Corporate issues: Hot topics and current thinking

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Agenda

- The corporate landscape
- Liability management and the de-risking journey
- Longevity hedging innovation
- Settlement developments
- What is the actuary's role?
- Questions and discussion

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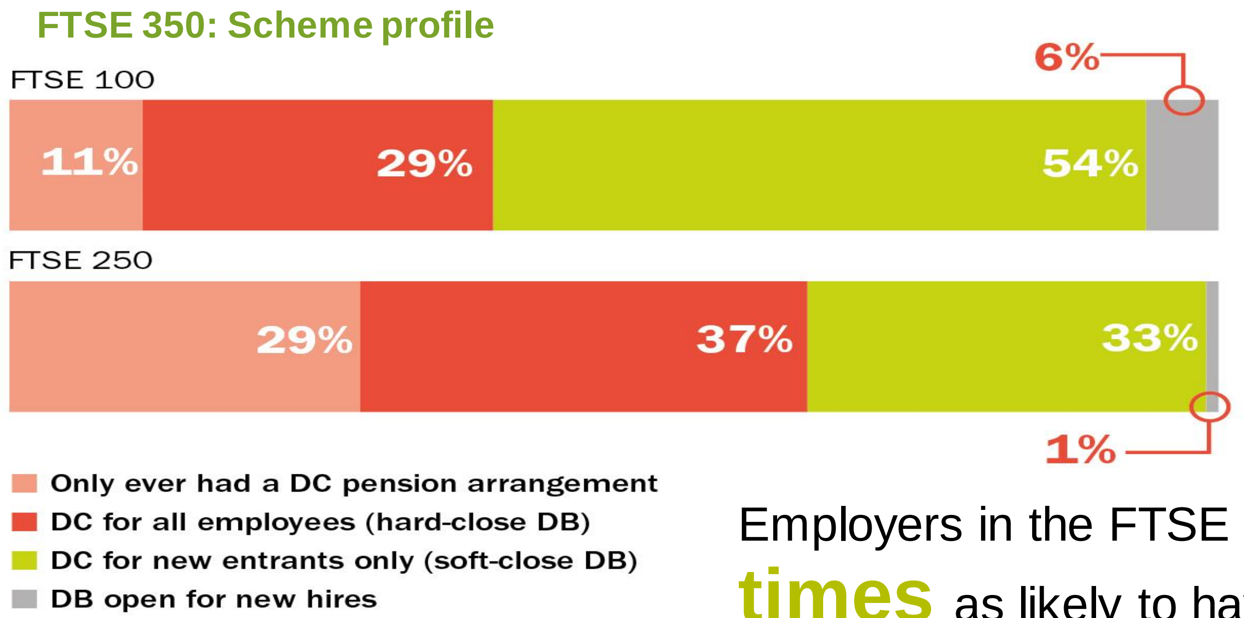
Funding and journey planning

Less DB accrual in the FTSE 250



Half of FTSE 100 employers have a **'two-tier' workforce** compared to just a third of FTSE 250 employers

Employers in the FTSE 250 are **three times** as likely to have only ever had a DC scheme than their FTSE 100 counterparts

How will the end of contracting-out in 2016 change this picture?

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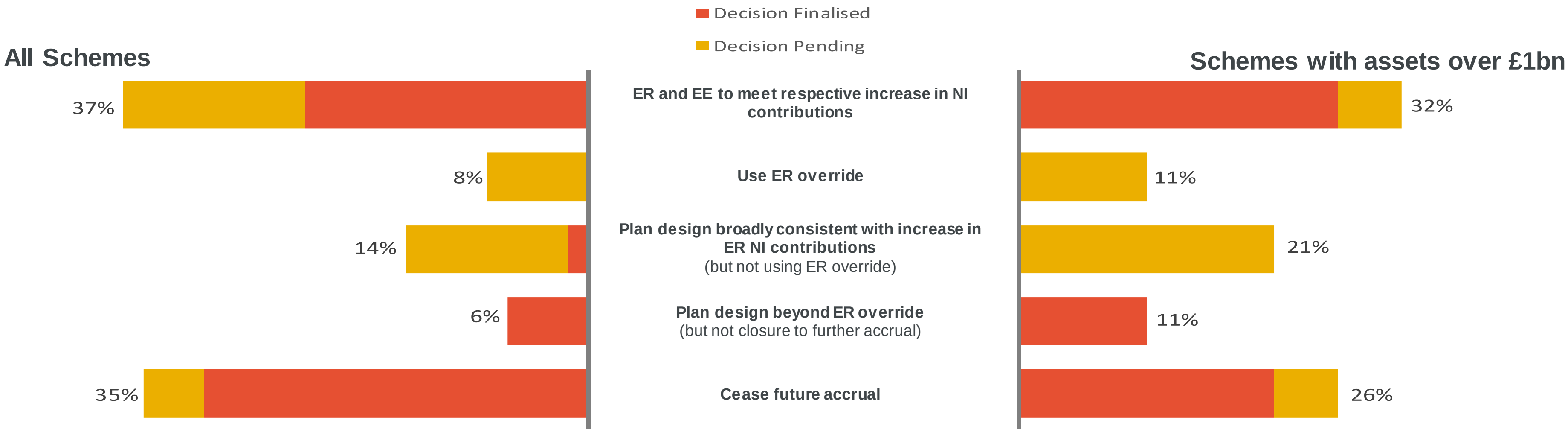
The end of contracting-out: future plans survey

Survey carried out by Towers Watson in March 2015

At present, what is the main option under consideration in relation to the cessation of contracting out?



