


The New Buy-out Market

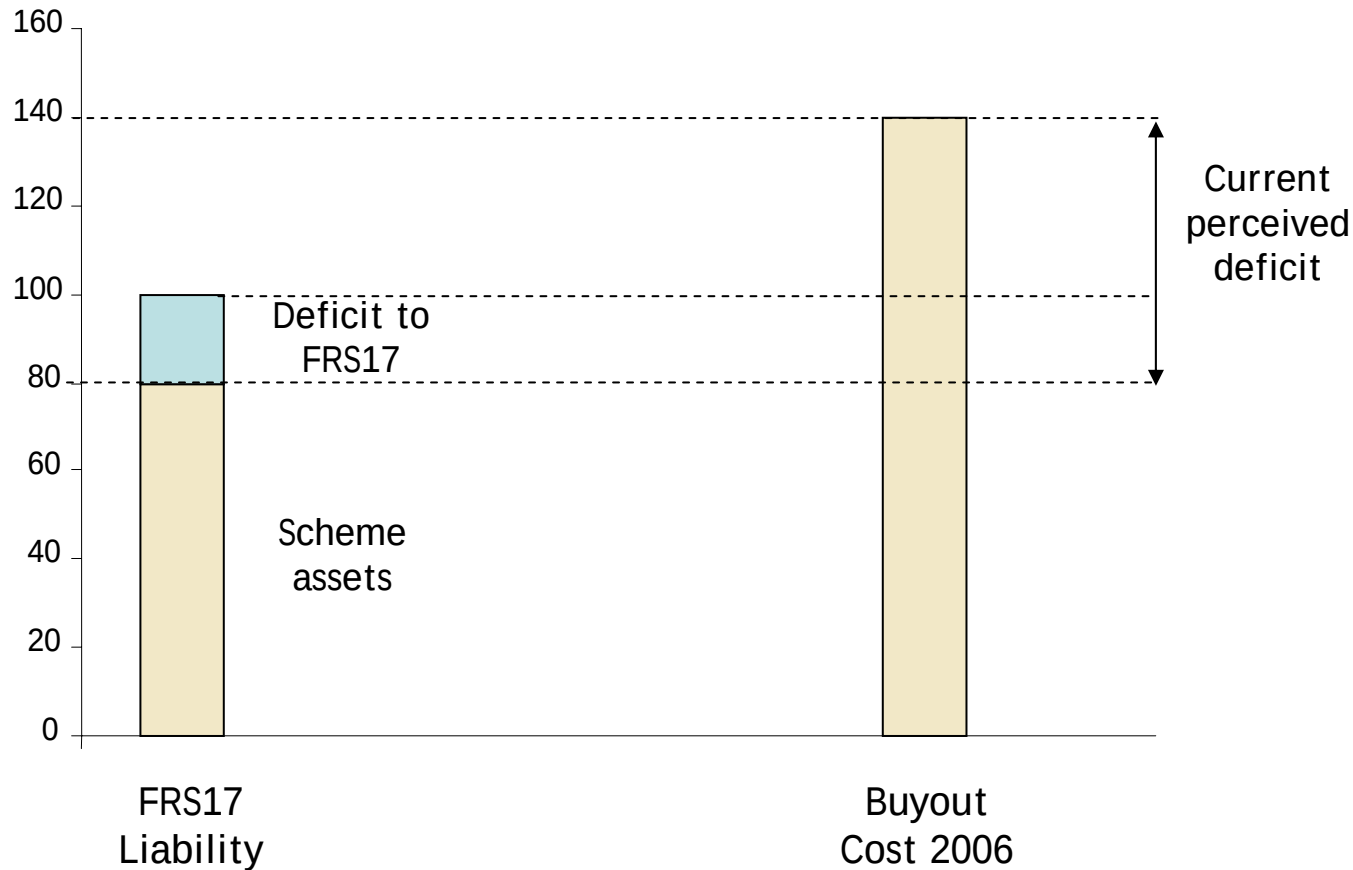
ACA Regional Meeting - Birmingham

Sammy Cooper-Smith
2 July 2007

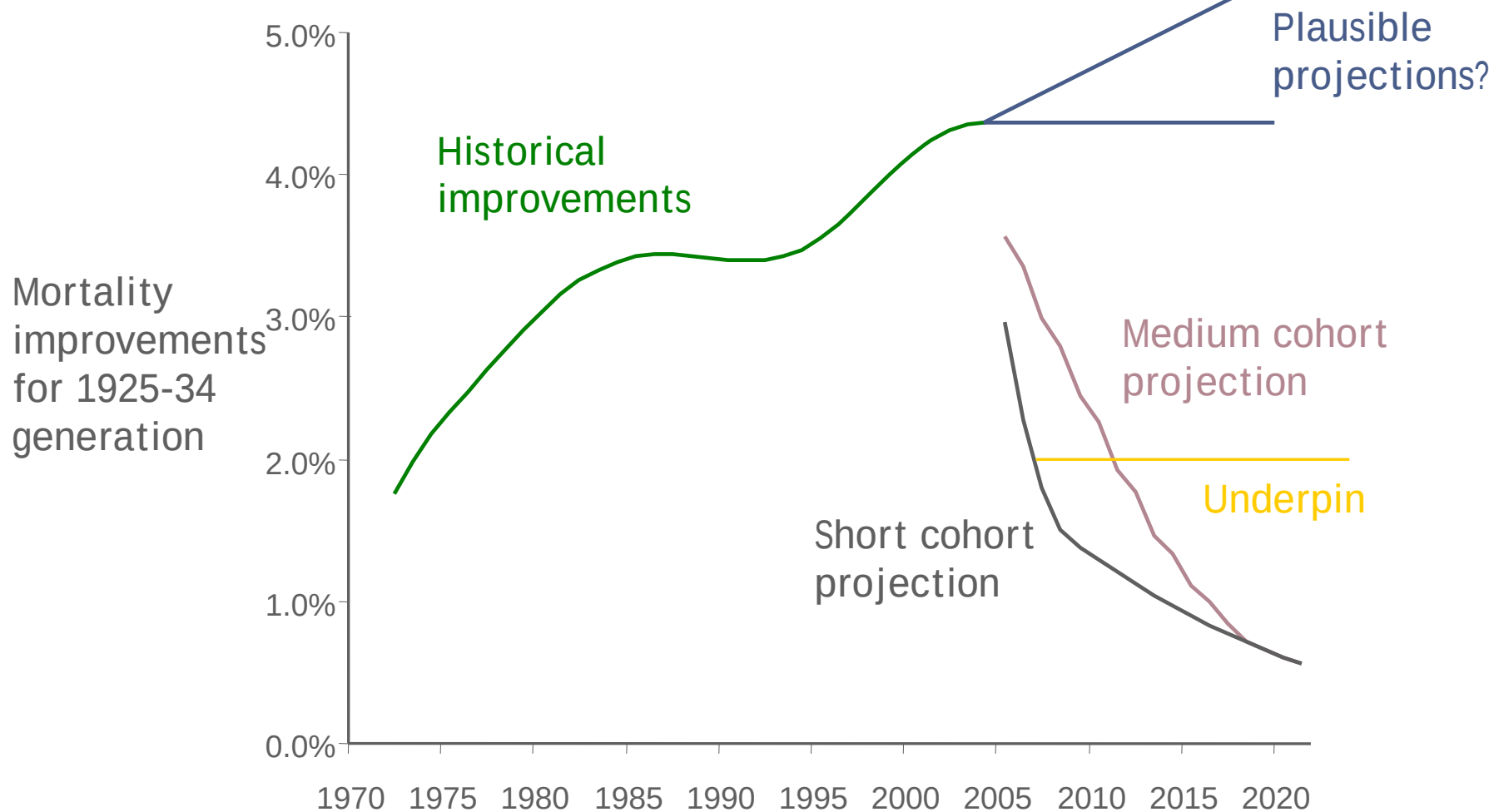
Agenda

- Is buyout really that expensive
 - The true economic cost of the pension
 - Current pricing in the market
- Latest thinking on products
 - Mortality underpin
 - Member behaviour

