



Comments on the Alternate Method

Huw Evans

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Caveat & overview

Caveat

- The views expressed in this presentation are my own and not necessarily those of my employer
- Moreover, I am a UK pensions actuary rather than a covenant expert, accountant etc

Overview

- Sponsor support is a key component of the capital for many IORPs
- Sheer diversity of IORPs means that a principles-based approach is more likely to succeed than detailed guidance
- Suitability of the proposed approach depends on the purpose, regulatory actions etc
- Using judgement to adjust for qualitative information may yield results that are more robust for policy-making, supervision etc.

Comments on general approach

Comment

- Quite positive about proposed alternate method but prefer “reliance on sponsor” as a balancing item that is “managed” by IORP managers etc
- Sponsor support is multi-dimensional and dynamic and these qualities are not captured when it is measured by a single number
- Suitability depends on the purpose, regulatory actions etc
- Using judgement to adjust for qualitative information may yield results that are more robust for policy-making, supervision etc.
- Somewhat counter-intuitive that value of contributions is less than the shortfall
- Consider linking recovery period to income cover and recovery rate to asset cover and testing sensitivity to variations in these credit ratios
- Consider implementation costs

Are these credit ratios the right measures?

Overview

- Actuaries are not experts in this field but, in general, these seem to be appropriate measures
 - But might benefit from adjustment to reflect qualitative information
 - Credit ratings can be valuable where they are available
 - A pension default event may be very different from a credit default and may depend on local insolvency legislation, so default probabilities may need further investigation
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Affordability

Comment

- Positive about emphasis on affordability
 - But affordability needs to reflect all the resources on which the IORP can draw
 - Income cover may be more relevant than sponsor strength when determining payment periods
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Recovery rates

Comment

- Alternate method omits recovery on default. However:
 - Sponsor support is potentially very sensitive to the recovery rate
 - Pension default could be the result of an asset rich company running out of cash. The recovery rate could still be close to 100%.
 - Perhaps assumed recovery rate should be linked to asset cover
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Maximum sponsor support

Comment

- IORPs unlikely to produce numbers they are not required to produce
 - But does there need to be a sense check on the value placed on sponsor support?
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Complex structures

Comments

- Group companies, multiple IORPs, industry-wide schemes etc are all more complex but the issues are not unique to pensions and have been addressed, for example, in M&A work.
 - A pragmatic approach is clearly required but alternate method may be too simplistic
 - Again a principles-based approach is more likely to succeed.
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