Base: Organisations sponsoring a DB pension scheme that is currently contracted-out where the main consideration regarding the cessation of contracting out has been shared n=63 of which those with assets over £1bn billions pounds n=19.

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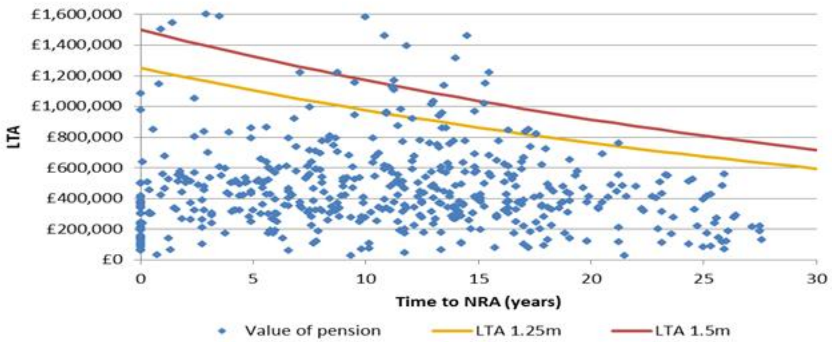
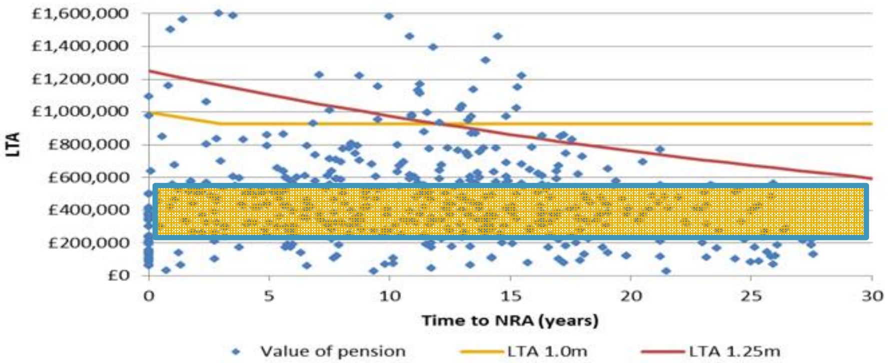
How do the HMRC changes impact members?





Previous analysis

- Companies will need to revisit any assessment undertaken

Revised analysis

- More members likely to be impacted
- Employers will need to:
  - Agree how any alternative package and policy for affected members is impacted
  - How members are communicated to
- DC flexibility also creates additional choices

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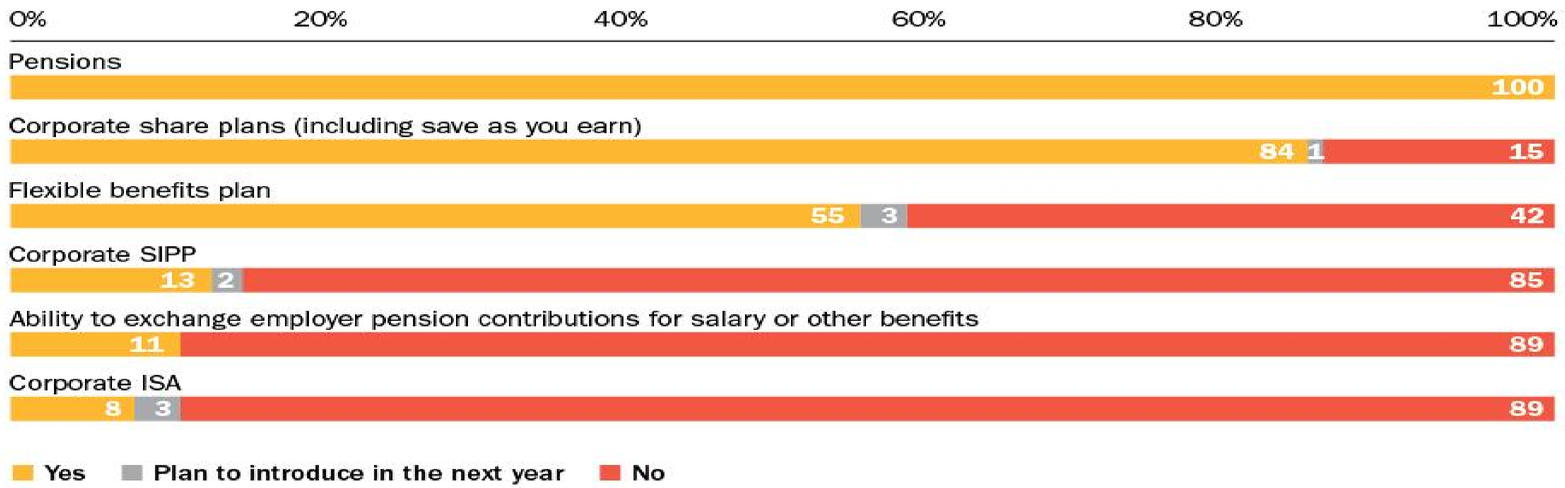
Pensions as part of wider benefits

