

WHAT DOES SELF-SUFFICIENCY LOOK LIKE?

SPEAKERS

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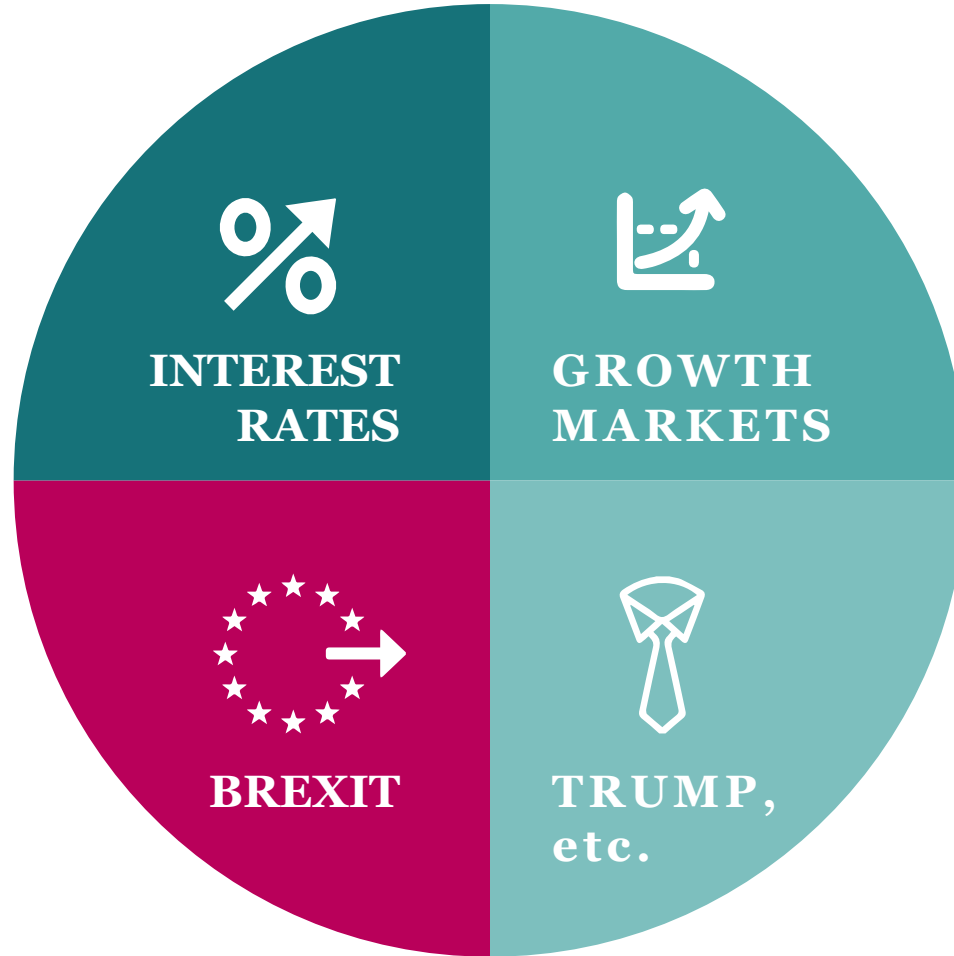
TIFFANY TSANG
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PLSA

