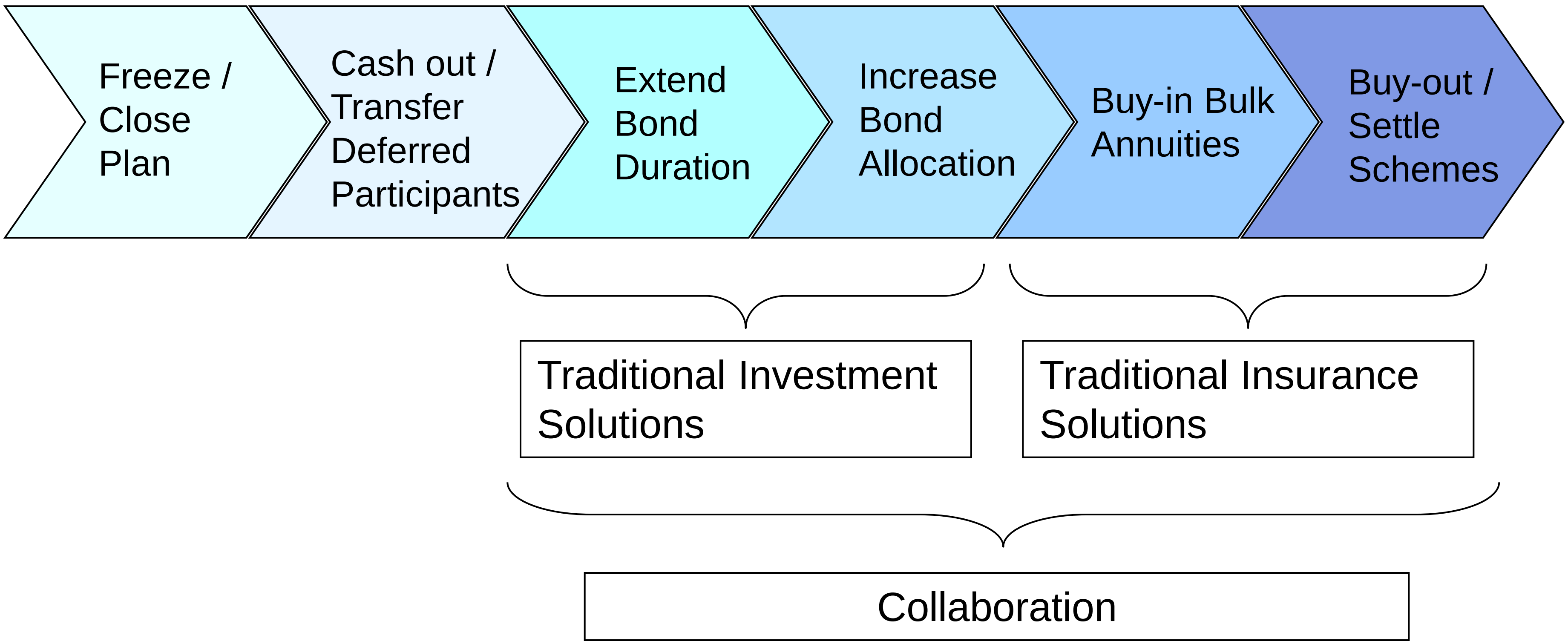


Source: Towers Watson.

