

Sponsor Covenant Working Party
Final Report The Actuarial Profession
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SDA retirement plan

SPONSORING COVENANT

COVENANT IS BIBLICAL CONCEPT

- ✘ Behold, I give you a covenant of peace: And he shall have it, and his seed after him, even the covenant of an everlasting priesthood; because he was zealous for his God
- ✘ Numbers 25:12
- ✘ Covenant is an inter-generational compact that is not interrupted by change of office holders or even death. It is initiated by the sponsor for the benefit of its subjects.

THE PLAYERS

- ✘ The Actuary quantifies liability based on calculation, (they are not management consultants.)
- ✘ The Trustees determine sponsor contributions
- ✘ The Pension Regulator is the Referee
- ✘ The Employer is required to collateralise his liability.
- ✘ Covenant Auditors - Those able to really assess the employers capacity & intent.

WHAT IS THE SPONSOR COVENANT?

- ✘ the combination of:
 - ✘ (a) – the ability
 - ✘ (b) – the willingness of the sponsor
 - ✘ (c) – the capacity of trustees to require the sponsor
- ✘ To pay sufficient advance contributions to ensure that the scheme benefits can be paid as they fall due.

A FORM OF CREDIT RISK?

- ✘ Pension liability is a form of Corporate Debt
- ✘ The extent and terms of the debt is determined by actuarial estimate and negotiation.
- ✘ The value is not precisely quantifiable in comparison to a pre-arranged loan facility for example.
- ✘ Indebtedness is determined by common consent – covenant – the sovereign commitment of the employer is required.

THE COMPLICATION OF A MULTI-EMPLOYER SCHEME

- ✘ How is the debt allocated / distributed?
- ✘ Is there a covenant between employers?
- ✘ Is it contracted or constitutional?
- ✘ Is it based on liability of employer or asset capacity of employer?
- ✘ Is ascending liability possible, are there fire-walls?
- ✘ How would debt be prioritised on wind-up?

DEFICIT REPAIR PLANS

- ✘ There is a need to balance:
- ✘ Improving the funding position of the plan
- ✘ Precipitating a cash crisis for the sponsor
- ✘ Informing the sponsor of his plight
- ✘ Requiring the sponsor to take remedial action

