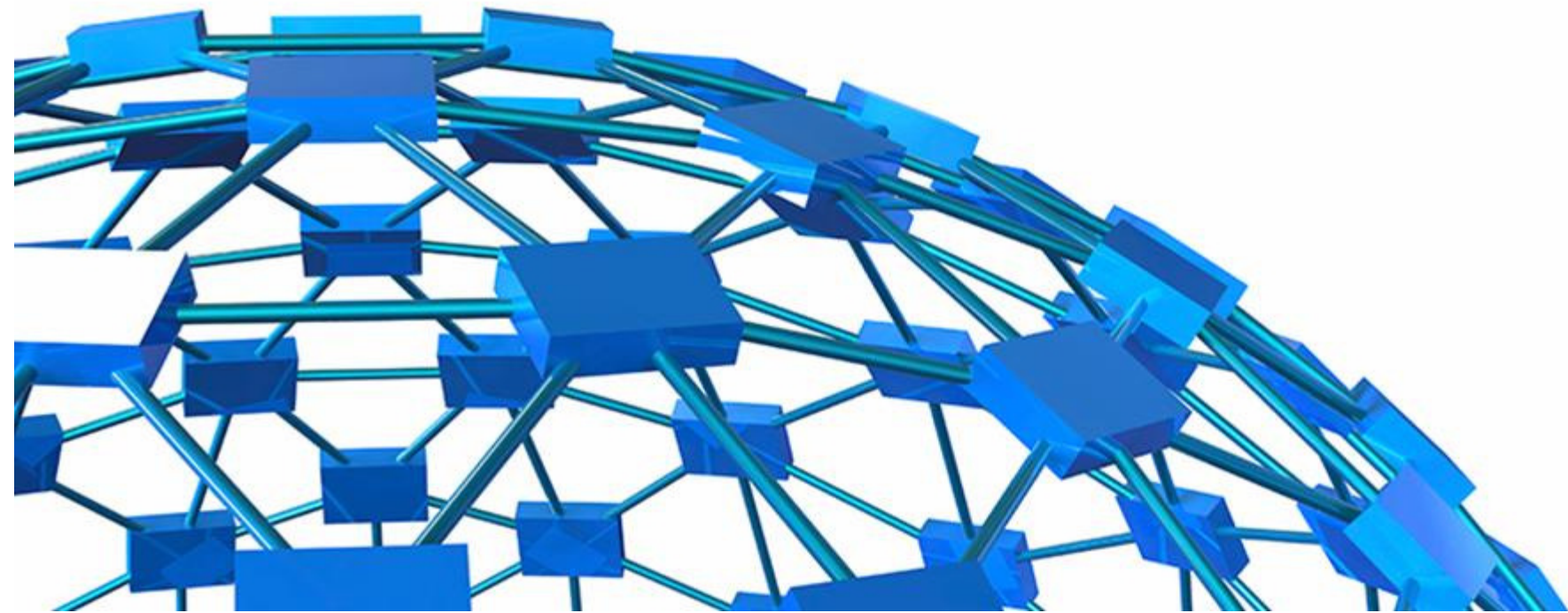




ACA – 23 April 2009

Some Practical Buy-in Thoughts

Antony Hayes

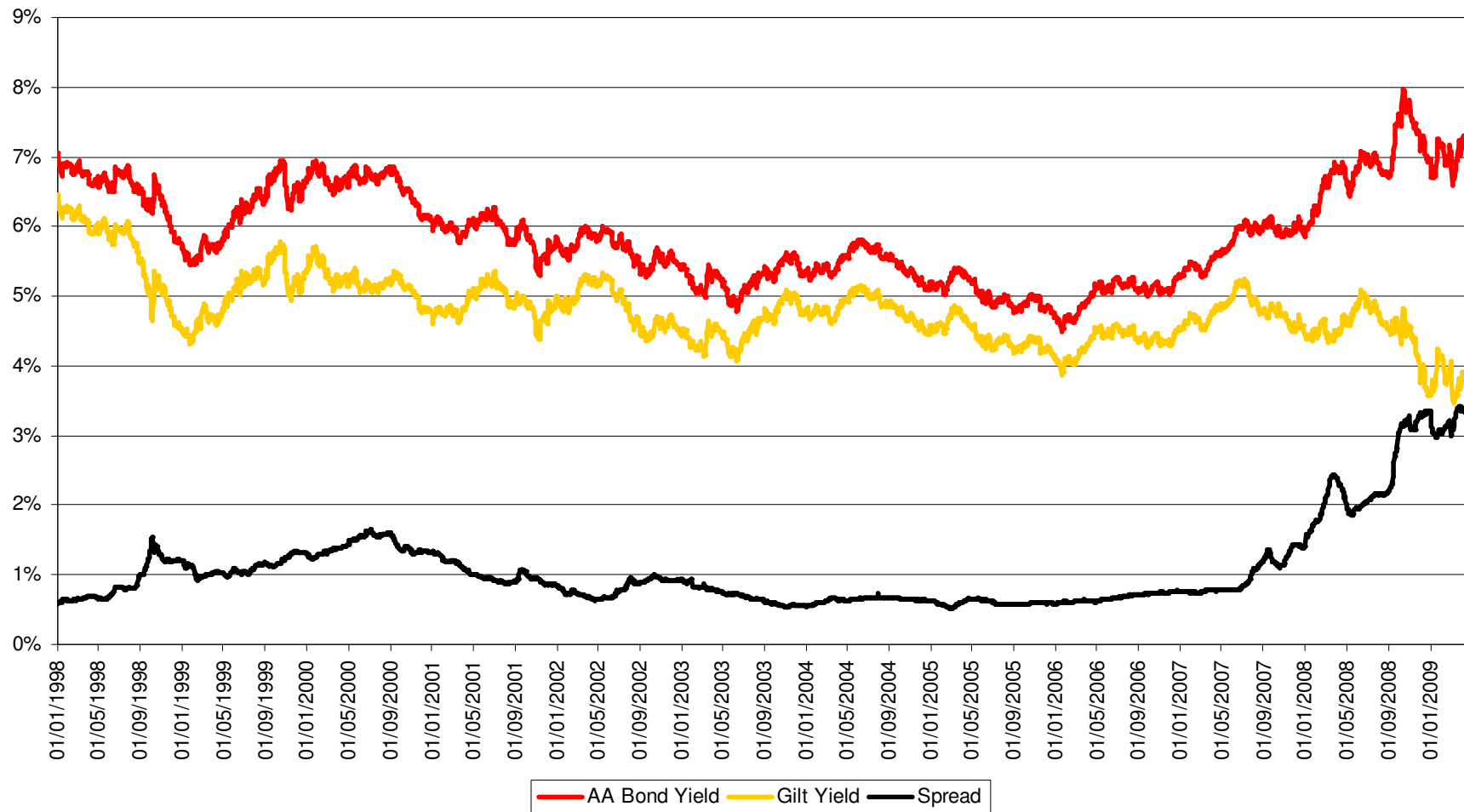
Agenda

- Current buy-in market status
- What clients are doing
- Optimising the transaction
- Selective buy-in

