



Corporate Pensions Briefing
13 June 2006

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Agenda



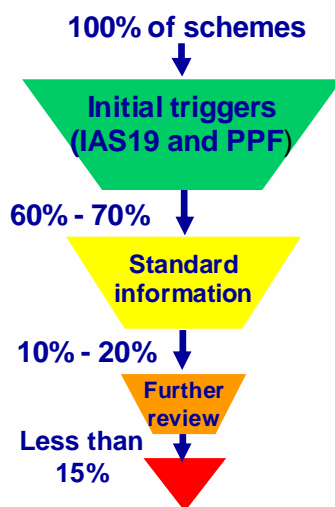
- The Regulator's role in funding
- Gearing up for the first valuation
- Headlines from WW Plan Design Survey 2006
- Mortality – key issues and risks
- Setting up a risk management framework
- Discussion groups

Key messages



- Regulator triggers to be IAS19 and PPF level - used to prioritise workload not funding targets!
- First scheme specific funding valuation likely to be most important for the next decade – early company input needed
- Benefit changes driven by reducing cost and DB exposure expected to continue but varied
- Greater focus and disclosure on mortality risk
- Need to determine a framework for managing pension risks

“Triggers not targets...”



- Regulator’s statement (4 May 2006) on monitoring funding of DB schemes. Aim is to identify schemes with imprudent or inappropriate funding decisions.

- Prioritise workload using “trigger points”:

Funding target (“technical provisions”)	If lower than IAS19 and/or PPF level of liabilities
Speed of correction (“recovery period”)	If greater than 10 years

- Where a scheme triggers the Regulator will request further “standard information” e.g. employer accounts, trustees minutes, evidence of advice and consideration of all relevant issues, etc

The Pension Regulator's monitoring



Other key themes

- Primary focus to ensure technical provisions calculated prudently
- More flexible when looking at recovery plan
- Credit may be taken for higher asset returns in deficit recovery plan (no requirement for a recovery plan to include deficit contributions)
- Contingent assets may be considered when assessing technical provisions or the recovery plan

Example

Liabilities	£110 m
Scheme assets	(£100 m)
Deficit	£10 m

If asset returns exceed the liability discount rate by 1% pa this would be sufficient to pay off the deficit over 10 years without any additional contributions.

Responsibilities – valuation process



Greater responsibility for the Trustees in valuation:

- Prepare an action plan for the valuation
- Set the technical provisions and draw up a Statement of Funding Principles
- Draw up a recovery plan if shortfall
- Agree schedule of contributions
- In some circumstances, modify future benefits

- Trustees expected to form objective assessment of company's covenant.

Company agreement required in most cases

Company entities need to make sure process/structure in place so its views can be provided at an early stage

Company actions

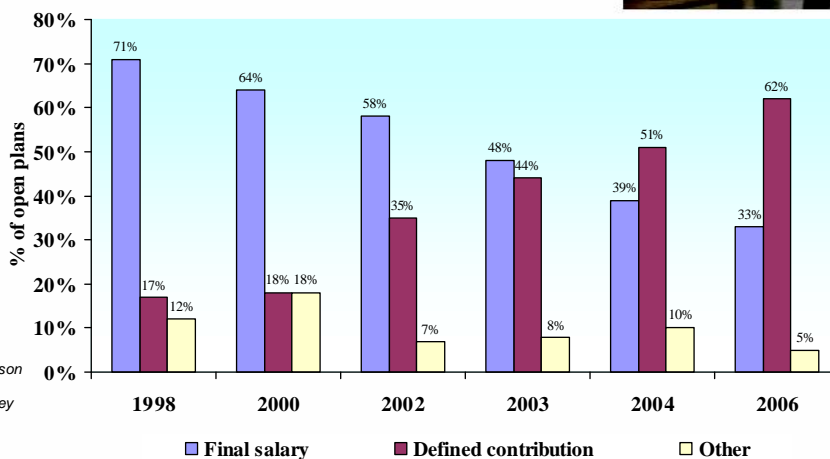


Includes:

- Identify acceptable level of cash contributions
- Determine preferred approach to funding and investment taking account of risk/reward trade-off over different time horizons
- Consider how to present employer covenant to trustees in the best light and present information to support company view on an acceptable level of cash contributions
- Consider impact of alternative options e.g. raising debt, contingent funding

The first SSF valuation is likely to set a precedent for future valuations – could be the most important for the next decade!

