

# Risk Management Case Study From A Trustee's Perspective

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26<sup>th</sup> May 2011

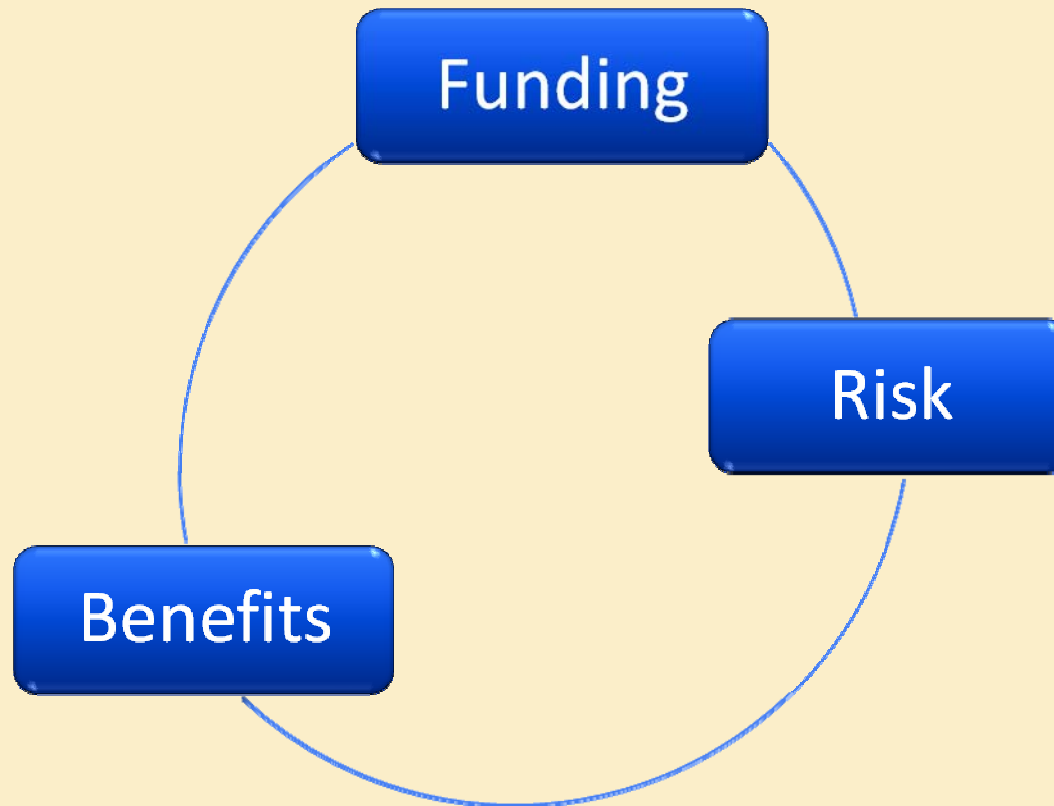
## Background to the Scheme

- Employer is in the Charity/Voluntary Body Sector
- Defined Benefit Scheme which was closed to new entrants in 1998
- Assets of the Scheme are €8m
- Portion of accrued liability relating to existing pensioners is currently 30%
- Historically had funded for and granted discretionary pension increases
- Cash funding is the main financial driver from the Employer's perspective

