Innovation

Association of Consulting Actuaries
Presentation at the Sessional Meeting
Jolly Hotel St Ermin's, 26 June 2008

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Agenda

- Background on Pension Corporation
- Corporate Solutions
- Longevity Insurance for Pension Funds
- Summary and Q&A

Pension Corporation: Background Information

PENSION CORPORATION

- Pension Corporation is a focused financial services organisation that has been established to provide innovative and affordable solutions to pension funds and their sponsors
- Pension Corporation offers both full insurance and other pension risk transfer products
- Pension Corporation has blue chip investors including The Royal Bank of Scotland, HBoS, ABN Amro, JC Flowers, Union Banque Privée, Swiss Re, Sampo Life, Istithmar World and a number of other institutional investors
- Pension Corporation has £4.8bn of pension fund liabilities, £4.3bn as sponsoring employer and £0.5bn as insurer
- Pension Corporation has the largest equity capital of any provider in the sector – close to £1bn providing the ability to underwrite up to £25bn of liabilities

PENSION CORPORATION

Corporate Solutions

Pension Corporation Investments
Corporate Solutions

Insurance Solutions

Pension Insurance Corporation
FSA-regulated Insurer

Pension Security Investment Corporation
Guernsey-regulated (Re-) Insurer

Pension Corporation: Innovation
Result: £4.8bn of Pension Liabilities

£4.3bn as Sponsor and £0.5bn as Insurer

- Thorn: Acquisition (£1.2bn)
  - First corporate solution transaction
  - Scheme assets in surplus over buyout
- Threshers: Acquisition (£0.1bn)
  - Established escrow to support the pension scheme
  - Scheme now in surplus
- telent: Acquisition (£3bn)
  - First public market corporate solution transaction
- Swan Hill: Full Buyout (£72m)
  - Transaction based on security, value, certainty, flexibility and focus on members
- Delta Pension Plan: Partial Buyout (£0.5bn)
  - Share price up 10% on announcement of transaction

Pension Corporation is the market leader in the growing pension transfer area

Corporate Solutions

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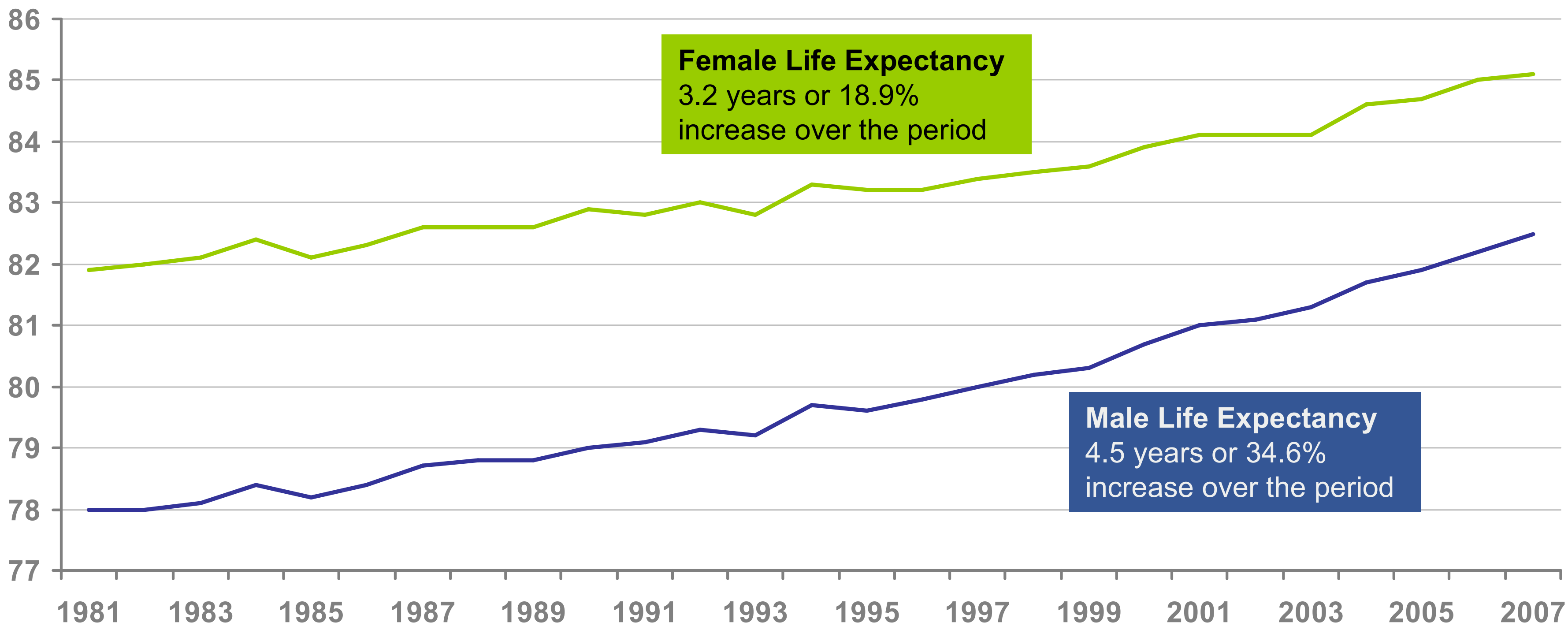
- Acquisition of small operating companies with large pension liabilities *or* substitution of sponsor relationship
- Applicable if
  - Owner wants to sell
  - Limited buyer universe (due to size of pension liabilities)
  - Pension fund is in deficit and needs state-of-the-art pension fund management which the sponsor cannot provide
  - Sponsor covenant can be strengthened by financial support (escrow etc.)
  - Trustees and tPR support the proposed transaction
- Aligning the company's interests with those of the pension fund:
  - Investors only make returns once the members' benefits are secure
  - Level of the covenant provided commensurate with the fund's risk profile
  - Out-performance and meeting funding targets benefits the members *first* and the company *second*