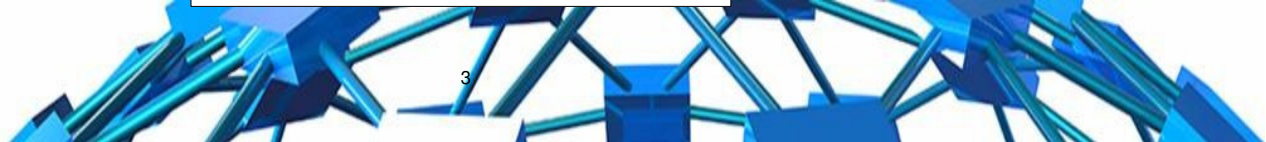


Credit spreads continue to keep prices down

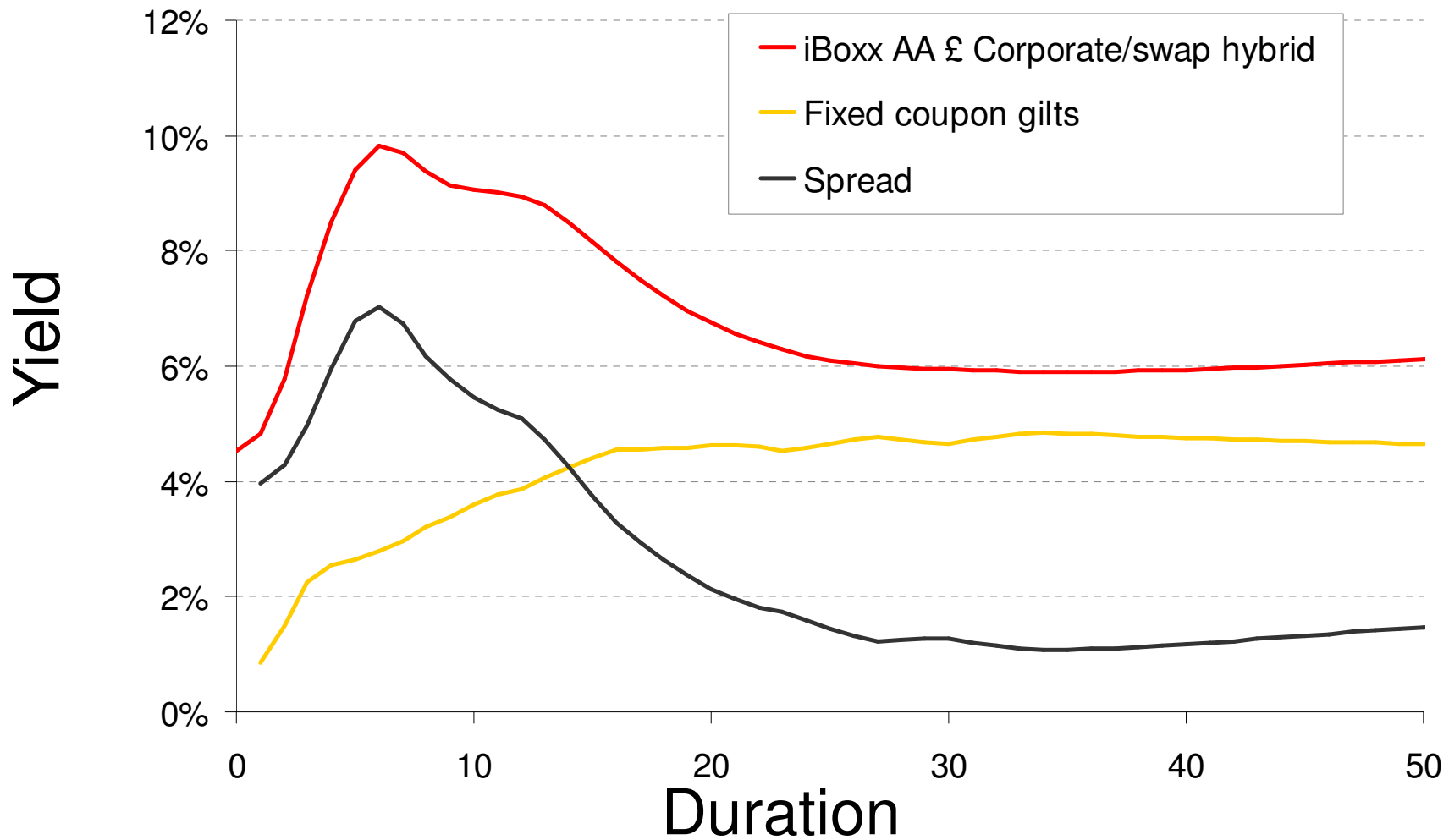
AA Corporate Bonds vs Gilts



Risk...Rewarded



Particularly at the short end



Risk...Rewarded



Insurer covenant

Trustees and companies are increasingly concerned about counterparty risk.