The cost of buy-out

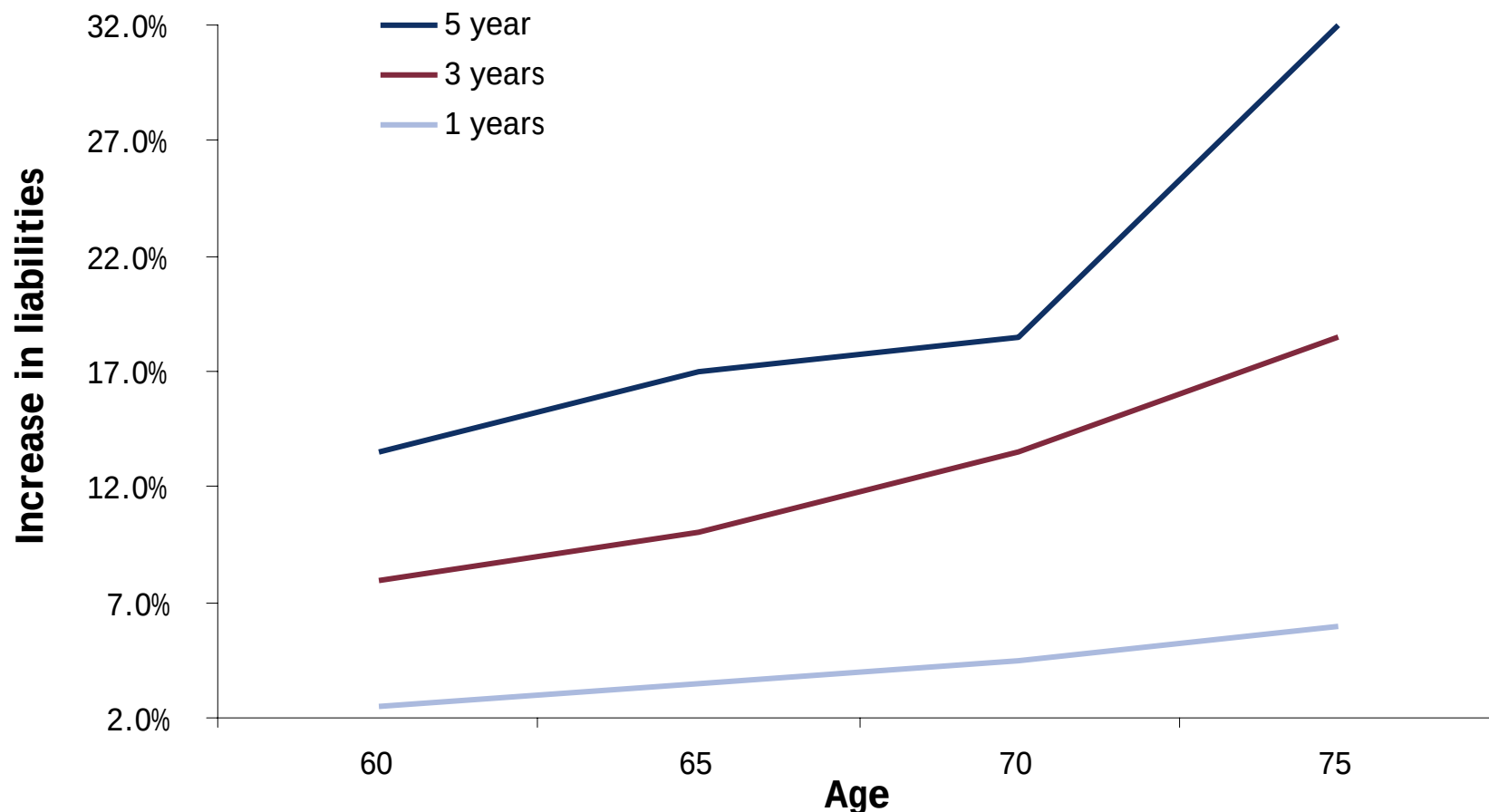


Mortality assumptions



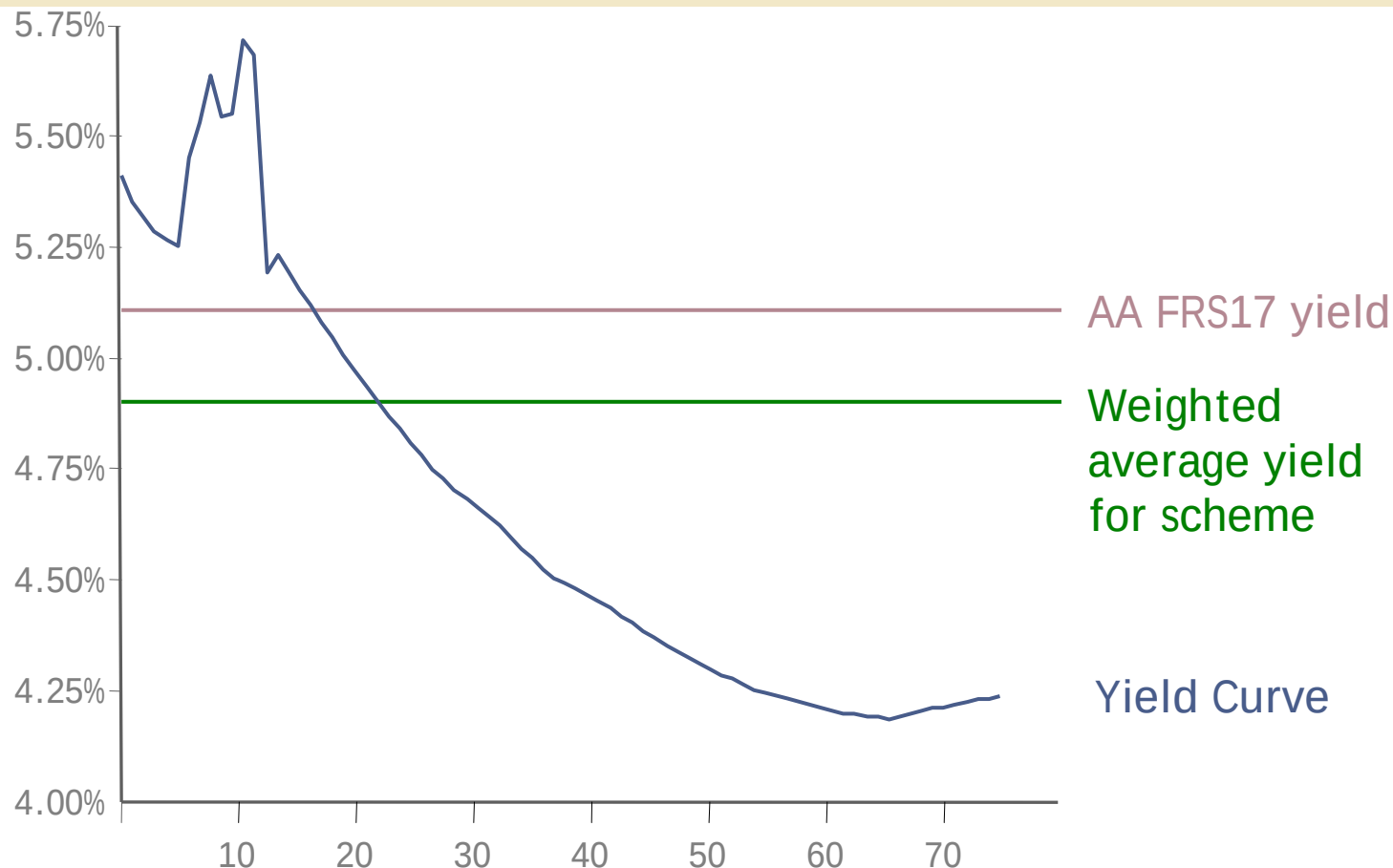
The cost of getting the assumptions wrong