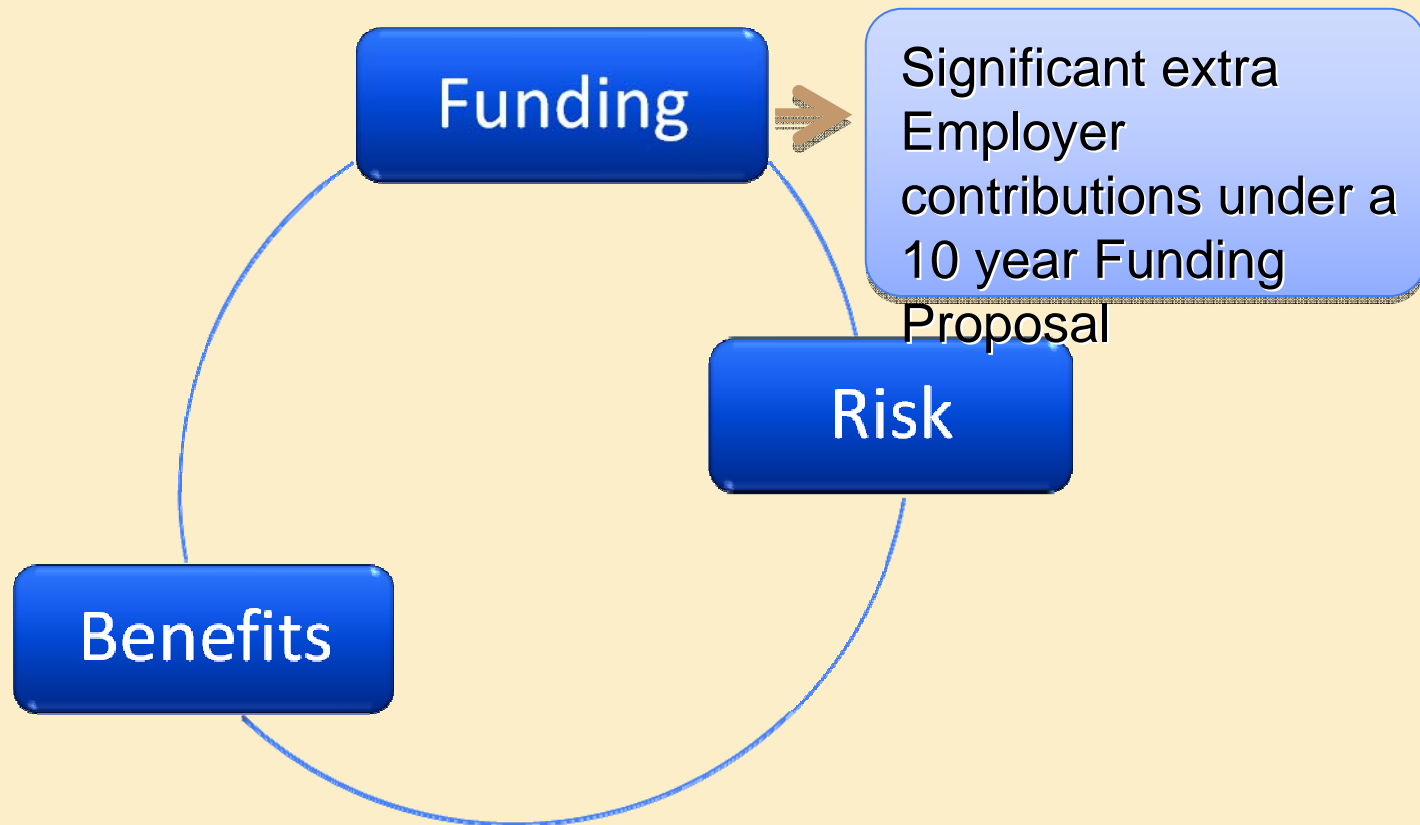
## Financial Position of the Scheme

- Scheme did not satisfy the Minimum Funding Standard. In mid 2010 it had a deficit of €1.5m on MFS liabilities of €9.5m
- Scheme set to mature further over medium term. 70% of accrued liabilities projected to relate to pensioners by 2020
- Scheme was 98% invested in a Managed Fund. Overall the fund had 18% invested in bonds

