Society of Actuaries in Ireland

Low bond yields

Pension perspective

Aisling Kelly

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Agenda

- Impact on Defined Benefit schemes
  - Minimum Funding Standard/Funding proposals
  - Ongoing funding
  - Accounting
- Defined Contribution considerations

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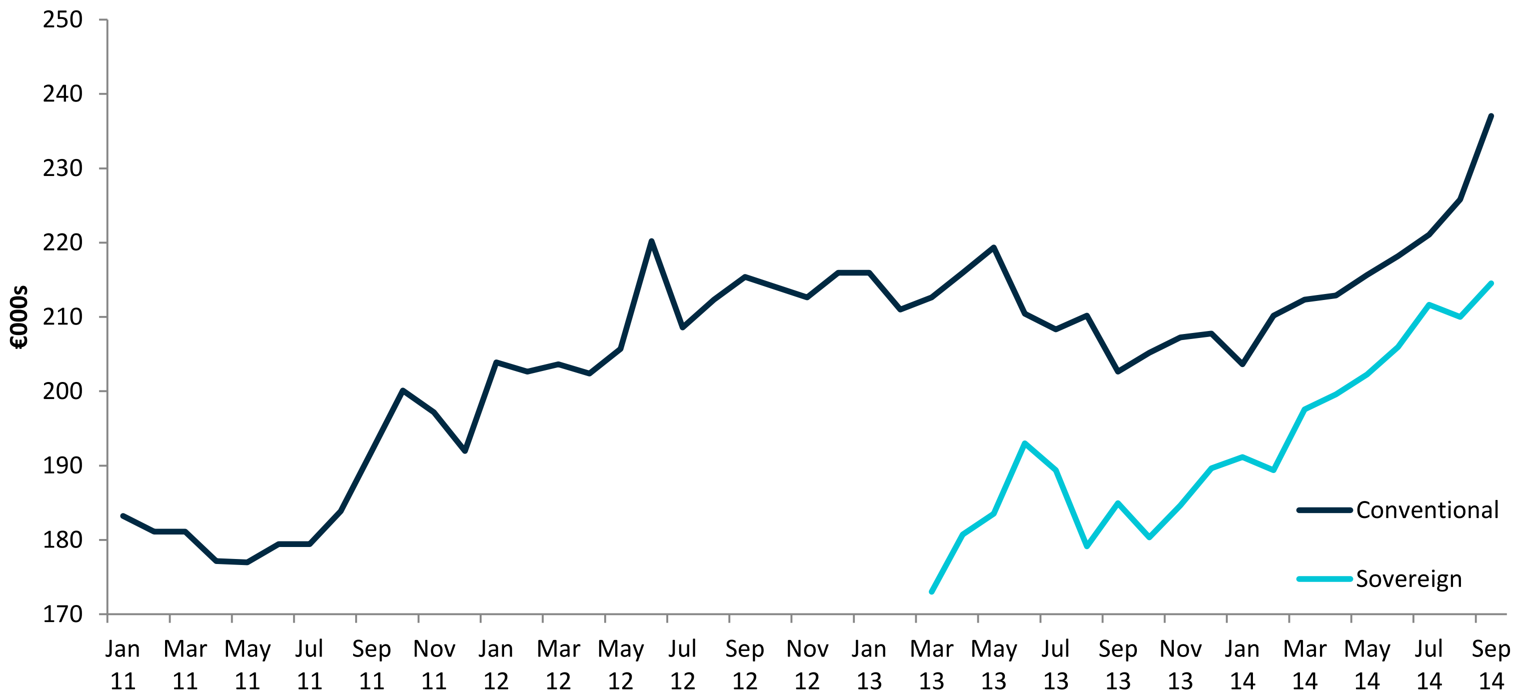
Impact on annuity costs

Cost of a joint life level annuity of €10,000 pa for a male aged 65



Minimum Funding Standard (MFS)

