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DEFINED BENEFIT PENSION SCHEMES

Future Risk Management Challenges for Trustees

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Overview

* 2013 – an unprecedented year
* 2014 – what happens next?
* Risk Management

Pensions Environment

- At start 2013 c.80% of defined benefit schemes in Ireland fail to meet the Minimum Funding Standard (MFS)

- Pensions Board had suspended the requirement to submit a funding proposal since 2008

- The deadline was reintroduced and suspended several times over the intervening period but reintroduced with effect from 30 June 2013

- C.50% of defined benefit schemes fail the MFS at the end of 2013

- Changes to the priority order on the scheme wind up

- Pensions becoming a hot topic in LRC and there are a number of pending court cases

Defined Benefit Scheme Funding Levels – Good News

* Strong performance on equity portfolios increasing value of scheme assets
- MSCI World Index up 22%
- ISEQ up 34%

* Annuity prices have fallen by c.5% driven by fall in underlying long dated bond yields

* Overall defined benefit schemes would expect to have seen funding levels improve significantly over 2013

Regulatory Changes

* Pensions Board re-imposes deadline for underfunded DB schemes to submit funding proposals
* Reduced Risk Reserve requirement
* Change in priority order on scheme wind up
* Tougher stance for longer FPs
* Reduction in Standard Fund Threshold (SFT)

Change to Priority Order

- Since the introduction of the MFS it has not been possible to reduce pensions in payment
- This generally resulted in an inequitable distribution of assets on wind between pensioners and non pensioners in underfunded schemes
- Trustees can now address this imbalance when a scheme winds up
- Increasingly puts pressure on trustees to make difficult decisions

Reduction in Pensions

- No reduction in pensions of less than €12,000 p.a.

- 10% reduction in pensions between €12,000 - €60,000 p.a.
- Subject to a minimum pension of €12,000

- 20% reduction in pensions greater than €60,000
- Subject to a minimum pension of €54,000 p.a.

Risk Reserve

* From 1st January 2016 schemes obliged to maintain a Risk Reserve
* Risk Reserve designed to act as a buffer against adverse market movements
- Falls in equity markets
- Falls in long dated core eurozone bond yields
* Impact of Risk Reserve can be reduced through a matching investment strategy
* However, a matching strategy will increase cost of funding

2014 – what next?

* DB schemes will have agreed funding proposals
* Contribution and de risking plans agreed for the next 10 years in some cases
* Some will have been forced into wind up
* Trustees and sponsors may think……..


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2014 – what next?

* Continued double digit return on equity indices are unlikely to continue for prolonged periods

* Schemes may go “off track” and have to negotiate changes to existing funding proposals