 @ThePLSA

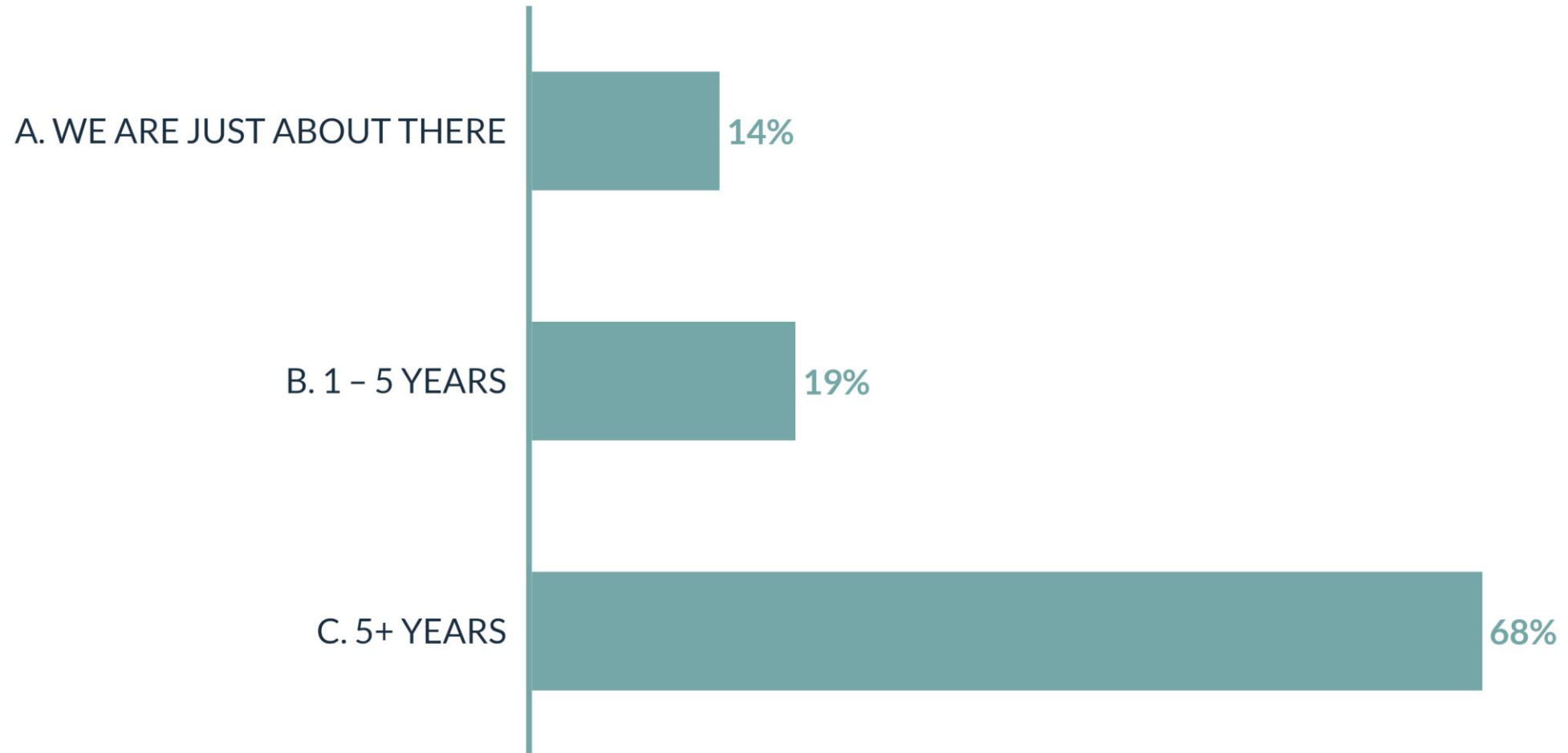


APP POLLING SESSION

STATE OF PLAY

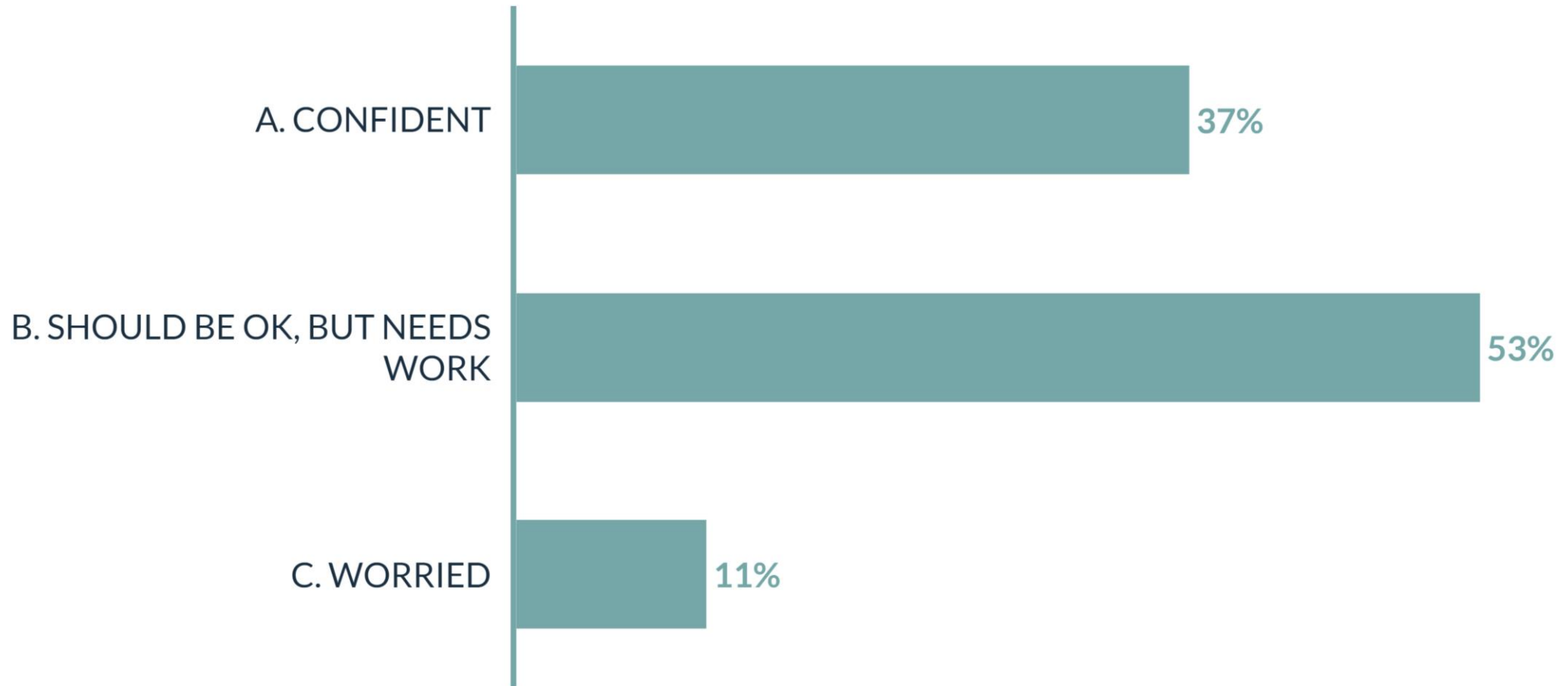


Q1. WHEN IS YOUR SCHEME LIKELY TO BE SELF-SUFFICIENT?



APP POLL

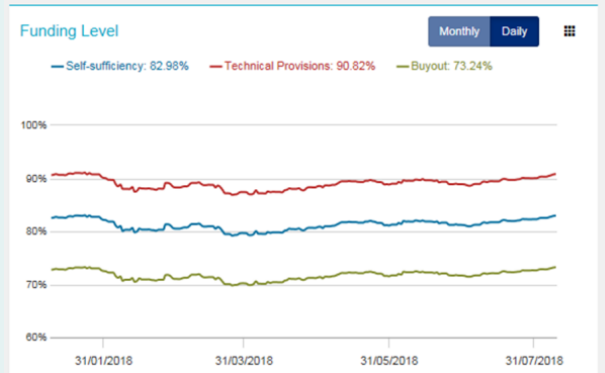
Q2. HOW CONFIDENT ARE YOU THAT YOU CAN MEET THE CHALLENGES POSED BY BEING SELF-SUFFICIENT?



APP POLL

WHERE ARE YOU NOW?