De-risking Trends

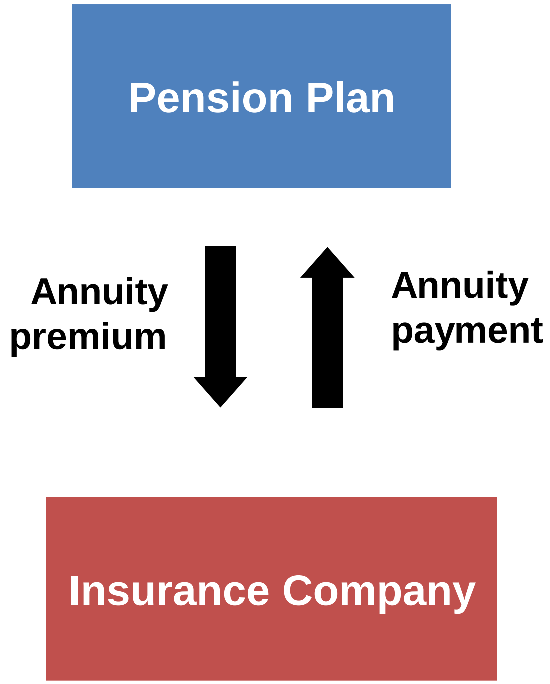


De-risking Trends

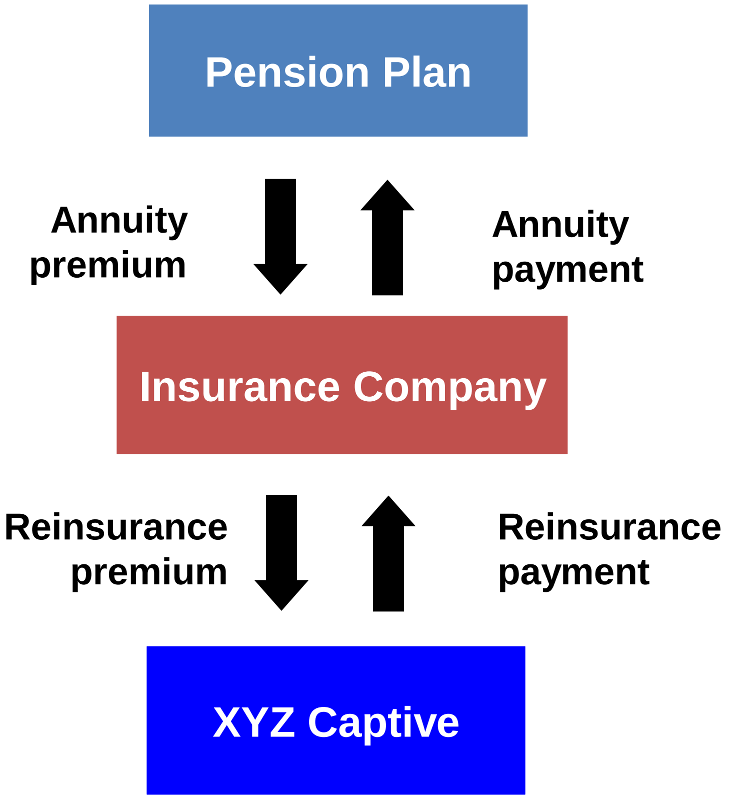


De-risking Trends

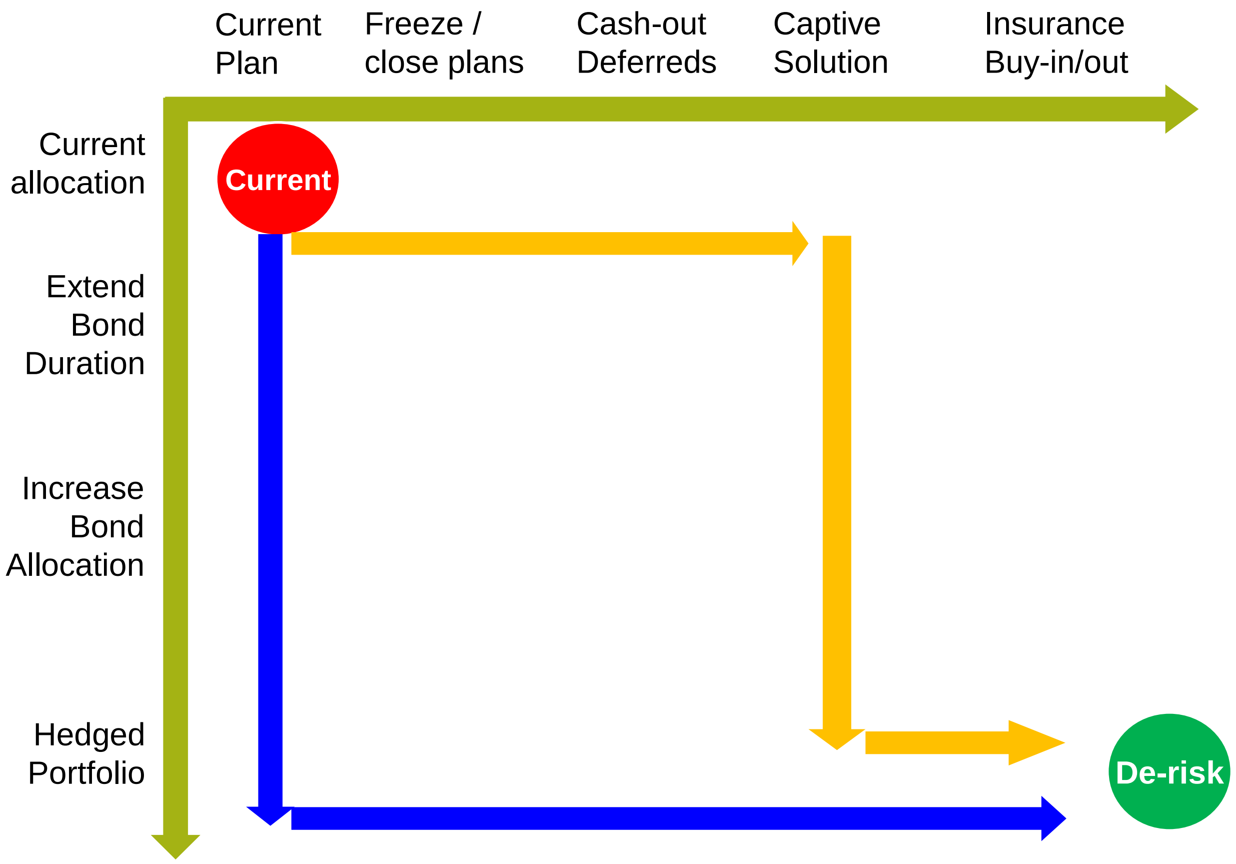
Pension Annuity