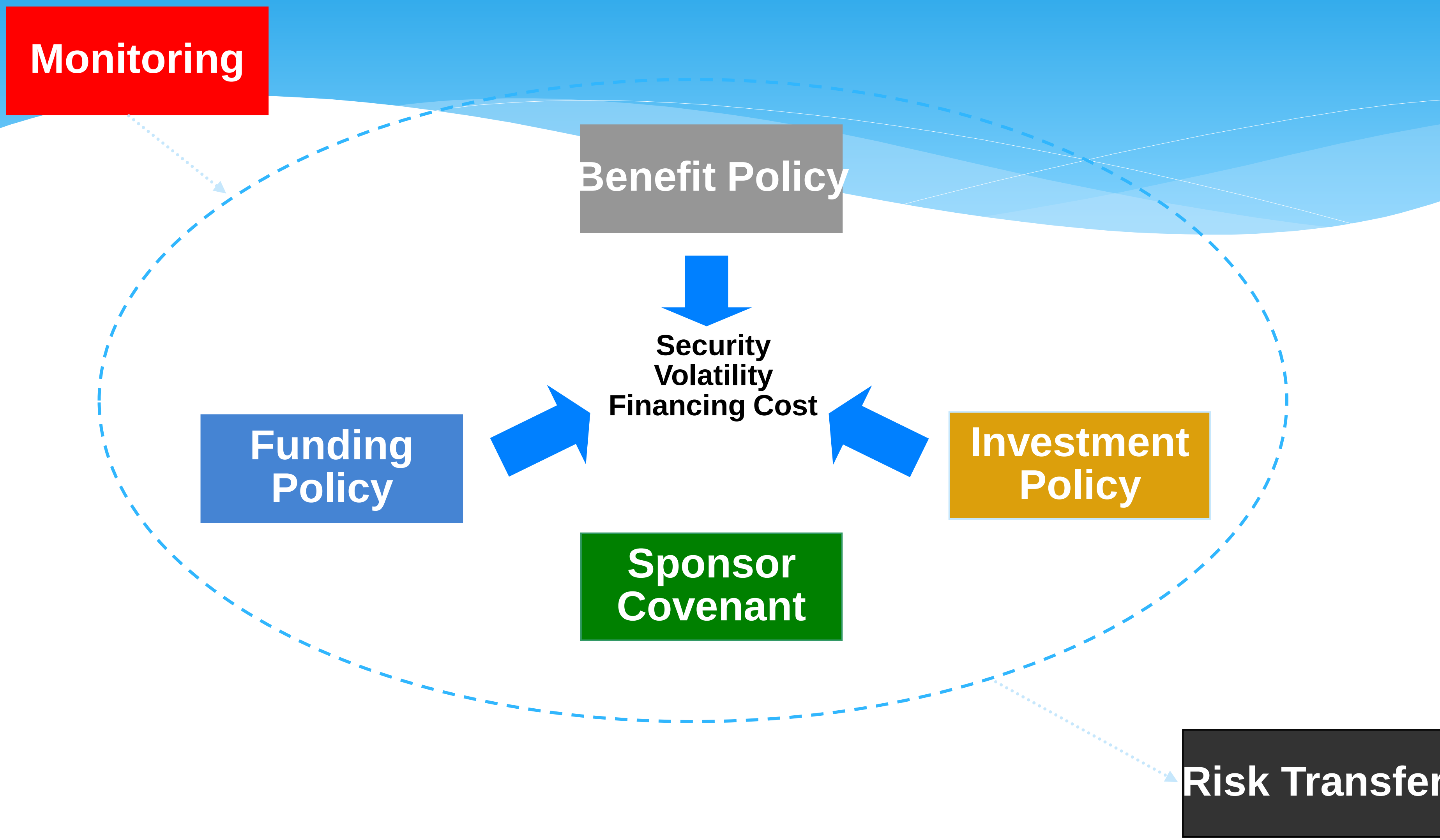
* Further regulatory changes may occur

* Outcome of high profile court cases may influence future policy
- Element 6
- Omega Pharma
- Waterford Crystal

Risk Management

Future Risk management challenges for Trustees and Sponsors of DB Schemes

DB Risk Framework



Areas for consideration

Sponsor Covenant	Covenant assessment Company guarantees
Benefit Policy	▪ Future benefit accrual policy ▪ Adjustment to accrued benefits ▪ Managing discretionary powers, non-hedgeable risks (e.g. salary increases)
Funding Policy	▪ Employer contribution levels ▪ Employee contribution levels ▪ Contingent assets ▪ Non-cash funding (e.g. Company assets), non-traditional funding (e.g. SPVs)
Investment Policy	▪ Return-Seeking / Risk-reducing split ▪ Interest rate / inflation hedging ▪ Diversifying sources of return ▪ Timing issues ▪ Hot topics
Monitoring	▪ How often should monitoring take place? ▪ Daily; Monthly; Quarterly; Annually ▪ Updates on market trends / significant events (e.g. developments in buy-out market) ▪ Demographic profile, and changes therein
Risk Transfer	▪ Annuity buy-out / buy-in ▪ Enhanced transfer values / transfer values to deferreds with small benefits ▪ Longevity solutions ▪ Wind-up

