


Pensions Conference 2010
Risk reduction or planning your route to buy-out

Paul Kitson FIA
 Senior Consultant, Towers Watson
 10 June 2010

TOWERS WATSON 

© 2010 Towers Watson. All rights reserved.

Agenda

- **A4: Risk reduction or planning your route to buy-out**
- Once a DB plan closes to new entrants it is heading for buy-out and this is accelerated when accrual for existing members ceases. Managing a plan through to buy-out calls for a change of focus and co-ordinated application of skills traditionally spread across pensions, investment and insurance actuaries. This session will explore how this is done.

towerswatson.com

© 2010 Towers Watson. All rights reserved. Proprietary and Confidential. For Towers Watson and Towers Watson client use only.

2

A journey starts with...

1. Prepare for the journey (data cleaning)
2. Pack the right equipment (know the tools at your disposal)
3. Work out where you are going (agree a target)
4. Take a map (clear and effective decision making)
5. Take a mobile (know when to bring in different skill sets)
6. Expect to get lost (market conditions will **not** behave as you expect)

towerswatson.com

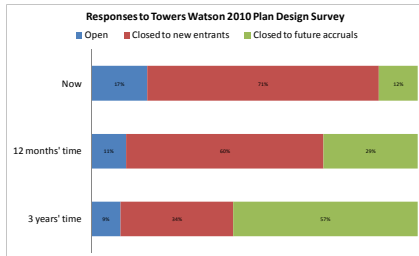
© 2010 Towers Watson. All rights reserved. Proprietary and Confidential. For Towers Watson and Towers Watson client use only.

3

The end of the world as we know it?

- "the die is cast and we will exit provision of DB; Government action that makes DB even more unattractive and opportunities in investment markets will hasten our exit"
- "companies offering DB schemes always seem to be under attack from one direction or another. What was an excellent employee benefit is, in hindsight, a millstone around the neck of the industry"

Comments from Towers Watson 2010 plan design survey



towerswatson.com

© 2010 Towers Watson. All rights reserved. Proprietary and Confidential. For Towers Watson and Towers Watson client use only.

4

Prepare for the journey

- Data cleaning – the new 'buzz words' of the actuarial profession
- Data verification
 - Calculation input data
 - Address data
- Process verification
- Experience data verification
- Data collection
 - Spouses details
 - Other information (e.g. enhanced annuities?)

towerswatson.com

© 2010 Towers Watson. All rights reserved. Proprietary and Confidential. For Towers Watson and Towers Watson client use only.

5

Pack the right equipment

	Pensions	Investment	Insurance
Enhanced Transfer Values	✓✓	✓	?
Pension Increase Exchange	✓✓	✓	✓
Buy-in	✓✓	✓✓	✓✓
Buy-out	✓✓	✓✓	✓✓
Longevity hedging	✓✓	?	✓✓
Cap pensionable pay	✓	✗	✗
Other insurance products	✓	?	✓
Investment management	?	✓	?

Already blurring between the lines

towerswatson.com

© 2010 Towers Watson. All rights reserved. Proprietary and Confidential. For Towers Watson and Towers Watson client use only.

6

Tools becoming increasingly commonplace

Enhanced Transfer Values	Balfour Beatty, Intercontinental Hotels, Peugeot
Pension Increase Exchange	British Telecom, ITV
Buy-in	Cable & Wireless, P&O, MNOF, Cadbury
Buy-out	Thorn, Rank, Delta, Leyland DAF
Longevity hedging	BMW, Babcock, RSA, Royal County of Berkshire
Cap pensionable pay	AA, Balfour Beatty, M&S, RBS
Other insurance products	<i>Some using: Captives, Stop Loss Insurance</i>
Investment management	<i>A number using: Dynamic De-risking, Equity Collar/caps</i>

Examples based on public domain information

towerswatson.com

©2010 Towers Watson. All rights reserved. Proprietary and Confidential. For Towers Watson and Towers Watson client use only.

7

How can they help?

	Reduces funding deficit	Reduces risk	Removes past service liabilities
Enhanced Transfer Values	?	✓	✓
Pension Increase Exchange	?	✓	✗ / ?
Buy-in	✗	✓	✗
Buy-out	✗	✓	✓
Longevity hedging	✗	✓	✗
Cap pensionable pay	✓	✓	✗
Other insurance products	?	?	✗
Investment management	?	✓	✗

towerswatson.com

©2010 Towers Watson. All rights reserved. Proprietary and Confidential. For Towers Watson and Towers Watson client use only.