Tax efficiency appears to be the **prime driver** for employers to offer these wider savings benefits

FTSE 350: Wider benefits



If pensions tax efficiency changes, would this picture change?

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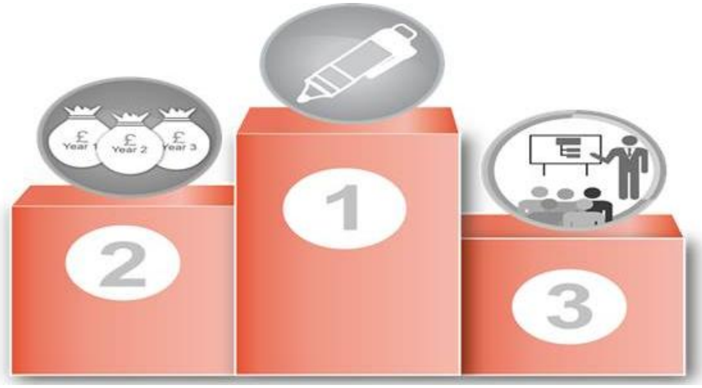
How are employees affected?

What type of help do you think members ideally need on retirement?



Annuity broking

Well-written communications

Pre-retirement seminars

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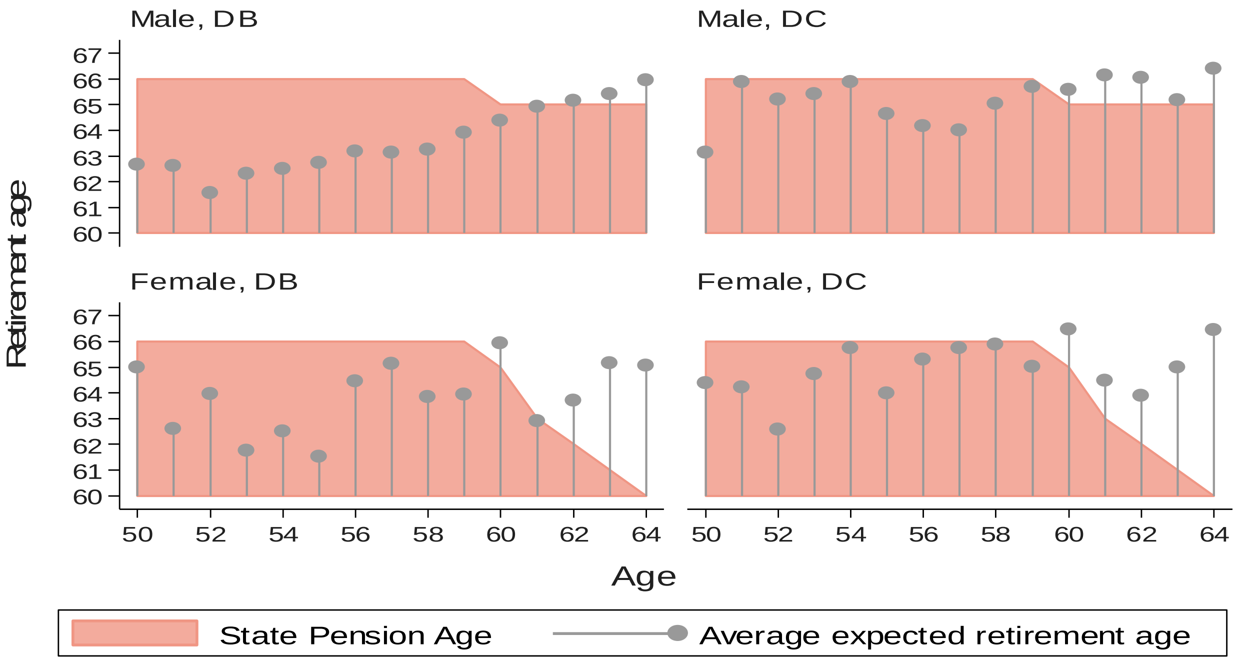
Expected retirement age

At what age do members think they will be able to retire?