Transactions are only likely to happen if exposure is considered to be:

- Small, as the deal is collateralised; or
- Well diversified; or
- Acceptable, e.g. the counterparty is either FSA regulated or of sufficient credit quality.

Mitigation strategies

- Syndication – (but is the cure worse than the disease?)
- Ring-fenced assets, triggered surrender values, letters of credit



What clients are doing currently

Well matched clients are still busy transacting

The others are:

- Cleaning data;
- Reviewing trust deeds and rules for benefit and decision making issues;
- Setting up decision making teams; and
- Monitoring:
 - Bulk annuity prices;
 - DIY cost estimates;
 - Accounting and technical provision measures; and
 - Assets.



Optimising the transaction

Assets

- Anticipated negative inflation is posing a problem
- As are wide bid-offer spreads and general illiquidity
- Optimisation involves considering assets which can be transferred cost effectively, and those which broadly match pricing bases.

Liabilities

- Broking is becoming commoditised – less difference between insurer prices
- Differentiator is a scheme that is well prepared to transact.



Selective buy-in

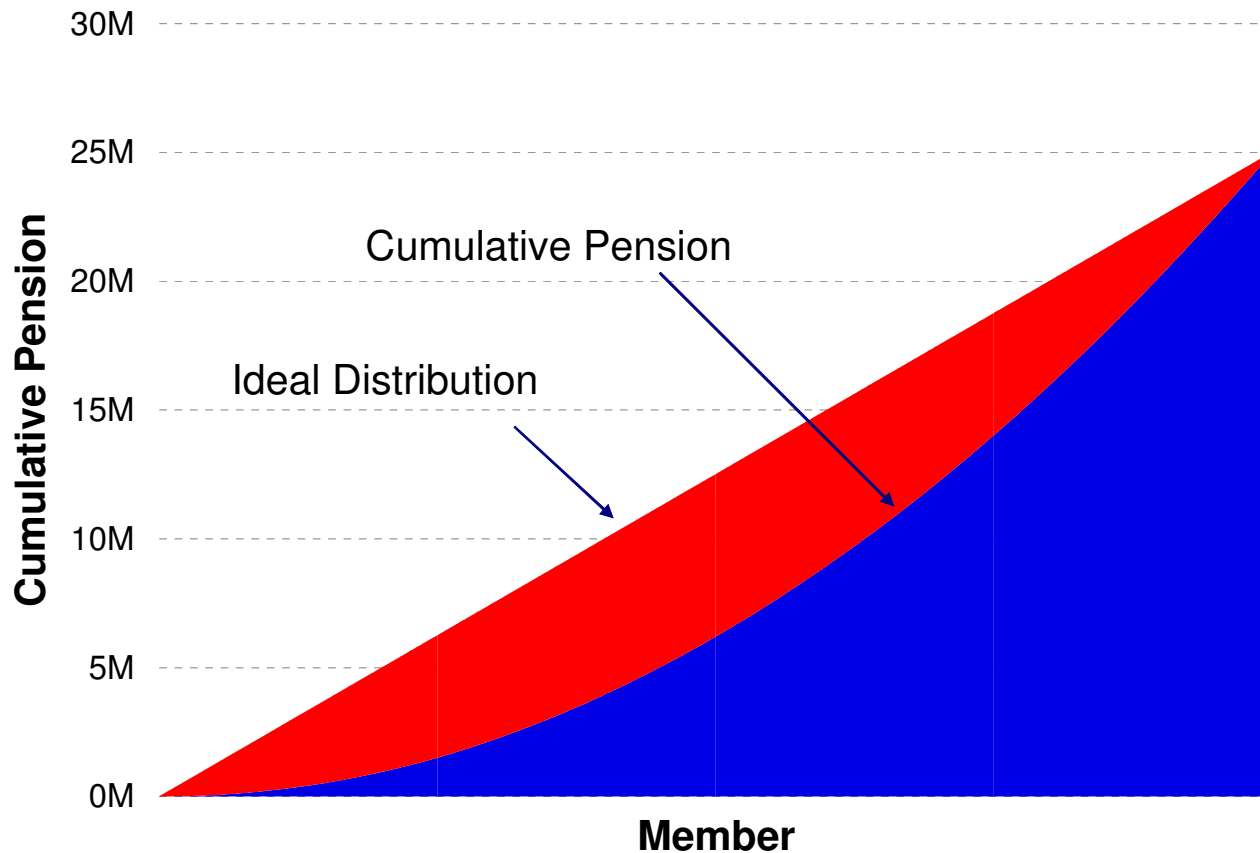
For a population of scheme pensioners, how do we determine:

- Which members to insure first, and
- How much of each of their pensions to insure?

Consider 1 pensioner with a £100,000 p.a. pension vs.
10 pensioners with £10,000 p.a. pensions



Lorenz Curve - line up pensioners according to size of pension



A population with an even distribution of pension sizes will have a low Gini coefficient, i.e. a small red area on the chart.

However contrast the volatility of reserve for pensioners aged 35, 55, and 95, all receiving the same pension.



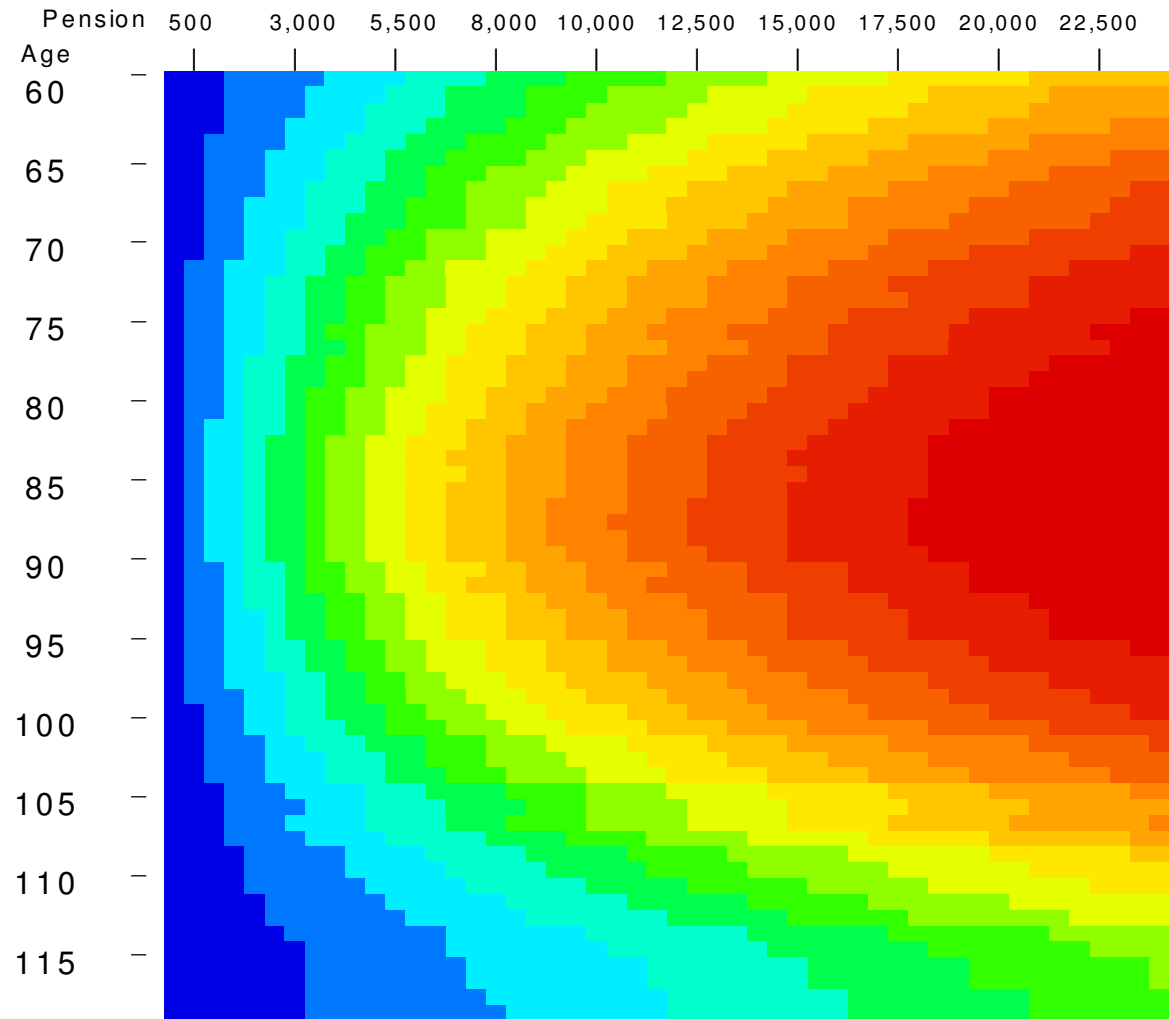
Insurance Efficiency - Simplified example