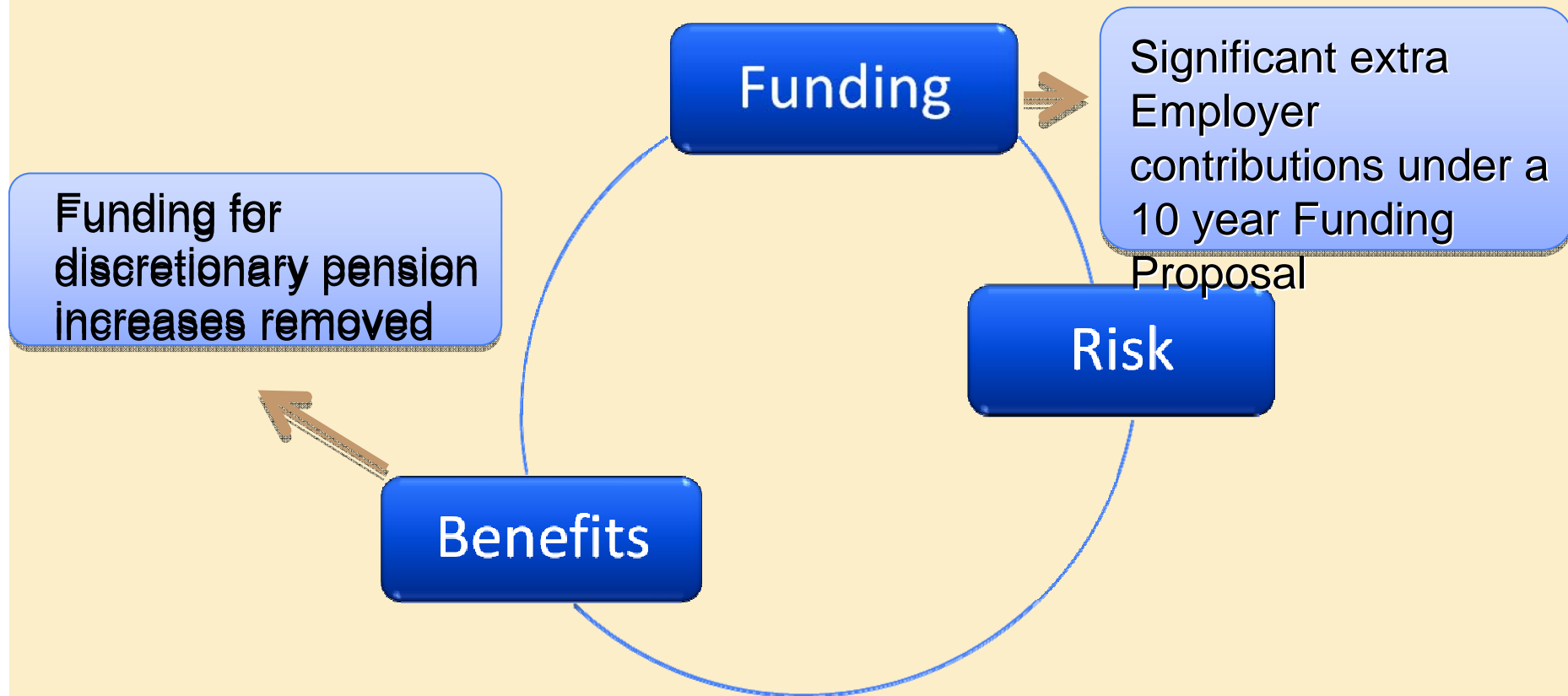
## Draft Funding Proposal (Q2 2010)



