



Institute
and Faculty
of Actuaries

Welcome to the 5th event of the Bulk Annuities and Longevity Swaps Member Interest Group

“Pension scheme consolidation”

19 July 2018

AGENDA

Welcome: Costas Yiasoumi	5:15pm
Presentations, Q&A, discussion and debate: Akash Rooprai, Ashok Gupta, Nick Johnson, Sarah Parkin, Tracy Blackwell	5:25pm
Networking	7:00pm

These events could not happen without your managing committee volunteers and the firms that offer their facilities to us

Objectives of the MIG	Your managing committee – now includes three volunteers* from legal community
<ol style="list-style-type: none">1. Education/CPD2. Share case studies/best practices3. Communication of new / developing ideas in the de-risking market4. Networking <p>May touch on related areas but these will not be a primary focus. Eg member option exercises, asset strategies and transition, benefit changes etc</p>	<ul style="list-style-type: none">▪ Akash Rooprai – Capita▪ Andrew Muddle – Munich Re▪ Costas Yiasoumi (Chair) – Legal & General▪ Dominic Moret – Legal & General▪ Frankie Borrell – Legal & General▪ Hannah Cook – Aon▪ Rachel Pinto* - Herbert Smith Freehills▪ Rebecca Zhang – JUST▪ Sebastian Reger* – Sackers▪ Steve Higginbottom – First Actuarial▪ Thibault Jeakings* – CMS▪ Vacancy – name TBC

400 members  **Some 200 here tonight!**

Work and Pensions Committee

Oral evidence, 6 June 2018

- **Steve McCabe:** You will have heard that I asked about the superfund model earlier, and I want to come back to that. Why should a scheme like the pension superfund be eligible for PPF protection and why should the PPF and people paying the levy be effectively underwriting what is a commercial profitmaking venture?
- **Oliver Morley:** That is a good question.

The evidence sessions are enlightening ...

Work and Pensions Committee

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- *Oliver Morley:* That is a good question.
- **Steve McCabe:** Give us a good answer.

... for their wit! ...

Written evidence from the Pension Protection Fund (BPW0029)

... and their content ...

- “As the PPF is itself a form of consolidation vehicle, we will recognise the potential benefits of consolidation. Consolidation offers opportunities to drive greater efficiency from scheme assets, reduce costs and improve governance.
- Given the highly fragmented nature of the universe of DB schemes, consolidation could play an important role in the long term.”

Written evidence from Association of British Insurers (BPW0030)

... but as ever there are many facets to any debate

- “Securing policyholder pension benefits must be at the heart of any new framework. It is then unclear why we would move to a system that means there may still be a 1-in-10 chance of members not receiving their full benefits. In contrast, insurance firms offer virtual certainty of payment because capital rules mean firms must be able to survive a 1-in-200 year event over a one-year time.”

Today's event

- Is all about bringing out the concepts and issues through an interactive format so that we can all leave tonight's event more informed and intrigued than when we arrived!
- It is not about consolidation vs no consolidation, or bulk annuities vs consolidation vehicles ...
- ... and we shall not be taking a show of hands at the end!

Introducing your presenters today



Akash
Rooprai

Capita



Sarah
Parkin

Linklaters



Tracy
Blackwell

Pension
Insurance
Corporation



Nick
Johnson

Clara
Pensions



Ashok
Gupta

Various

Commercial Consolidation

(self diagnosis and self medication)