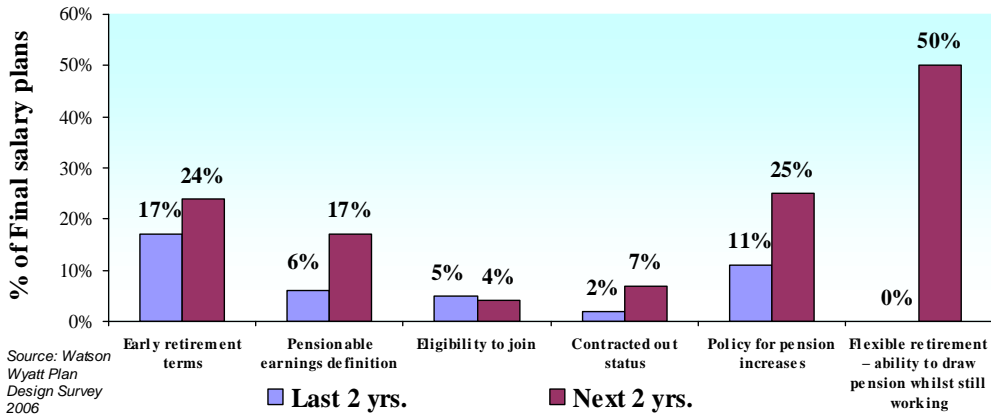
Trends in pension provision



Source: Watson Wyatt Plan Design Survey 2006

Continuing move to DC for new hires

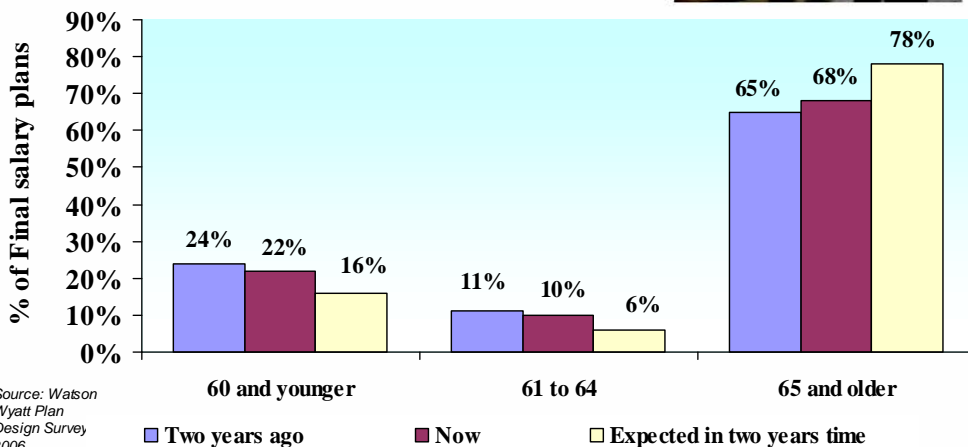
Changes to final salary plans



Source: Watson Wyatt Plan Design Survey 2006

Variety of changes anticipated

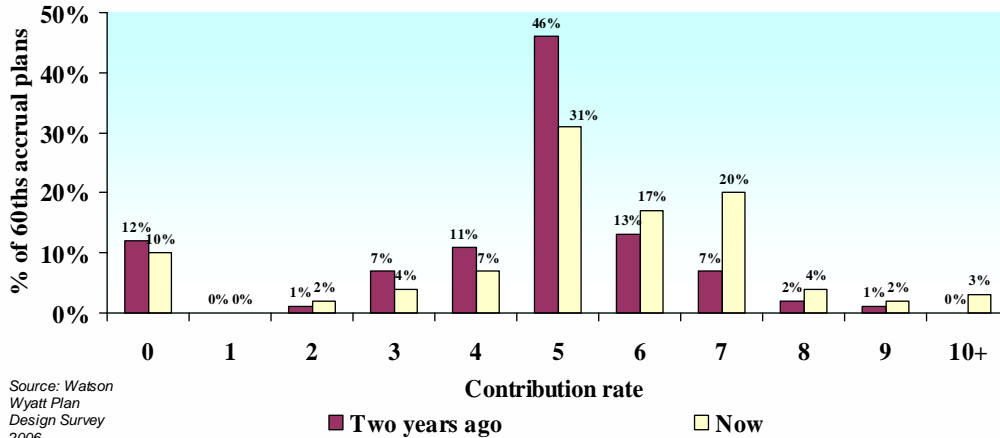
Changes to NRA



Source: Watson Wyatt Plan Design Survey 2006

Over ¾ of plans expected to have NRA of 65 or over by 2008

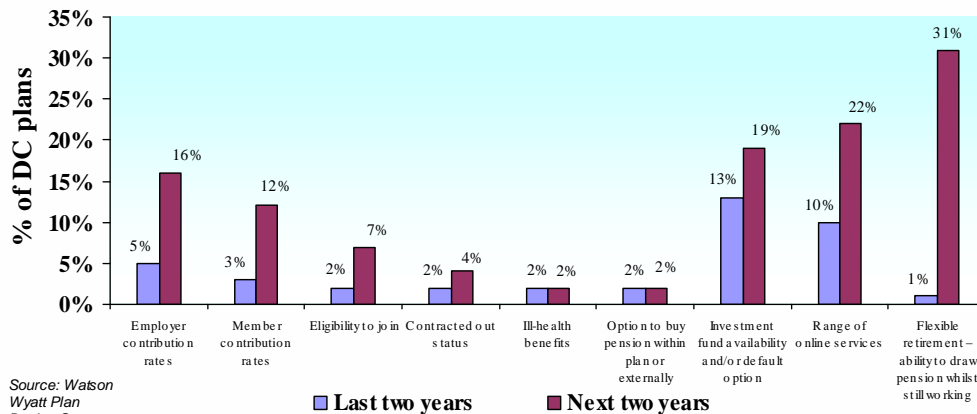
Member contributions (for 60ths accrual plans)



Source: Watson Wyatt Plan Design Survey 2006