PROGRESSION OF FUNDING

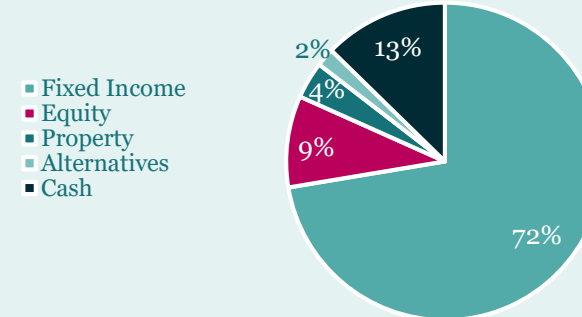


ASSESSING COVENANT

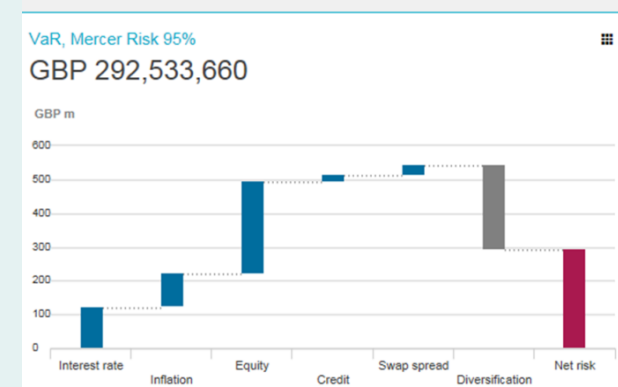


LOW RISK INVESTMENT STRATEGY

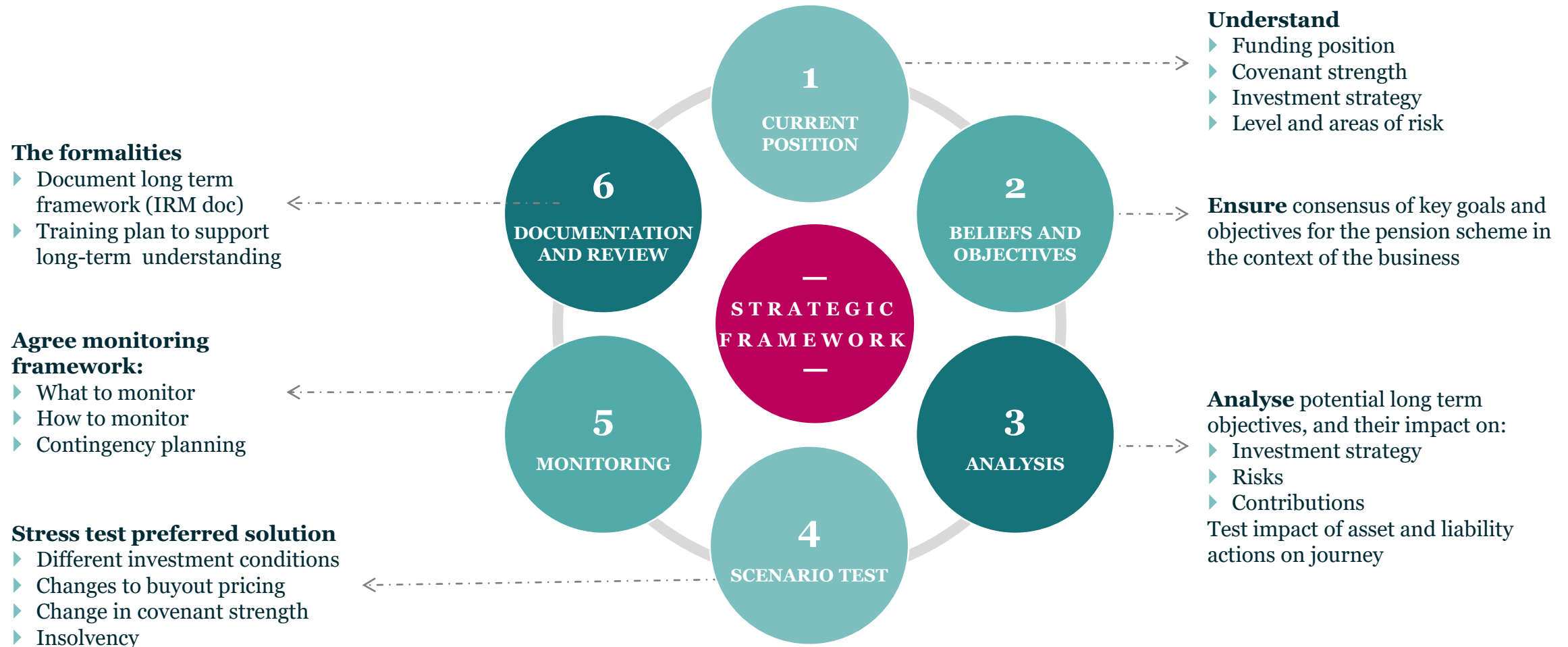
Assets 30 June 2018



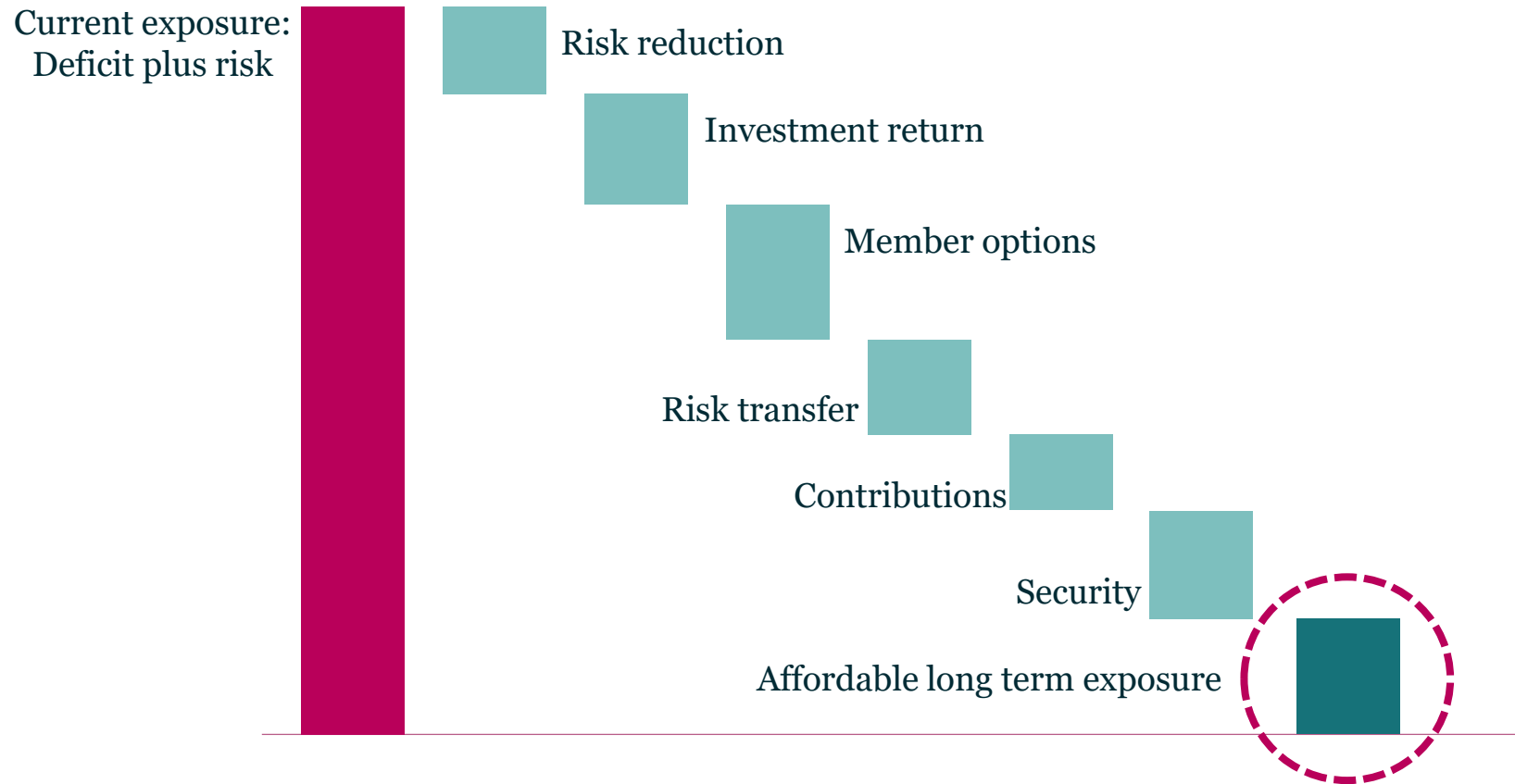
VALUE AT RISK



STRATEGIC FRAMEWORK CREATING AND MAINTAINING



HOW FAR ARE YOU PROGRESSED ALONG YOUR STRATEGIC FRAMEWORK?