Identify key risk factors

Equities
Corporate bonds
Alternative investments

Take those that are expected to be rewarded

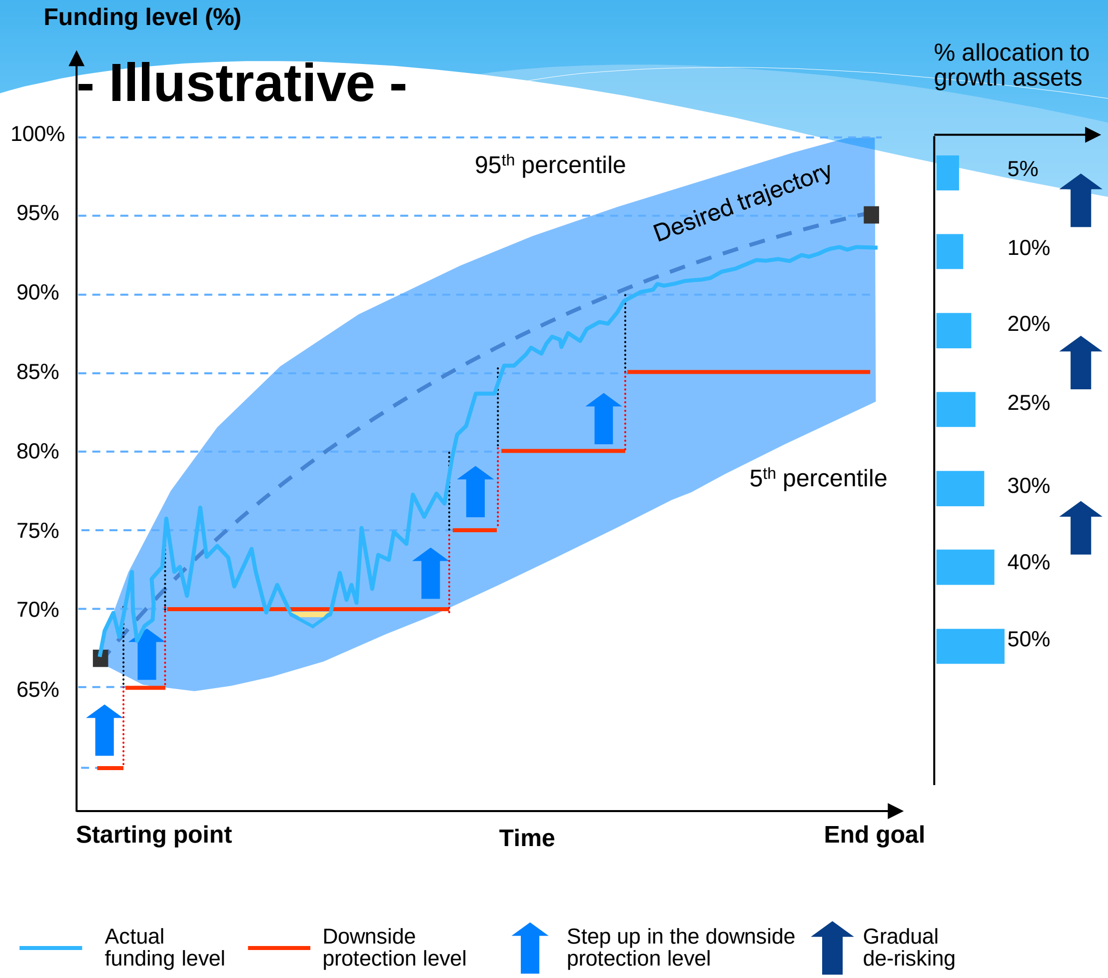
Inflation risk
Interest rate risk
Mortality risk