Nick Johnson
19 July 2018

Commercial Consolidation

A Difficult Balancing Act - The Key Structural Challenges



Return on Capital

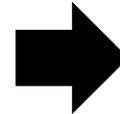
Risk Capital carries the first loss

Risk Capital provides additional security

Requires a reasonable return



Member Security
Absolute requirement



“One-way” Capital

Capital fixed

Difficult to compel recapitalisation

Capital release a one-way valve

Definition of release thresholds



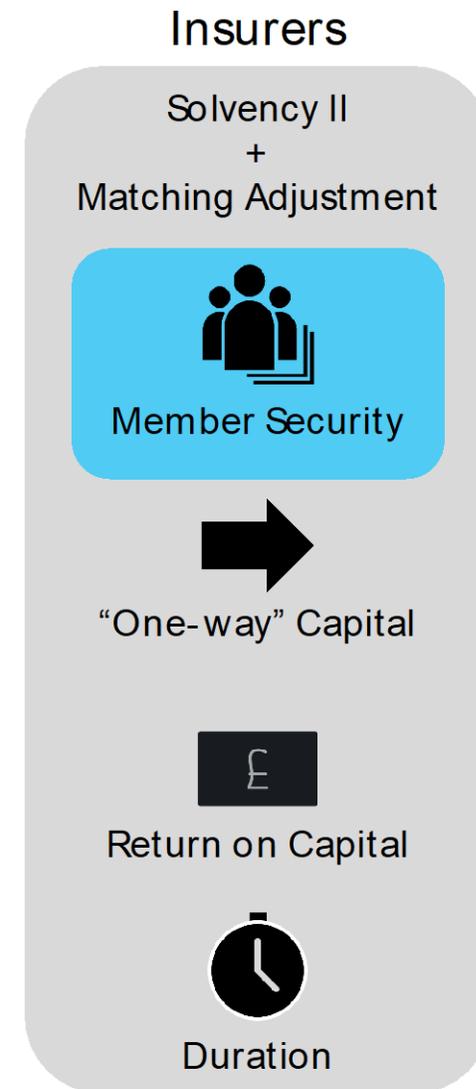
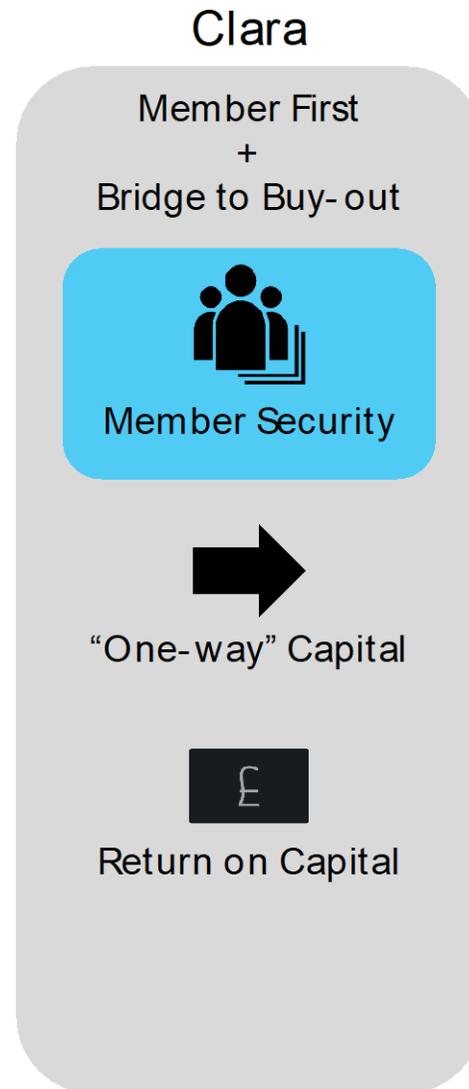
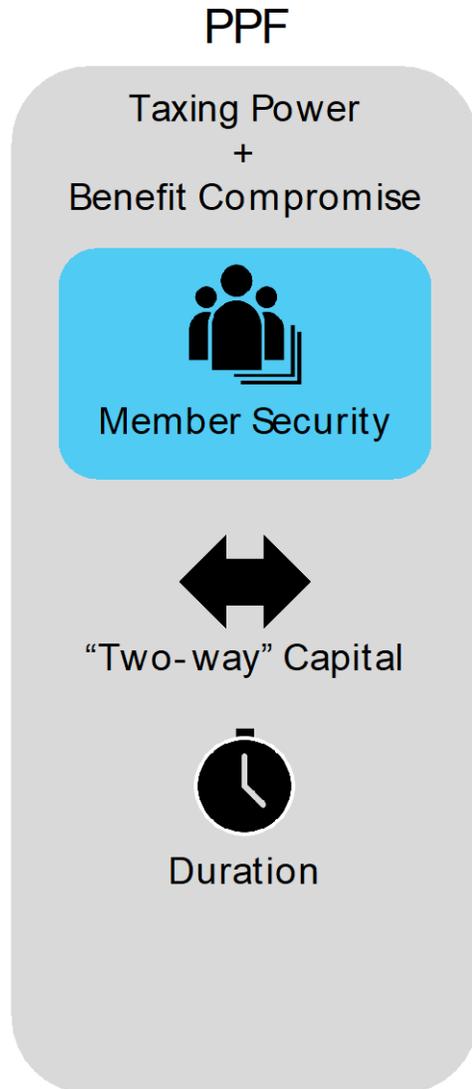
Duration