Corporate Solutions are attractive by improving the members' security where full or partial insurance solutions are not affordable

Longevity:
Improvement Trends Drive Demand for a Solution



"… it is vital to understand that nobody can be confident about future longevity experience any more than they can predict future stock market levels. It is about measuring and managing risk and uncertainty…"

Stewart Ritchie, President, Faculty of Actuaries / Nick Dumbreck, President, Institute of Actuaries (March 2007)

Source: Office for National Statistics; Government Actuary's Department

These figures represent period life expectancies – that is, the average number of years that a person could be expected to live if they experienced the mortality rates of the *given time* for the rest of their life. This does *not* take into account projected changes in mortality in future years.

Longevity: Future Longevity Improvements: Highly Uncertain and Material to Pension Funds and Sponsors

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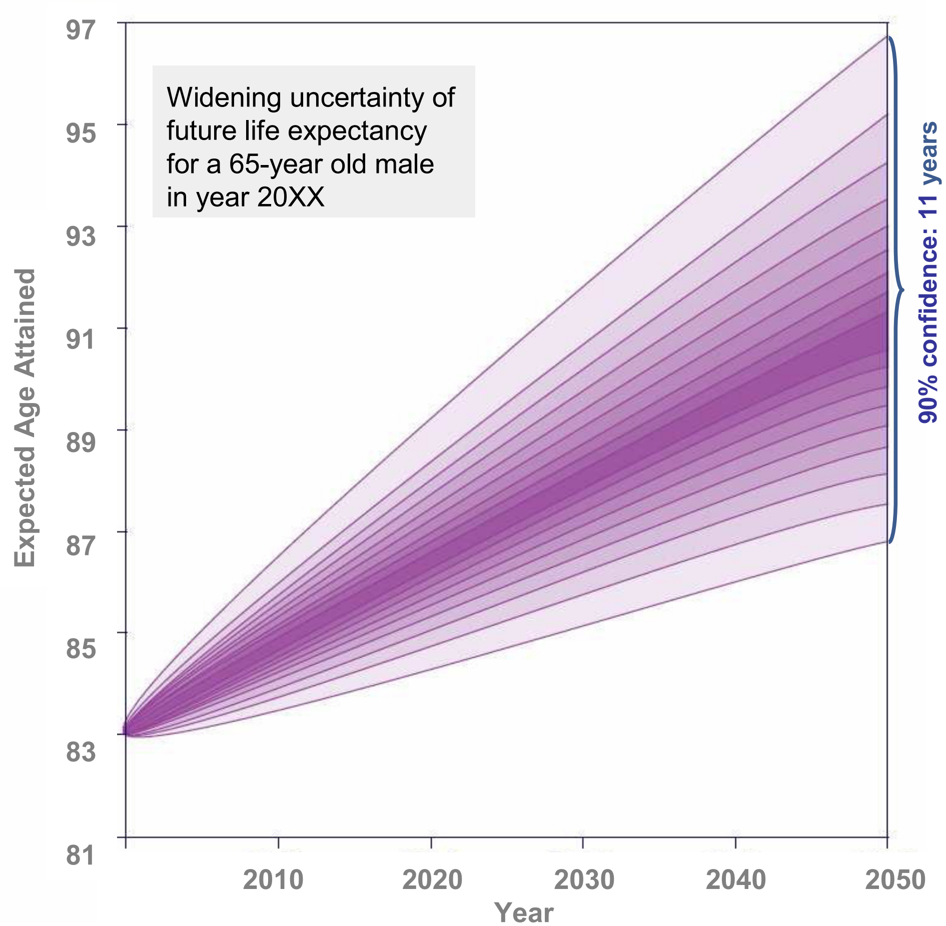
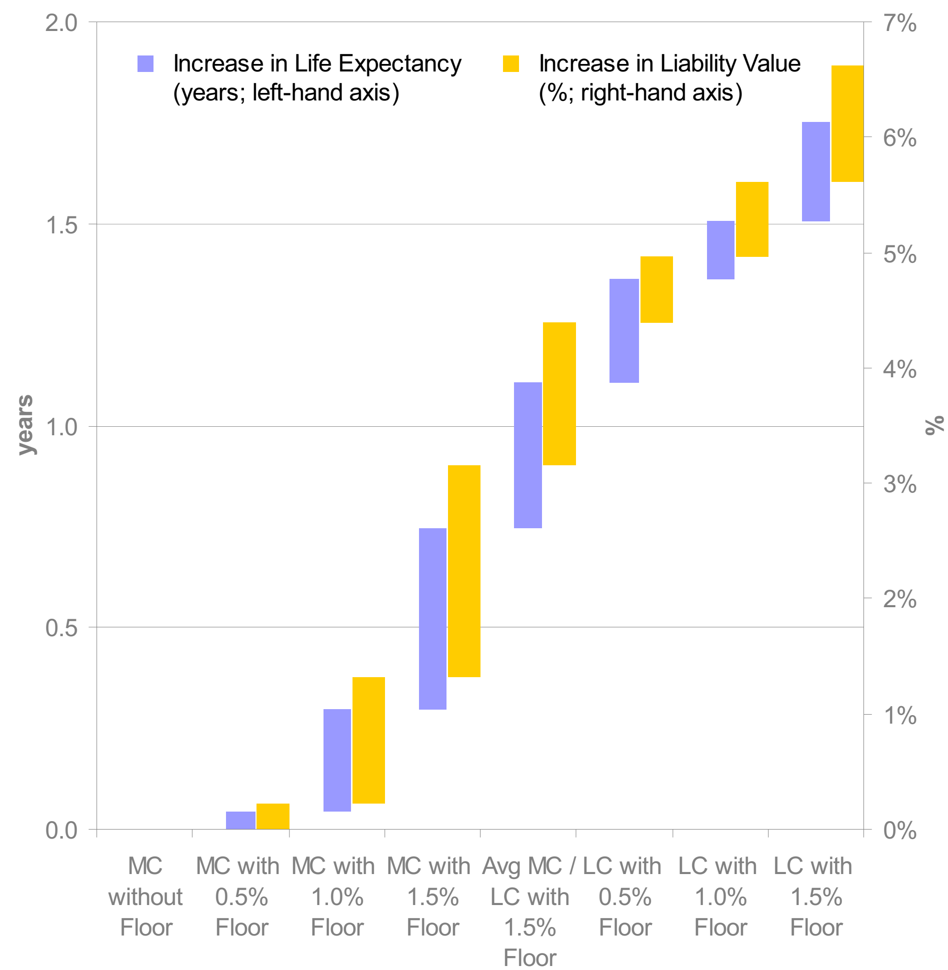
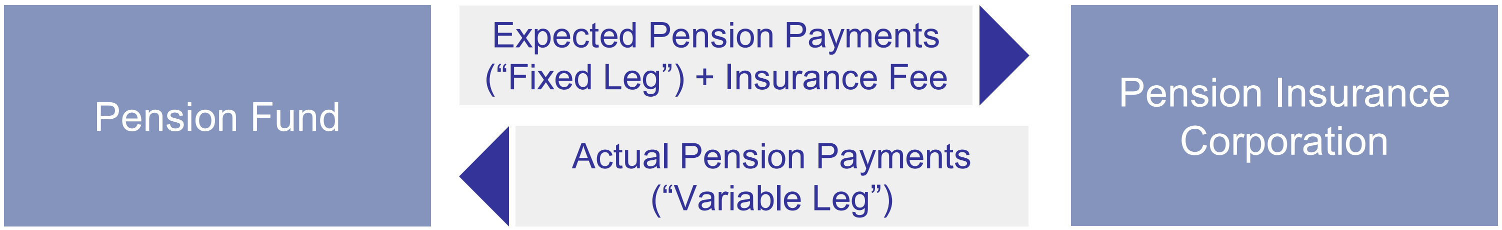