- Wind up test
  - Values pensioners at open market annuity costs
  - Transfer values for actives and deferred members
- Currently c. 50% of schemes meet MFS, > 40% have recovery plans and < 10% putting recovery plans in place
- Impact of risk reserves in 2016
- A significant level of volatility will remain while pensioner liabilities must be priced by reference to annuities (unless liabilities are matched by core Eurozone bonds)

Funding proposals

- Risk of funding proposals going off-track
  - Increase in liabilities in excess of asset growth
  - Inability to follow derisking plan
- Actuaries can allow for an element of yield reversion over course of funding proposal term (minimum five years)
  - What amount, if any, should be allowed for?
- Sovereign annuities may be of help for some schemes but discount has reduced significantly

Ongoing funding

- Triennial valuation, determines contribution rate using long term assumptions
- Trustees may need to reconsider long term investment assumptions
- Reports include funding position on both scheme specific long term funding basis and a bond basis
- Regardless of how matched the assets are with a scheme’s liabilities, the future expected return is likely to be lower
- Benefit/investment strategy may need to be reviewed
  – Are planned derisking strategies still appropriate or affordable?

Accounting

- Annual valuation for company accounts
- Calculated by reference to corporate bond yields
- Recent falls will have significant effect on funding levels
- Impact will depend on size of scheme relative to company
- Last few years has seen significant volatility on accounting costs – not only bond yield movements but also changes in methodology
- Pension deficits of FTSE350 companies increased by £17bn over August 2014 (total liabilities estimated at £685bn)*

*Source Mercer's Pensions Risk Survey (UK)

Investment decisions

- Assets should be considered in conjunction with liabilities
  - Choice of assets –
    - If on a derisking path under a funding proposal, how will this be progressed?
    - Is now a good or bad time to buy bonds?
    - How does the scheme profile affect investment decisions
    - Sovereign bonds/annuities – will they be of benefit?
- Least risk position
  - What previously represented a good match may need to be re-examined
- Where mismatched, need to understand the risks

Challenges for trustees and sponsors

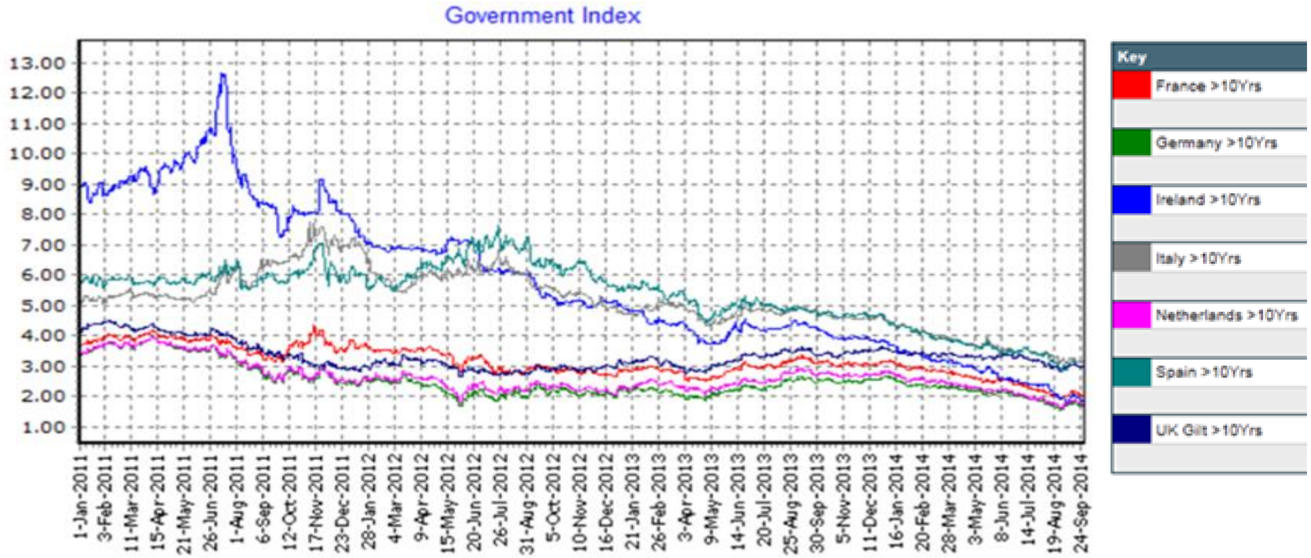
- Risk assessment and management
  - Pensions Authority guidelines
  - Sensitivity analysis becomes more important
- Consider whether scheme factors need to be reviewed – transfer values, commutation

If a low bond yield environment is here to stay, will the current level of benefits and contributions be sustainable?