This heat map shows the relative efficiency of insuring individual pensioners.

“Efficient” means that insuring part of that member’s pension provides the largest reduction in scheme volatility per unit of insurance cost.

Implication: start with

- ▣ 85 year olds with
- ▣ Big pensions

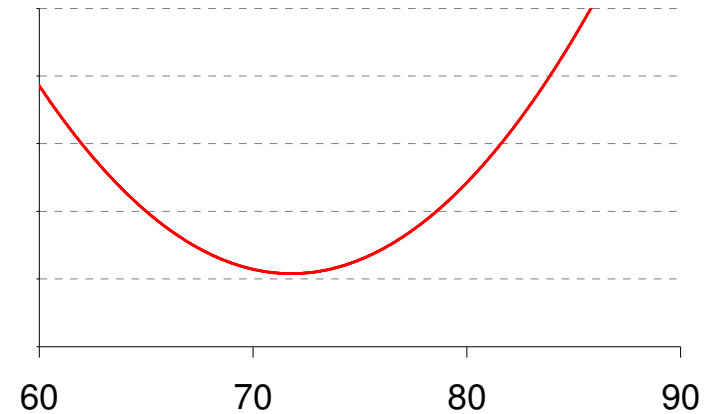


Optimal Distributions

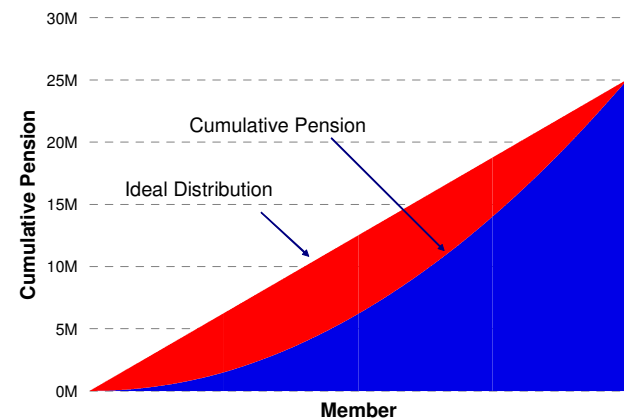
The optimal distribution is as follows:

- Optimum distribution of pension by age:
- Optimum (smooth) distribution of pensions within each age group