Longevity fan chart for 65-year-old males in England and Wales. Source: Dowd et al (2007)



Source: PIC calculation for pensioners in a ‘typical’ pension fund; MC: medium cohort; LC: long cohort (defined as per Institute of Actuaries)

Longevity Insurance:
General Structure



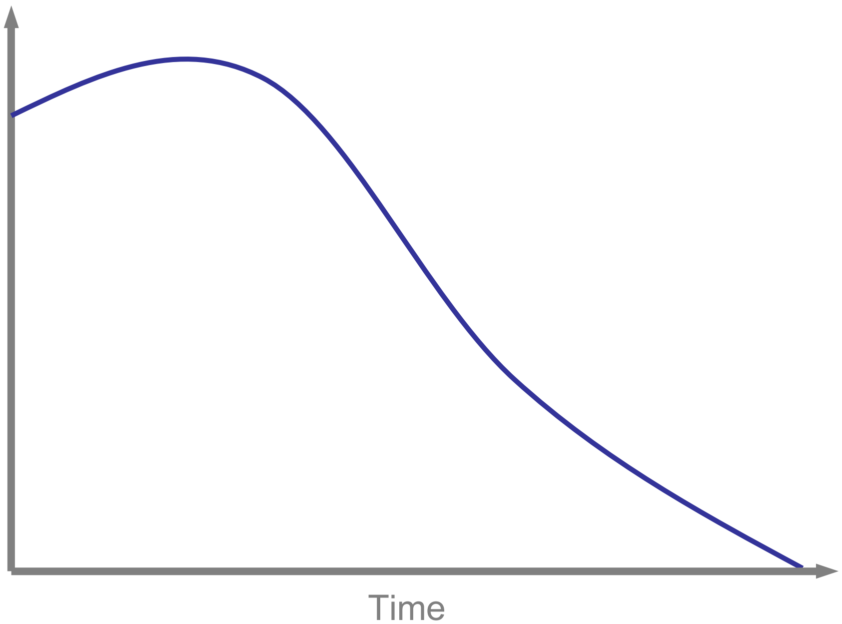
- Insurance agreement defines an expected “cash flow line” based on agreed mortality basis and assumptions for future improvements

- PIC pays to Pension Fund the Actual Pension Payments due to the pensioners in return for the Expected Pension Payments as defined in insurance agreement plus an Insurance Fee