An error in the assumptions used can have a material impact on liabilities



Yield curve

FRS17 uses a single discount rate where as the current shape of the UK yield curve implies a lower weighted average yield for this scheme



The cost of buy-out



Competition

P A T E R N O S T E R



Goldman
Sachs



AIG



PRUDENTIAL



PENSION INSURANCE
CORPORATION



NORWICH UNION
an AVIVA company



UBS



AEGON



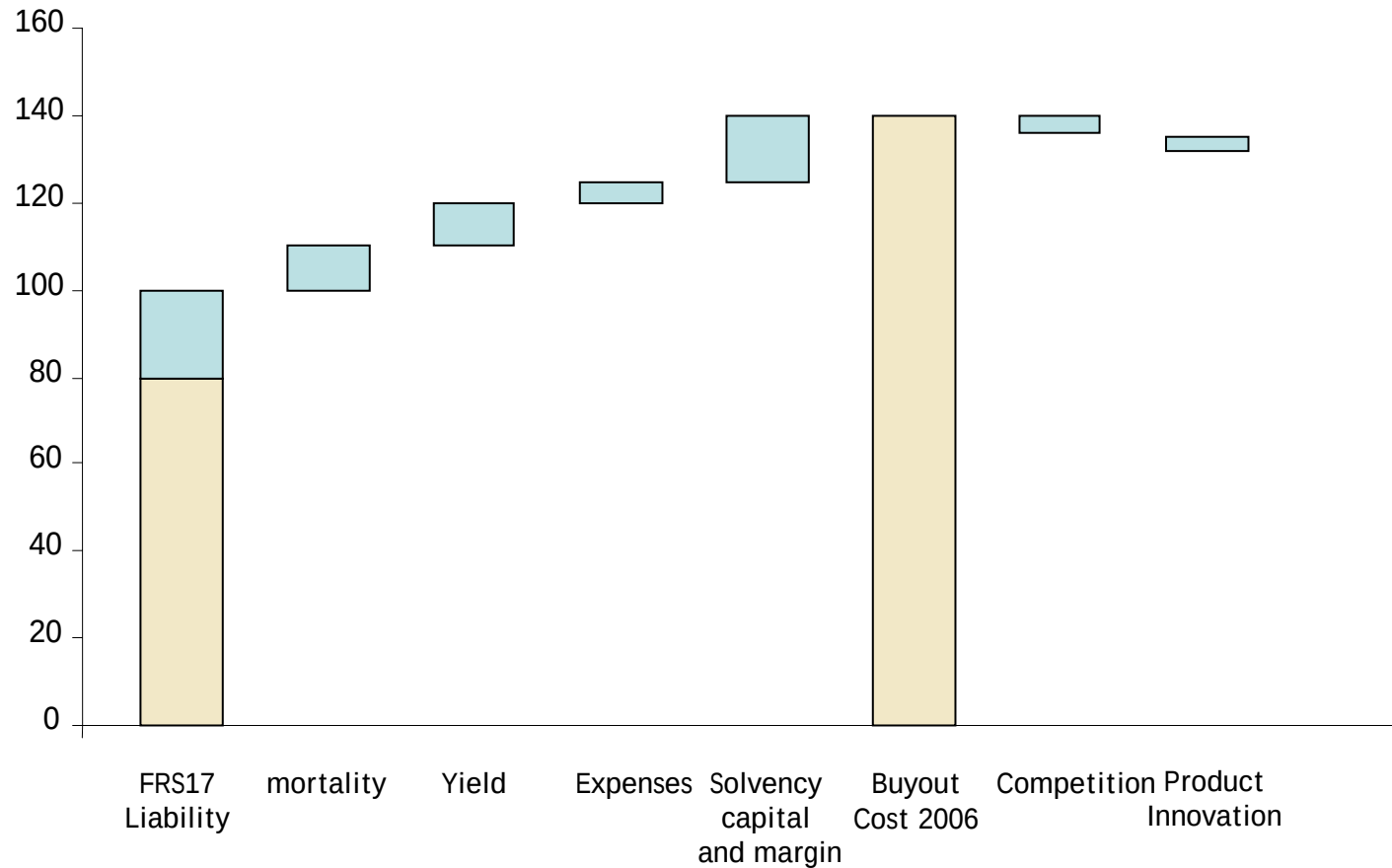
Legal &
General



Synesis

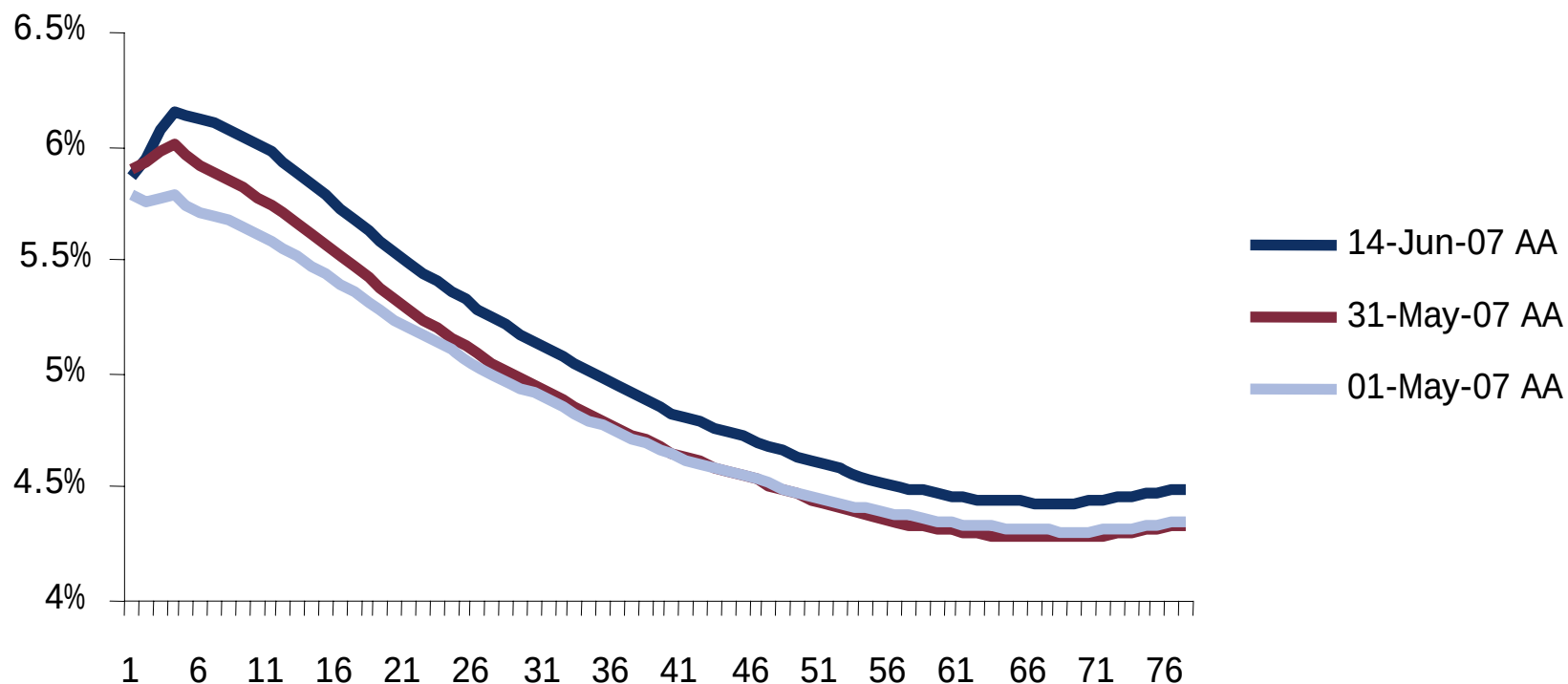
P A T E R N O S T E R

The cost of buy-out

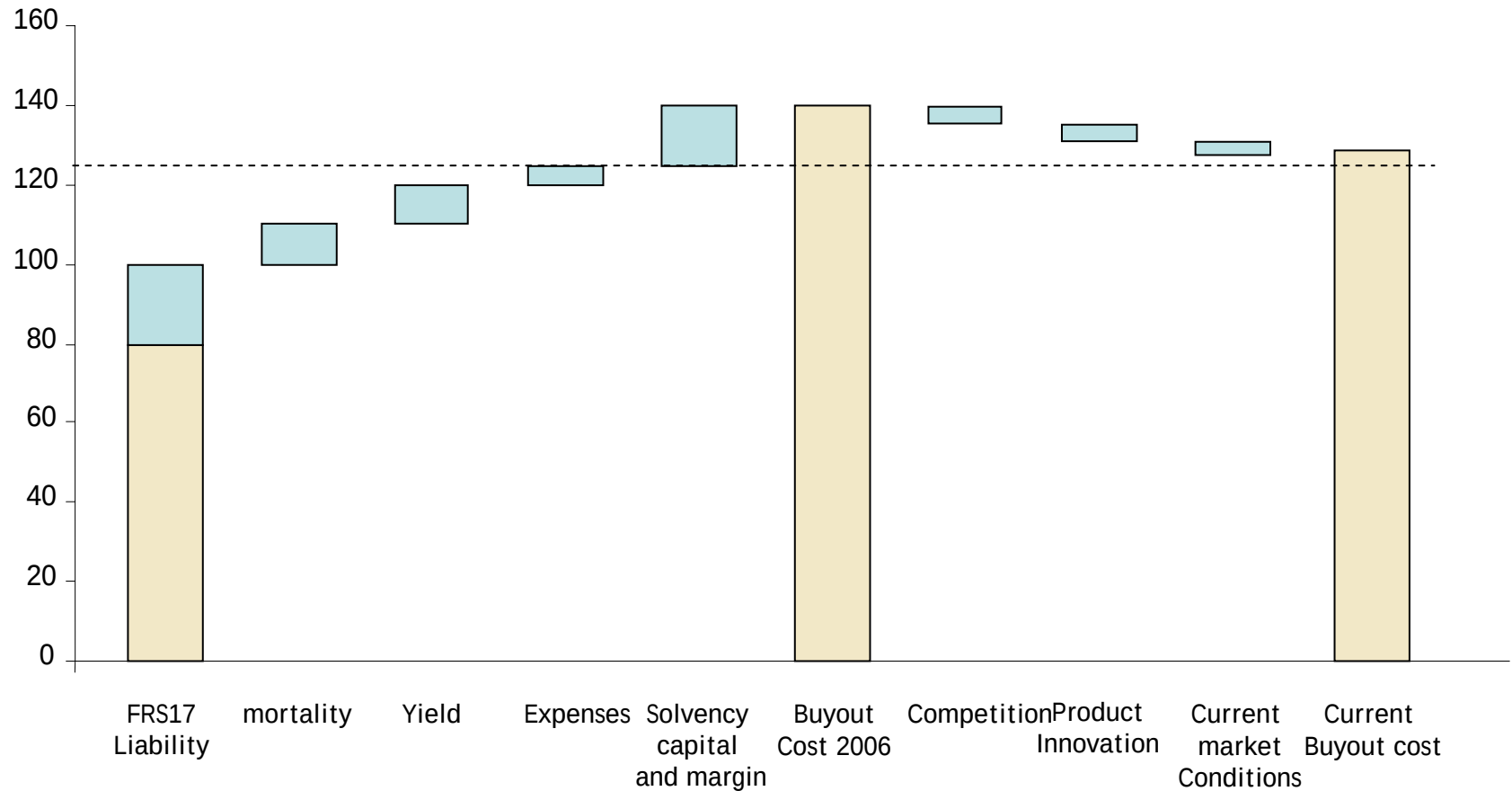


Market conditions

The upward movement of the yield curve over the last two months has dramatically reduced DB pension scheme deficits