Framework constructed as a result of thorough review of the appropriate combination of levers.

Key that the path to reducing the unwanted exposure is consistent with visibility on covenant.

Dynamically manage the levers: Size and Timing

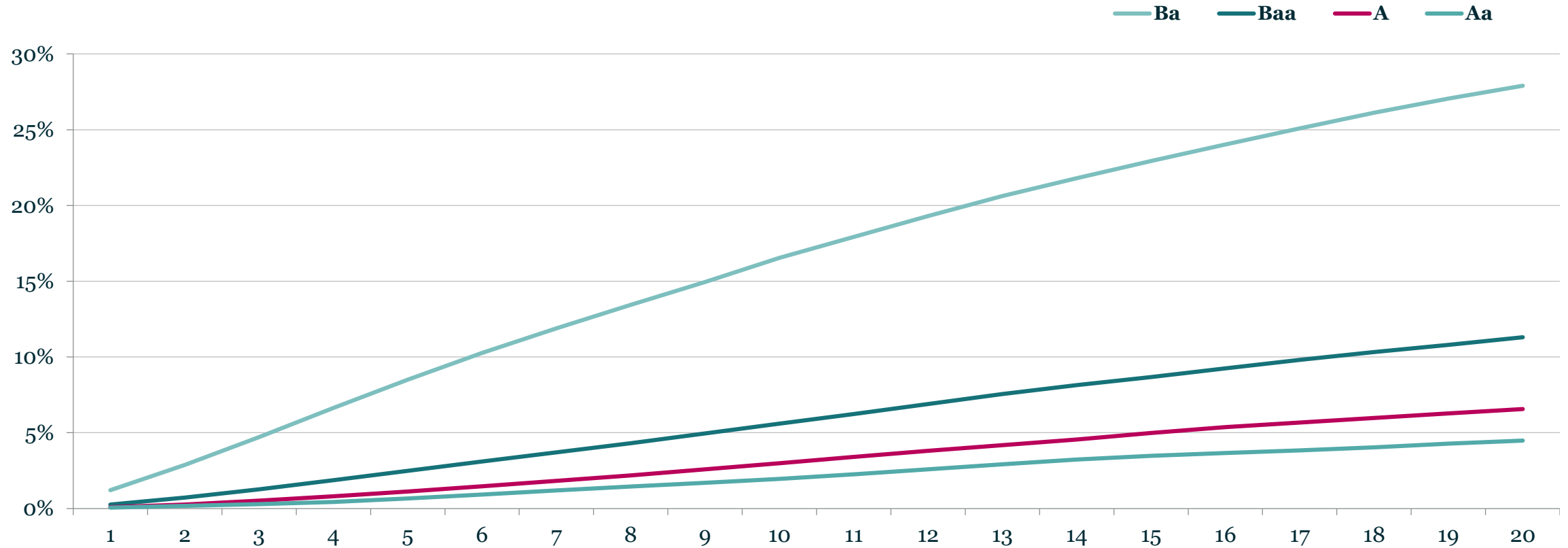
Assess new opportunities and threats in terms of adjusting the Framework

“SELF SUFFICIENCY”