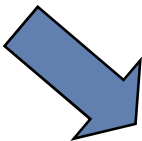
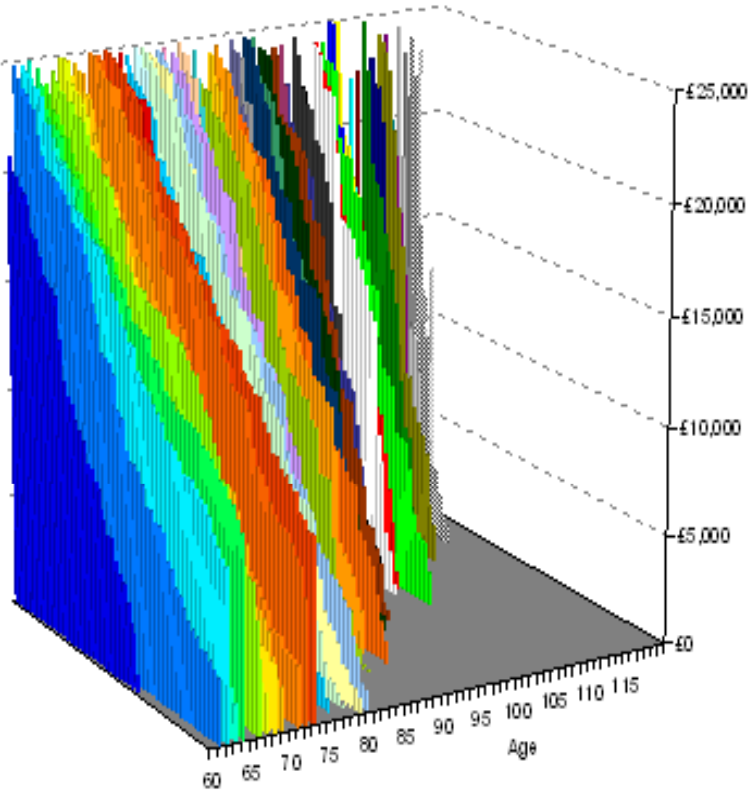
Optimal pension by Age



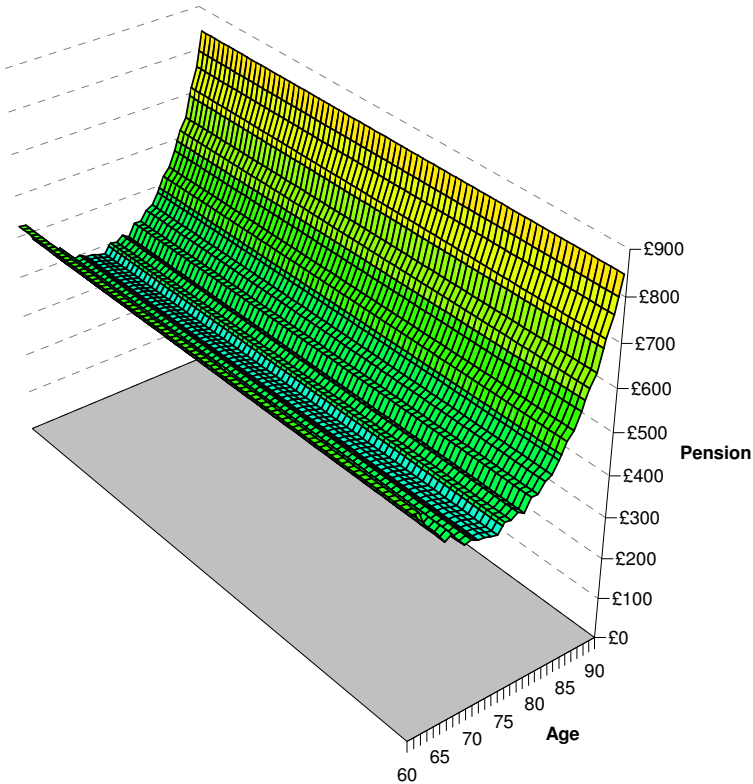
Lorenz Curve for all 60 year olds...



