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Can UK pension schemes benefit from stealing the best bits of Solvency II?

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Can UK pension schemes benefit from stealing the best bits of Solvency II?

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What our discussion will cover today

Wasn't Solvency II trying to help?

So why so many negative headlines about Solvency II

What are the best bits of Solvency II?

How could this apply to UK pension schemes?

What next?

Solvency II

A little bit of background

- Applies to EU insurers and re-insurers. Regulated by EIOPA.
- Aims to implement solvency requirements that better reflect specific risks
- Increases Solvency capital, Governance, and Disclosure

Brief History:

1 1990s	2 2000s	3 2010s	4 1.1.2016
Issues with several insurers causes public lack of faith*	Need for reform “*healthy will be dragged down by the sick*”	Post credit crunch: Lots of models, testing, and documentation!	Gone live!

- Pillar 1: Quantitative requirements (“Solvency Capital Requirements” = SCR)
- Pillar 2: Supervisory requirements (“Own Risk Solvency Assessment” = ORSA)
- Pillar 3: Reporting and disclosure requirements (all stakeholders)

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*Most notable include Independent Insurance Group, Drake Insurance

Case Study: Insurance Company DB Scheme

How Solvency II can impact on the way risk is viewed / managed

Negative headlines and compliance burden

- 2015 was a challenging year for insurers as they prepared for Solvency II

FT ADVISER

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By Stephen Spurdon | Published Sep 02, 2015

Insurers struggling with Solvency II compliance

The Telegraph

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Insurers haggling over Solvency II rules weeks before deadline

Phoenix says it will be ready but that the details on capital rules are still being ironed out with the Bank of England

TheActuary

The magazine of the actuarial profession

LIFE PENSIONS GI INVESTMENT RISK & ERM HEALTH REINSURANCE ENVIRONMENT REGULATION

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Solvency II costs UK insurers £3bn

How big an issue?

100,000

Pages of governance!

Solvency II – The best bits

What are the good things buried in all the compliance?

Best bits:

1. Evidence-based decision making, with clear responsibility and application of “Expert Judgement” where subjectivity
2. Appropriate challenge to assumptions
3. All risks assessed and combined – using sophisticated techniques – which may lead to increased capital
4. Acts to balance commercial pressure
5. Regulated using a “Common Measure”
6. Better communication, not just increased disclosure!
7. Encouraged innovation / risk models

Worst bits:

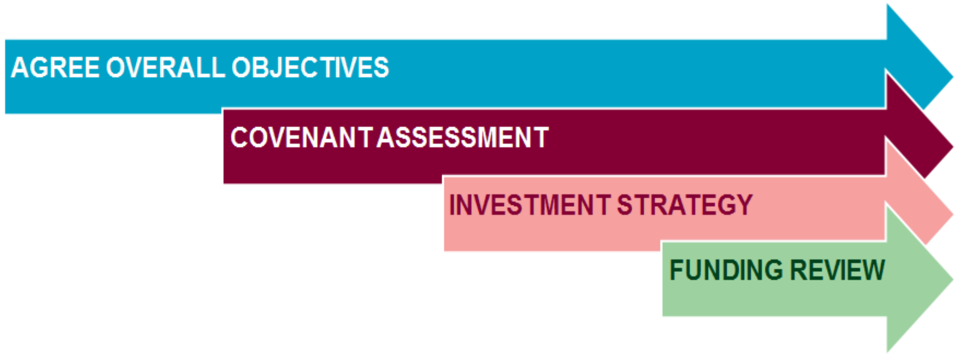
1. Increased compliance
2. 1:200 measurement somewhat arbitrary
3. Model governance “cumbersome”
4. “Hammer to crack a nut”?
   (As not welcomed by practitioners?)

There are lots of advantages, but could they have been achieved without the pain?