Significant risk in liability tail

Balance risk and capital support

Basis of measure important

Commercial Consolidation Achieving Balance



Clara

Achieving Balance



Misaligned Interest / Profit Motive



Member First

Fixed Capital



Funded and Permanent Capital

One-way Valve / Capital Release



Risk Capital is First in Last Out

Duration of Liabilities



Secure Full Benefits in Insured Market

Asymmetric



Objective Benchmark

Member Options



Increase Capital Cover | Accelerate Buyout



PENSION FUND CONSOLIDATION

Tracy Blackwell
CEO

July 2018



PENSION INSURANCE
CORPORATION

Risks transferred, pensions insured

■ Bulk annuity insurers are consolidators of DB schemes

■ Regulation

- Regulated by the PRA and FCA on a close and continuous basis
- Solvency II significantly developed

■ Risk based capital

- The level of surplus resources held is directly linked to the level of risk being run

■ Governance

- Board (with independent members) provides oversight and governance
- Separate management team to run the business

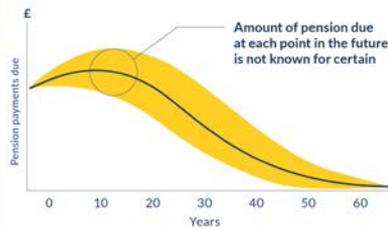
■ Risk management

- “Three Lines of Defence” model with fully formed risk, internal audit and compliance functions

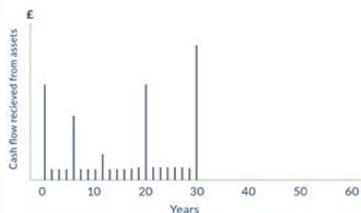
Our business model: key steps to secure member benefits

1 What we receive

Pension liabilities taken on are uncertain in both timing and amount (longevity and inflation uncertainty)



Assets are typically received in cash and gilts and are not cash flow matched to the liabilities



The profile of cash returns from the assets are typically very different to the profile of the cash payments due to pensioners (see chart above)

2 What we do

LIABILITIES ARE HEDGED FOR INTEREST RATE AND INFLATION EXPOSURE

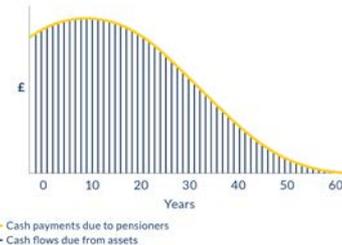
ASSETS RECEIVED ARE REINVESTED TO OPTIMISE RETURNS ON A CASH FLOW MATCHED AND RISK-ADJUSTED BASIS

LONGEVITY RISK IS REINSURED TO REMOVE RISK, CREATE CERTAIN LIABILITY CASH FLOWS AND OPTIMISE CAPITAL DEPLOYMENT

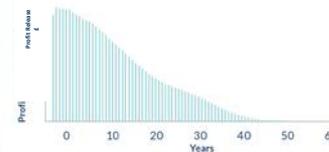
PIC CAPITAL RESOURCES COMMITTED

3 The outcome

Best estimate liabilities are made certain and cash flow matched with high quality assets to provide secure long-term pensions for our policyholders



Underlying profit loading in premium is optimised and, together with the committed capital resources, is released over time, generating attractive risk-adjusted returns on capital employed



Keys to success

PIC is a specialist insurer completely focused on the activities required to succeed in its chosen sector