63.4
DB

Average retirement age

65.0
DC

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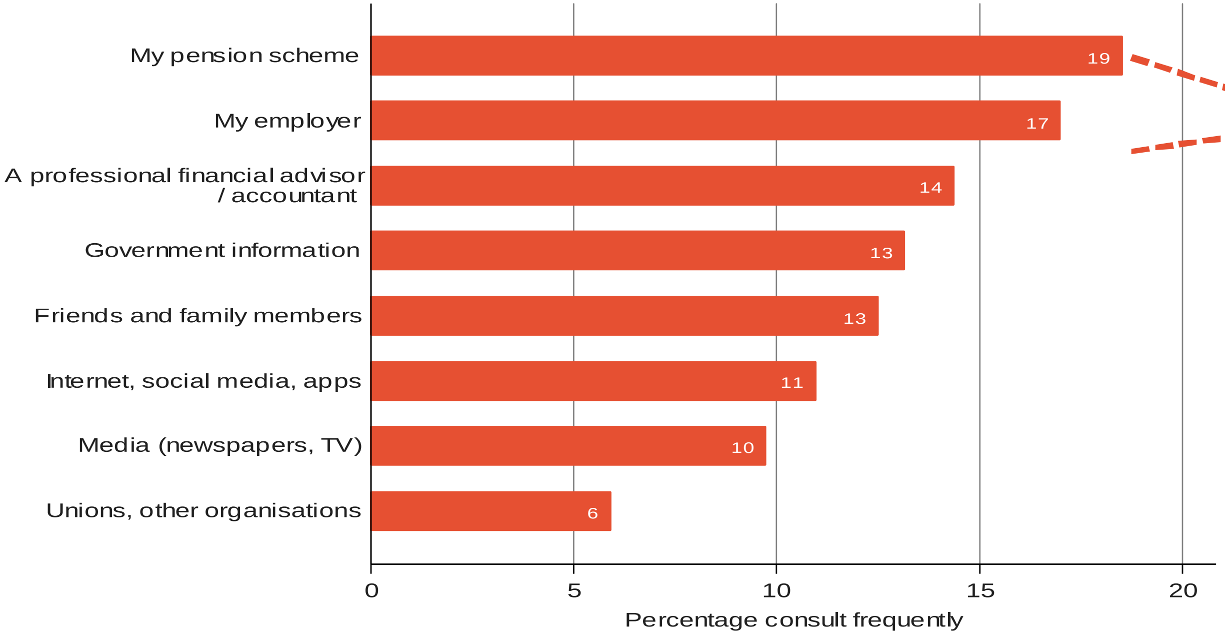
Members will be looking to employers and schemes for information

Who do you turn to for information on managing your retirement savings?



25% indicate their employer or pension scheme

Sample: Plan members

Source: 2014 Choices at Retirement Survey
Numbers reported are rounded to nearest whole, bars reflect un-rounded data

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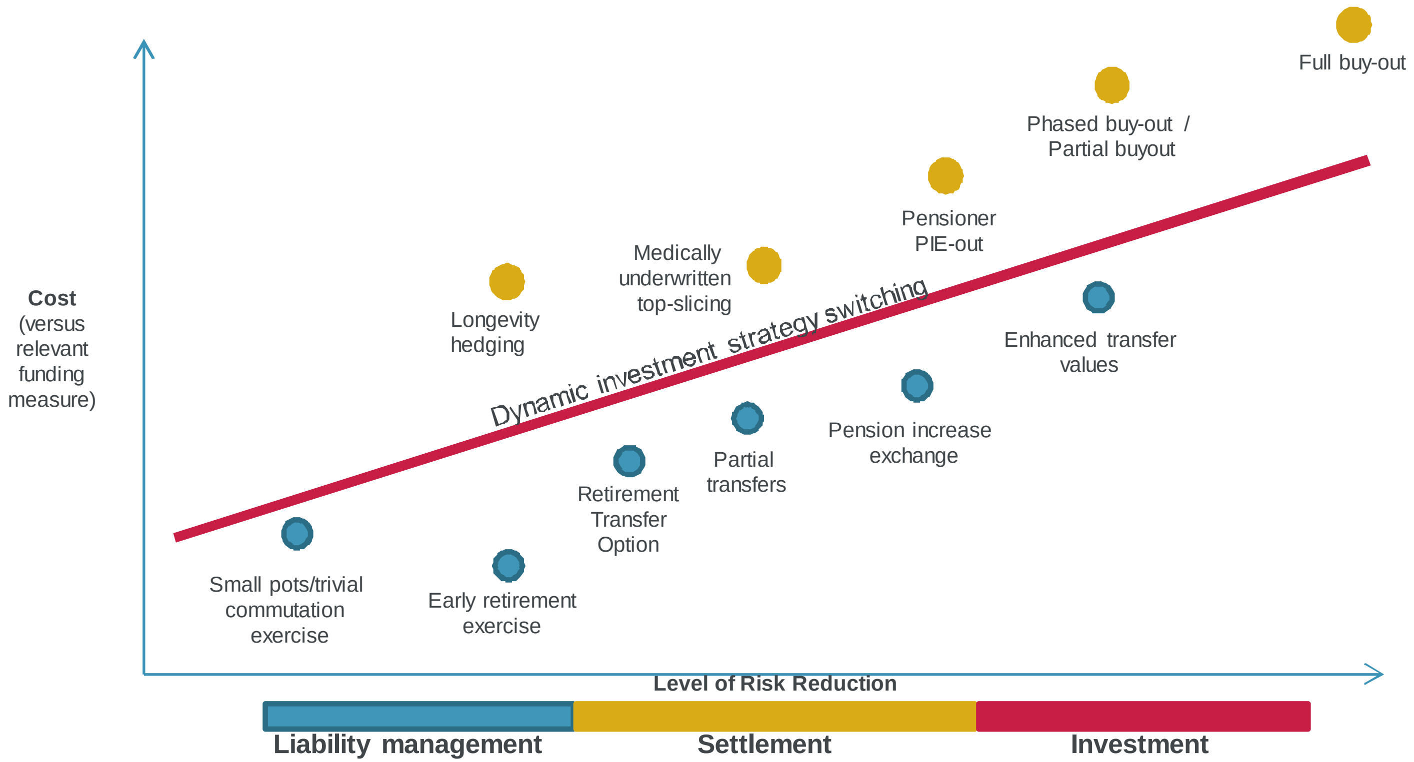
Options for reducing or removing risk