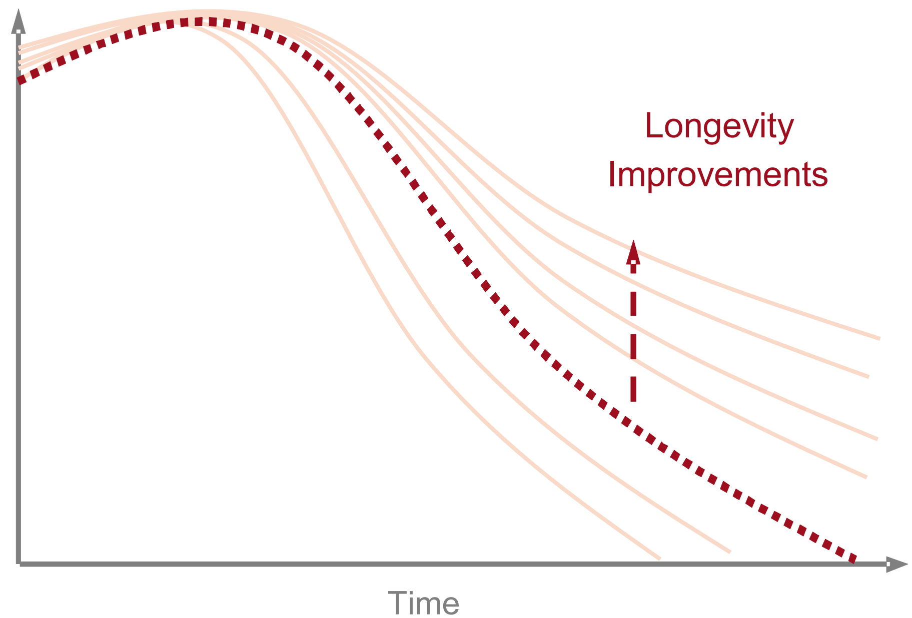
- Payments are made on a net basis:
  - If Actual Pension Payments are larger than Expected Pension Payments plus Insurance Fee, PIC pays difference to Pension Fund
  - Otherwise, a payment is due from the Pension Fund to PIC

Longevity Insurance: Cash Flows

Pension Fund Pays
Expected Pension Payments + Fee



Pension Fund Receives
Actual Pension Payments



Longevity Insurance: Four Key Advantages Versus Other Products

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- Insurance policy from a UK FSA-authorised and regulated insurance company – not a complicated derivative
- Covers the specific longevity risk of the pension fund; it is not an index based on the longevity of the population of England and Wales
- “Whole of life,” e.g. it provides coverage until the last pensioner and his or her last covered dependant dies, rather than a ten year duration
- Requires no upfront premium, so that the pension fund can retain 100% of its assets to reach its targeted funding objective more quickly

Longevity Insurance: Key Benefits

- Substantially eliminates the most significant long-term risk to a pension fund
- Hedging of interest rate and inflation (LDI) can be done much more precisely
- Asset returns flow directly to surplus, with no leakage to increasing longevity assumptions
- ‘Risk budget’ (or “VaR”) previously held against longevity risk can be reallocated to enhance future asset returns in the fund
- Reduced risk allows company and pension fund to budget with more certainty
- Eliminates the risk of the regulator requiring higher longevity assumptions
- Transfer of longevity risk can be considered as a step along the road to full buyout

Why Longevity Risk Needs to Move

Pension Funds	Pension Insurers	Capital Markets
• Original owners of longevity	• Underwrite price specific pension fund risk • Create large portfolios of risk • Carry the basis risk	• Longevity not correlated to credit and market risks • Buy indexes

- Unrewarded, historically underestimated and unmanaged material risk for pension funds
- ‘Natural or original’ owners of a risk are not the ‘best owners’
- ‘Best owners’ of longevity risk are the pension insurers and capital markets:
  - Spreads risk around larger number of markets and participants
  - Risk flows to those best able to manage it
- There are limitations to the use of VaR models in the analysis of diversified risk effects because:
  - There is much longer duration tail risk with longevity
  - Trends in longevity are secular in nature rather than pure ‘volatility’

Top 10 Thoughts for Consulting Actuaries

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10. Address the principle of whether the scheme should hedge longevity risk
9. Build longevity risk into traditional asset-only ALM models
8. Obtain sufficient mortality experience data
7. Develop house views on measures of longevity risk, including VaR and others
6. Clean up the data and ask for a quotation: know the price to sell a risk
5. Communicate that the price will rise for late adopters of longevity insurance
4. Develop ability to provide *complete* risk management solutions, using a suite of products / strategies
3. Use widening spread of AA corporate bonds to increase assumptions for longevity risk and inflation
2. Identify and engage with clients for whom it makes most sense (before someone else does)
1. Get one transaction done and be the most knowledgeable consultant in this area