Not forgetting the DC world…

- Increasing annuity costs mean members may face a significant drop in their expected income
- Challenge to define an appropriate lifestyle approach
- Is the typical end point of bonds and cash significantly more risky than anticipated?
  - Actual decisions taken by members (lump sum/annuity/ARF)
  - Risk of mismatch
- Employee understanding
- Choice of funds (and regular review) a key issue for trustees
  - Lifestyling suitability
  - Level of advice required for members

All bonds are not equal…



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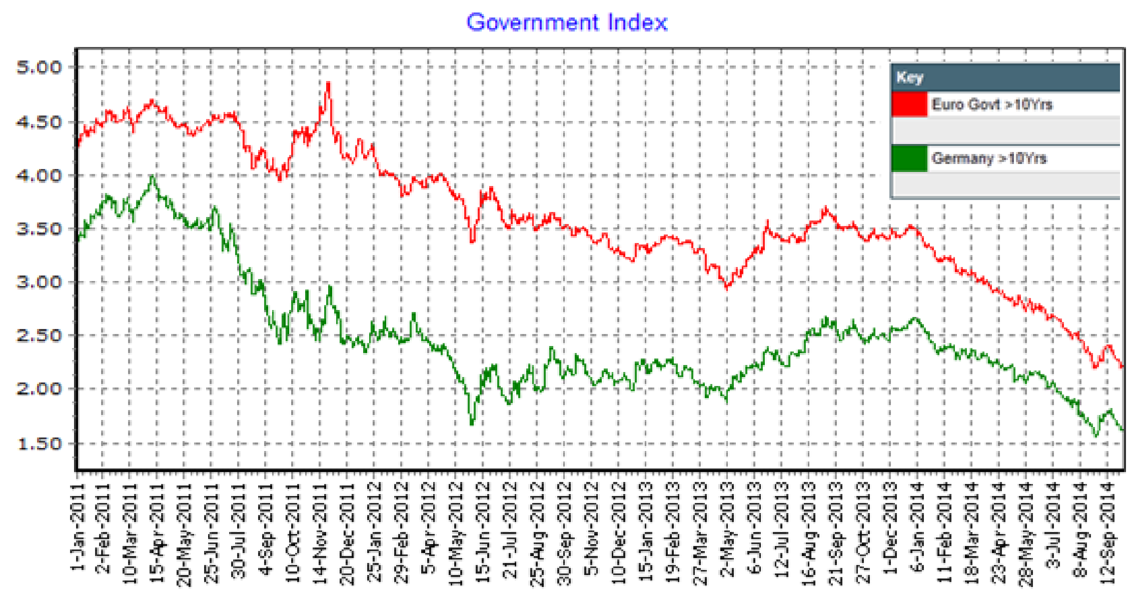

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Approved Retirement Funds (ARFs)

- Will ARFs become more widely available/used for DC members?
- Possible bomb out risk
- Choice of investment funds post-retirement
  - Investment return (plus charges) v imputed drawdown for tax purposes of 5%

Summary

- Well matched DB schemes will be relatively unaffected by recent movements for accrued benefits
- But… how many schemes are truly in that position?
- A low bond yield environment will increase liabilities on all bases
  - How will this affect future contribution rates?
  - What impact will this have on the viability of schemes?
- Trustees/employers need to understand the risks
- Challenge of engaging members in a DC world on bond yields
  - Trustees will need to ensure that options available are reasonable