

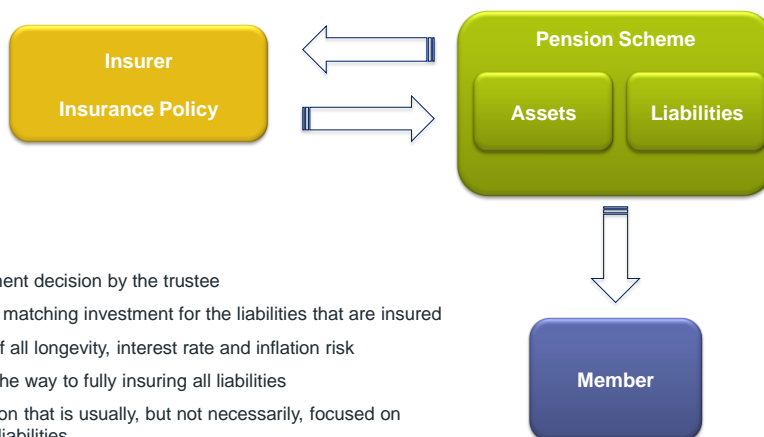
## Pensions – The End Game Colin Parnell and David Collinson

# Buyouts

6 March 2013

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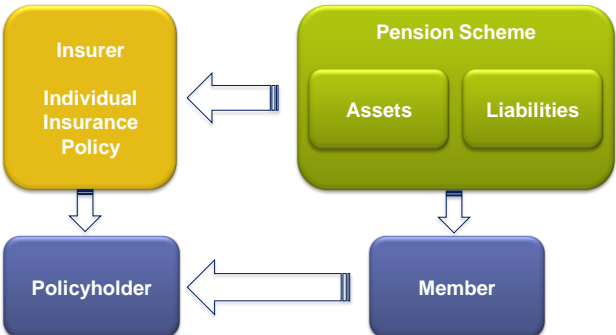
## What is a pension insurance buy-in?



In summary:

- An investment decision by the trustee
- A perfectly matching investment for the liabilities that are insured
- Removal of all longevity, interest rate and inflation risk
- A step on the way to fully insuring all liabilities
- A transaction that is usually, but not necessarily, focused on pensioner liabilities

# What is a pension insurance buyout?



In summary:

- A full and definitive settlement of the liabilities insured
- A transfer of the scheme member's promise from the pension scheme to the insurer
- The removal of the pension liabilities from the scheme and the employer's financial reports
- Allows the pension scheme to be wound up

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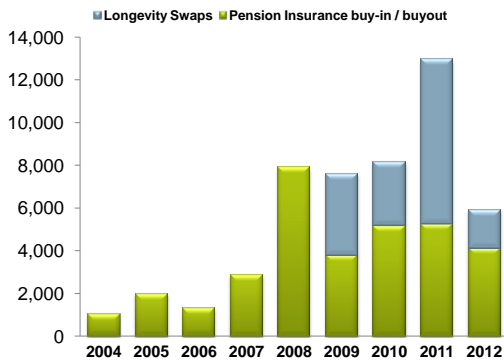
# Why insure through a buy-in or buyout?

Sponsor perspective	Trustee perspective
<ul style="list-style-type: none"><li>■ <b>Buyout and buy-in</b><ul style="list-style-type: none"><li>- Risk relating to asset and liability volatility removed</li><li>- Demographic and longevity risks passed to insurer</li><li>- Removal of one sided option risk for employer</li><li>- Risks of future changes to insurance pricing methods removed</li><li>- Frees up management time to focus on core business</li><li>- Pension Protection Fund (PPF) levies reduced or removed</li></ul></li><li>■ <b>Buyout</b><ul style="list-style-type: none"><li>- The expenses of running a pension scheme are removed</li><li>- Risk of increased and unknown costs removed</li><li>- Accounting changes &amp; increasing disclosure obligations no longer a burden on the company</li><li>- Risk of changes in pensions legislation removed</li><li>- No restrictions on corporate activity due to pension liabilities</li></ul></li></ul>	<ul style="list-style-type: none"><li>■ <b>Buyout and buy-in</b><ul style="list-style-type: none"><li>- Asset and liability risks all passed to the insurer which has stringent reserving and capital requirements to allow it to manage these risks</li><li>- Remove reliance on the corporate covenant</li><li>- Deals now with the issue of increasing scheme maturity causing liability outgo to surpass investment returns</li><li>- Increased security of members benefits</li><li>- Provides members with the protection of an insurer supported by the Financial Services Compensation Scheme (FSCS) as opposed to the PPF</li><li>- Access to the economies of scale available to an insurer</li></ul></li><li>■ <b>Buyout</b><ul style="list-style-type: none"><li>- A full and definitive settlement of their duties as trustees to scheme members</li></ul></li></ul>

