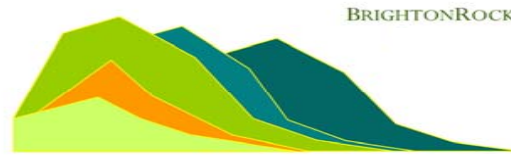


Increasing pension risk using insurance solutions

Andrew Slater
10 October 2007

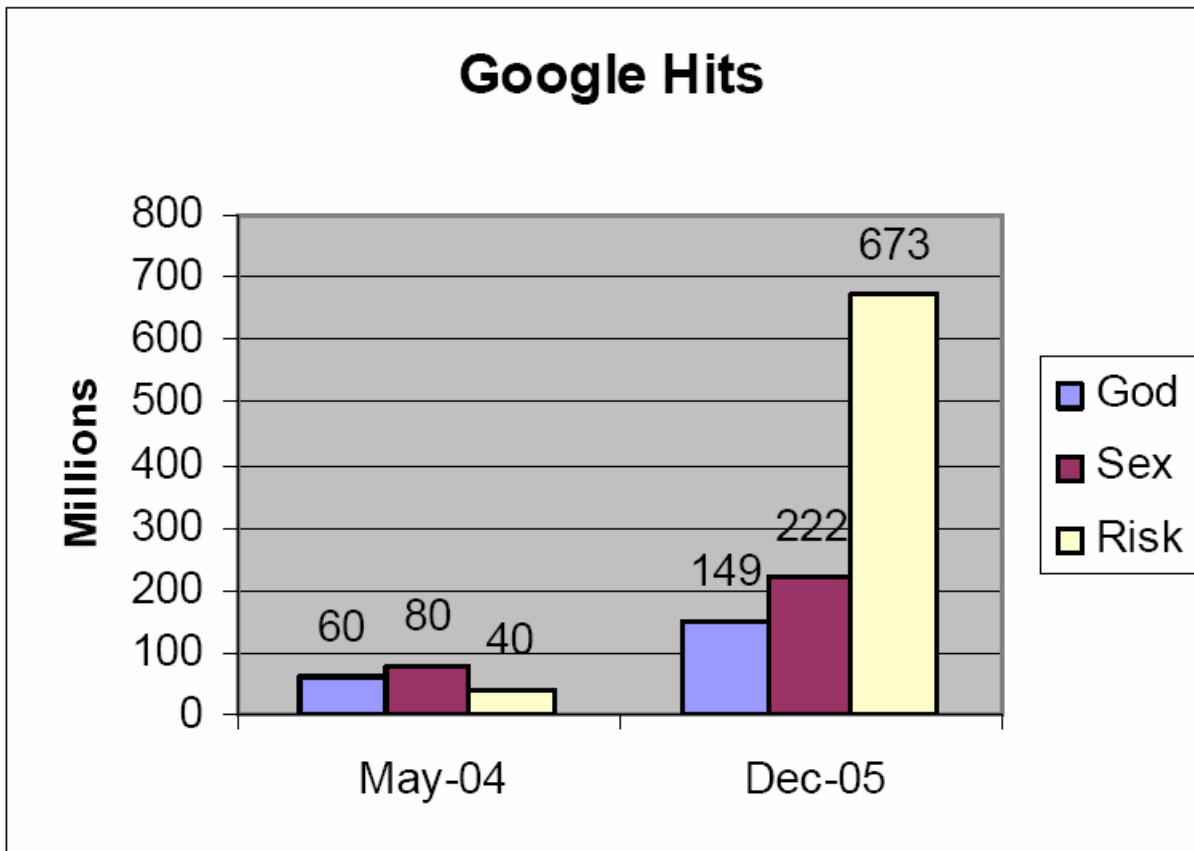


Agenda

- Insurance of the employer covenant
- Extending the forms of security for pension obligations
- Optimal scheme financing: is it 100%?
- Re-risking asset allocation

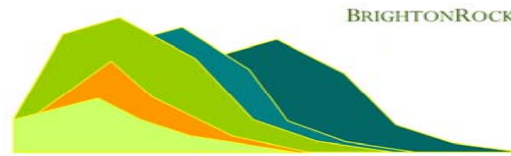


Risk management or reduction?