- Being “self-sufficient” is generally understood as the pension scheme being able to stand without additional future funding from the sponsor
- Traditionally this has meant a target of gilts plus a small margin (commonly 0.0% to 0.5% p.a.) based on targeting an asset strategy with very little risk
- However, a low-risk target is not no-risk
- Some investment risk will remain and other risks might not be dealt with e.g. longevity risk
- Self-sufficiency brings a number of operational issues to manage
- This is the optimal time for trustees to consider how well their governance framework fits in this scenario and what changes might be necessary to mitigate identified risks/manage operational issues

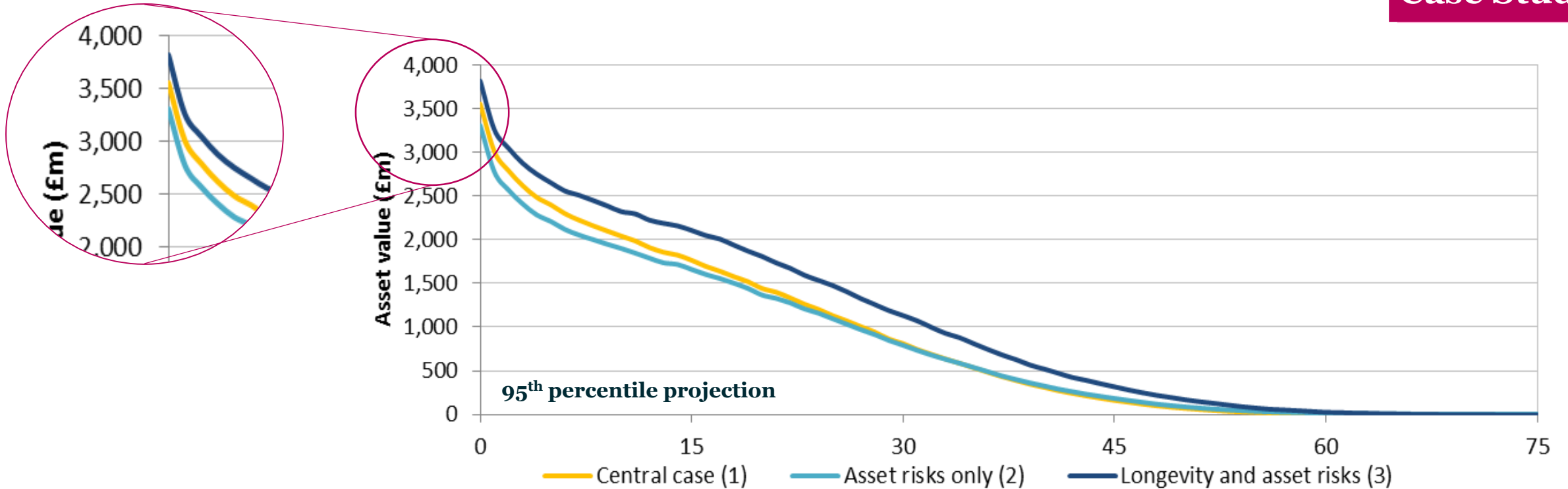
SPONSOR STRENGTH VISIBILITY DETERIORATES

CUMULATIVE PROBABILITY OF DEFAULT (Moody's: 1920-2017)



WHEN ARE YOU SELF-SUFFICIENT? - ANALYSIS

Case Study



1

no excess return
no asset risk
no demographic risk

Initial assets required £3,522m

2

0.4% excess return
0.75% asset risk
no demographic risk

Initial assets required £3,275m

3

0.4% excess return
0.75% asset risk
2.2% demographic risk

Initial assets required £3,717m

WHEN ARE YOU SELF-SUFFICIENT? – RESULTS

Case Study

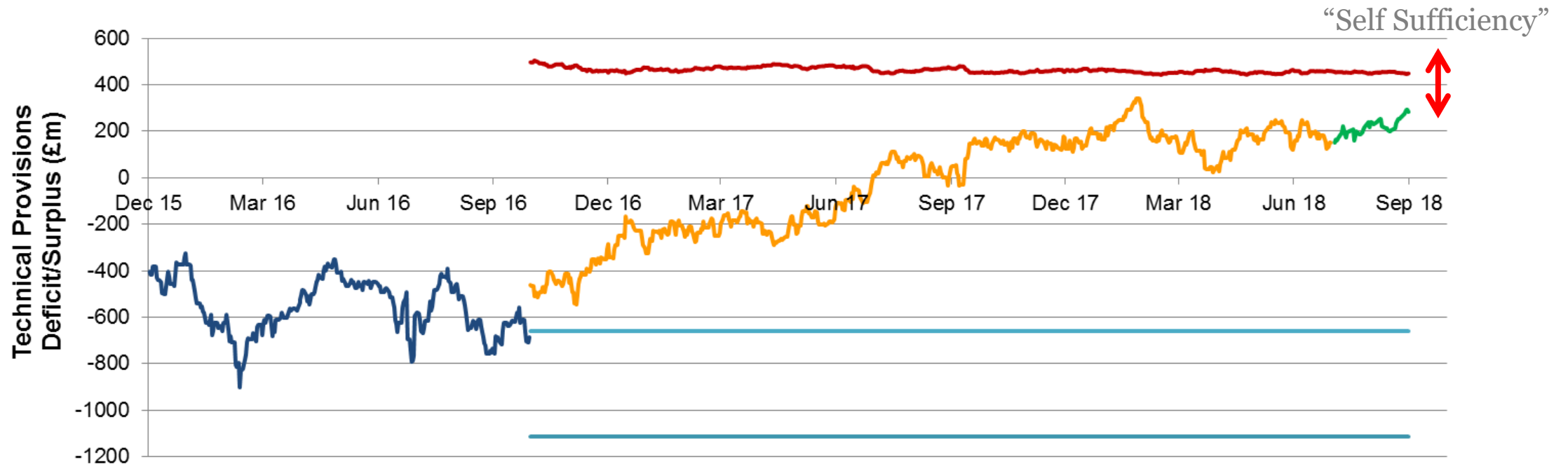
Required likelihood of paying all benefits	Returns/Risks included	Risk reserve in addition to the best estimate gilts basis £m	Implied self-sufficiency margin over gilts p.a.
95%	None	0	0.00%
95%	Asset risks only	-247	+0.33%
95%	Longevity and asset	195	-0.24%
99%	Longevity and asset	465	-0.55%

A 95% probability of meeting all benefits as they fall due equates to a gilts + 0.33% + longevity hedge basis. Additional certainty would require a stronger basis. The analysis assumes that Scheme administration costs are paid in addition.

