Society of Actuaries in Ireland

SOA Presentation re Sovereign Annuities/Bonds

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05.09.12

Overview of Options

Trustees have two key options;

Discharge Liability from Scheme	Purchase Sovereign Annuities in the name of the member ("Buy Out")
Retain Liability in Scheme	Purchase Sovereign Annuities ("Buy In") /Bonds in the name of the Scheme

In either scenario, the Trustees are making an investment decision either;
- For the member directly, or
- For the Scheme.

The investment decision being made is overlaid with the fiduciary responsibilities to consider best interests of all Scheme members. Trustees facing difficult decisions as they trade off benefit entitlements and benefits security.

Trustees need to consider the future of their Scheme and which option provides most efficient risk return profile for their particular Scheme.

Defining Return

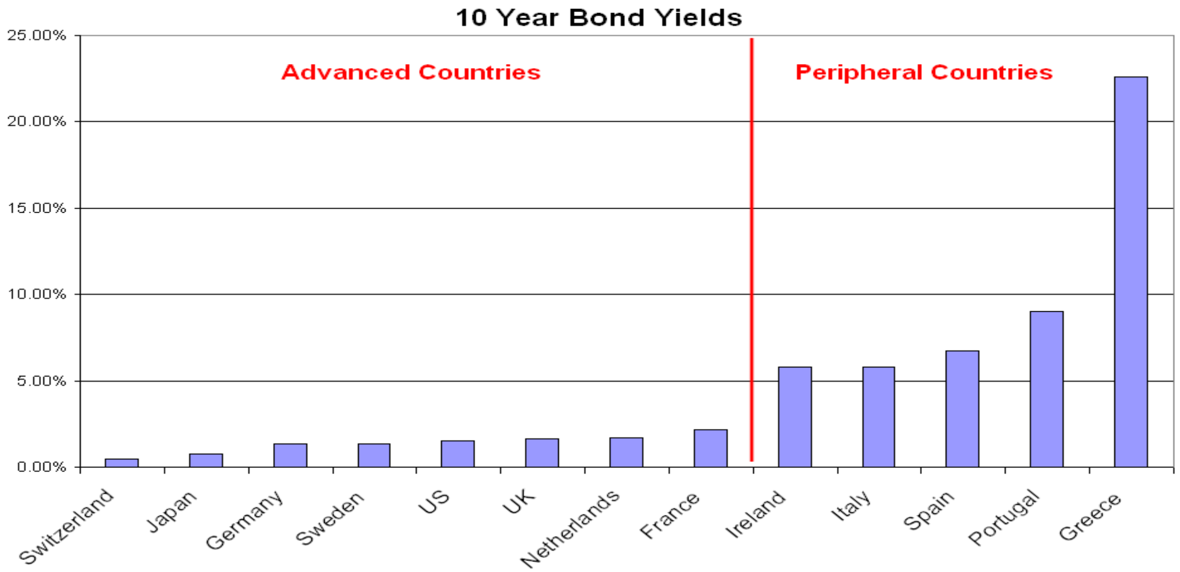
Evaluating Nominal Return

Irish Amortizing Bonds: Recent NTMA issue of Bonds of 5.72% (2027) – 5.92% (2037+)

Future Issues will be issued on a reverse enquiry basis with yields reflecting prevailing market conditions.

Index Linked bonds being proposed.

Other Sovereign Bonds:



Defining Return

Is there a need to evaluate return with reference to other aspects?

For Schemes In Wind Up

By Investing in Sovereign Annuities, Scheme Trustees may be able to secure higher levels of benefits for beneficiaries i.e. principally actives/deferreds.

For On Going Schemes

There is now a link between the valuation of liabilities for MFS and the investment strategy for the Scheme.
- Buy In provides a full reduction in MFS liability (ignoring pension increases) with no mortality gain/loss, whereas
-the Sovereign Bond provides a 20% reduction phasing to 5% over the Funding Proposal Term (+ reduction to risk reserve) with mortality gain/loss.

This may provide an opportunity to manage the effective discharge of liabilities over time.