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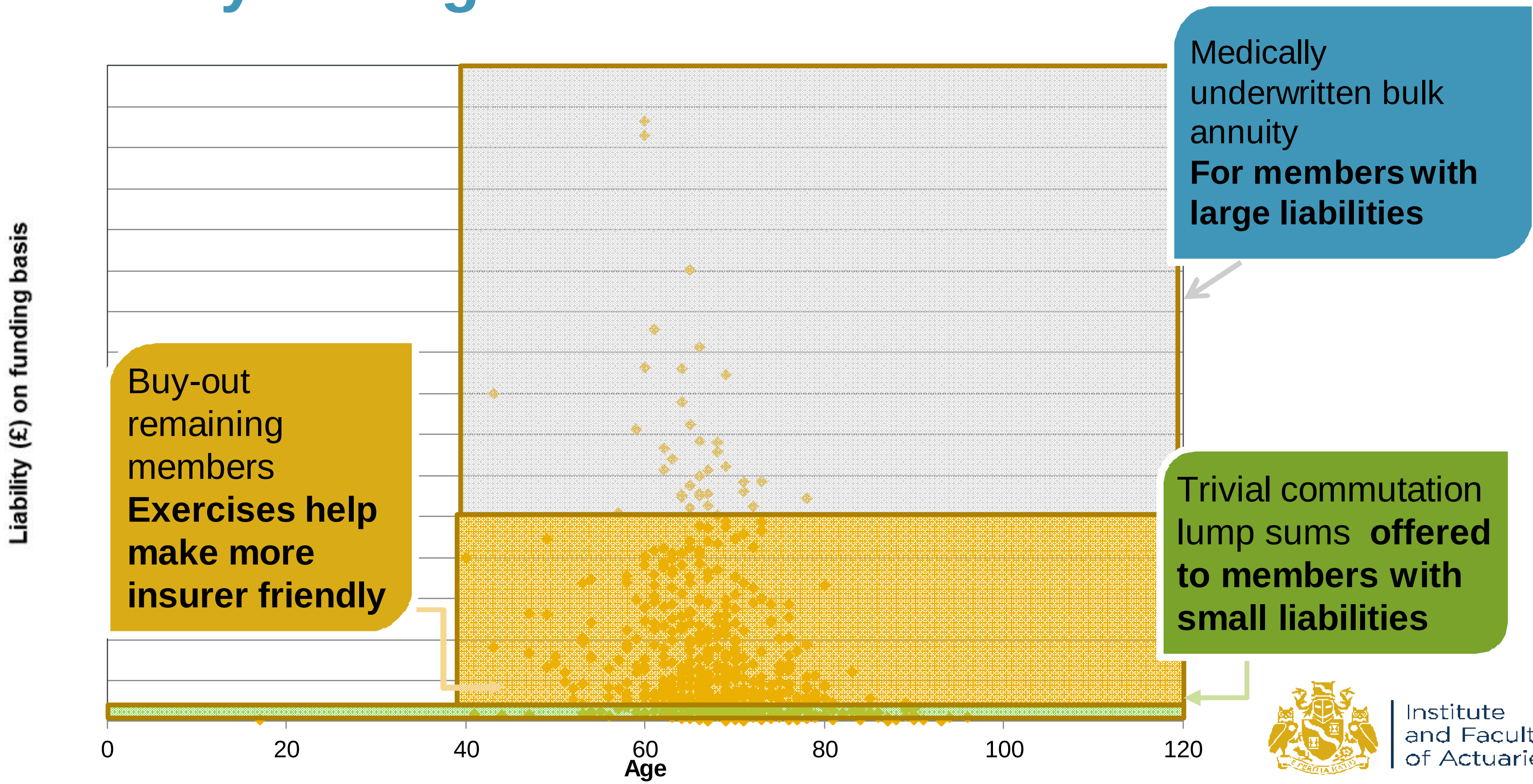
Liability management



