

IAPF



Investment Seminar

Funding Proposals – Investing to Recovery & Beyond



MERCER



MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

David O'Sullivan
Financial Strategy Group
Mercer



iapf

Risk Management – Increased Focus

“Too many schemes did not take account of the investment risks they were running in 2008. Too often it seems that schemes’ primary goal is to keep contributions to a minimum and they give little or no thought to risk.”

Source:

Launch of 2008 Pensions Board Annual Report

by Brendan Kennedy (Chief Executive)

“Defined benefit scheme funding must be based on realistic assessments of investment returns and of life expectancy. It is not appropriate for trustees to focus solely on minimizing contributions and satisfying the funding standard: a scheme needs to be sustainable for the long term, and trustees must therefore consider realistic costs, investment risks, and the ability and willingness of the employer to support the scheme”.

Source:

2008 Pensions Board Annual Report

Foreword by Brendan Kennedy (Chief Executive)



Investment Strategies – Pensions Board View

- **No single best investment strategy**
- Looking for evidence that the Trustees have
 - **fully considered their investment strategy**
 - **Considered the effect of potential investment losses on benefit security under a number of scenarios**
- Trustees must demonstrate that investment policy is **grounded in sound risk management principles**
- Special consideration will be given to investment risk where the Employer has stated that it is either **unwilling or unable** to pay higher contributions



iapf

What Constitutes a “Fully Considered Investment Strategy”

1. A review of the liabilities of the scheme and its risk profile.
2. Consultation with the Employer in relation to its ability and willingness to underwrite the risk profile identified.
3. Decide on current and likely long term investment policy of the scheme.
4. Assessing the overall target return required to complement the funding policy.
5. Targeting that return with minimum risk.
6. Considering what will happen if the risk doesn't pay off or indeed does pay off.
7. Considering implementation of any change to strategy.



Problems with MFS

- **Weak measure for non pensioners**
 - Fully funded on MFS does not mean ALL benefits can be guaranteed (unless scheme is all pensioners)
- **Prioritisation of pensioner liabilities causes gearing effect if unmatched investment strategy**
- **Difficult to fully hedge MFS liabilities**
 - Not a market based measure
 - Difficult to be “locked down” as a result
 - Implications for any Section 50 applications?



iapf

MFS Liabilities – Implications for Seeking Matching assets

Membership class	Liability “return”
Pensioners	Annuity rates
Others < 10 yrs to NRA	7.75% - 4.50% pa*
Others > 10 yrs to NRA	7.75% pa*

- **No single best matching asset available for non pensioners**
- **“Least risk” portfolio may be a combination of bonds and cash**

* Plus MVA



iapf

Implications of not Being Able to Match

	Assets unchanged		Equities fall 20%	
	Young	Old	Young	Old
Assets*	85	85	73	73
Pensioners	30	70	30	70
Non Pensioners	70	30	70	30
Coverage	85%	85%	73%	73%
Residual coverage	79%	50%	61%	10%

* Assume invested 70% equities, 30% bonds



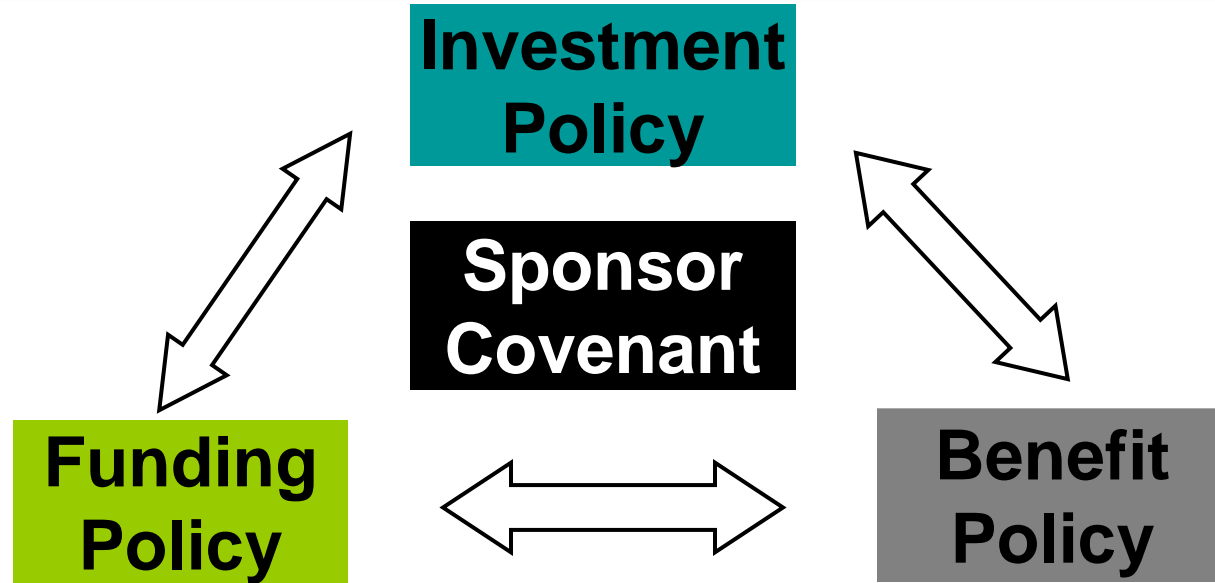
A Better MFS for Investment Strategy Setting??