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## The pension insurance market

### UK pension risk transfer transacted since 2004



Source: PIC analysis, LCP buyout report 2010, Hymans Robertson buyout report 2009, 2010, 2011 and 2012

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## I want to do a buyout/buy-in but....

- I don't have enough money
- I don't have enough cash
- I only want to buyout some of the benefits
- I have unusual benefit features that will take time to sort out
- I don't know what benefits I ultimately want to insure (PPF cases)
- I want to remove all uncertainty on the final cost
- I have active members
- There is too big a gap to technical provisions

## Case studies

Benefits to be insured are uncertain and asset position is also uncertain.

The sponsor will only make the money available for an insurance if a part of the scheme is bought out.



### Alitalia Italian Airline £53m full buyout

- Buyout from PPF assessment
- Flexibility to alter benefit structure post-transaction
- Pensions insured: significantly in excess of PPF minimum in each case
- Flexibility to allocate future recoveries from parent to uplift benefits



### Delta Pension Scheme £451m partial buyout (pensioners)

- First large partial buyout
- Insured liabilities removed from the sponsor's balance sheet
- Improved security position for non-insured members

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## Case studies

We need the pension fund risks and liabilities off balance sheet immediately on signing and want to allow future accrual.

We would like to lock in to insurance pricing for the next 5 years of retirees.



### 5 Schemes of Denso Manufacturing pension schemes £336m full buyout

- Japanese parent company
- All risks, costs and liabilities covered: Data, GMP, legislative, regulatory, trust deed & rules, wind up costs, etc.
- Unique structure whereby sponsoring employer exits within days of transaction
- Maintaining on-going benefit accrual for active members rather than transferring them to a DC arrangement



### London Stock Exchange £158M pensioner buy-in

- Future retirees
- £45m on pre-agreed terms

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## Case studies

The scheme is underfunded and the sponsor would rather stick to the existing contribution schedule than accelerate it.



### Arnold Laver Scheme £43m full buyout

- Full buy-out whilst scheme in deficit
- Premium payments tied into company contribution schedule
- RPI / CPI flexibility
- Accommodate ETV exercise

The insurance needs to be priced at close to the Technical Provisions liabilities.



### Cadbury Pension Fund £500m pensioner buy-in

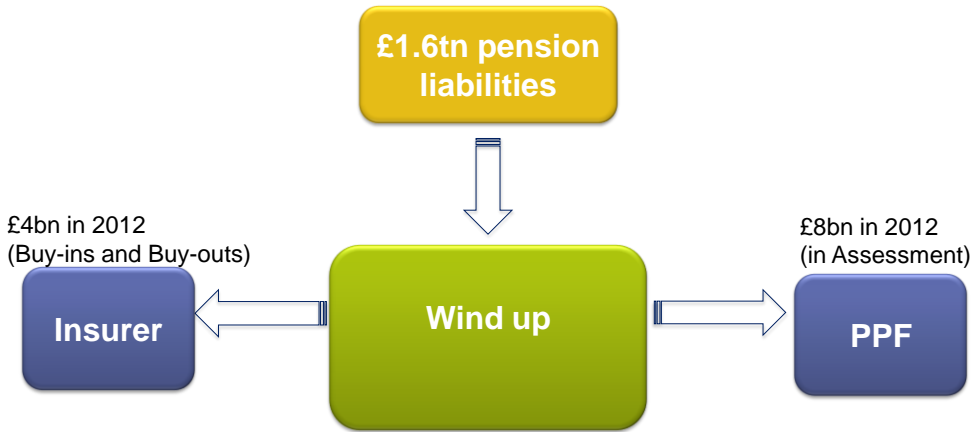
- Worked with Trustees to determine optimal risk profile to transfer