Average contribution rate now 5.2% and expected to rise by 1% over next 2 years

Changes to DC plans



Source: Watson Wyatt Plan Design Survey 2006

Review and changes to DC plans expected more often in future as DC becomes more significant

Mortality issues

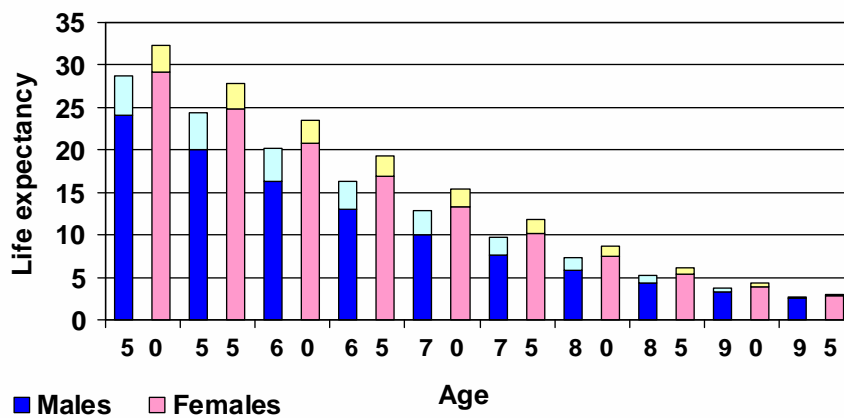


- A look back at improvements
- What are the current projections?
- Uncertainty?
- Disclosures in accounts

Past improvements in mortality (population statistics 1981 – 2003)



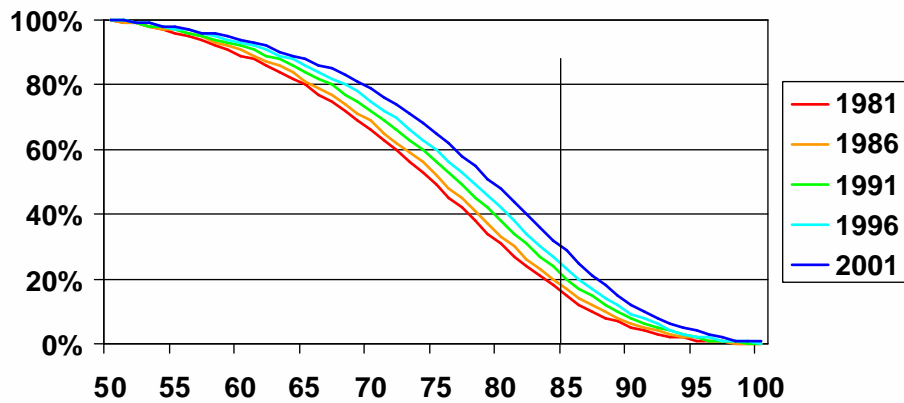
Expectation of life 1981 plus improvements to 2003