The cost of buy-out

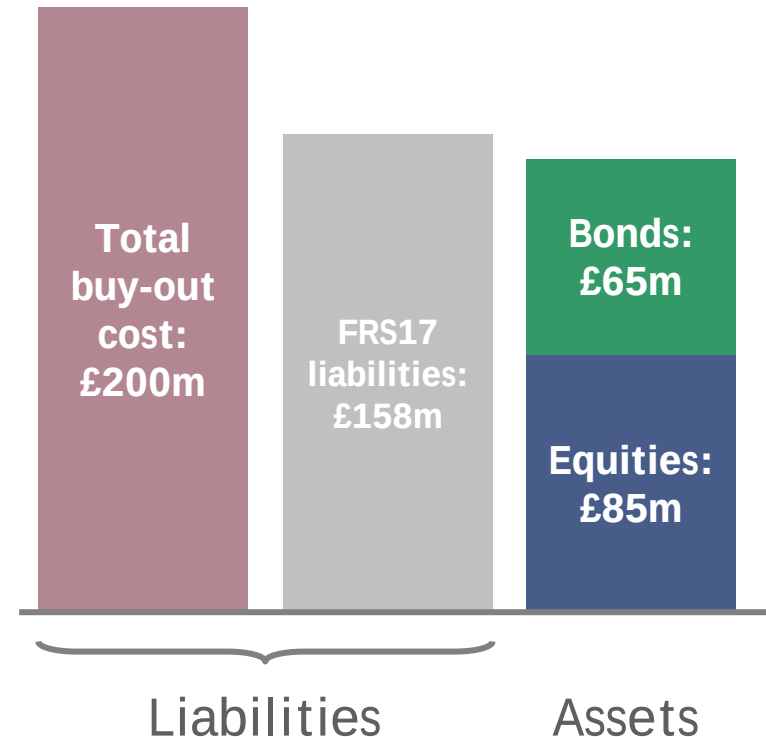


Product innovation

Removing Mortality Risk

Staged buy-out - a case study

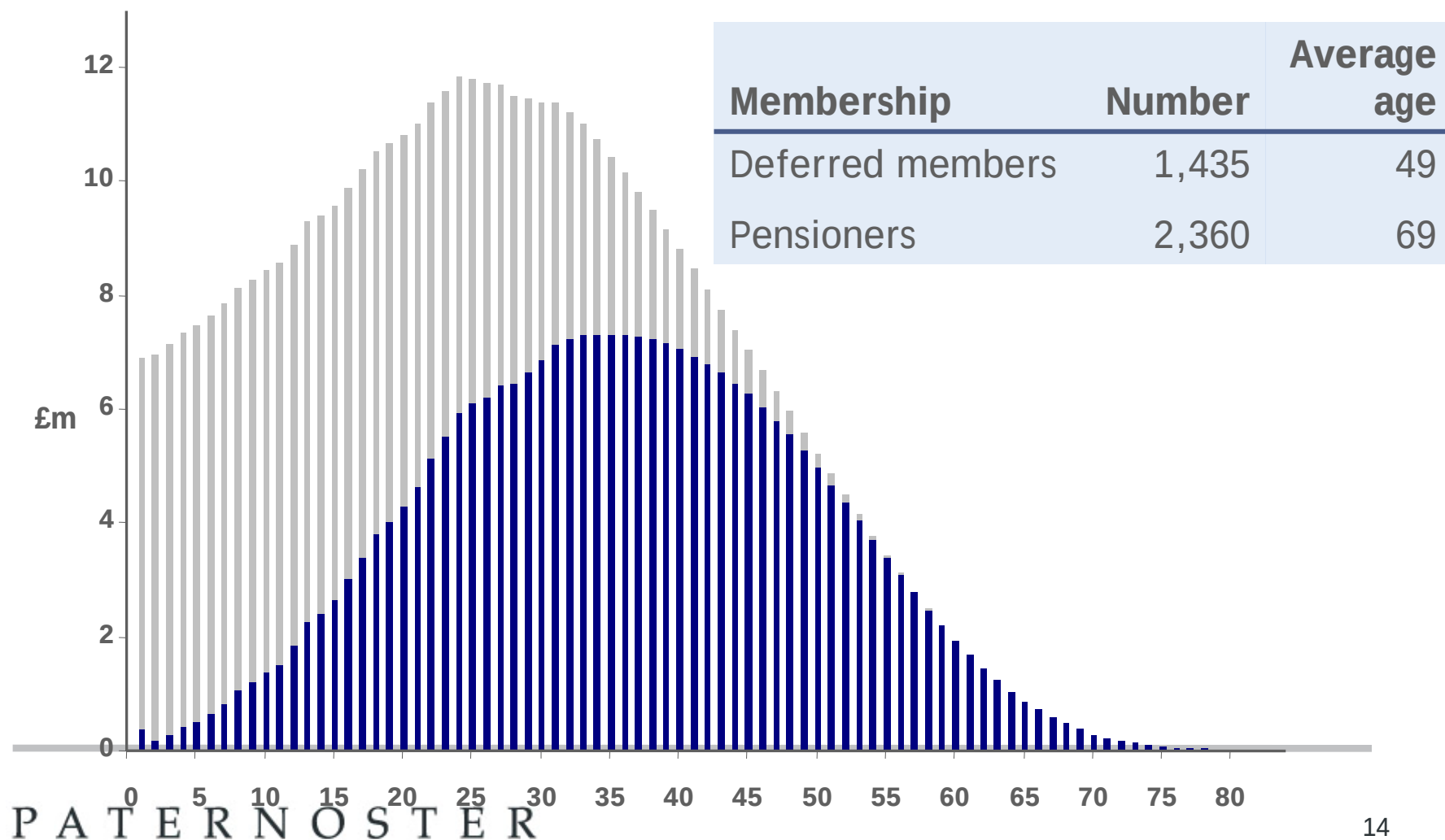
- Client A is contemplating a buy-out of its pension scheme
- Full buy-out cost quoted as £200m
 - Compares with FRS17 liabilities of £158m
- Scheme currently has assets of £150m
 - i.e. FRS17 deficit of £8m
- Assets invested 55% in equities and 45% in matched bonds
- Company prepared to inject £20m into scheme



Can Client A manage its pension scheme risks for a cost of £20m rather than £50m?