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Longevity market overview

Longevity hedging has typically been written by reinsurers via an intermediary	• Over 20 transactions completed by UK pension schemes which have predominantly been intermediated hedges covering £1bn to £5bn of pensioner members. • In July 2014 the BT Pension Fund completed the first longevity hedge via a wholly owned captive insurer. • Since then MNOPF trustees adopted a similar approach, although using a pre-packed insurance cell.
The provider market is evolving	• The providers in the longevity hedging market have changed over the short period since the first trade in 2009.
There is significant reinsurer appetite	There are currently eight to ten active reinsurers actively seeking to take on longevity risk from UK pension schemes because of: • Offsetting effects with mortality risk • Diversification across lines of business
There are a number of potential ways to access the reinsurer market	• **The intermediated model** – used for the majority of transactions to date • **'Direct to reinsurer'** – reinsurer sets up an "insurance company"; previously used by Swiss Re although no reinsurer is currently active in this space. • The use of a **cell or captive insurer** to access reinsurance markets. • Credit risk **pass through model** – being developed by intermediaries to limit their credit exposure to the reinsurers.

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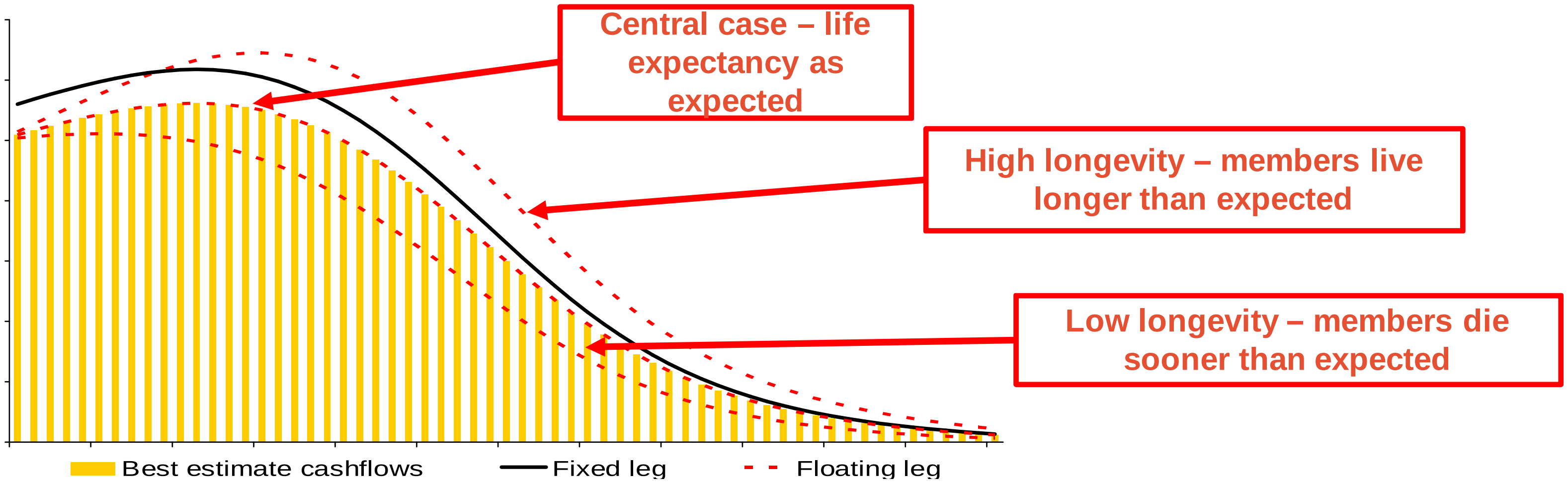
Longevity swaps – how they work



Best estimate cash-flow	Cash-flows projected at outset using best estimate longevity assumptions
Fixed leg cash-flow	Best estimate cash-flows plus longevity hedging fees
Central case	Members life expectancy is as expected at outset. Scheme pays fees to provider over the term of the swap
High longevity	Members live longer than expected. Scheme receives payments under the swap which offset the increase in liabilities to pensioners
Low longevity	Members die sooner than expected. Scheme makes higher payments under the swap but this is offset by the decrease in liabilities to pensioners

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Overview of longevity hedging options

Intermediated

- **Fully intermediated:** Scheme transacts with provider. Provider takes 100% of the credit risk with respect to the hedge counterparties
- **Hedge counterparty risk share**: Scheme transacts with provider. Scheme takes on a predefined portion of the counterparty risk (say 75%)
- **Pass-through trade:** Scheme transacts with provider. Scheme takes 100% of the credit risk with respect to the hedge counterparties. This could be through either an onshore or offshore structure.

Cell structure

- **Bespoke cell:** Scheme creates an Incorporated Cell Company (ICC) and Insurance Cell (IC) that transacts directly with the Reinsurer. Scheme takes 100% of the credit risk with respect to the hedge counterparties.
- **Pre-pack cell:** Scheme acquires an IC from an existing ICC and transacts directly with the Reinsurer. Scheme takes 100% of the credit risk with respect to the hedge counterparties.