This longevity reserve may reduce as the Scheme’s membership matures, unless demographic risks are realised. We estimate that in 15 years time, the reserve may be **20-30bps lower**.

THE “POST VALUATION” WORLD

Case Study

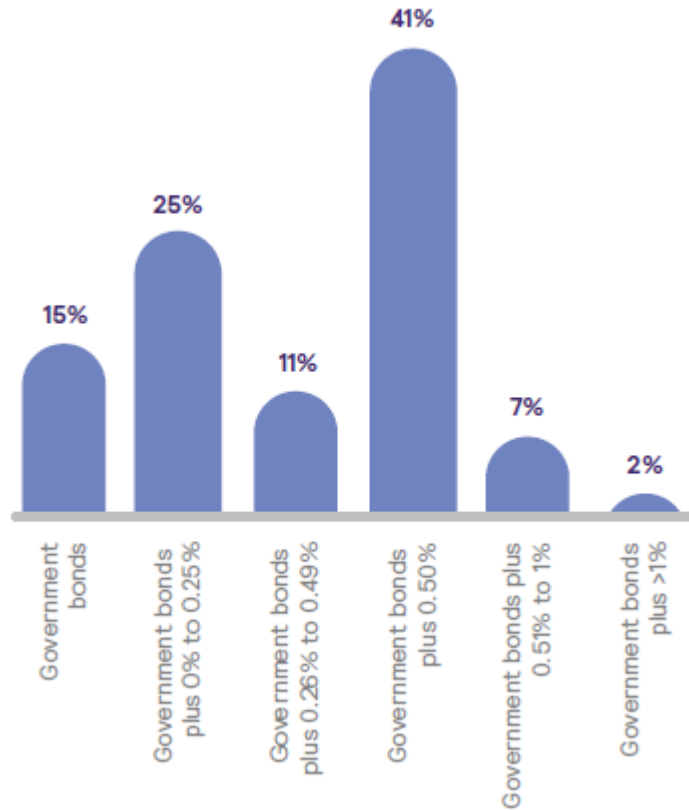


- ▶ Continual, not 3 yearly
- ▶ Greater confidence in target vs current downside implications?

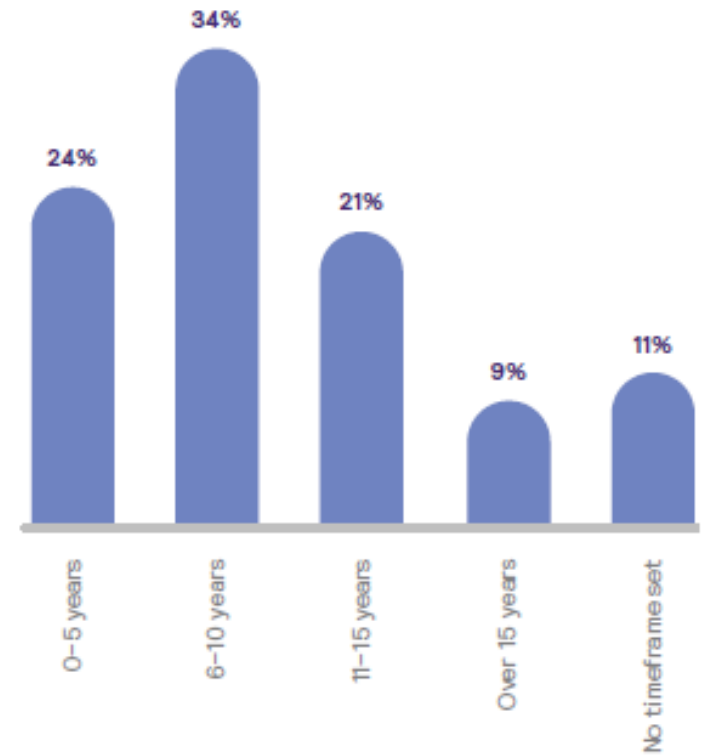
COMPARATOR PRICING

PEER COMPARISON

SELF-SUFFICIENCY BASIS



TIMEFRAME FOR FULL FUNDING



LITTLE ROOM FOR ERROR...