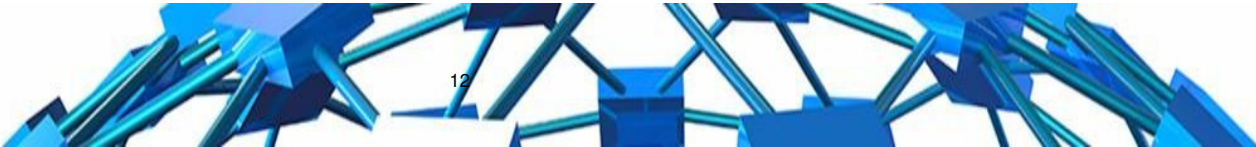
In 3D

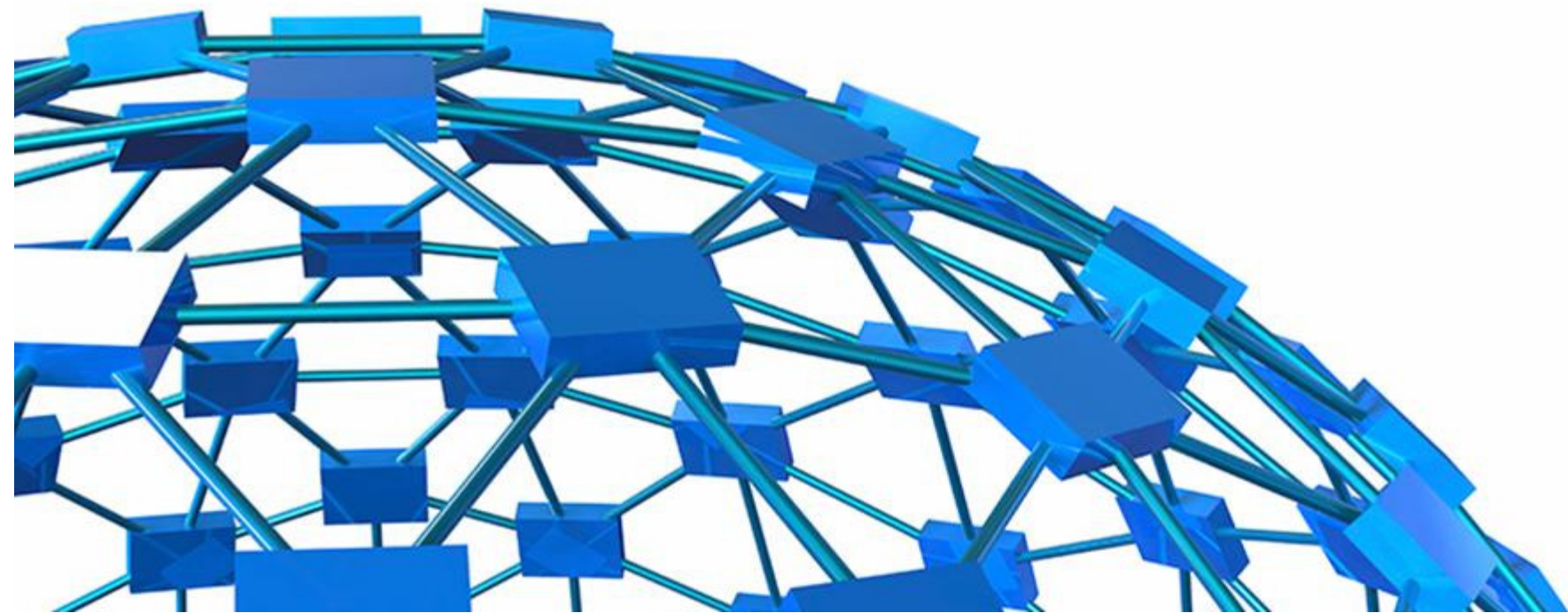


Ideal Distribution



Risk...Rewarded





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Risk...Rewarded



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