Pension Captive



Collaborative Approach

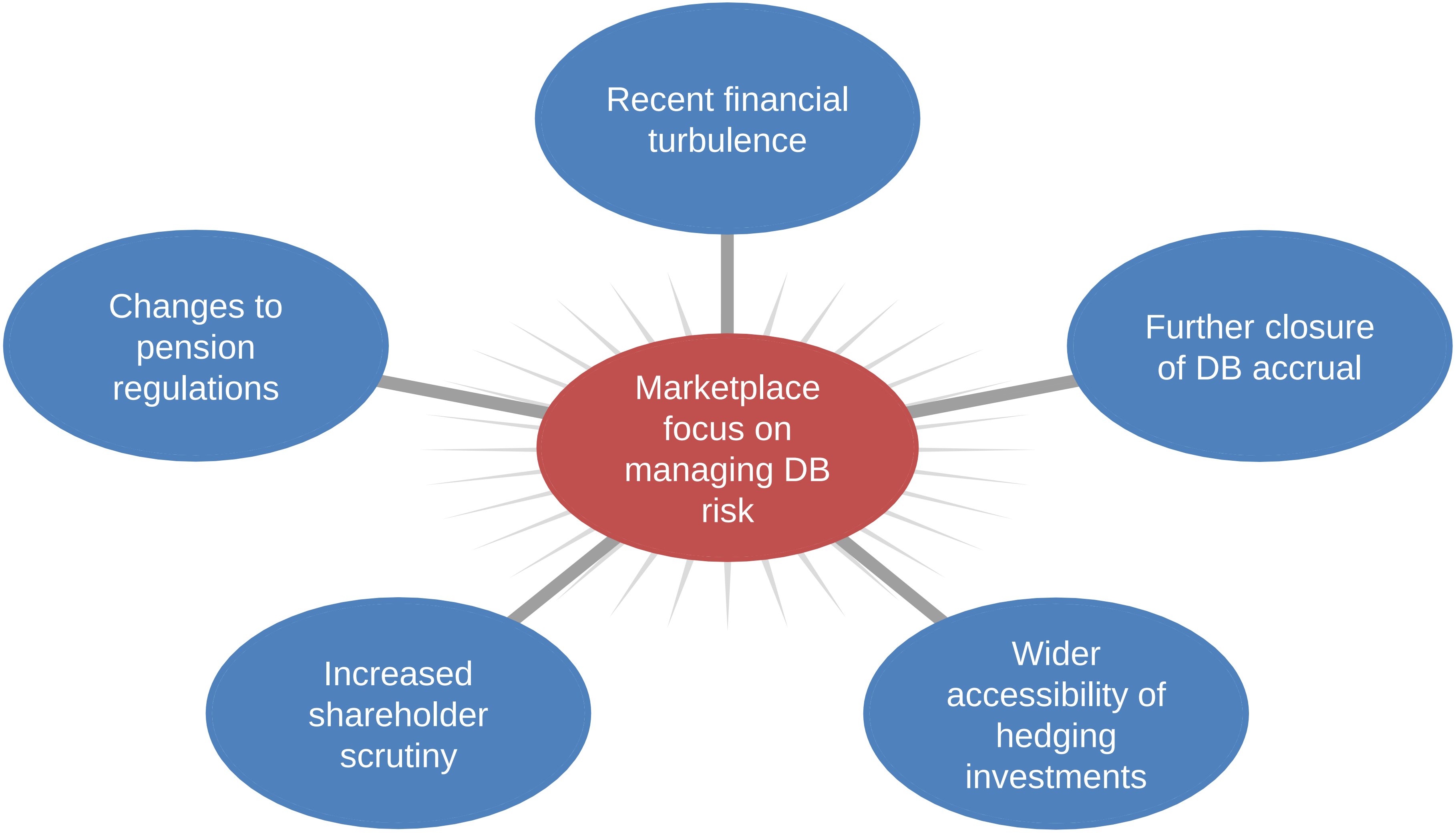


Capabilities

DERISKING OF PENSION FUNDS

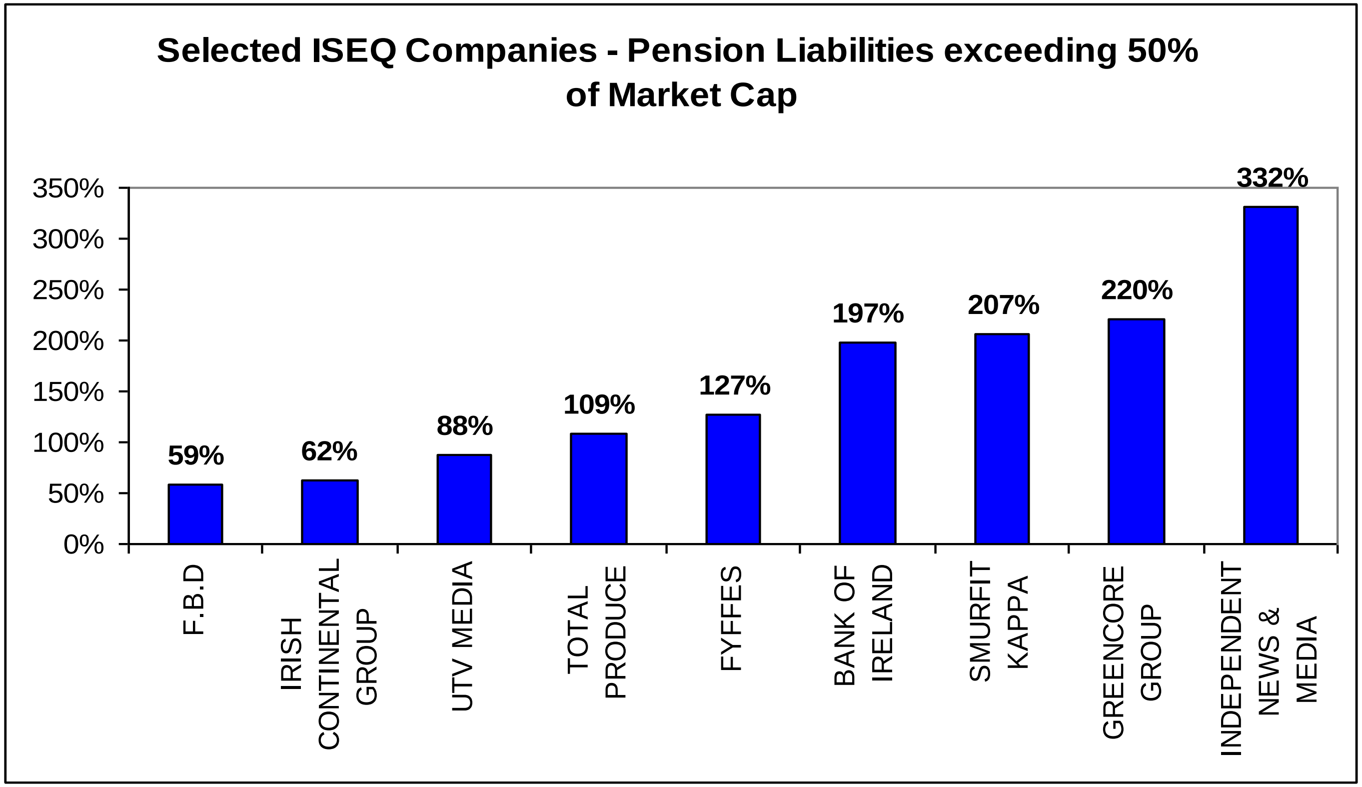
FOCUS ON IRELAND

Managing DB Risk