Survivorship curves



Male population

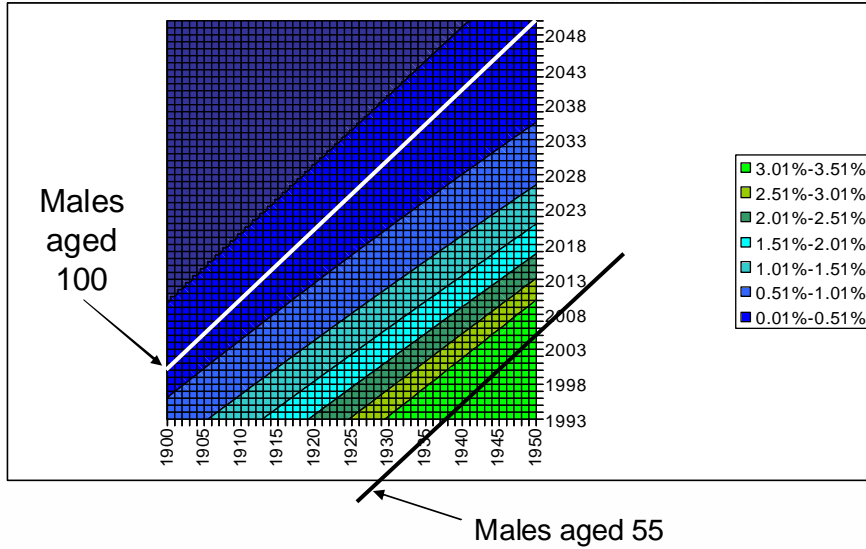


The 'cohort' improvements

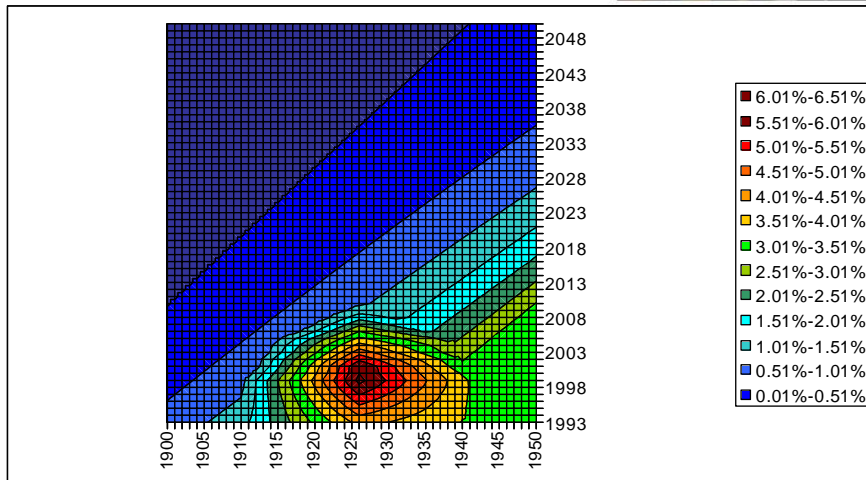


- The latest formal mortality projections from the actuarial profession were published in 1998
- In late-2002 variations were published which reflected the emergence of a "favoured cohort" with more rapid mortality improvements than other adjacent groups.....