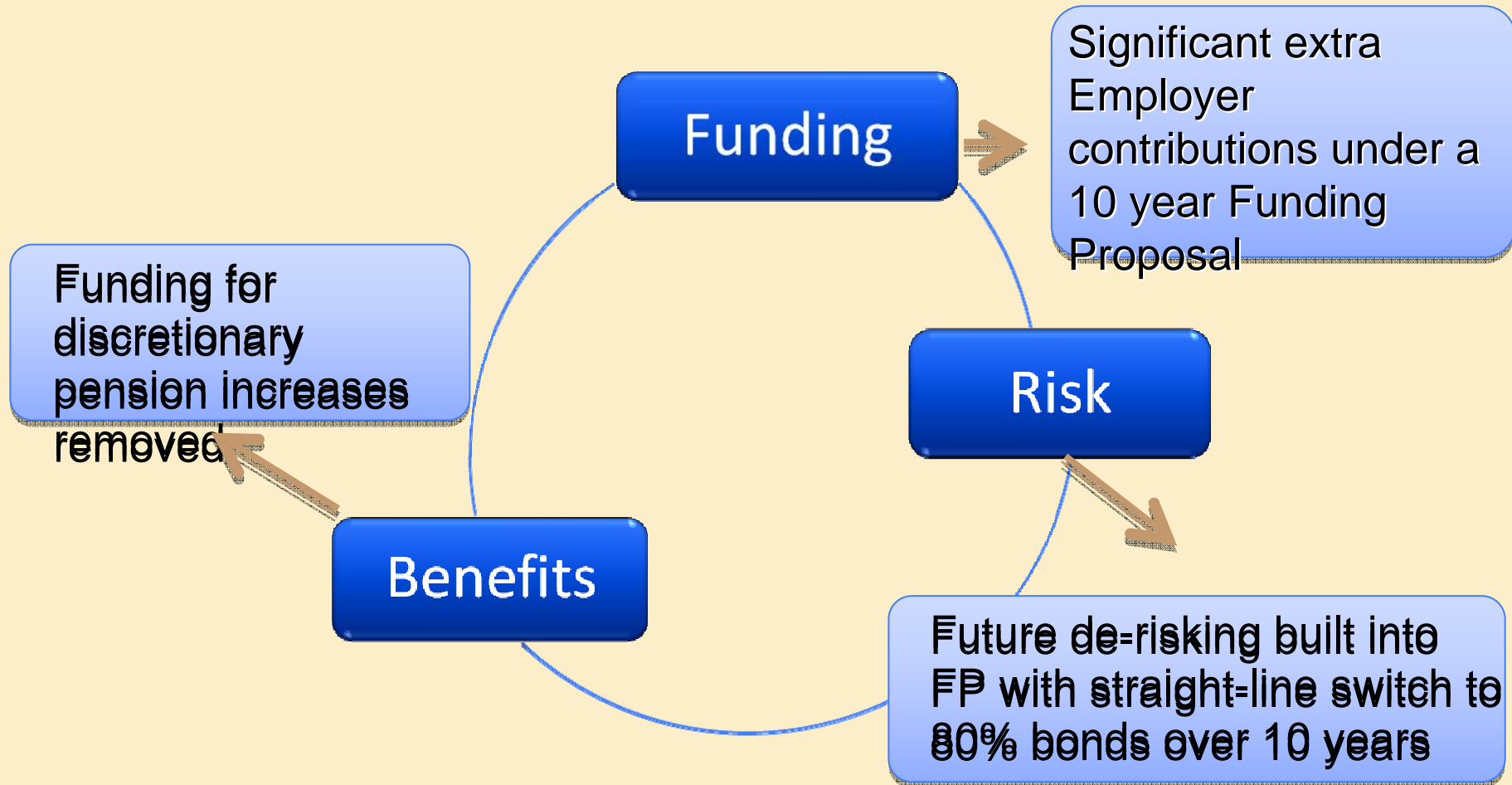
# Draft Funding Proposal



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## Key Conclusions From Discussions on FP

- Employer contributions very stretched – No capacity for increases in contributions in the future
- Clear agreement reached that priority should be to provide greater security to members and certainty of funding to the Employer
- While future de-risking was built into the draft funding proposal, it was agreed to carry out a full review of investment strategy

## Conclusions From Investment Review (Q4 2010)

- No initial increase in defensive assets, although changes to the defensive funds used
- Agreed we will manage future risk dynamically:
  - If relative investment returns achieved are **in line with** Funding Proposal then **switch planned amount**
  - If returns are **better** than assumed then **accelerate de-risking**
  - If returns are **worse** than assumed then **decelerate de-risking**
- Significant diversification of growth seeking portfolio
- Partial currency hedging of non-Eurozone assets

## Implementing De-Risking

- We have put in place an automatic trigger mechanism which will track relative movement in equities and bonds
- Conscious not just of the sell side but also of the price at which we will be buying into bonds. Therefore we split the triggers into:
  - a) Triggers which will cause us to sell out of growth assets
  - b) Yield level triggers at which we will buy into bonds