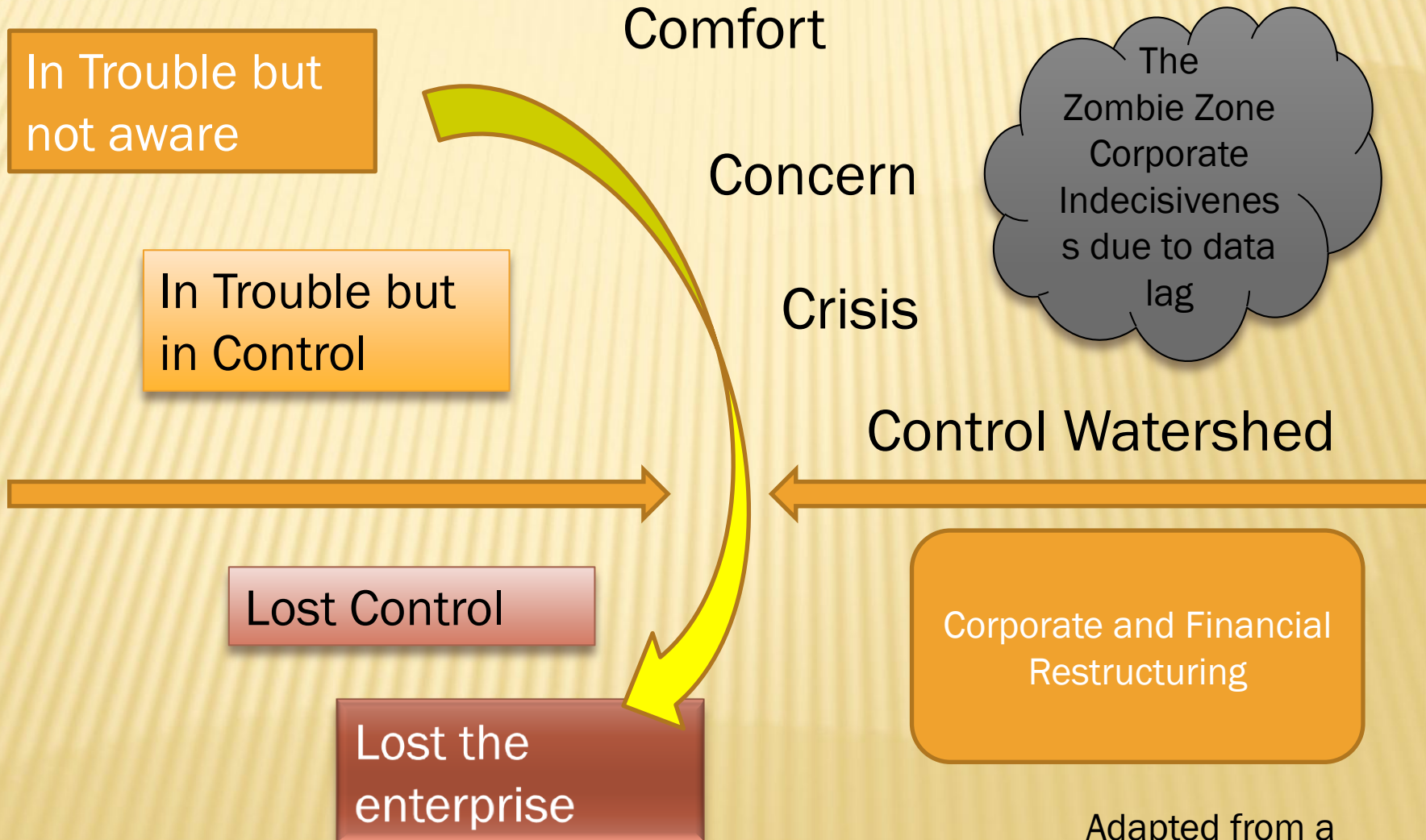
ADEQUATE SECTION 75 COVER

- ✘ Buy out debt (in our case £68million) is covered by the sponsors assets in the event of insolvency.
- ✘ Trustees may take a long term view: but
- ✘ They must put in place monitoring powers to ensure that the position does not deteriorate and formalise covenants at the time of actuarial valuation.

INADEQUATE SECTION 75 COVER SPONSOR RISK IS A VERY REAL ISSUE!

- ✘ If the employer has cash – press for reduction in underfunding.
- ✘ If the employer does not have liquidity:
- ✘ Gain security over company property
- ✘ Identify activities that may yield cash in the future. (Sale of assets for example)
- ✘ Ensure that they have preferential ranking in the hierarchy of debt.

THE CORPORATE DEMISE CURVE



Adapted from a PWC model

THE CHALLENGE FOR TRUSTEES

- ✘ Comfort zone induces inaction by stakeholders
- ✘ Management denial is strong
- ✘ The Comfort to Crisis slope is swift
- ✘ Advisers (Actuaries / Auditors / Lawyers) are not experts in corporate decline.
- ✘ Trustees are conflicted in times of crisis
- ✘ Trustees have to compete with the vultures
- ✘ The vultures get there first !

TRUSTEES MONITORING

- ✘ Review sponsor accounts regularly
- ✘ View PPF levy as a proxy for risk evaluation
- ✘ Transfer PPF levy to sponsor since this sharpens the mind of sponsor
- ✘ Interview CFO's of sponsor to ensure future strategy takes account of Pension Liability.
- ✘ Impose informational covenants that require consultation on strategies.
- ✘ Require record of resolutions of commitment by each employer.