Taken from "Making God Laugh" by John Adams, Financial World, February 2006

John Adams is a professor of geography at University College London and author of *Risk* (Routledge, 1995)

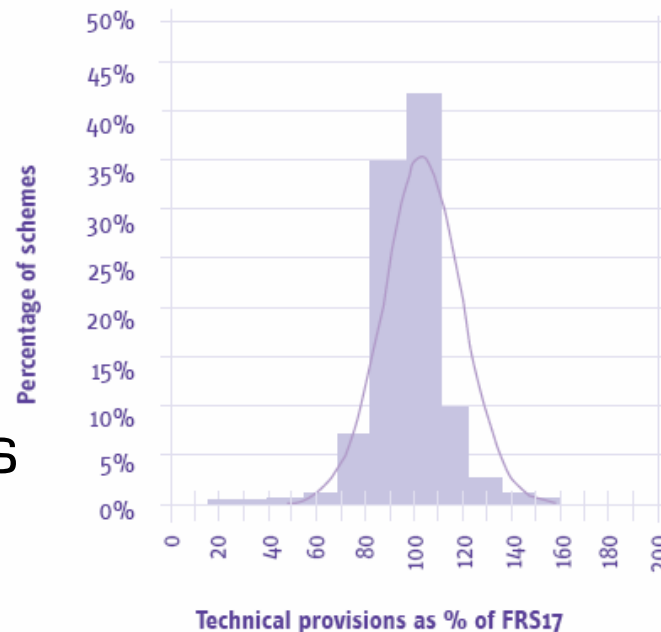


The new UK pension landscape

Figure 2.11

Distribution of technical provisions as a percentage of FRS17

- tPR
- PPF
 - Contingent assets
- SSF
 - Technical provisions

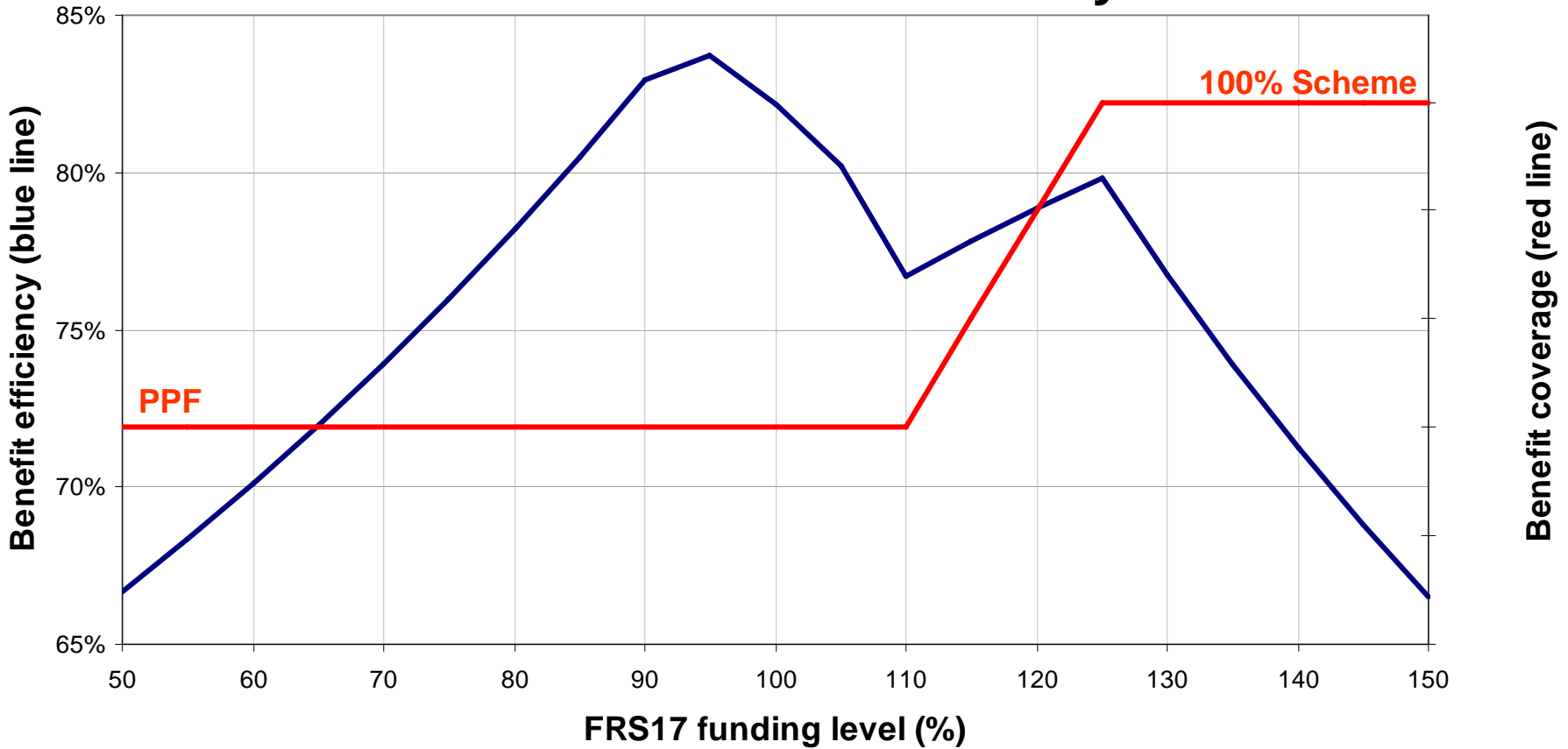


Source: Recovery plans: an initial analysis, tPR, September 2007

Base for all funding level distribution charts: maximum of 1,286 schemes at 30 July 2007 (1,292 schemes less some outliers that are currently being investigated by the regulator)