Reinsurer market

hannover re

Munich RE

PACIFIC LIFE RE

RGA

PartnerRe

Prudential

challenger

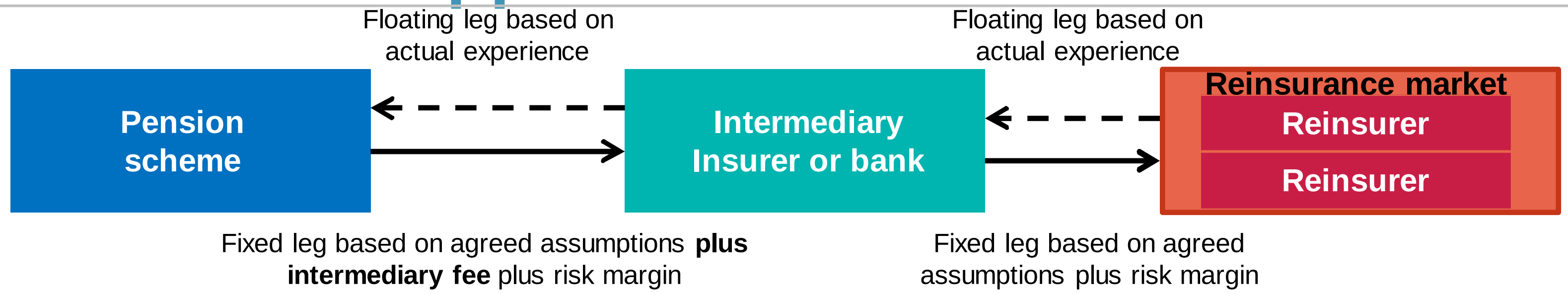
RBC

Wilton Re

SCOR

Swiss Re

Intermediated approach



Benefits

- The approach represents a well trodden path
- The scheme's counterparty risk is to the UK intermediary (but some intermediaries are reluctant to take all of the risk of default of the reinsurer)
- The intermediary provides support in terms of the structuring and on-going operation of the hedge

Challenges

- Small market with limited competition - little downward pressure on fees
- Limited appetite to take credit risk to reinsurers limits transaction sizes, increases the number of reinsurers involved and increase prices
- Some risk on novation that the intermediary is a "blocker"
- Contract has to accommodate the needs of the intermediary
- Costs whilst payable per annum are agreed for the lifetime of the contract so even if the intermediary is no longer necessary in the structure, the cost remains

Market participants

- Legal and General, Deutsche Bank and Zurich

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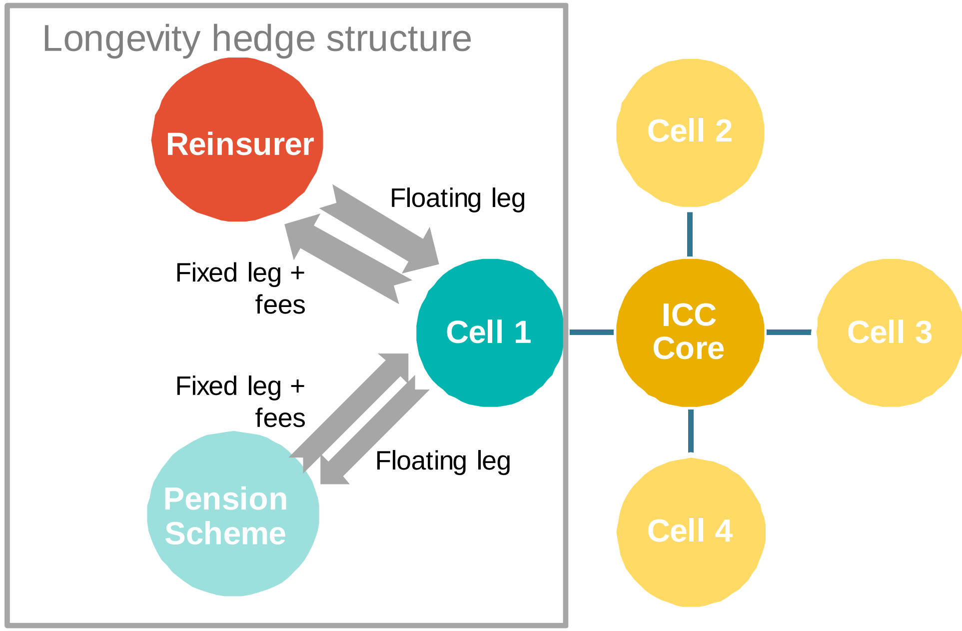
Use of a captive insurance cell company

Incorporated Cell Companies (ICCs)

- ICCs can create cells which are separate legal entities with assets and liabilities ring-fenced within the cells.
- They have governance requirements similar to those of a traditional company.
- Cells are individually capitalised.
- Cells enter into back-to-back transactions with identical payment structures.
- Other cells may be created to facilitate separate transactions



Medical underwriting

Same as a ‘traditional’ buy-in but medical and lifestyle information collected from members