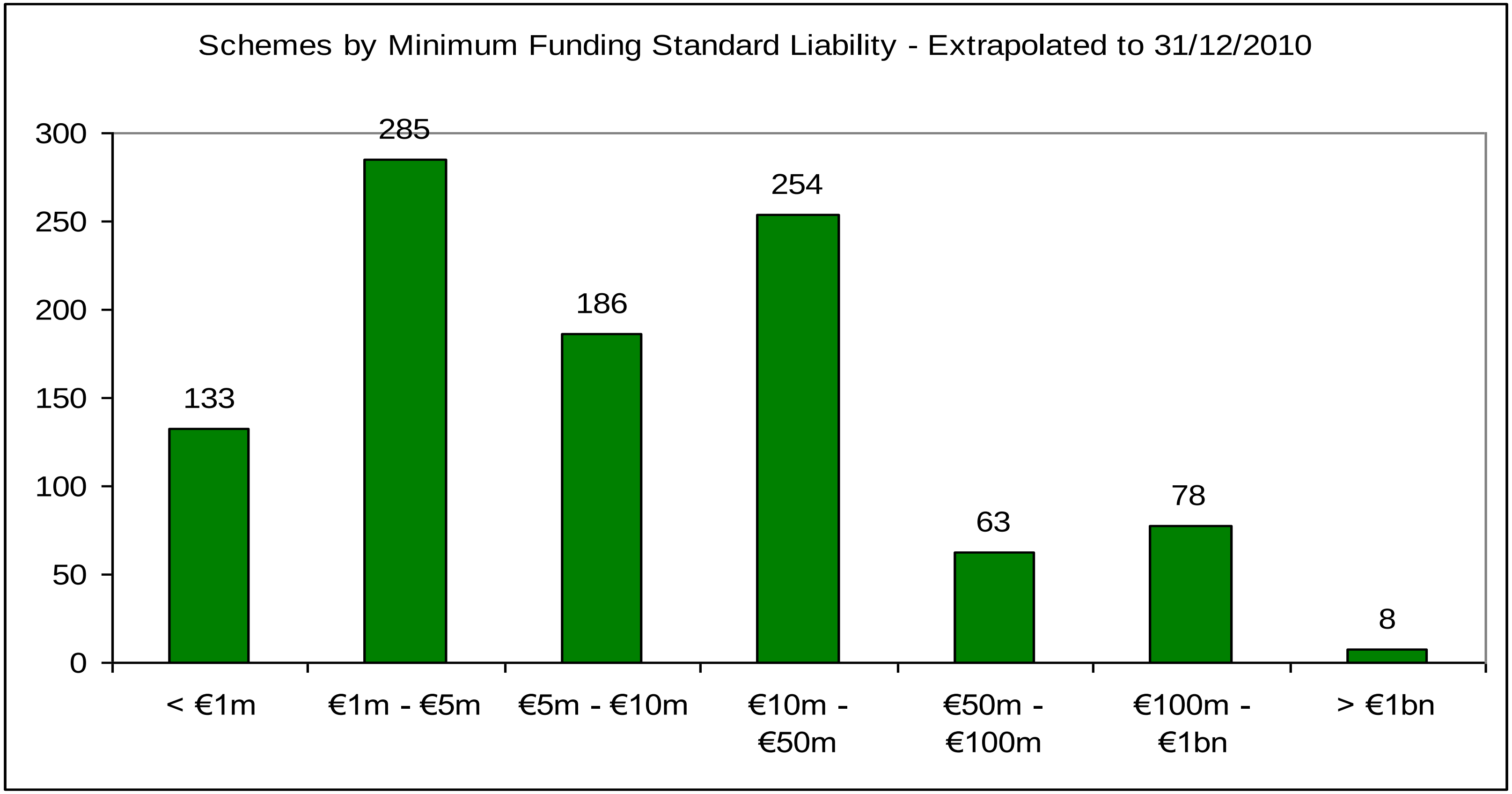
Pension Risk & Irish Corporates

- ISEQ companies had pension scheme deficits of c. €4bn at end 2011
- Pension risk is a material issue for many Irish plcs