- ▶ Negative cashflow... Shortfalls compound fast



- ▶ Mapping cashflows need to be deliberate



- ▶ Fees and expenses matter more than ever

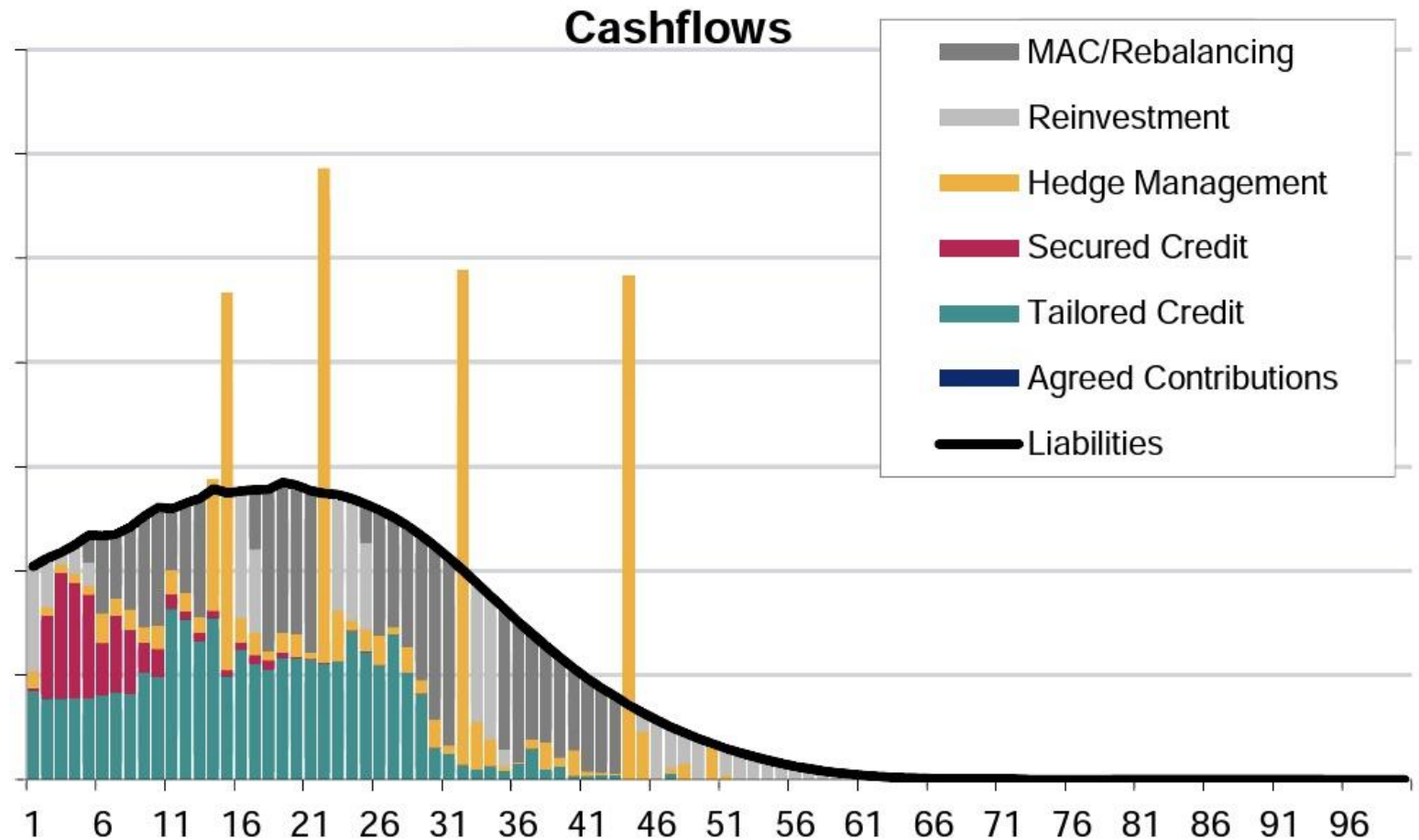


- ▶ Little room for hedge inaccuracy

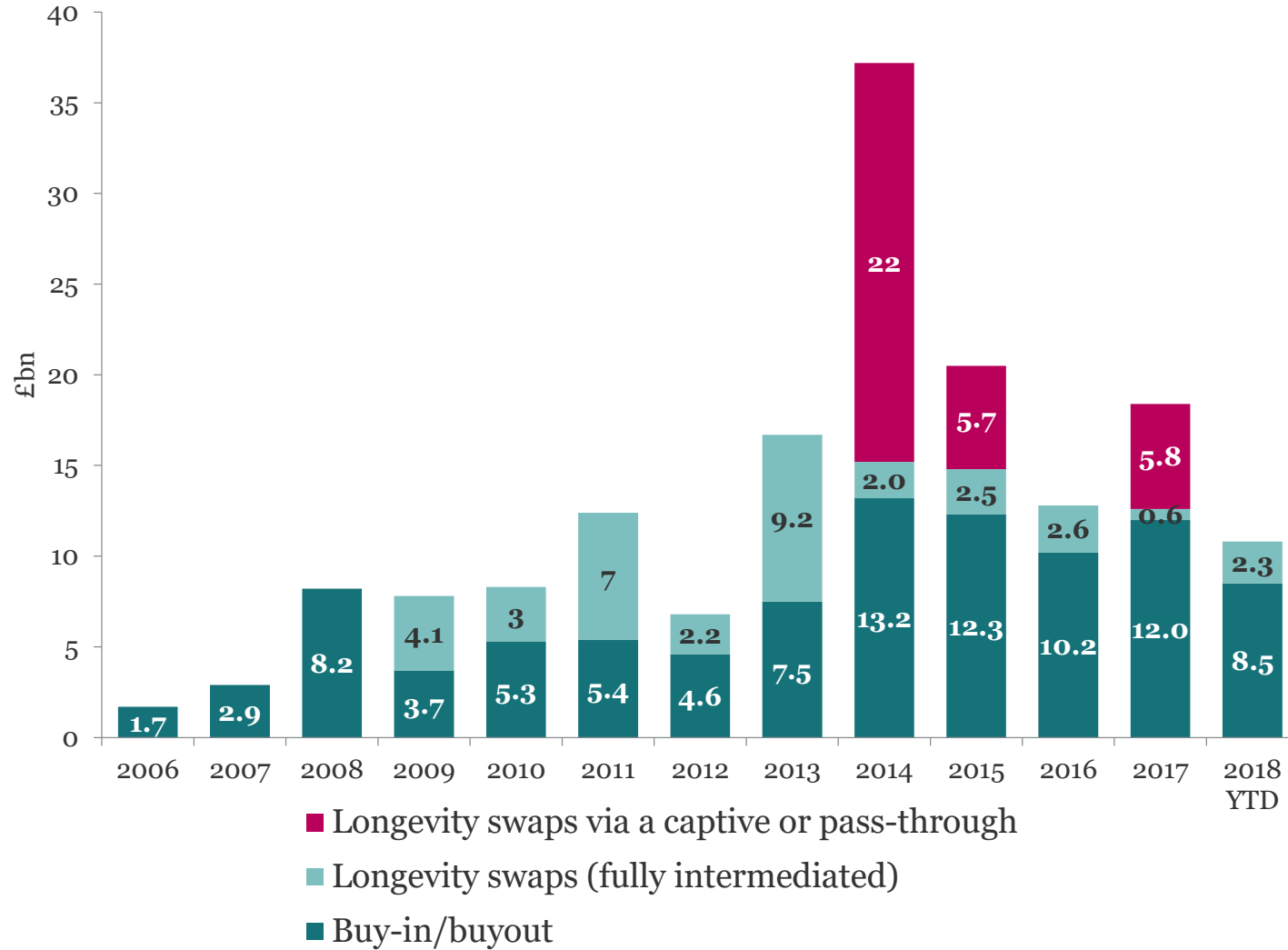
Trustee board must be fit for purpose and prepared for next steps