Defining Risk

Default Risk

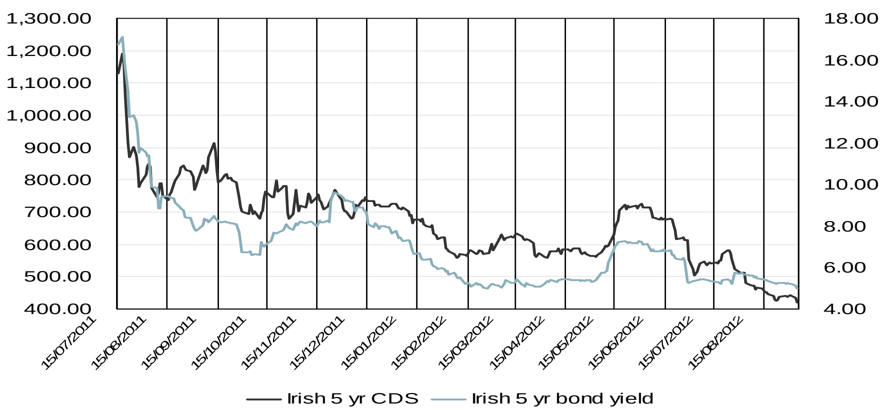
Pricing risk is not the same as actual risk. Requires assessment of the ability for the Irish State to meet its ongoing obligations.

Sovereign Annuities/Bonds may be construed as reducing security of benefits to a level consistent with the Irish States social welfare and public sector payment obligations.

Draghi: The implied default rates in sovereign yields are distorted by risk premia that "have more to do with (currency) convertibility"

Recent moves represent major boost to collective creditworthiness of all Eurozone participants. Anticipated ECB moves towards "lender of last resort".

Irelands CDS quotes fallen significantly since October 2010 implying investors more relaxed about Irelands default risk.



Defining Risk

Concentration Risk

Diversification always has a value in managing risk.

Revised regulatory framework aims to incentivise asset allocation from higher risk equity investments to fixed income so as to closely align assets with liabilities.

Within this fixed income exposure, additional incentives for Irish Sovereign Debt.

Of c€51bn of assets of DB Schemes c€23bn allocated to fixed income with the majority invested in Euro land debt (sovereign and corporate).

	End 1998		End 2011	
	Domestic	Foreign	Domestic	Foreign
Ireland	78	22	21	79
Italy	73	27	61	39
Portugal	68	32	69	31
Spain	83	17	65	35

** Source: ECB, DB Global Managers*

As at End June, only c0.54% of outstanding sovereign debt held by Irish pensions funds and insurance companies.

Investors need to question the counterparty risk being adopted and evaluate this relative to return on alternatives i.e. Core Bonds.

Defining Risk

Liquidity Risk

Illiquidity means Trustees are making a decision now that may be difficult to reverse in the future.

Sovereign Annuities: no ability to sell these assets i.e. in the event of future wind up no capacity to convert to traditional annuities i.e. are Scheme Trustees restricting options on wind up.

Sovereign Bonds: should be purchased on a buy to hold basis. Consideration needs to be given to the practicality of purchasing annuities in the future.

Other Risks

This is not a complete list of risks. The other risks facing fixed interest investors include; inflation risk, interest rate risk, mark to market risk.

Developing an Investment Strategy

Determining an investment strategy for the Scheme needs to factor;

The Scheme Sponsor/Alternative Options?

Sponsors facing increasing and potentially unaffordable costs
Strength of Employer Convent and Funding position will determine outcome
Trustees need to balance benefit levels v benefit security

What Instrument – Sovereign Annuities or Bonds?

Trustees need to consider;
- The funding position of Scheme and significance of MFS
- The future of Scheme and need for flexibility/liquidity

Sovereign Annuities
SA have not yet been issued although the first SA product has been approved.
Scheme Trustees will need to engage with SA provider to establish terms.

Sovereign Bonds
Sovereign Bond option can be implemented on a reverse enquiry basis with NTMA or other Sovereign Bonds.
Bonds need to be purchased through the primary dealer network.
Bonds need to be held by Investment Manager with Global Custodian.

Developing an Investment Strategy

What Level of Exposure?

Schemes in Wind Up

Benefit Levels v Benefit Security

OnGoing Schemes

Benefit Levels v Benefit Security

(Nominal Return + MFS Impact) v (Risk of default + Risk of Illiquidity)

LT Solution (Sovereign Annuity) v ST Solution (Sovereign Bonds)

Asset allocation of non matching assets

Conclusions

Trustees facing difficult decisions over the coming months as they seek to manage the funding position of the Scheme.

Need to consider the Sovereign Annuity/Bond option for their Scheme if only to evaluate alternative options i.e. benefits reductions.

While there are a number of advantages to Sovereign Annuities/Bonds such as;

(a) Return in nominal terms and by reference to other Sovereign Bonds

(b) Reduction in MFS liabilities

The key issues with both the Sovereign Annuity and Bond options are;

(a) the concentrated exposure to a single Sovereign State (albeit Ireland) and the consequences for the future benefits of members, and

(b) The actual/likely illiquidity of the investment.