Size of Irish Pension Schemes

- Over 85% of pension schemes had liabilities of €50m or less at end 2010



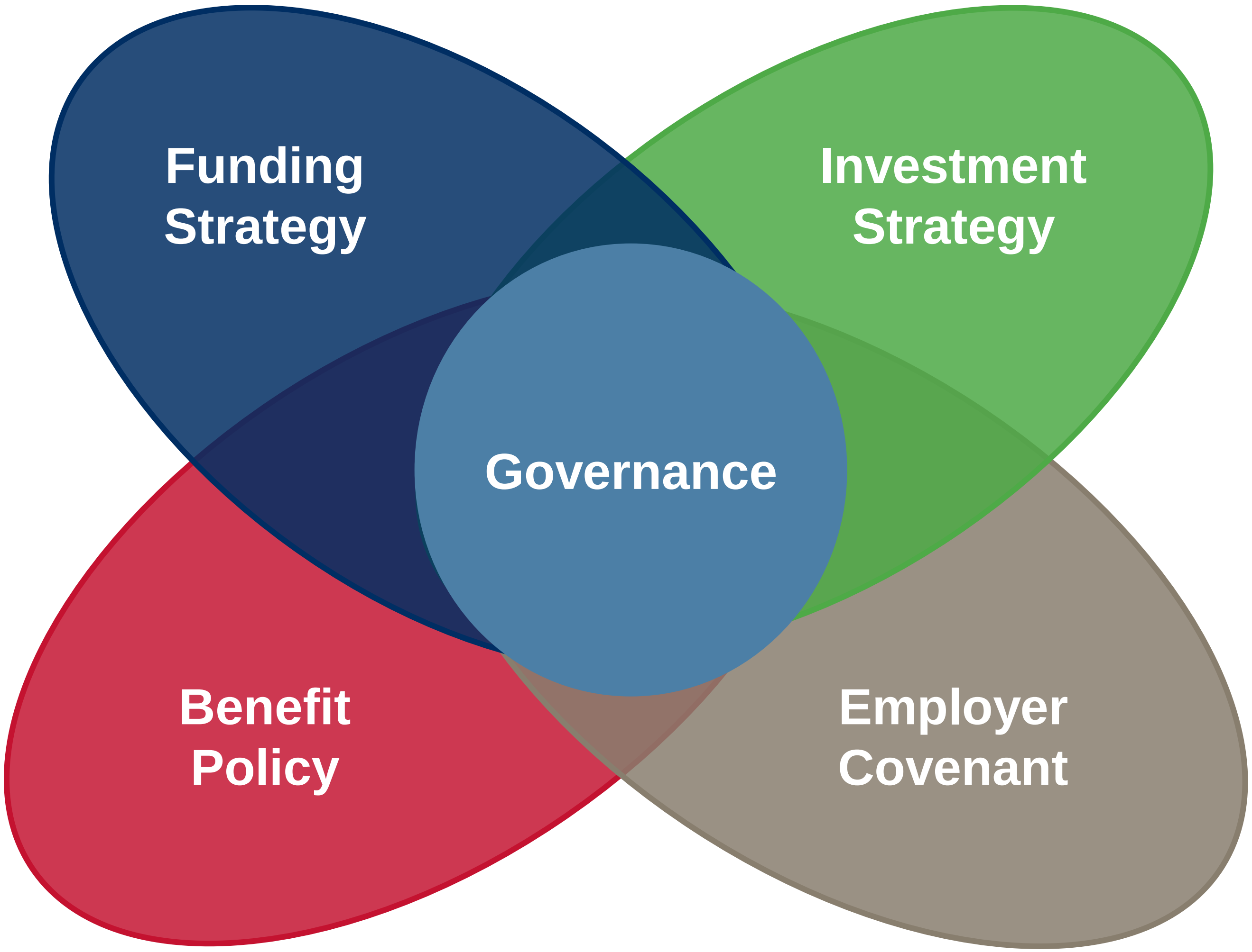
- Source: Pensions Board Defined Benefit Survey 2010

Irish Pension Legislation & Regulations

- New regulations & guidance recently released
- Introduced need for schemes to hold a “Risk Reserve”
  - Will likely encourage a move from equities to EU sovereign bonds
- Sovereign annuity concept also introduced
- Lack of Debt on Employer for schemes winding up in deficit

Pension Risk

Factors to Consider

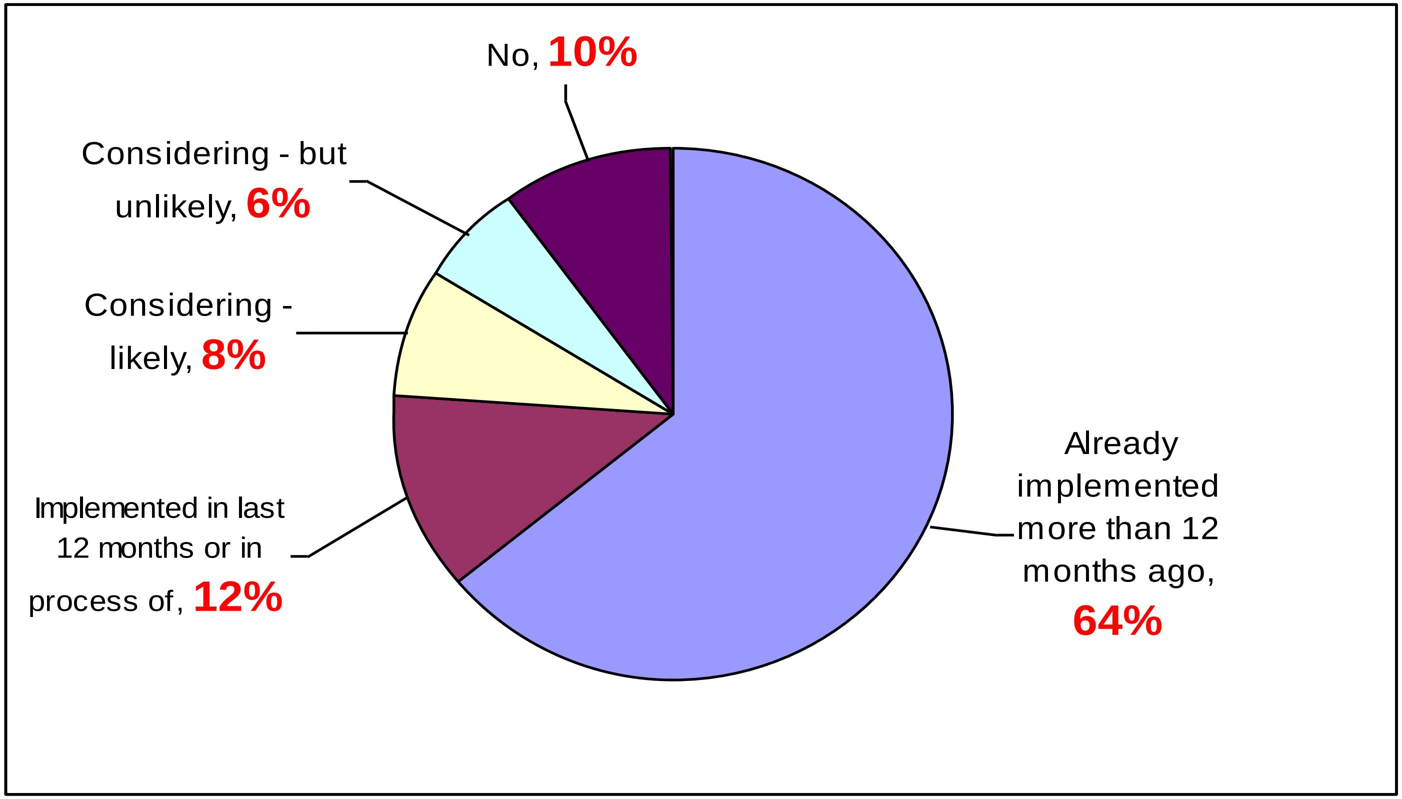


Benefit Policy

- Initial area of focus for managing DB risk
- Range of actions taken by pension scheme sponsors, including but not limited to:
  - Closure to new entrants
  - Reduce future service benefits (e.g. CARE)
  - Cease future accrual
  - Reduce past service benefits (Section 50)