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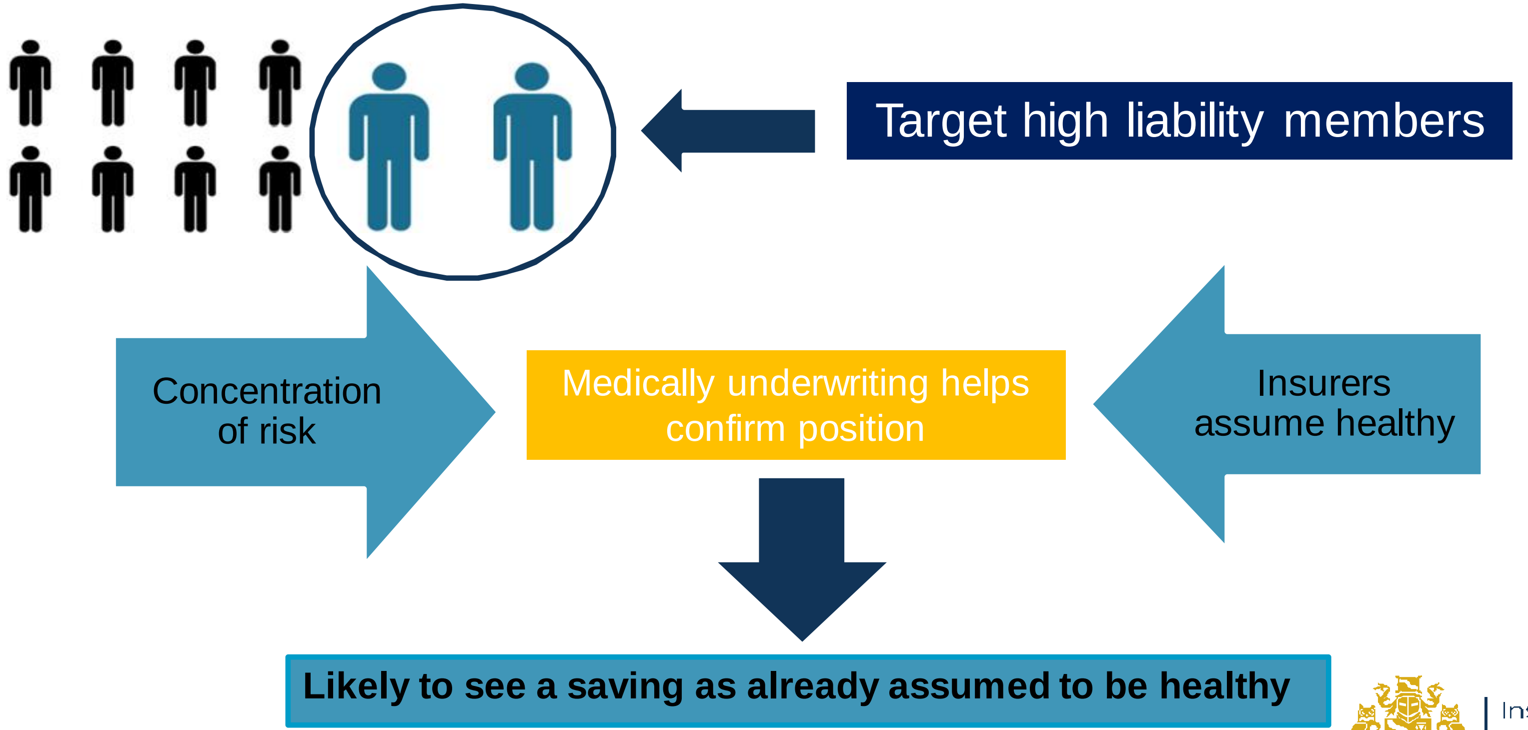
‘Top slicing’ – what it is



PIE-Out

What is it?

An exercise combining PIE with a buy-out.

There are two options for doing this:

- Run as a two stage process i.e. either run a PIE exercise followed by a buy-in or buyout, or complete a buy-in with specially negotiated terms that allows completion of a PIE exercise shortly afterwards.
- Run as a combined process i.e. offer as part of a partial buy-out *(as for the TRW £2.5bn deal, Dec 2014).*

Illustration of use in a partial buy-out

Combining a PIE and partial buyout may increase take up of PIEs especially if covenant is a concern in the scheme.

Consideration needs to be given to:

- Length of time the selected insurer's pricing terms will remain open for to allow the PIE exercise to complete.
- Costs for splitting the scheme on a solvency basis or funding basis for the purposes of a partial buy out.
- Benefits from the arguments of a stronger employer covenant for residual members where the size of the scheme relative to the employer has shrunk.

What is the actuary’s role?

- Should we start from the premise that all corporate de-risking initiatives are bad for the member?
- Is there a future mis-selling risk?
- What is the role of the actuary in these discussions?
- Are individuals given sufficient financial and pensions guidance throughout their lifetime?
- Is the Code of Good Practice helpful? Does it go far enough?
- Is there a wider role for the IFoA in promoting and education?

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Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

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