Integrated Risk Management

TPR guidance on good risk management practice for pension schemes

"adopt an integrated approach to risk management across the key risk areas to funding plan success – employer covenant, investment and funding related risks" CoP



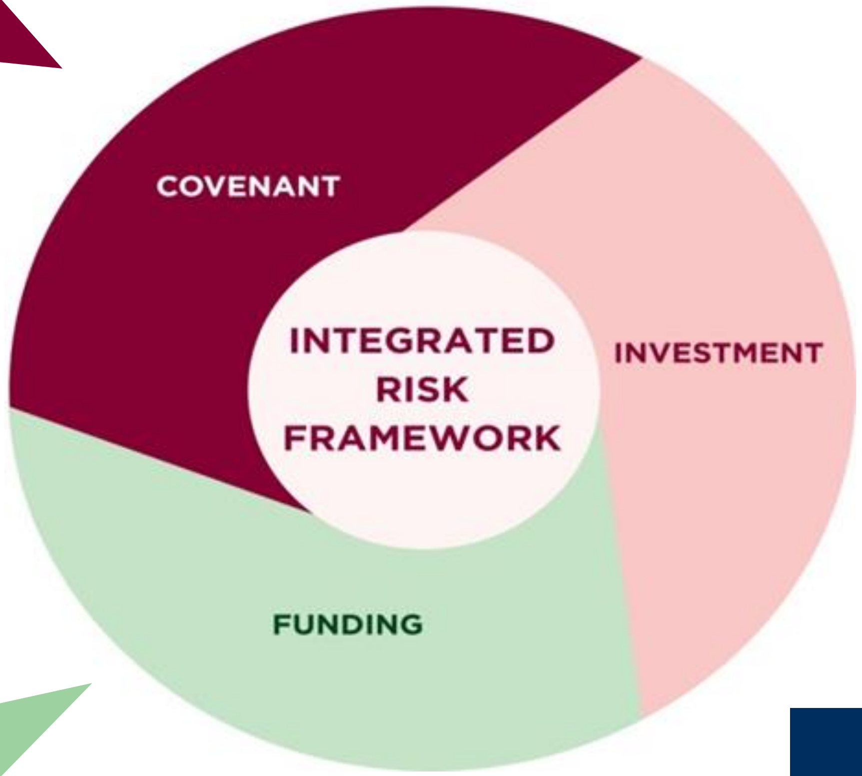
See Seminar D36 (Darren Masters) "Striving for Integrated Risk Management"

http://www.thepensionsregulator.gov.uk/docs/guidance-integrated-risk-management.pdf
http://www.thepensionsregulator.gov.uk/docs/code-03-funding-defined-benefits.pdf

Case study – London-based retailer

Key risks faced by the Scheme

- UK economic downturn
- Terror threat in London
- Fail to develop online
- Cash flow availability



- Equity returns
- Interest rates
- Credit spreads
- Liquidity

- Interest rates
- Inflation
- Mortality
- Correct benefits
- Member options

Integrated approach
Wide ranging discussion
Considering contingent asset from sponsor

Implementing an IRM framework

What does tPR suggest you do?

Step 1: Initial considerations for putting IRM in place

*"…There is no one set formula for what IRM should look like. It…will be **proportionate** to the trustees' scheme objective and the employer's objectives, in the light of their needs and circumstances…"*

*"Putting an IRM framework in place, with appropriate documentation, requires **an initial investment in time** and resources. This will then be repaid as the framework is used by current and future trustees, for and between subsequent valuations…"*

Dec 2015 TPR guidance

Step 2: Risk identification and initial risk assessment – advisors should use consistent assumptions

Step 3: Risk management and contingency planning

Step 4: Documenting the decisions

Step 5: Risk monitoring

The principles of the IRM guidance are very well aligned to Solvency II.
But without the burdensome aspects – so implementation may take many forms

Some possible next steps

There is a lot that could be done to improve pension risk management

Consider Governance	Implement IRM	Better Disclosure
More Professional Trustees?	Stress-tests / Reverse stress tests / VaR	EIOPA's stress-test results
Contingency planning	Integrate risks systematically	Member Options

Hopefully, IRM is the opportunity to benefit from the innovations created by Solvency II, without having to drag pensions through the bureaucracy

Questions

Scope

- This generic presentation should not be relied upon for detailed advice or taken as an authoritative statement of the law.
- All views expressed are those of the author, not those of LCP, the ACA or any other organisation.
- If you would like any assistance or further information, please contact the partner who normally advises you.
- While this document does not represent our advice, nevertheless it should not be passed to any third party without our formal written agreement.
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Appendix

Ask the audience

Let's assume that DB pensions are "deferred pay"

	BANK	INSURER	DB PENSION SCHEME
Should they hold enough assets to pay out cash flow in normal circumstances?			
Should they hold enough to pay out in a bad period?			
Should they ensure that they have access to enough to pay out in the long-term?			
With what level of security? *Would you be happy if a 1 in 20 bad year meant "no money"*?			