Benefit Policy

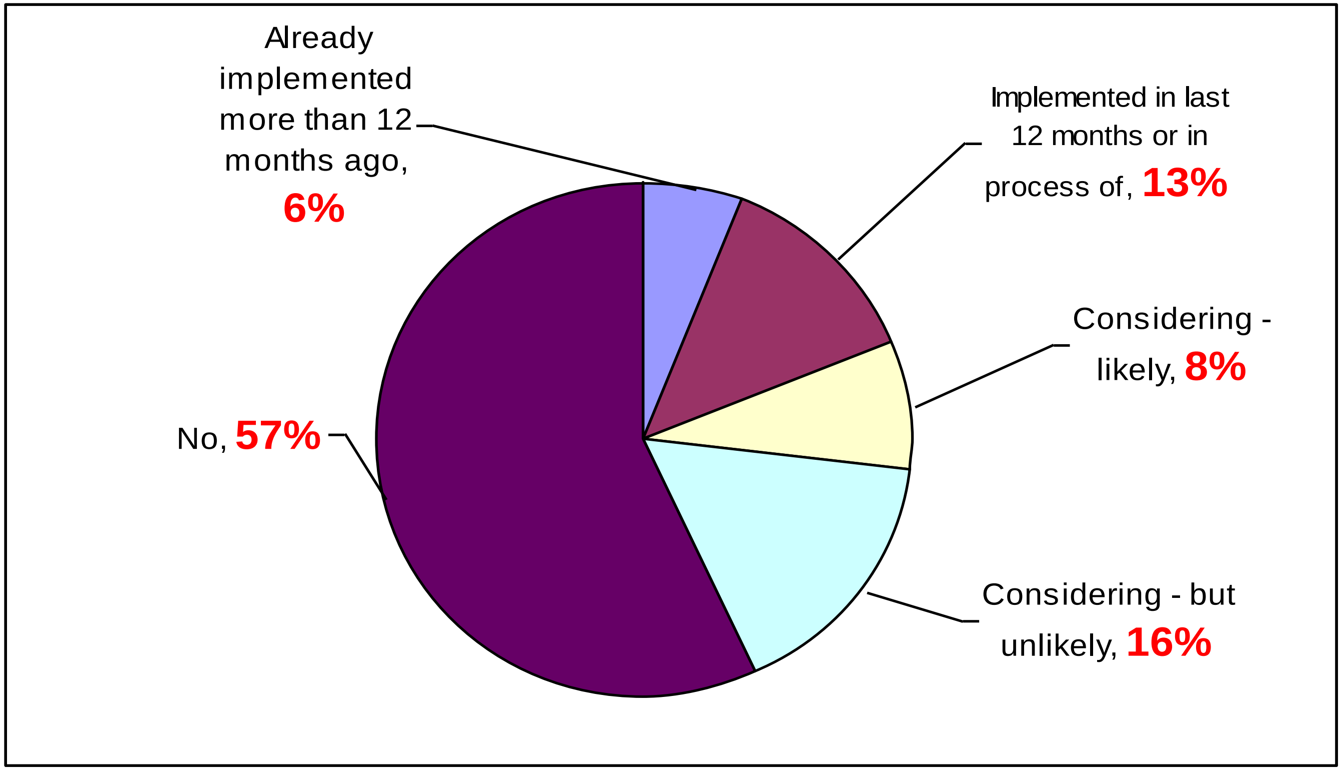
- Closures to new entrants



- Source: Irish Association of Pension Funds Short Survey 2011

Benefit Policy

- Closures to future accrual



- Source: Irish Association of Pension Funds Short Survey 2011

Funding Strategy

- Traditionally involved Employer paying a contribution rate that varied with scheme's funding position
- Many now paying maximum affordable contribution
- Other funding options therefore being considered
  - Contingent Assets
  - Unsecured Employer Undertakings
    - To cover new Risk Reserve requirement
  - Special Purpose Vehicles
    - Using Company assets to generate cashflow stream