- **Hedgeable measure of liabilities!**
- **Linked to market interest rates?**
 - Eurozone yields?
 - Irish government bond yields?
- **Benefit increases linked to eurozone inflation rather than CPI?**
 - In the absence of a deep Irish inflation market
- **Mandate funding and hedging a lower level of benefit?**
 - 100% security of a lower level of benefit on wind up
 - Resiliency reserves required if unmatched investment strategy?



iapf

Conceptual Policy Framework for Considering Risk



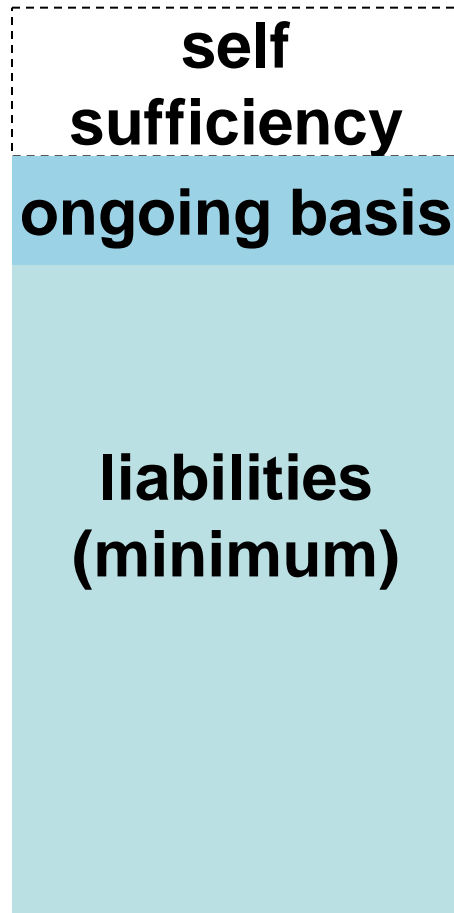
- Risk-taking in one area is inextricably linked to the position in the other two
- All three areas considered together to achieve a balanced solution
- Sponsor Covenant is the fulcrum