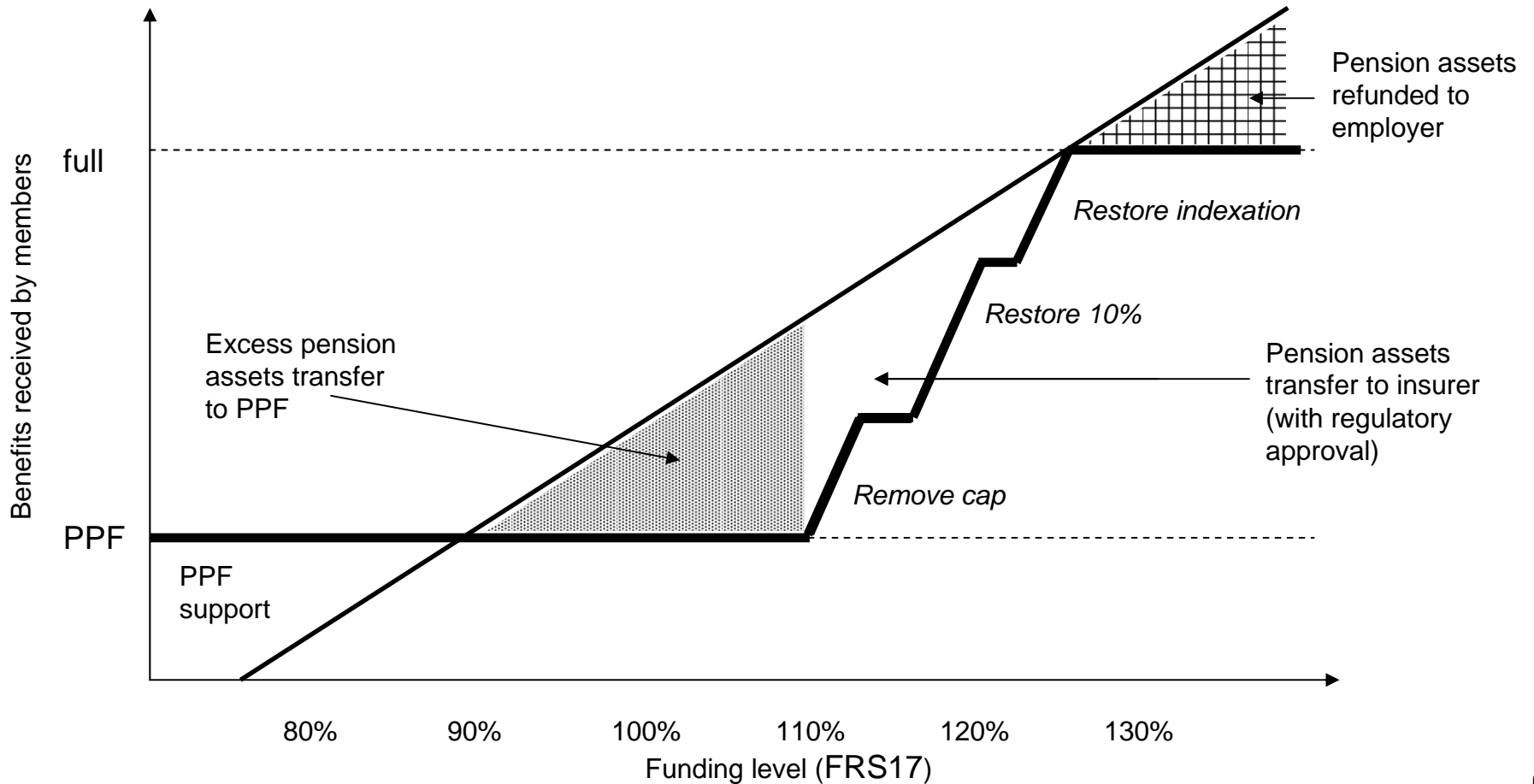
Benefit efficiency



$$\text{benefit efficiency} = \text{benefit coverage} / [\text{assets} + \text{SSF deficit} + \text{NPV(PPF levy)}]$$



The Dead Zone





Bringing insurance to pensions

- Risk = [frequency] × [severity]
 - Liability Driven Investment
 - Bulk Pension Annuity
- Risk = [frequency × severity]
 - BrightonRock
 - aka Diversification