TRUSTEE ACTIONS TO MITIGATE

- ✘ Increase Bond portfolio thereby reducing the scope for weak technical provisions.
- ✘ Invest in assets that payout in the event of failure. (Credit Swaps – maybe PPF fulfils this?)
- ✘ Insist that investments in property carry security in favour of Pension Fund.
- ✘ Ratchet contributions to increased income
- ✘ Require contingent contributions on deterioration of financial position.

ACTUARIAL FEEDBACK CYCLE

- ✘ If the actuary perceives that the covenant is weak, it is likely that provisions / factors will be strengthened.
- ✘ Actuarial advice is torn between the assumption that the enterprise is eternally ongoing against the real possibility of imminent wind up ('don't panic Mr Manwaring' versus 'we are all doomed' – while avoiding the perception that Actuaries are playing Dads Army)
- ✘ Trustees have to moderate these extremes.

DO WE NEED A CREDIT RISK CONSULTANT?

- ✘ Which consultants have expertise in our domain?
- ✘ Would consultants tell us anything we do not know?
- ✘ Would the employer really act on their finding?
- ✘ What do we have that is measurable?
- ✘ What techniques are appropriate?
- ✘ Would there be a cost-benefit?

ASSESSMENT TECHNIQUES FOR A NOT-FOR PROFIT ORGANISATION

Method	Description	Features
Business Outlook	General view of sponsor in the context of its sector	Cheap, Subjective, Non Quantifiable
Financial Metric	Assessment of capitalisation	Cheap, doesn't measure risk, access to internal accounts.
Credit Rating	Dun & Bradstreet	Low level, inspecific, cheap, not incisive.
Independent Business Review	Insolvency Practitioner	Expensive, Sponsor cooperation, Not a general monitoring tool, useful in crisis situation, It may answer the question: How much can the sponsor afford?

THE ADVENTIST COVENANT IS POLITICAL!

- ✘ The market value of all Assets within the British Union are probably sufficient to meet Section 75 / Buyout criteria, but they are otherwise designated.
- ✘ The theology of Hope is forward looking with a propensity to disregard encumbrance.
- ✘ Prior to the 1992 Charities Act, the unincorporated structure gave convergence of command and ascending liability.

CONSTITUTIONAL TENSION

- ✘ GC / Divisional entities were responsible for policy, custody and implementation of prior liabilities, yet deny liability devolving these to Unions.
- ✘ Union has nominal responsibility without constitutional control.
- ✘ Conferences operate storehouse control without primary responsibility for pension.
- ✘ Institutions operate in deficit and dependent on appropriations from Union & Conference.

OPERATIONAL TENSION

- ✘ Each entity is required to operate a balanced budget including the provision of pension contributions, even though Balance Sheet is in deficit.
- ✘ Multiplicity of institutions distributes Governance such that no one body of Governors has responsibility for the whole or even knows the whole.
- ✘ Democratic determination is compartmentalised to frustrate rationalisation.

POSSIBLE ACTIONS

- ✘ Constitutions should reference the Pension Plan in their schedule of wind up procedures.
- ✘ Constitutions should recognise the shared ongoing liability currently recorded by Deed.
- ✘ High level action should be considered to rationalise the number of institutions where these are currently unaffordable.
- ✘ New properties purchased with central support should be registered as contingent assets.
- ✘ Joint meetings of Governance should recognise the whole picture annually.

NEW COVENANT - HEBREWS 8

- ✘ But now hath he obtained a more excellent ministry, by how much also he is the mediator of a better covenant, which was established on better promises...
- ✘ For this is the covenant that I will make...
- ✘ I will put my laws into their mind, and write them in their hearts: I will be to them a God, and they shall be to me a people.

WE HAVE DRUNK FROM WELLS WE DID NOT DIG

- ✘ Houses full of good things, which though filledst not, and wells digged, which though diggest not, vineyards and olive trees, which though plantest not; when thou shalt have eaten and be full. Deut 6:11

ACTION

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