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Current Issues in Pensions
The Developing Buy-Out Market

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Synesis Life

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"People always live for ever when there is an annuity to be paid them. An annuity is a very serious business; it comes over and over every year, and there is no getting rid of it."

Jane Austen (Sense and Sensibility - 1795)

The Old Bulk Purchase Annuity Market

"For many years, there were only two UK insurers who would quote, and not always as many as two, and then it was a slow and cumbersome process"

Reactive strategy	⟺	**A product of last resort**
• Small schemes		• Inflexible products
• Insolvent wind-ups		• Limited capacity
• Compulsory purchase		• Lengthy quotation process
		• Perceived duopoly price

Demand for a new market

A changing world ⟷ **A solution needed to high profile liabilities**

- Significant deficits and volatility
- Pensions liabilities recognised as unsecured debt
- Closed and maturing schemes
- Growing recognition of longevity issue
- Regulatory pressure & PPF
- Increasing attention from investors / analysts

- Increased debate as to how pension liabilities should be managed
- Larger / solvent schemes looking for alternative solutions
- Active pension risk management
- Impact on M&A

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The new market



Capacity **£2-3bn pa**

Capacity **£50bn +**

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Innovation increases the range of options

Liability discharge ⟷ **Risk management options**

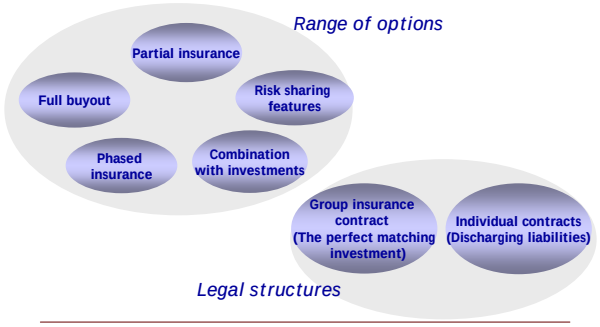
- Increased capacity for larger schemes
- More competitive pricing
- Wind-up in M&A timescales
- Upfront pricing of data risks and winding up costs
- Pricing to reflect anticipated liability management savings
- Alternative non-insurance structures

- Insurance as an asset class
- The perfectly matching bond
- Partial insurance
- Flexible contract terms
- Surrender values
- Benefit adjustments
- Can be an interim step to liability discharge

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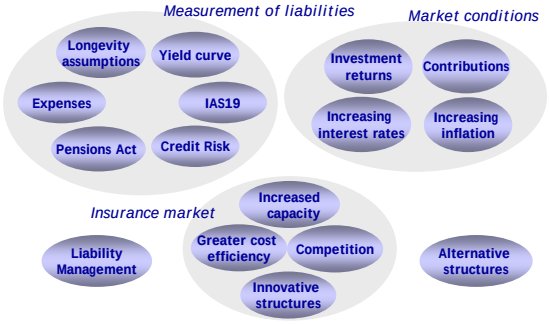
Range of insurance solutions



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The narrowing affordability gap



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Liability management options

- Many schemes looking at liability management options
- Helps reduce level and volatility of liabilities
- Can help bridge the gap to buy-out

Transfer values

Early retirement

Trivial commutation

Scheme provisions

Data cleaning

- Can form a key component of a cost effective process to discharge pension liabilities
- Can provide flexibility and valuable options for the members.

BUT

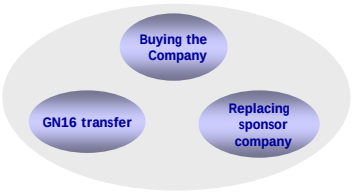
- These processes must to be carefully managed to ensure that the communication and advice provided to members is robust and of high quality.

The potential savings from liability management can be factored into the buyout price up-front or through a profit share

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Alternative structures



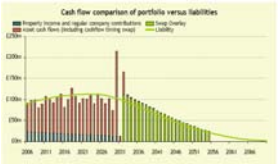
- Potentially an arbitrage between Pension and Insurance Regimes
- Security depends upon covenant of new sponsor and timing of insurance
- Rapid execution to achieve a clean-break (including data and expense risks)
- Could be an interim step to full insurance

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Capital market solutions

- Investment strategy
- Interest rate and inflation hedges



lifeMetrics

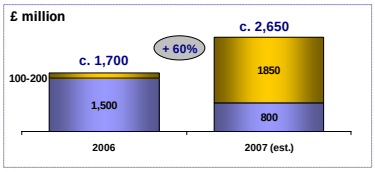
Portfolio of q-Forwards
Standardised Hedge Building Blocks

Ages 50-59 Male	Ages 60-69 Male	Ages 70-79 Male	Ages 80-89 Male
Ages 50-59 Female	Ages 60-69 Female	Ages 70-79 Female	Ages 80-89 Female

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Recent examples of solvent insurance transactions



- ***Pipeline continues to grow***
- ***"…2008 is likely to be the year of the pension buy-out"***

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Issues to consider

- **Ensure consistency of terms**
  - Terms for commutation to tax free cash
  - Early and late retirement factors
  - The level of transfer values promised
  - Other member options
- **Security offered**
- **Liability management options**
- **Structure of contract**
  - What are the main objectives?
  - Risk management or transfer?
  - Speed of execution
- **Administration and communication**
  - Who retains control and responsibility?

Summary

- Longevity is increasingly becoming the key risk for pension schemes
- Capital markets may offer some protection, but limited scope and imperfect matching
- At present insurance represents the only perfect matching asset
- The insurance environment offers the gold-standard by which other methods of transferring pension liabilities should be judged
- Far more flexibility is now available to manage or transfer pension liabilities
- Liability management can help to reduce the cost
- Alternative structures may offer a lower cost, but at the price of lower security…unless benefits are ultimately insured in UK regime

"I advise you to go on living solely to enrage those who are paying you annuities"

Voltaire (1694 – 1778: died age 83)