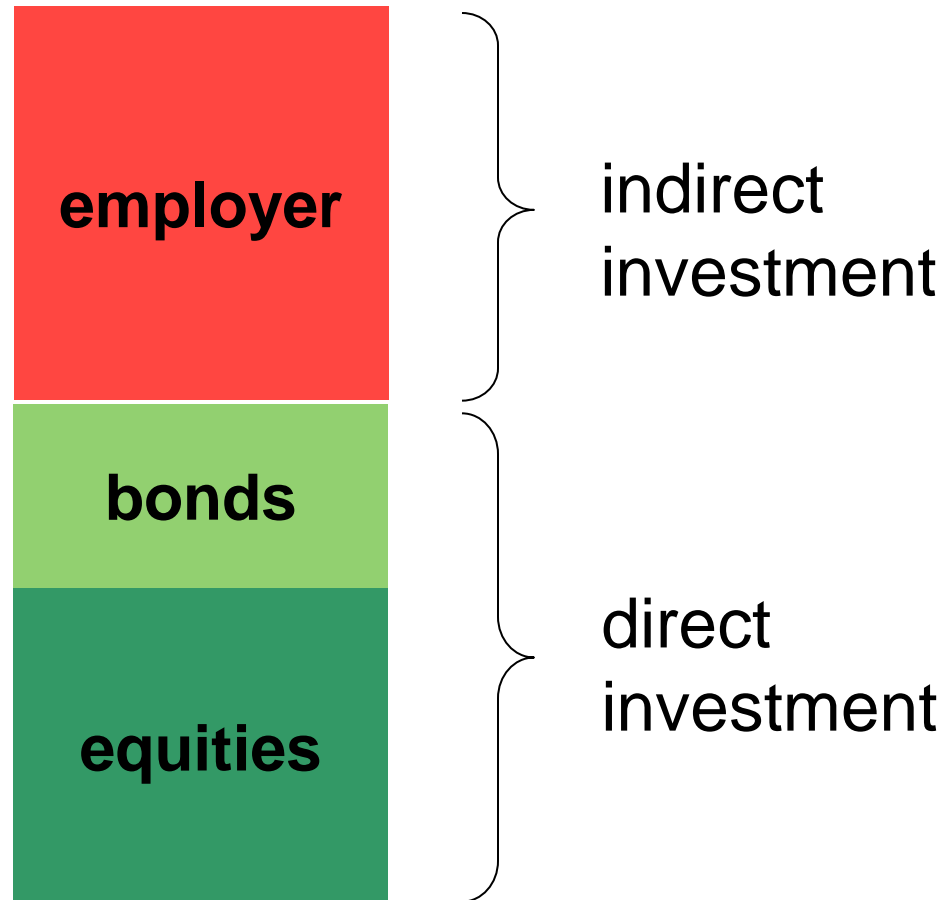
iapf

Sponsor Covenant Risk

Pension Liabilities



Pension Assets





iapf

What if Risk Doesn't Pay Off?

Impact on deficit			Growth Assets				
			-20%	-5%	0	+5%	+20%
Interest Rates	Current Strategy	-1%					
		0					
		+1%					
	Proposed Strategy	-1%					
		0					
		+1%					

- Simple example of the type of risk analysis that Trustees consider on a regular basis



Trustee Questions for Company

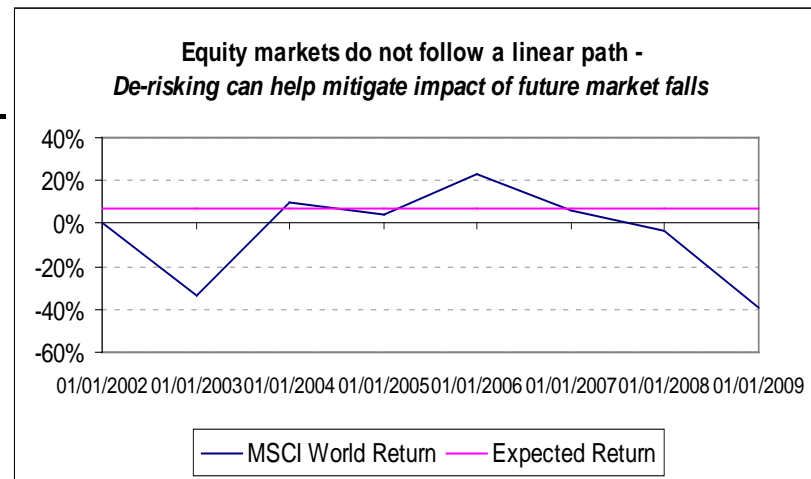
- What is the maximum level of contribution that the company can bear?
- Over what time period would the company like to restore the scheme to solvency?
- Has the company considered any benefit changes?
- What level of risk can the company bear on balance sheet, P&L, cashflow?
- If deficit worsens by say a further €xm what would the company do?
- Assuming the company would like to derisk, how quick a timeline would they prefer?
- Any potential for contingent assets, company guarantee etc?



iapf

If the Investment Risk Pays Off?? De-Risking when Gains Arise

- **Opportunistic de-risking:**
 - Only de-risk if Scheme hits certain pre-determined funding level targets
 - Aims to help the Scheme to 'bank' market gains and de-risk only when it can be 'afforded'



Sample Dynamic De-risking Framework	Initial Position	Target 1	Target 2	Target 3	Target 4
Funding Level					
MFS Funding Level	Initial	>10%	>20%	>30%	>40%
Asset Allocation					
Total 'Return-Seeking' Assets	70%	60%	50%	40%	30%
Total 'Risk-Reducing' Assets	30%	40%	50%	60%	70%



Implementation Considerations

- **May need to move away from current investment arrangements**
 - e.g. move out of Managed / Consensus Fund
- **As part of this may need to consider**
 - ‘Return-seeking’ portfolio
 - ‘Risk-reducing’ assets
- **Agree de-risking mechanics and implement changes to investment arrangements**
- **Consider ongoing monitoring**



Summary

- Need for an integrated funding and investment approach
- Consideration of extent of sponsor backing for scheme
- Clarity on sharing of risk between all members
- Implementation of changes to strategy
- Regular monitoring
- Clear communication to members



MERCER



MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

David O'Sullivan

Financial Strategy Group

Mercer