CASHFLOW DRIVEN INVESTMENT

- ▶ Contractual income assets create much more outcome certainty
- ▶ Recognise liability cashflows still remain uncertain
- ▶ Operational management quite different to traditional approaches
- ▶ ...but avoid unnecessary complication and cost



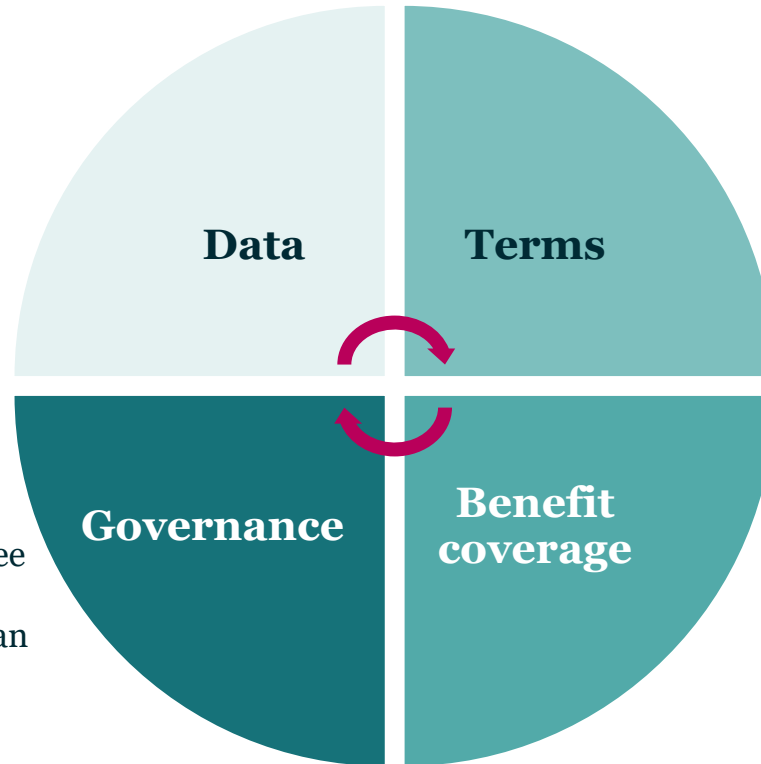
THE RISK TRANSFER MARKET



- £164bn of UK pension scheme longevity risk transferred since 2006, c.71% (£116bn) has been completed since 2013
- Bulk annuity insurers (on the whole) transfer longevity risk to global reinsurers
- Overarching constraint on bulk annuity capacity is underlying longevity reinsurance capacity

PREPARING FOR A TRANSACTION

- ▶ Experience data
- ▶ Data cleanse
- ▶ Collate spouse data
- ▶ Reduce scope for data risk margin in pricing







- ▶ Key commercial priorities
- ▶ Agree potential target pricing and risk budgets
- ▶ Consider parties involved in the process

- ▶ Establish framework to enable clear and agile Trustee and Sponsor decision-making
- ▶ Determine clear go/no go milestones and project plan
- ▶ Agree reporting process

- ▶ Benefit specification
- ▶ Identify potential liability subsets to hedge/insure
- ▶ Consider areas for simplification

ALONGSIDE WORK CONSIDERING FUNDING, INVESTMENT AND OPERATIONAL/ADMINISTRATIVE IMPLICATIONS

MONITORING

	CURRENT STATUS	NEXT STEP	TIMING	RESPONSIBILITY	DOCUMENT REFERENCES
 <p>RISK UNDERSTANDING, CAPACITY AND APPETITE (what do we know?)</p>	<ul style="list-style-type: none"> [e.g. complete/in progress/ to be reviewed/to be addressed] 	<ul style="list-style-type: none"> [e.g. covenant advice to be assessed by trustee] 	<ul style="list-style-type: none"> [e.g. Next trustee meeting] 	<ul style="list-style-type: none"> [e.g. Scheme actuary/trustee/ investment adviser/covenant adviser] 	<ul style="list-style-type: none"> [covenant report] [date?] [funding updates] etc.
 <p>RISK ASSESSMENT (where are the problems?)</p>	<ul style="list-style-type: none"> [e.g. complete/in progress/ to be reviewed/ to be addressed] 	<ul style="list-style-type: none"> [e.g. establish/ identify key milestones] [e.g. raise issue for discussion with sponsor] 	<ul style="list-style-type: none"> [e.g. H2 2018] 	<ul style="list-style-type: none"> [Risk sub-committee] 	<ul style="list-style-type: none"> Risk Register
 <p>RISK MANAGEMENT AND CONTINGENCY PLANS (how do we improve the position?)</p>	<ul style="list-style-type: none"> [e.g. complete/in progress/ to be reviewed/ to be addressed] 	<ul style="list-style-type: none"> [e.g. establish Risk Committee] 	<ul style="list-style-type: none"> [e.g. Next trustee meeting] 	<ul style="list-style-type: none"> [trustee board] 	<ul style="list-style-type: none"> Minutes of meetings with Sponsor
 <p>MONITORING PROCESS (how do we remain informed?)</p>	<ul style="list-style-type: none"> [e.g. complete/in progress/ to be reviewed/ to be addressed] 	<ul style="list-style-type: none"> [e.g. establish regular meetings with sponsor] 	<ul style="list-style-type: none"> [e.g. Q4 2018 and ongoing] 	<ul style="list-style-type: none"> [e.g. transaction sub-committee] 	<ul style="list-style-type: none"> [Project plan]