

CLOSED PENSION FUNDS

SEMINARS, 10 MARCH AND 20 MARCH 1995

A half-day seminar on closed pension funds was held at Staple Inn Hall on 10 March 1995. To meet the demand for places, the same programme was repeated on 20 March 1995. Each seminar consisted of a series of presentations given by members of the actuarial and legal professions, and ample time was made available after each presentation for contributions from the floor.

A closed pension scheme is one which no longer accepts new entrants. Such schemes can exist with or without a sponsoring employer and, in the former case, continued benefit accrual may occur for existing members. The main issues covered in these seminars were the arguments for running a closed fund rather than winding up the scheme, the choice of investment strategies for a closed fund, and the legal issues involved for trustees and their advisers.

The first presentation was given by Mr E. S. Topper, an actuary with practical experience in this field. He observed that, in principle, a closed fund could run for many years with only gradual changes in the investment strategy to accommodate the reducing average term of the liabilities. However, if a wind-up of the scheme was expected in the relatively near future, an immediate switch of investments from equities to gilts was likely, in order to match the accrued liabilities. Mr Topper was concerned that such a policy might result in a scheme with an on-going surplus moving into deficit on a closed fund basis. He questioned whether the members' interests were best served by the purchase of deferred annuities, given the terms on which such contracts were typically sold. He was also concerned that, prior to a wind-up, the trustees of a scheme which was in deficit on a buy-out basis might receive legal advice that cash equivalents should be scaled back. This was clearly unjustified if the scheme had sufficient assets to pay full cash equivalents to all its members.

The second presentation was given by Mr M. R. Slack, an actuary who has advised a large closed fund on suitable investment strategies. He said that it was essential to project the incidence of future benefit payments, so that the scheme could estimate when, and in what quantities, assets would need to be realised. An equity-based investment strategy was justified for a scheme consisting mainly of deferred pensioners, but what strategy was suitable when most of the members had retired? While accepting that pensioner liabilities should normally be matched by a suitable gilt-edged portfolio, Mr Slack gave two reasons why significant equity exposure might still be appropriate, viz:

- (1) equities are expected to produce superior returns to gilts; and
- (2) equities are real assets, and thus may allow greater scope for discretionary increases to pensions in payment.

He then outlined possible methods of determining a suitable asset mix, one of which was to match the projected benefit outgo over a fixed time horizon against gilt-edged stocks, and invest the remainder of the fund in equities.

The third presentation was given jointly by Messrs J. Seres and D. Sloan, both members of the Association of Pension Lawyers, who commented on the legal aspects of running a closed fund. It was pointed out that running the scheme as a closed fund without further accrual of benefit generally required amendment of the scheme documentation. As this requires the consent of the sponsoring employer, such a course of action may not be practicable in the circumstance of the employer's liquidation. Mr Sloan said that advice given to trustees on whether or not to run a closed fund should be based on a rational assessment of the risks and potential rewards compared with buying out the liabilities. Mr Seres, however, felt that trustees were not in a position to make strategic decisions of a kind that involved sacrificing security for potential extra investment returns. He went on to suggest that the preservation legislation be amended to allow the purchase of insurance policies which did not guarantee the accrued benefits, given that without-profit policies were generally seen as uncompetitive.

The final presentation was made by Mr J. Penna, an acting closed fund trustee. He spoke of the increased burden on trustees in the absence of a sponsoring employer. Services previously provided by the employer, such as premises, administration, answering members' queries and professional advice, now became the responsibility of the trustees. In such circumstances, trustees could be left feeling exposed. In the case of his own scheme, he felt that retaining the same actuary had been helpful and reassuring. He said that the main reason for running a closed scheme was to get a better deal for members than could be obtained by buying out the accrued benefits, but eventually the trustees would have to make a decision to wind up the scheme. Mr Penna believed that the main factors affecting the timing of such a decision would be the annuity terms available in the market, the size of the remaining membership, an increase in running costs due to overbearing legislation, failure to maintain a competent trustee board, and failure to maintain adequate administration services.

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