## Triggers

### **Trigger 1:**

**Sell** €1m if relative movement in equities over long bonds exceeds 10%

**Buy** long bonds immediately if German bond yield is above 3.5%,  
otherwise hold in cash until yield exceeds 3.5%

### **Trigger 2:**

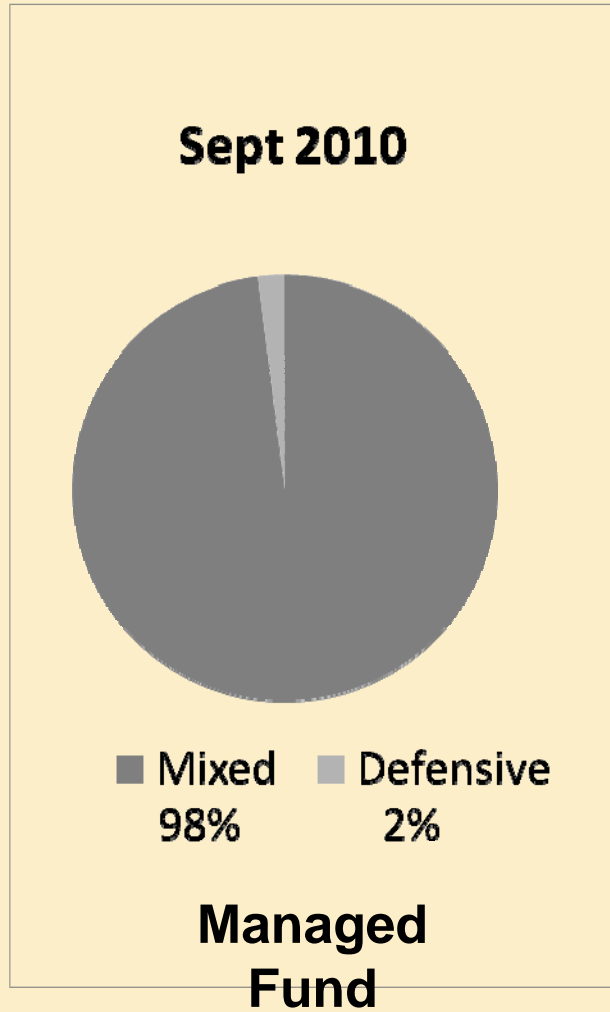
***As above***

Agreed also to arrange special trustee meeting after trigger 2 changes have been implemented.

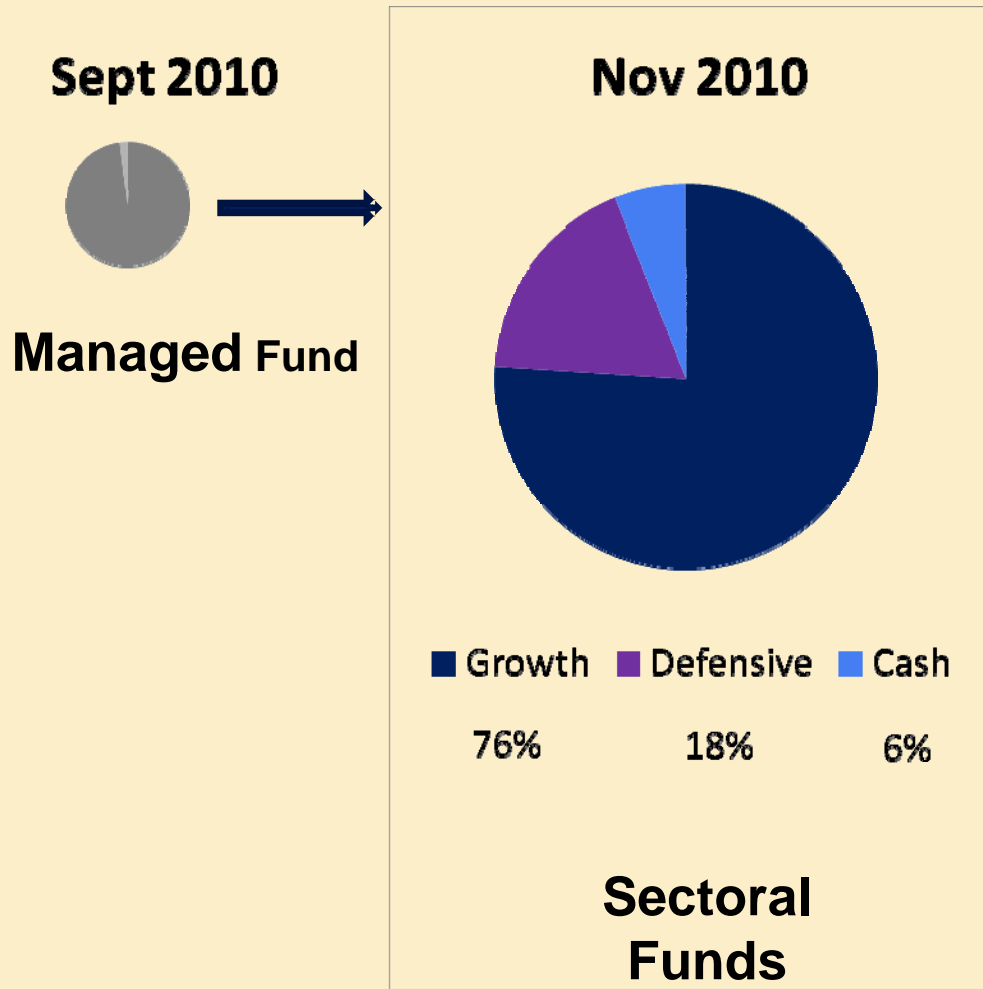
### **Trigger 3:**

***As above***

# Progress So Far



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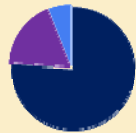
# Progress So Far