Summary and Q&A

- There are benefits to providing your clients with innovative ideas
- The news that Corporate Solutions are dead is premature
- Longevity Insurance for pension funds directly addresses the needs of the clients and is now available in the market
- Great advice is what the client wants

For further discussion / information, please contact John Fitzpatrick, Partner & Director
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fitzpatrick@pensioncorporation.com or visit www.pensioncorporation.com

Appendix

Board of Directors

PENSION CORPORATION

Executive Officers

Sir Mark Weinberg
Chairman

President of St James's Place plc, co-founder in 1991 of St James's Place Wealth Management Group. Co-Founder of Hambro Life (Allied Dunbar) in 1969

John Coomber
Deputy Executive Chairman

Director and former Chief Executive Officer of Swiss Re; Fellow of the Institute of Actuaries

Edmund Truell
Chief Executive Officer

Founder of Duke Street Capital, 22 years experience in building up private equity business. Built largest leveraged loan investor in Europe from start-up to sale

Richard Priestley
Chief Financial Officer

Former CFO of Swiss Re Life & Health. 16 years insurance financial management experience

Directors

Sir Martin Jacomb

Former Chairman of Prudential plc, former Deputy Chairman of Barclays Bank and Director of the Bank of England

Bob Scott

Former Group CEO of Aviva plc and former Chairman of the Association of British Insurers. Director at the Royal Bank of Scotland, Jardine Lloyd Thompson and Swiss Re

Ravi Sinha

Head of Europe and Managing Director of J C Flowers & Co LLC.
Former Managing Director Goldman Sachs

John Amato

Chief Investment Officer, Istithmar, formerly at Lehman Brothers

John Loveless

Former Head of Trust and Private Banking, SG Hambros

John H. Fitzpatrick

Former CFO of Swiss Re. Former CEO of Swiss Re Life & Health. 28 years of insurance and financial management

Sir Nicholas Montagu

Former Chairman of HM Inland Revenue

Kari Stadigh

Group Deputy CEO Sampo plc. Chairman of P&C Insurance Holding Ltd and Sampo Life Insurance and the Federation of Finnish Insurance Companies

Nick Parker

Former Managing Partner at PwC Project Finance and privatisations

Danny Truell

Chief Investment Officer, Wellcome Trust. ~ Former co-head of Global Investment Strategies at Goldman Sachs Asset Management

Graham Cooper

Fellow of the Institute of Actuaries. Founded New Bridge Street Consultants pension and actuarial practice in 1986

Pension Transactions in Excess of GBP 50m since January 2007

Name	GBPm	Insurer	Date	Type
Telent	**3,000**	**Pension Corporation**	**Nov-07**	**UFB**
Thorn	**1,200**	**Pension Corporation**	**Jun-07**	**UFB**
P&O	800	Paternoster	Dec-07	PPB
Rank	700	Rothesay Life	Feb-08	Full
Delta	**452**	**Pension Corporation**	**Jun-08**	**PPB**
Powell Duffryn	400	Paternoster	Mar-08	Full
Friends Provident	350	Norwich Union	May-08	PPB
TI Group	259	Legal & General	Mar-08	PPB
Weir Group	240	Legal & General	Dec-07	PPB
Thomson Regional Newspaper	200	Citigroup	Aug-07	UFB
DRG Pension Fund	180	Legal & General	Jan-07	PPB
M-Real Corporation	180	Legal & General	Mar-08	Full
Electricity Association Services	170	Legal & General	Nov-07	Full
Emap	170	Paternoster	Oct-07	Full
Morgan Crucible	160	Lucida	Mar-08	PPB
Eni Lasmo	150	Paternoster	Nov-07	Full
Hunting	110	Paternoster	Jan-07	PPB
Threshers	**100**	**Pension Corporation**	**Jun-07**	**UFB**
Lonmin	78	Paternoster	May-08	Full
Book Club Associates	75	Legal & General	Dec-07	Full
Ravenmount (Swan Hill)	**72**	**Pension Corporation**	**May-08**	**Full**
Queens Moat Houses	60	Legal & General	Dec-07	Full
Unknown	53	Legal & General	Mar-08	PPB

UFB: Uninsured Full Buyout, PPB: Partial Buyout, Full: Full Insured Buyout

Source: Pension Week, 26 May 2008
plus addition of recent PIC transactions

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