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Case for Pension Risk Transfer

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Swimming against the tide

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No longer a staff retention tool

Percentage of schemes	2006	2007	2008
Open	41%	36%	31%
Closed to new members	44%	45%	50%
Closed to future accruals	14%	16%	17%
Winding up	1%	2%	2%

Source PPF / tPR Purple Book

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Under Appreciation of Risks Transferred

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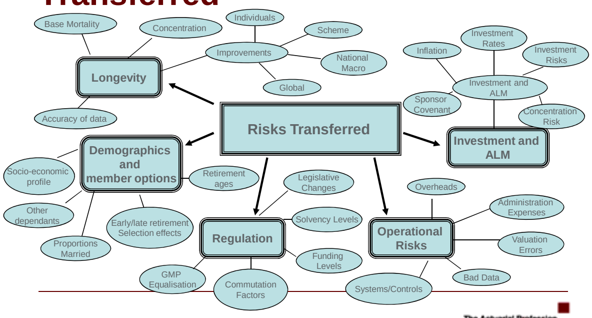
Under Appreciation of Risks Transferred



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Analysts don’t know how to deal with it

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They are worried

(Quote from Peter Elwin – Cazenove, March 2009)

Pensions remain very long-term liabilities and accounting will continue to struggle to represent the liability and associated assets in a meaningful way to shareholders and other users of the accounts. But however sceptical one might be regarding the various ways of calculating pension deficits, the fact remains that pensions rank before shareholders.

In the more extreme cases, this means that shareholder returns depend upon the performance of the pension fund, offset by changes in the pension liability, rather than how well management succeeds in running the company itself.

“Performance of the pension fund”

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Concerns played out in the press

(Quotes from Guardian 28 April, 2009)

“Whitbread defers move to cut £500m pension deficit

… The vast majority of scheme members – about 27,000 people – are former staff who work elsewhere, reflecting Whitbread's evolution from a brewer and pub owner to a budget-hotel and coffee-shop business …

Geoff Collyer, a leisure analyst with Deutsche Bank, cut his target price for Whitbread by 6% in response to the new pension deficit valuation, though he still gave the stock a "buy" rating, suggesting speculation about the likely deficit had already been reflected in the share price.”

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Delta Plc - example

- **FTSE 350 steel engineering and mining company – largely Asia, Australia and South Africa.**
  - Market cap : £150-200m
  - UK pension liability: £650m
- **Insured pensioners (£450m) in June 2008**
  - £50m cash injection by company
  - Yet share price rose by 10%
  - Market cap up by £20m
  - Pension liabilities reduced by £450m

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Before and After – volatility view
(PIC estimates)

Liability sensitivities (£m)	BEFORE Estimated	AFTER Estimated
0.5% decrease in discount rate	+£44m	+£22m
0.5% increase in inflation	+£25m	+£13m
1 year increase in longevity	+£25m	+£3m

Where has the volatility gone?

Understand risks – expert teams

- Asset / Liability matching
- Longevity, demographic uncertainty
- Operational, administrative, regulatory

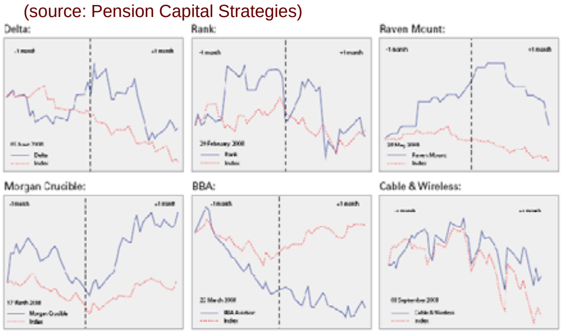
Disperse risk – highly specialist partners

- Inflation and interest rate risk is unrewarded and is eliminated by transitioning assets into swaps
- Longevity risk is packaged up and spread out to reinsurers and wider capital markets
- Outsource administration to “best of breed”

Manage residual risk actively

- Measure and act on variances
- Dedicated, available, liquid capital

Positive reaction to reducing risk
(source: Pension Capital Strategies)



Wider benefits

- Investors want exposure to chosen sector – not to a leveraged investment trust
- Freedom to restructure without requiring Trustee / tPR clearance
- Frees up Board and management
- Reduces volatility in P&L
- Company more attractive in M&A / Private Equity transactions
- Avoids double whammy in economic down turns

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No miracle solution

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But it pays to play safe

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