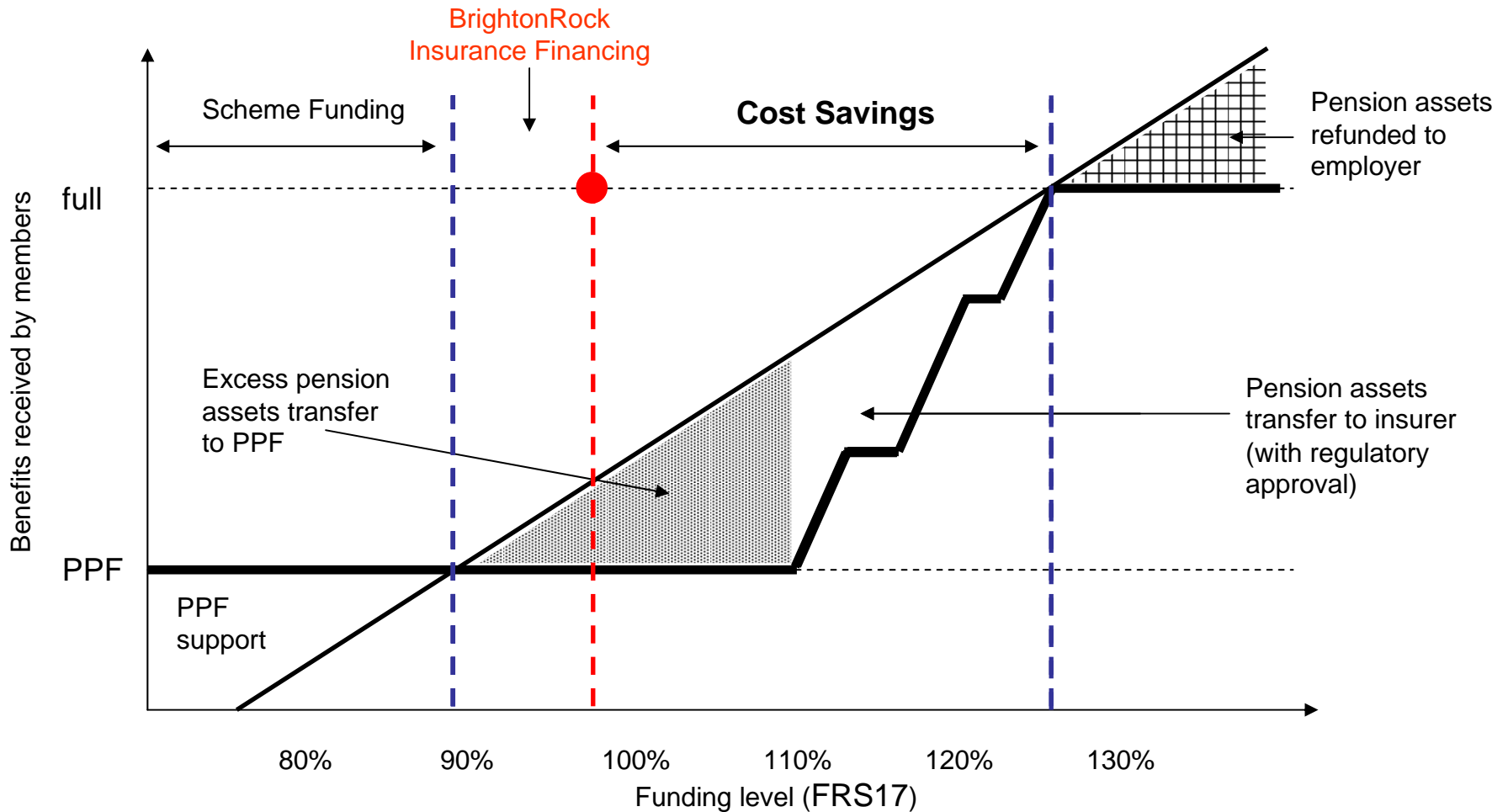


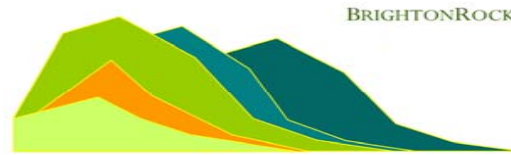
Insuring the employer covenant

- BrightonRock is an EU regulated insurer
 - Solvency II capital adequacy
- **“Pay pensions in full upon sponsor failure”**
 - The scheme’s benefits not limited by statute
- Sponsor/trustees fund for the best estimate of the pension liabilities
 - Insure against the risks of the best estimate, rather than hold margin



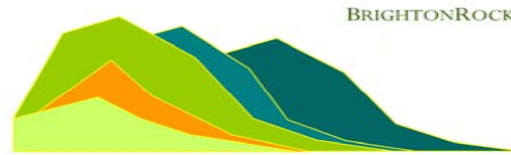
Being optimal in the Dead Zone





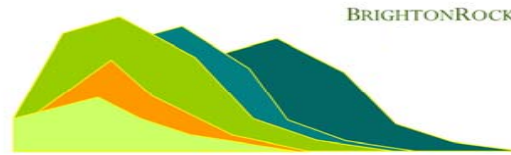
Asset allocation

- Security for members *vs* Return to offset contributions
- Scheme obligations *vs* Sponsor accounting
- Insure the employer covenant and the assets have one less master to serve
 - Greater freedom
 - Re-risking possible, even desirable



A specific illustration

- FTSE100 company earning 15+% pa on equity.
- UK pension scheme
 - assets of £1bn (× multiple)
 - fully funded on FRS17
- Extend financing instruments to investments and insurance
 - premium payable £2m per £1bn of PBO
- Reduce scheme funded status to 90%
 - releases £70m to company (10% of £1bn less tax)
- This company is a stronger credit after release of excess pension funding
 - the expected loss in default at all horizons is lower at 90% scheme funding than at 100%



Summary



CART MASTER:
Bring out your dead!

CUSTOMER:
Here's one.

CART MASTER:
Ninepence.

DEAD PERSON:
I'm not dead!

CART MASTER:
'Ere. He says he's
not dead!

CUSTOMER:
Yes, he is.

DEAD PERSON:
I'm not!

CART MASTER:
He isn't?

CUSTOMER:
Well, he will be soon.
He's very ill.