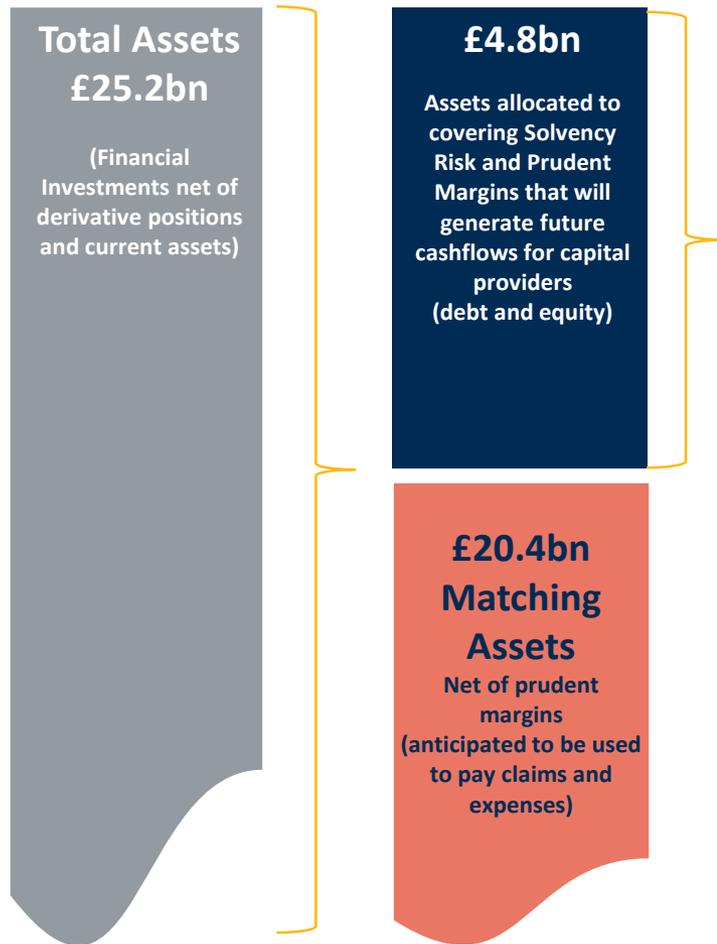
Success in the bulk annuity market requires expertise in

- looking after policyholders
- structuring transactions
- investing assets
- hedging liabilities
- reinsuring longevity risk
- raising capital
- bringing all these skills together on a coordinated and efficient basis for transacting and transitioning new business.

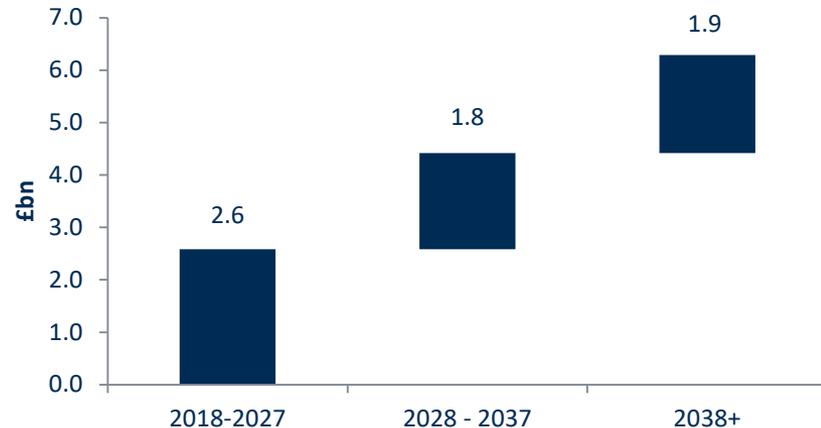
PIC's track record in all of these areas underpins its position as a leader in providing bulk annuities.

Alignment of investor and policyholder interests – PIC balance sheet at year-end 2017

Asset Breakdown:



Illustrative profile of future cash generation from current in-force business



The £4.8bn of assets held in excess of that allocated to meet claims and expenses will only flow to shareholders **once the pensions it protects has been paid.**

- Protection of scheme member benefits is at the heart of the system
 - Policyholder benefits guaranteed, and then backed by FSCS to 100%
- Management of the potential for systemic risk
- Robust regulatory framework
- Well-resourced, proactive regulators
- Alignment of interests between investors and policyholders
- All engenders trust in the system

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