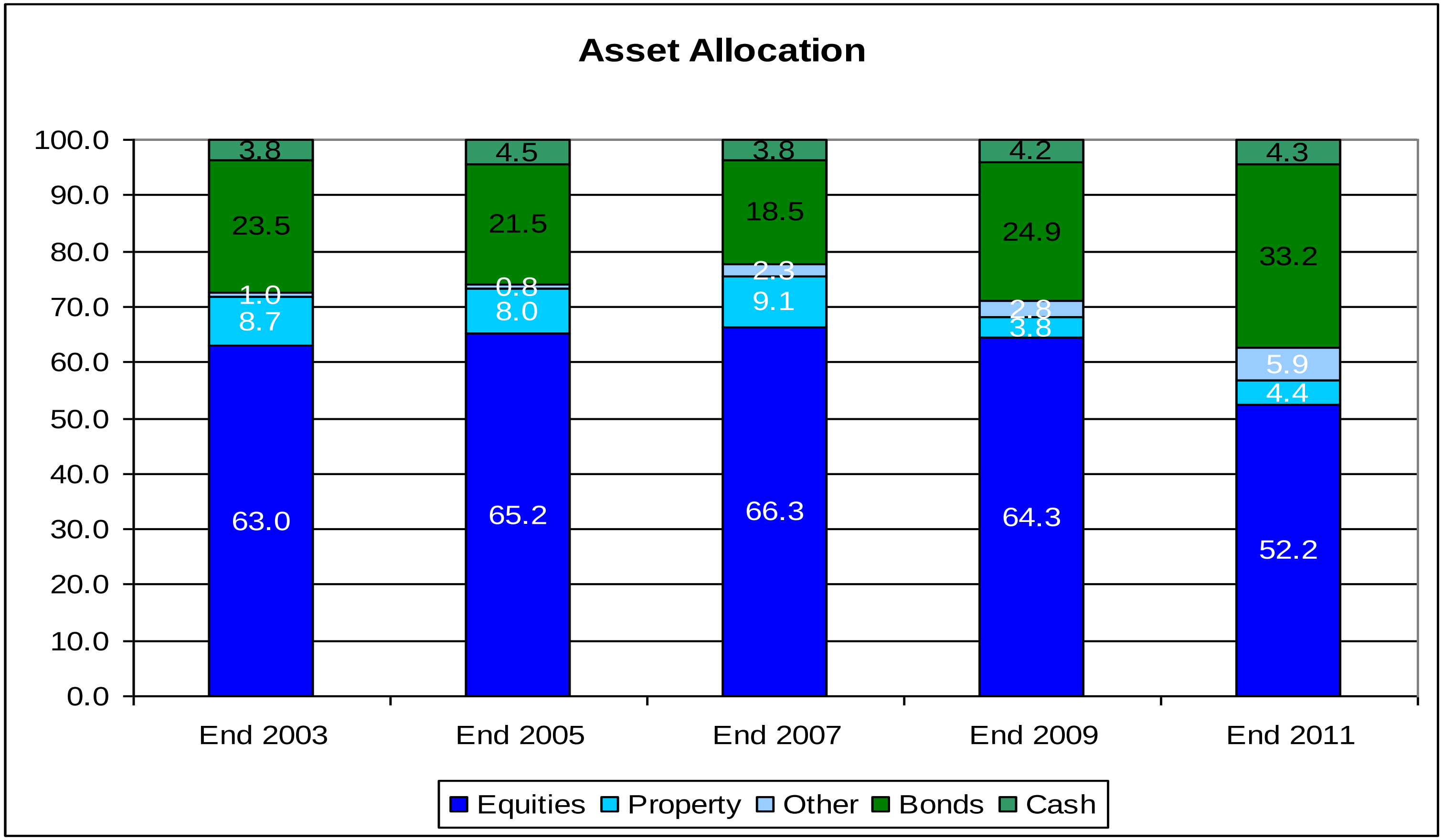
Investment Strategy

Why take investment risk?

- **Trustees' Perspective:**
  - – Excess return can improve the funding level
  - – High investment return can improve member benefits (e.g. provide discretionary benefits)
- **Company Perspective:**
  - – Higher investment returns can reduce contributions
  - – Leads to lower P&L accounting charge
    - Although accounting rule changes remove this incentive from 2013 onwards

Investment Strategy

- Move towards lower risk assets in recent years



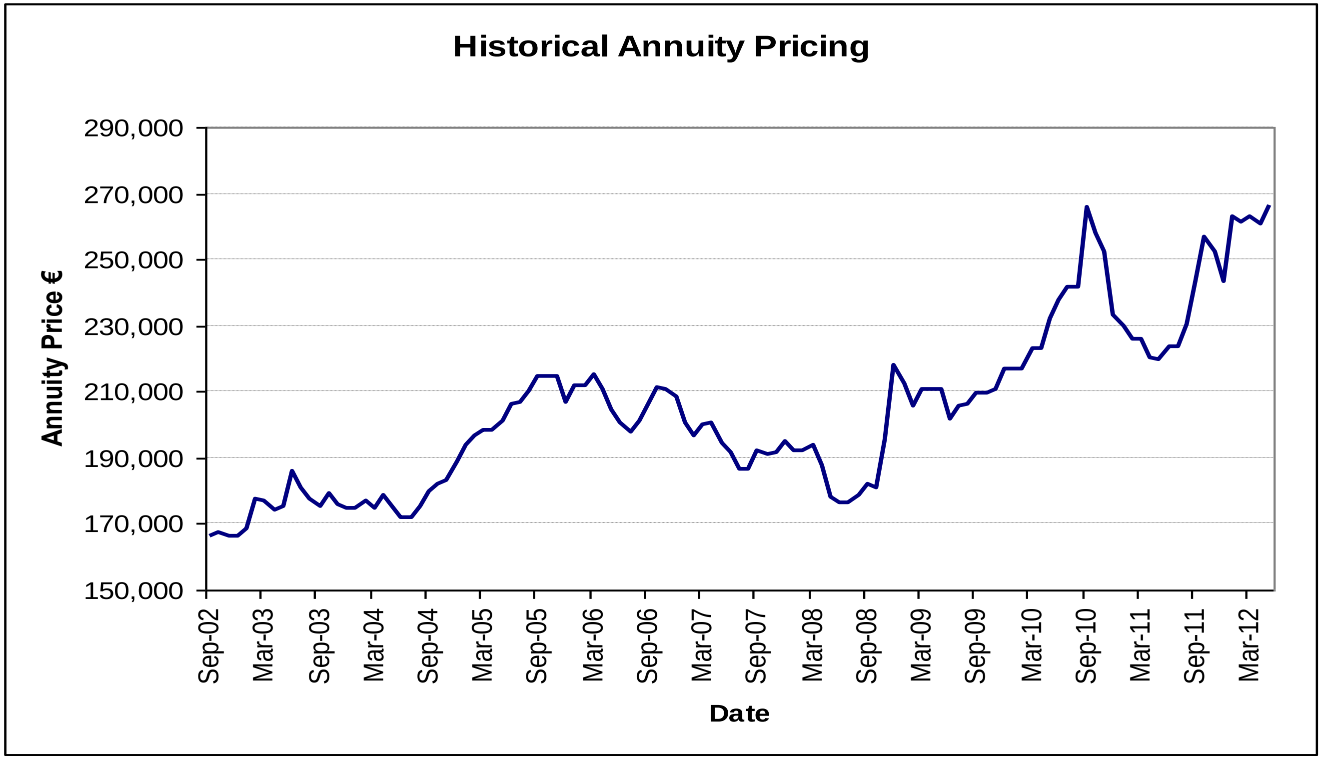
- Source: Irish Association of Pension Funds Asset Allocation / Investment Surveys

