Pension Scheme Wind Ups

Paul Victory

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Overall Wind Up Environment 1

- Estimated that 70% of private sector DB pension schemes are in deficit under the Minimum Funding Standard

- Many of these schemes have been through one or more funding proposals in the past and employers are becoming increasingly frustrated at their advisors' seeming inability to come up with an affordable long term solution

- New funding standard will require significant de-risking or additional reserves
  - Either of the above will increase the amount of funding required from employers and scheme members
  - However, the delay in implementation of the new standard will mitigate this issue

- Other changes due to be introduced
  - Pensions Board to have power to wind up schemes
  - Proposed change in way accrued benefits are revalued
  - Proposed change in priority rules – introduction of threshold for pensioners

Overall Wind Up Environment 2

- The majority of private sector DB schemes are closed to new entrants and many schemes are now closed to future accrual
- This is accelerating the rate at which the proportion of liabilities relating to pensioners is increasing
- Balance sheet volatility is also a major concern for publicly quoted companies
- Many employers are struggling financially and are seeking ways of reducing both costs and volatility
- An increasing number are concluding that the only way they can achieve this is by winding up the scheme
- The more this happens, the more other companies are likely to follow suit

Trustee perspectives and issues 1

- In many cases, the decision by the employer to cease supporting the scheme comes after a lengthy consultation process between the employer and the trustees, which may have included one or more funding proposals
- In other cases, it happens suddenly with little or no advance warning or because the employer has become insolvent
- Whatever the circumstances, there are a number of issues that the trustees need to address without delay
  - Investment Policy
  - Can/should they issue a contribution demand to the employer?
  - When should/must they wind up the scheme?
  - Need for independent legal advice
  - Are any of the trustees or their advisors conflicted?

Trustee perspectives and issues 2

- The answers to many of these questions will be found in the formal scheme documentation, in particular the sections dealing with
  - how contributions are determined
  - any notice period prior to ceasing contributions
  - how and when a scheme must be wound up

- It is likely the trustees will need to seek immediate legal advice on how to proceed

- It is also likely that one or more of the trustees will be conflicted and may have to resign

- The role of the scheme actuary will also need to be addressed, taking into account the conflict of interest protocol that is in place

Wind up process 1

Initial Decision

- Wind up date
- Appoint advisors
- Deal with conflicts
- Contribution demand

Investment Issues

- Decide appropriate strategy
- Communicate with AVC (or other DC) members

Legal/Compliance/Actuarial

- Notify relevant parties (Pensions Board, members/beneficiaries, unions, Revenue)
- Establish wind up priorities and estimated funding position
- Make claim to Insolvency Fund (if appropriate)
- Ongoing compliance requirements (TARs, AFCs, valuation reports)

Wind up process 2

Administration issues

- Verify data
- Trace members
- Advising members of options
- Dealing with member queries

Distribution of assets

- Get annuity quotes and appoint annuity provider
- Establish default option for members’ transfer values
- Full or partial distribution to active/deferred members?
- Dealing with pension increases (fixed/CPI, pensioners/non-pensioners)
- Allocation of investment returns between date of wind up and date of final distribution

Key technical/practical issues

- Wind up date/contribution demand
- Investment strategy
- Data cleansing
- Benefit calculations
- Determining the priority order
- Annuity purchase
- Transfer payments
- Other issues

Wind up date/contribution demand

- Key decision is when to wind up the scheme
- The formal scheme documentation
  - may be prescriptive or
  - may allow the trustees discretion to delay the wind up if they have good reasons for doing so
- Likely to be the date on which the employer's obligation to contribute to the scheme ceases
  - this may be immediately on notifying the trustees or
  - subject to a notice period
- The trustees may decide to issue a contribution demand
  - this might cover the entire deficit, depending on the terms of the contribution rule
  - may be issued even if no notice period, but legal standing uncertain
  - where no notice period, trustees may issue demand if they feel wind up imminent
- Where a demand issued, may be difficult to enforce
  - this may be due to corporate structure or legal issues or may lead to employer insolvency
  - having the option of issuing such a letter may be used by the trustees as a bargaining chip to negotiate a better deal for members

Investment strategy

- It is likely to take several months (or longer) to distribute all the scheme assets on wind up
- The trustees will need to address how best to invest the scheme's assets over the period between date of wind up and date of final asset distribution
- The most prudent approach would be to immediately adopt a policy that matches as closely as possible the way in which the assets are going to be distributed
  - For pensioners, this means bonds of appropriate duration and type
    - AAA or broader eurozone sovereign bonds?
  - For actives/deferreds, best match is probably cash, although not ideal if wind up process is likely to be protracted
- However, trustees may have concerns about timing issues and may wish to wait for a market recovery before adopting a more matched strategy
- Illiquid assets such as property
  - Place in a sale queue as quickly as possible in order to avoid having to delay the final asset distribution

Data cleansing

- A significant issue in most wind ups

- Pensioners
  - Spouse/adult dependant – status, date of birth, date of marriage
  - Children – age, education status, permanently disabled
  - Contingent beneficiaries where pension fully commuted

- Active members
  - Relatively straightforward?
  - However, lots of issues can arise including part time employees, shift pay, temporary absence, split service, date of joining scheme, etc.

- Deferred members
  - Current addresses
  - PPS number
  - Who can help trace them?
  - Advertisements
  - Dependants

Benefit calculations

- Members' entitlements crystallise at date of windup
  - members close to normal retirement age treated as deferred members and can not draw retirement benefits until assets distributed
  - members past normal retirement age treated as pensioners and can be processed as normal (provided pension liabilities fully covered)

- Complications can arise in underfunded schemes when calculating entitlements for active members
  - Pre scheme service
  - Pre 1991 service
  - Transfers in
  - Employer augmented benefits
  - Deferred early retirement following redundancy
  - Benefit changes
    - Accrual rate
    - Pension increases
    - NRA
    - Salary definition

Determining the priority order

- Determined by the formal scheme documentation and the provisions of the Pensions Act
- Pension Act provisions are very complex and have been developed piecemeal over a number of years
  - Expenses
  - AVCs
  - Pensions (excluding future increases)
  - Transfer values (excluding post retirement increases; includes non AVC DCs)
  - Post retirement increases on the above
  - Other
- Unravelling these priorities is primarily a legal issue, but likely that the scheme actuary will be involved in the process/discussions
- What falls into the “other” category?
  - Pre scheme service
  - Pre 1991 service?
  - Revaluation of pre 1991 benefits?
  - Minimum contributory retirement benefit?

Annuity purchase

- Pensions continue to be paid from the fund pending annuity purchase
- Suspend pension increases until annuities are being purchased and/or the final asset distribution is taking place?
- Index linked increases or fixed rate substitution?
- Sovereign annuities?
- Pensions Insolvency Payment Scheme where the employer is insolvent?
- Choosing a provider
  - Price
  - Security
  - Administrative issues (deductions, change in payment date, etc.)

Transfer payments

- Standard SAI basis or stronger basis?
- Calculation date
  - Date of wind up
  - Date of final distribution
  - Other?
- Adjustment for investment return
  - Strip out pensioner assets/liabilities?
  - AVC/DC returns
  - Interaction between priority classes
  - Consult with trustees
- Timing of payment
  - Initial ‘payment on account’
  - Final distribution
  - Adjustment for pension increases

Other issues

- Pension adjustment orders
- Divorce proceedings
- Death claims
- Life cover
- PHI claimants
- Pensions levy
- Trustee discretion
  - Other dependents
  - Early retirement
- Accounting disclosures
- Surplus?

Questions/comments?