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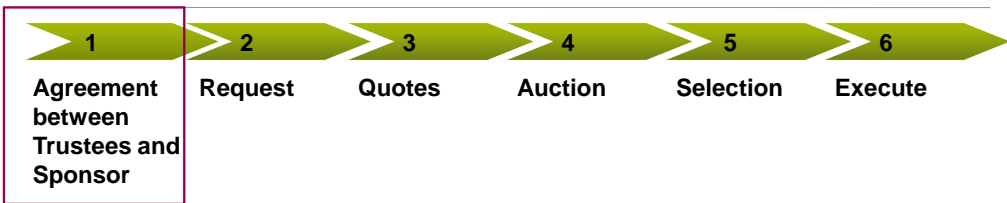
## Buy-in vs technical provisions

- TPs on Gilts + basis, but Gilts are being used to fund the transaction?
- Spot discount rate vs yield curve?
- Off market inflation assumption?
- Caps and Floors?
- Saved investment management expenses?

## The race for the final destination?



## How to do a deal – proper preparation



- Objective?
- Extra cost versus risk reduction – alternatives?
- Buy-in or Buy-out?
- Trustees decide on insurers to approach
- Priority order agreed
- Data/Benefits issues?
- GMP equalisation
- Legal guidance, investment advice, accounting discussion

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## How you can gain interest from insurers

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- **Demonstrate affordability**
  - Funding estimates / indicative quotes
  - Employer funding available?
- **Clear transaction timeline**
  - Understand assessment criteria
  - Involve trustees and employer
- **Aligning your assets**
- **Attractive demographic profile**
  - Remove large pensions
  - Average pension size
  - Blue / white collar
  - Geographical location
- **Good quality membership data**
  - Has data cleansing been undertaken?
  - Existence checking
  - More detailed than for funding valuation
    - Postcodes
    - Current marital status
- **Clear benefit description**
  - Detailed administration procedures required, e.g.
    - On what day of the month are pensions paid?
    - When do spouse's pensions start?
    - Which reference month is used for RPI/CPI linked increases?
  - Hard-code Trustee discretions

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## Top deal breakers

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- No clear objectives set from the outset
  - Lack of sponsor support
  - No Price objective
  - Check wider issues e.g. accounting hit to sponsor
- Poor benefit specification
- Poor data
- Poor coordination between advisors, client, asset manager and insurer

**LEARNING POINT: Planning ahead is essential**

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## Decision rule: additional funding?

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### Extra funding required for annuity:

- Annuity premium less Technical provisions
- Plus: Funding deterioration since last valuation
- Plus: Lost outperformance in Recovery Plan

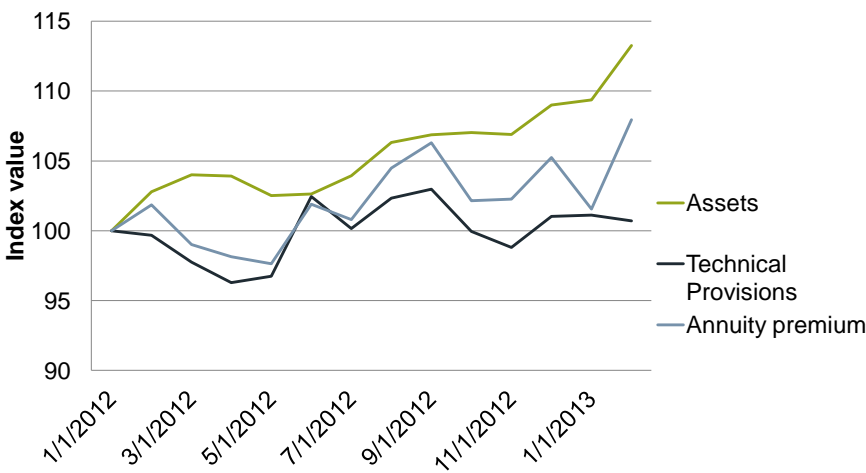
**DECISION: Can the Company afford the additional funds?**

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## Funding reserve vs. annuity premium vs. assets

All categories with assets in average allocation

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## Contact

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**David Collinson**  
**Co-Head of Business Origination**

David is a qualified actuary and is responsible for business development, pricing and management of insurance transactions. David has over 20 years of experience in pensions and insurance and has lead a significant number of successful insurance transactions, including the £1.1bn Thorn buyout and the ground breaking £450m Delta pensioner buyout. Prior to joining PIC David was Global Head of M&A services at Watson Wyatt.

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