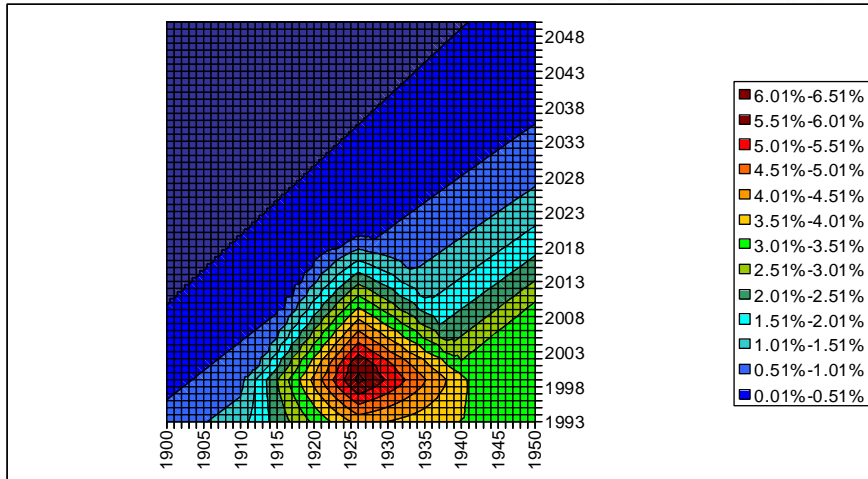
92 base table – male improvements



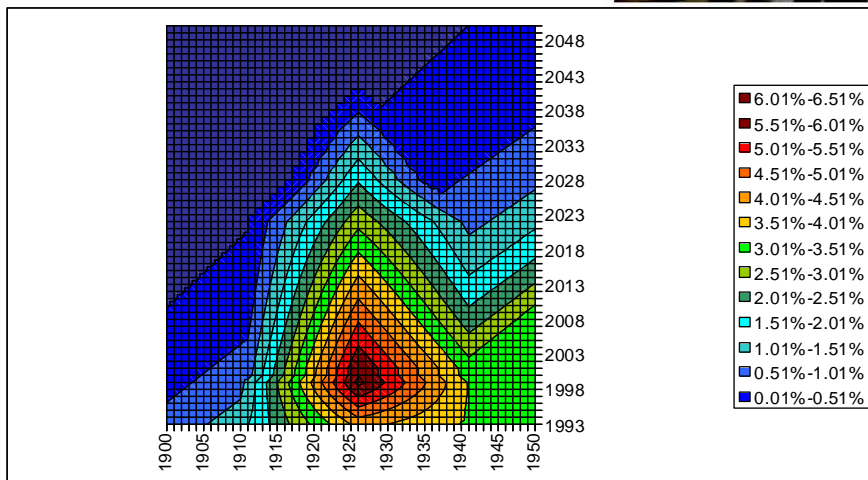
92 short cohort – male improvements



92 medium cohort – male improvements



92 long cohort – male improvements

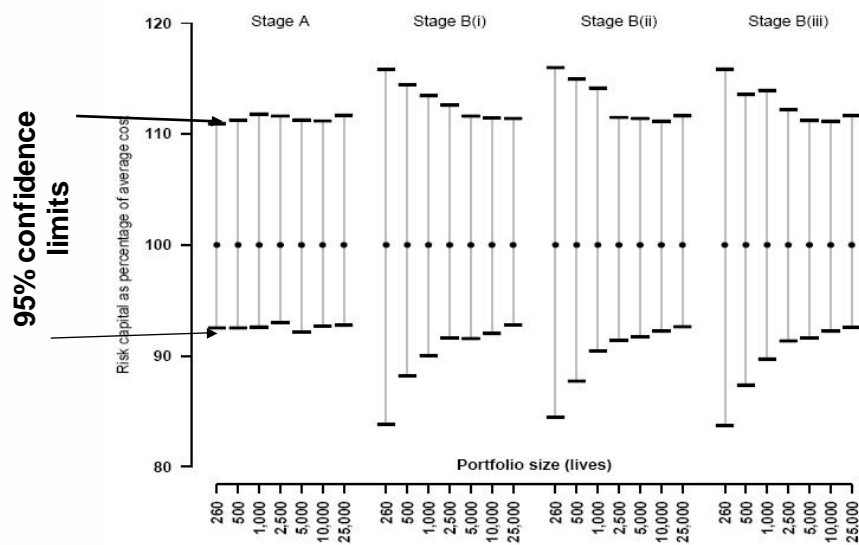


Uncertainties in projections?



- What is the overall direction of improvements (the Big One)?
- Allow for further uncertainty at member level
 - Variations around the trend line
 - People have different pensions
 - Large pensions last longer than small pensions
- Law of Averages does seem to apply to large schemes

Stochastic modelling of mortality risk



Accounting disclosures



- ASB Exposure Draft – “Retirement Benefits – Disclosures”
- Suggests longevity assumptions are material
- Disclose, for all material groups
 - Current expectation of life – at NRA?
 - What is this expected to be in 10 years time?
 - Sensitivity analysis - what is effect of an increase in expectation of life of one year on liabilities?