Mitigate unrewarded risks

Sponsor risk
Demographic risk
Regulatory risk

Monitor those that cannot be removed

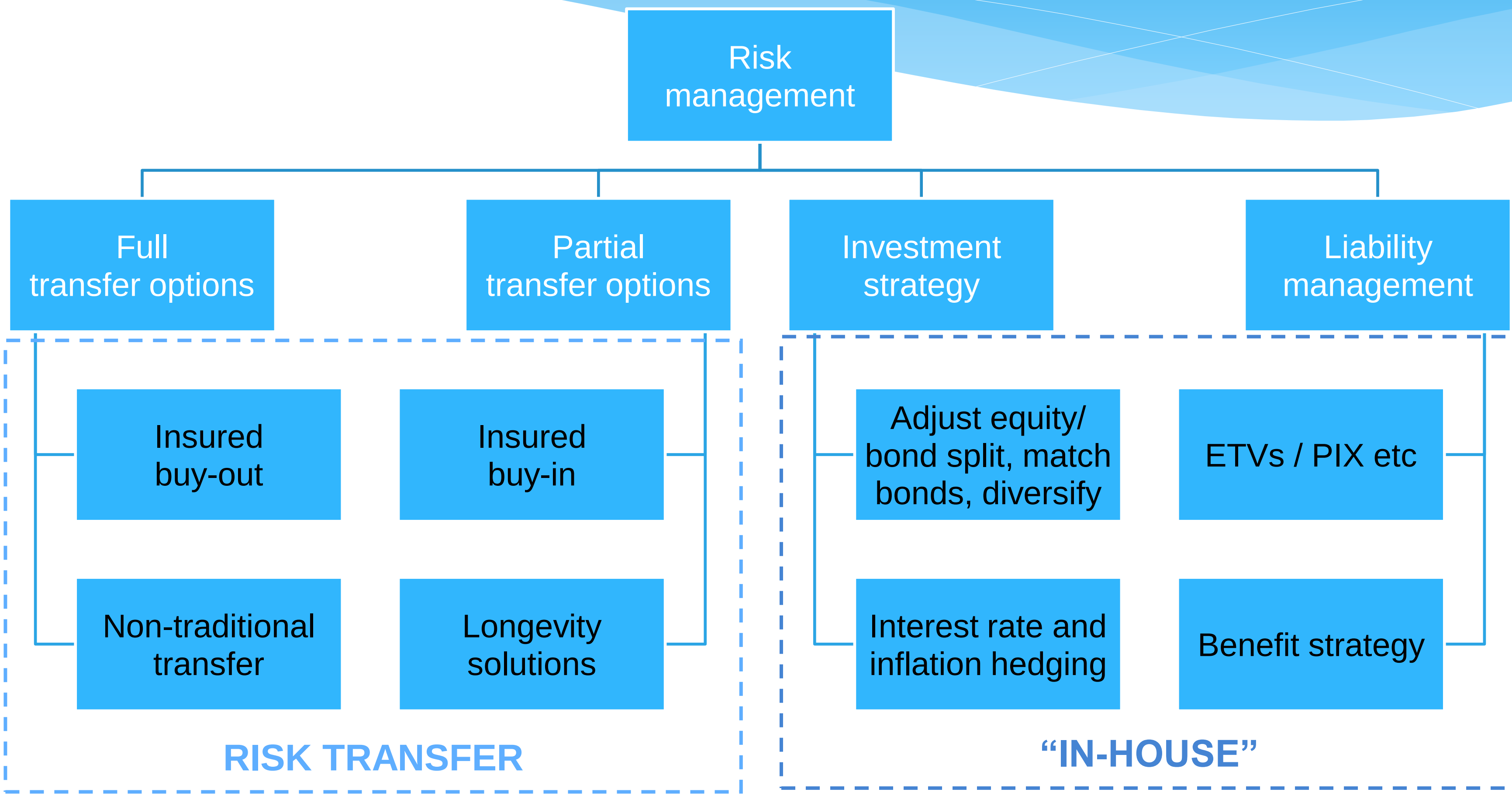
Dynamic De-risking Approach



Commentary

- Specify a time horizon, risk appetite and target funding level
- Use this information to define a path appropriate for the scheme
- The funding level is monitored daily, weekly, monthly, quarterly etc.
- As funding levels improve, de-risking steps are taken by reducing assets held in the growth portfolio
- If funding level falls below the downside protection level then a strategy is implemented to reduce further losses

The broad array of alternatives



Key Objectives for Trustees & Sponsors

* Understand the risks associated with their DB schemes
* Consider whether they are being rewarded for the risks that they are taking
* Set up a framework in which risks can be monitored and action taken were necessary

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