**Sept 2010**



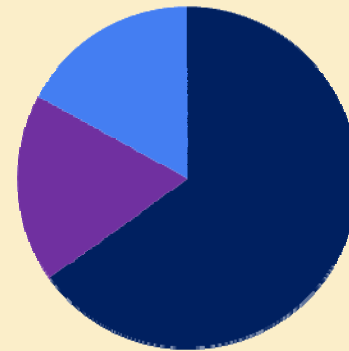
**Managed  
Fund**

**Nov 2011**



**Sectoral  
Funds**

**March 2011**



■ Growth 65%   ■ Defensive 18%   ■ Cash 17%

**Sell Trigger**

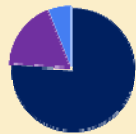
# Progress So Far

Sept 2010



Managed Fund

Nov 2011



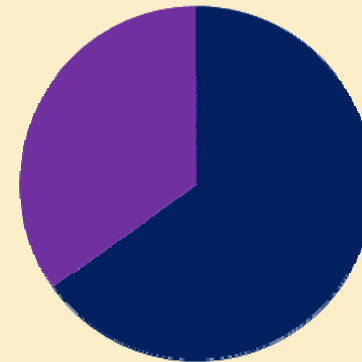
Sectoral Funds

March 2011



Sell Trigger

?



■ Growth 65%   ■ Defensive 35%

Bond Buy



# Progress So Far

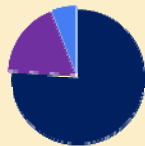
Sept 2010



Managed Fund



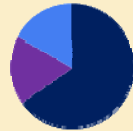
Nov 2011



Sectoral Funds



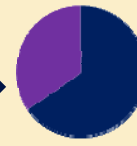
March 2011



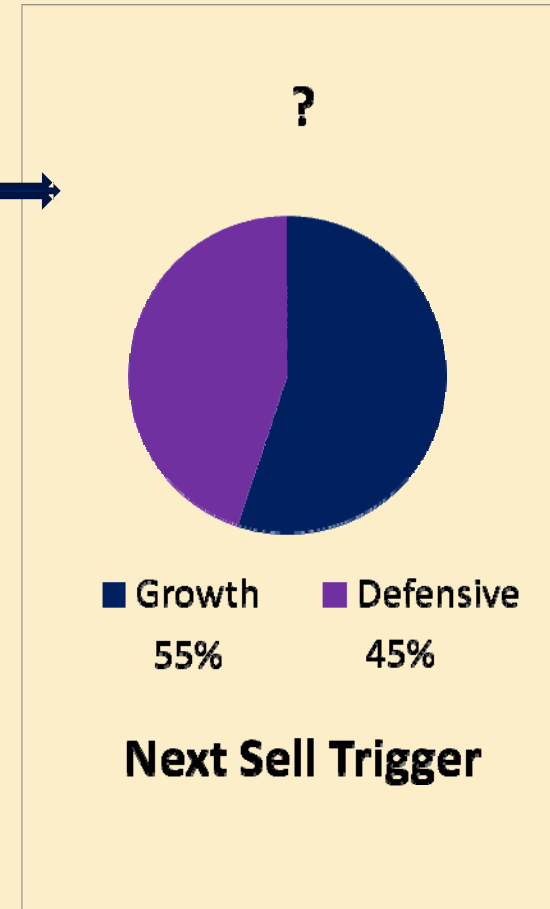
Sell Trigger



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Bond Buy



## Observations on Managing Risk

- Essential to have a clear objective for the future operation of the scheme
- First port of call was if possible, to build in automatic de-risking into the operation of the scheme
- Dynamic de-risking added to accelerate de-risking
- Clarity on which parts of the portfolio will and will not contain risk
- Having separate sell and buy triggers may not be everyone's cup of tea?
- As with all investment reviews, important to make first order decisions. If second order decisions are confusing things, may be best to park them
- Need to have a strong and automatic implementation mechanism
- Keep under review

# Trustee Principles

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