8

Work out where you are going

- What is the right target and when do you want to hit it?
 - Gilts (plus or minus)
 - Buy-out
 - Self sufficiency
- What role does a dual discount rate play in the journey plan?
- Does the target have to be the same as the Technical Provision target?
- What role does/should the Company covenant play?
- Increased use of non-cash assets?
 - Post valuation experience
 - Guarantees
 - Escrow accounts
 - Contingent contributions
 - SPVs
 - Charge over assets

towerswatson.com

©2010 Towers Watson. All rights reserved. Proprietary and Confidential. For Towers Watson and Towers Watson client use only.

9

Take a map

- Clear and nimble decision making has not traditionally been pension schemes strong point
- Joint committees (Trustee AND Employer)?
- Employer presenting as a 'fait accompli'
- Increased delegation to advisers?
- Outsourcing of entire journey plan?
- Advisers with the correct skill sets?
- Role of Longevity Consultants, Strategic Advisers, Specialist Advisers?

towerswatson.com

© 2010 Towers Watson. All rights reserved. Proprietary and Confidential. For Towers Watson and Towers Watson client use only.

10

Take a mobile

- Know when to 'phone a friend'
- Have access to specialist skill sets to help with journey planning
 - Traditional actuarial practice areas
 - Insurance and Investment banking counter-parties
- Work together to produce optimal result

towerswatson.com

© 2010 Towers Watson. All rights reserved. Proprietary and Confidential. For Towers Watson and Towers Watson client use only.

11

Expect to get lost

- Any journey plan is likely to encounter 'shocks'
 - Sudden changes in market conditions
 - Longevity shocks (War, Pandemics, cures for disease, etc)
 - Legislation \ Regulation change
 - Relative changes in regulatory regimes (i.e. pensions vs insurance)
 - Accounting changes

towerswatson.com

© 2010 Towers Watson. All rights reserved. Proprietary and Confidential. For Towers Watson and Towers Watson client use only.

12

Journey planning – a case study

- MNOPF – large multi employer scheme c£2bn split into two segregated sections (the Old Section and the New Section)
- Advice structure:
 - Scheme Actuary
 - Delegated CIO
 - Strategic adviser
- Old Section closed to all accrual

towerswatson.com

13

© 2010 Towers Watson. All rights reserved. Proprietary and Confidential. For Towers Watson and Towers Watson client use only.

MNOPF Old Section journey plan

- Agreed a clear objective and target
- View risk holistically, i.e. including longevity risk
- Understood risk parameters and agreed metrics
- Applied agreed journey plan metrics to market opportunities
- Initial £500m buy-in with Lucida (*September 2009*)
- Progress against Journey Plan monitored regularly
- Positive progress against Journey Plan flagged ability to de-risk
- Further £100m buy-in with Lucida (*May 2010*)
- Journey Plan will continue to re-iterate and look at other opportunities as they arise

towerswatson.com

14

© 2010 Towers Watson. All rights reserved. Proprietary and Confidential. For Towers Watson and Towers Watson client use only.

Questions



towerswatson.com

15

© 2010 Towers Watson. All rights reserved. Proprietary and Confidential. For Towers Watson and Towers Watson client use only.

Limitation and Reliance

- This presentation is prepared for the Pensions Conference. It has not been prepared for any other purpose. As such it should not be relied upon by any person for any purpose, including, without limitation, by individuals for individual investment or other financial decisions, and those persons should take their own professional advice on such investment or financial decisions.
- The content of this presentation was based on our understanding of the Act, Regulations, Codes of Practice, Guidance and other relevant information available as at the time of preparation.
- The written comments included in this presentation should be considered in conjunction with the supporting and amplifying oral comments and background provided by Towers Watson.
- This presentation should not be disclosed to any third party. Unless otherwise specifically agreed in writing we assume no responsibility, duty of care or liability to any party who may gain access to a copy of this document.
- We are not lawyers and cannot provide legal advice; professional legal advice should be taken if required.
- Any comments made in this presentation are based on publically available information at the time. The accuracy of any statements made is not guaranteed and may be based on anecdotal evidence and experience.

towerswatson.com

16
© 2010 Towers Watson. All rights reserved. Proprietary and Confidential. For Towers Watson and Towers Watson client use only.