Pension Risk
Risk Transfer

- Various ways of transferring risks associated with operating a pension scheme to the members / insurers
  – Paying transfer values (standard or enhanced)
  – Annuity purchase (deferred or immediate)
- Annuity purchase most common method, although still mostly used on scheme wind-up

Risk Transfer
Annuity Purchase

- Traditional annuity pricing near all-time highs

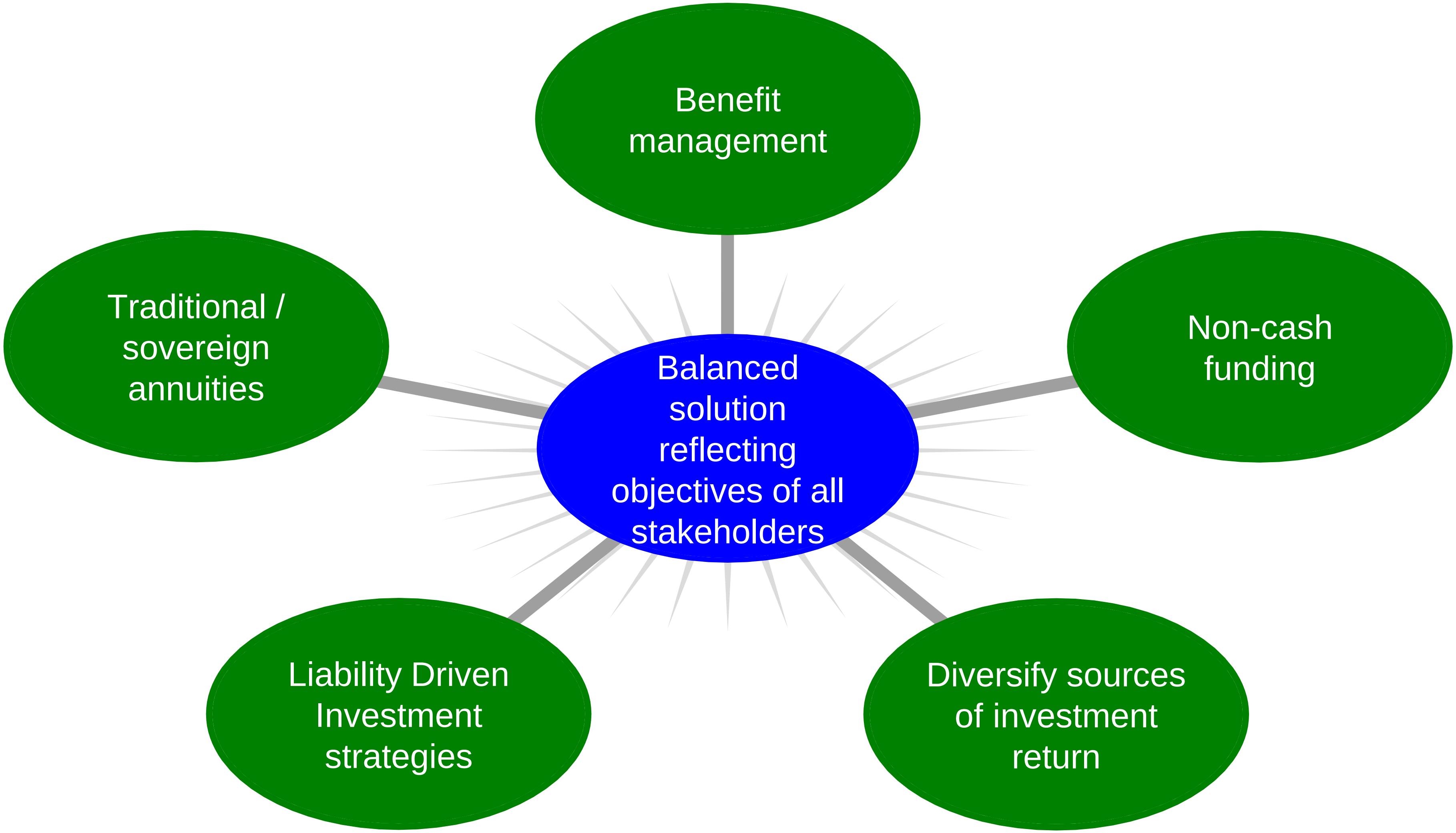


* Graph shows the cost of buying a pension of €10,000p.a. for a male aged 55, with a five year guarantee and an attaching 50% reversionary annuity (husbands assumed to be 3 years older than wives)

Pension Risk
Focus on Sovereign Annuities

- Sovereign annuity concept recently launched in the Irish market
- Schemes have option of buying sovereign annuities
  - Priced off Irish bond yields
  - Leading to a material reduction in the value of pensioner liabilities (c. 20% - 30%)
- **BUT…**
- A default / restructure of Irish sovereign debt is borne by annuity holder

Derisking of Pension Funds - Options



THE IRISH INSTITUTE

OF PENSIONS MANAGEMENT