Expectations of life disclosed in company accounts

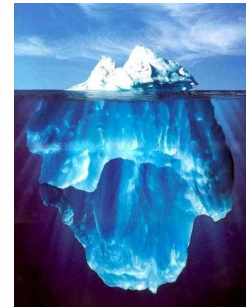


Company	Current		In 10 years time	
	Male (60)	Female (60)	Male (60)	Female (60)
A	23	26	n/d	n/d
B	25.4	28.2	26.2	29.0
C	25.8	29.5	26.5	30.1
D	23	26	24	27
E	25.6	27.6	26.4	28.3
F	20.3	23.3	21.5	24.5
G	24.7	26.8	25.4	27.5

Pension risks



- There are a number of key risks involved in running a DB pension scheme
- A sensible risk management process seeks to identify the key risks, understand and, where possible, measure them
- Risk exposure will vary by:
 - company
 - pension arrangement
 - time horizon



A potential risk framework part 1



Risk	Area of impact on sponsor	Risk management tools
Investment <i>e.g. asset returns underperform liabilities</i>	<ul style="list-style-type: none"> ● Balance sheet (and P&L) volatility ● Capital efficiency ● Impact on cashflow 	<ul style="list-style-type: none"> ● Regular monitoring ● Stochastic modelling ● Scenario testing, projections ● Benefits policy ● Contingent funding
Non-investment <i>e.g. mortality improvements</i>	<ul style="list-style-type: none"> ● Affordability of deficit, future service benefits ● Market perceptions ● Dividends and shareholder returns 	
Surplus <i>e.g. the sponsor's inability to access "trapped" surplus</i>	<ul style="list-style-type: none"> ● Destruction of shareholder value 	

A potential risk framework part 2

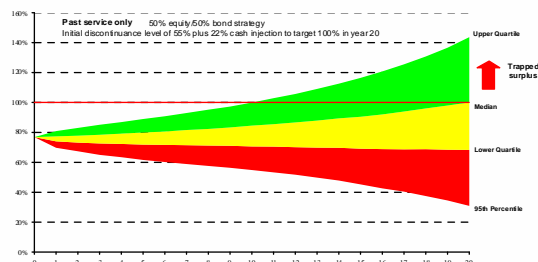
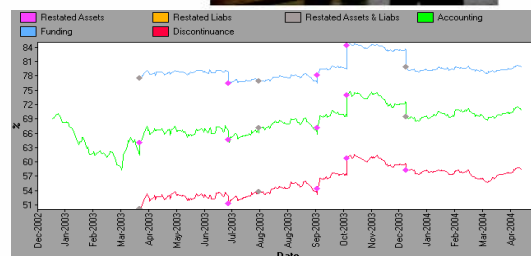


Risk	Area of impact on sponsor	Risk management tools
Trustee <i>e.g. funding and investment powers</i>	<ul style="list-style-type: none"> •Cashflow flexibility •Dividends and shareholder returns •Tax efficiency 	<ul style="list-style-type: none"> •Pensions governance structure •Determine / review company approach to funding and investment •Proactive interaction with trustees •Ensure internal understanding of impact of corporate activity
Regulation <i>e.g. Pensions Regulator powers; accounting changes</i>	<ul style="list-style-type: none"> •Capital efficiency •Financial reporting and market perceptions 	
Government <i>e.g. debt on employer regulations</i>	<ul style="list-style-type: none"> •M&A and corporate restructuring •Benefit affordability 	

Monitoring quantitative risks



- Regular updates of financial position
e.g. every quarter / year
- Projections and stochastic modelling of longer-term (e.g. Asset Liability Modelling)
- Consider significance relative to business operations (e.g. VaR analysis)



Managing pension risks



- Agree appropriate Governance structure
- Determine appropriate metrics and tolerances for monitoring, including the right balance between risk and reward
- Risk monitoring need not be entirely quantitative
- Measure at a frequency which allows action
- Focus on the largest risks, not the easiest

Identify risks, mitigate where appropriate, and monitor

Key messages



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