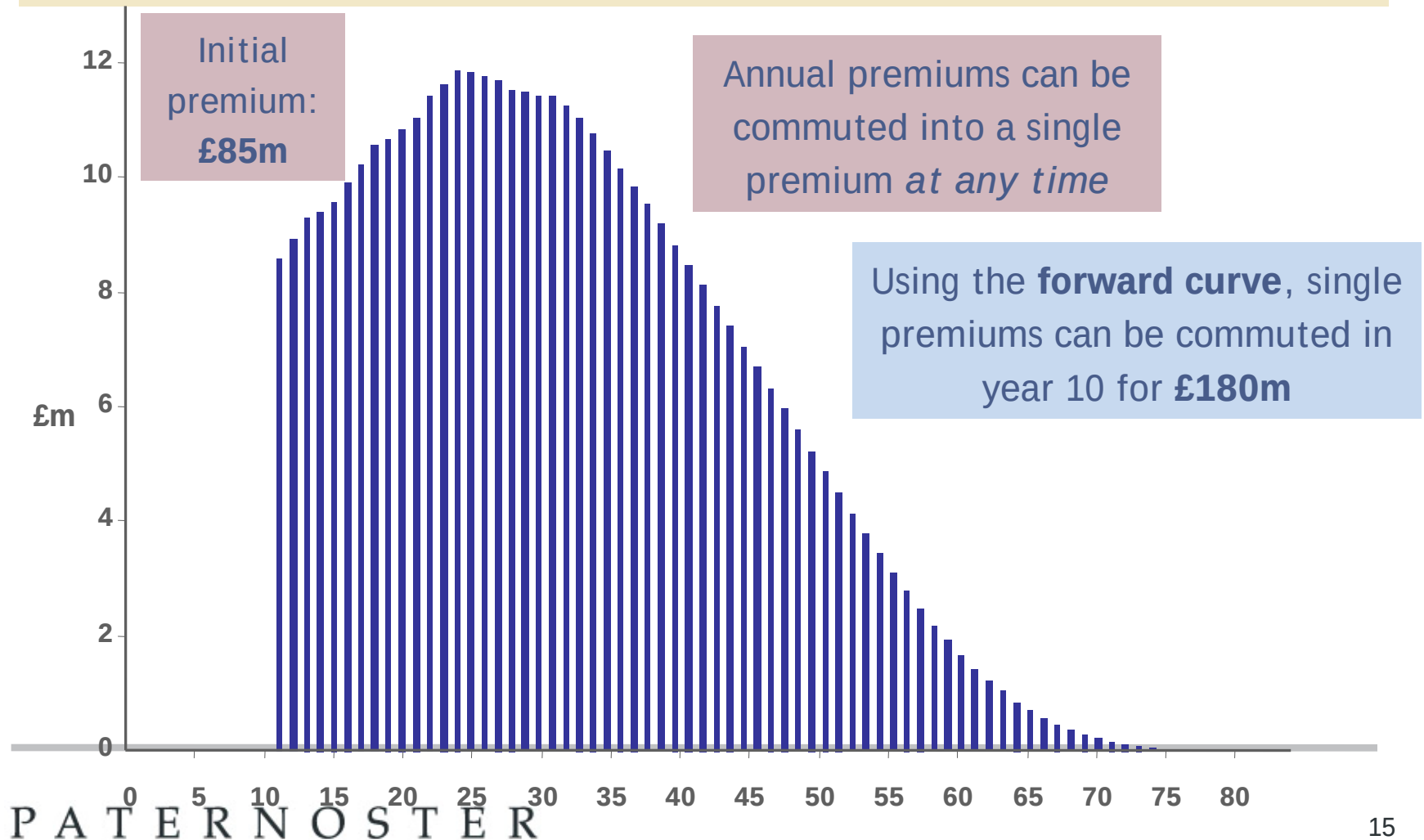
Staged buy-out - scheme cash flows

85% of the scheme's cash flows are payable after 10 years



Staged buy-out - premiums payable

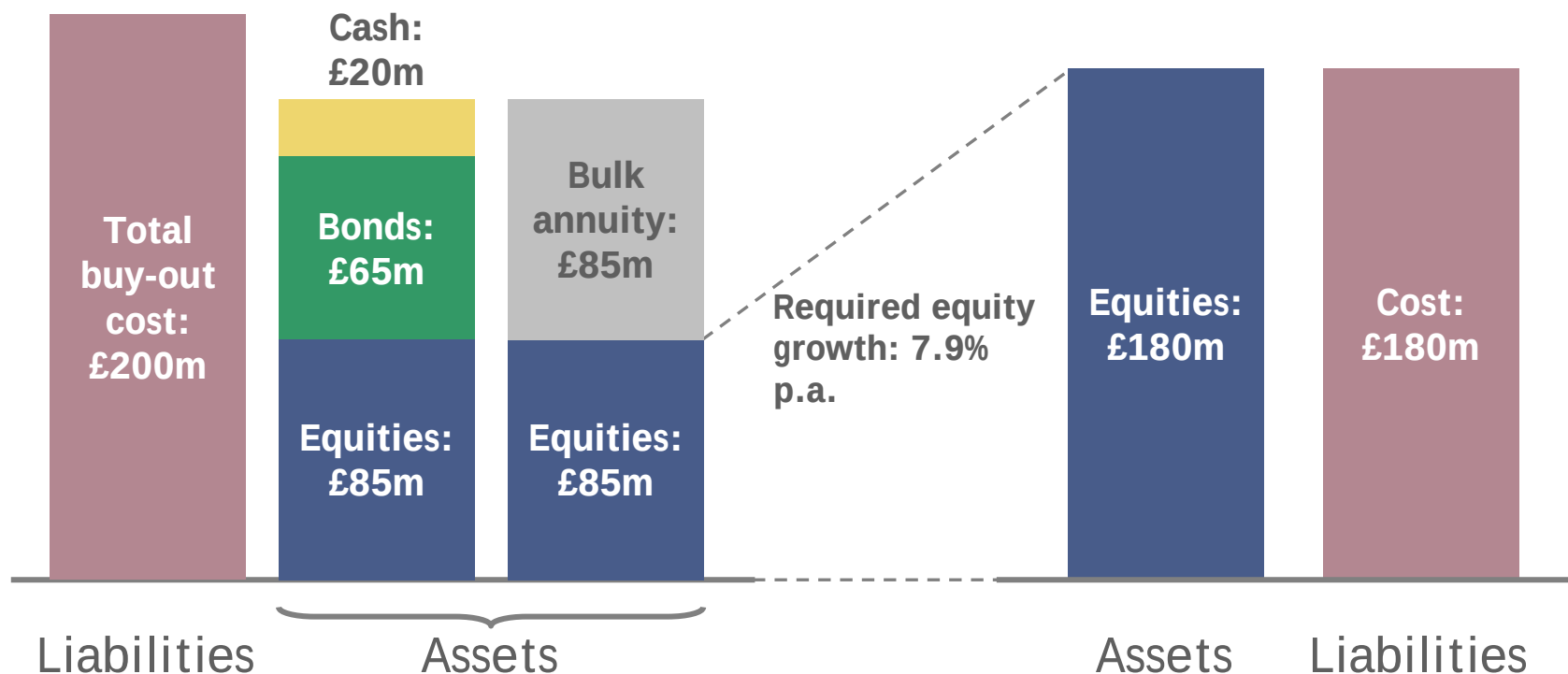
Mortality and certain other risks can be removed through an initial premium and a series of annual premiums payable from year 11



Staged buy-out - equity earn-out

OUTSET: Initial premium

YEAR 10: Commutation of single premiums



If single premiums are to be commuted in year 10, equity portfolio must grow at 7.9% p.a.

Staged buy-out - key features

- Scheme has removed all cash flow obligations for 10 years
- Remaining cash flows can be secured *at any time* over the life of the scheme
- Mortality risk has been removed for the lifetime of the scheme
- As interest rates/ inflation estimates change, the level of annual premiums will rise or fall unless these risks are hedged
 - Risks can be retained if there is a belief financial benefits can be gained
- Other assumptions could be either fixed or allowed to vary
 - Married proportion assumption
 - Cash commutation rates

The Staged Buy-out brings the flexibility for the scheme to retain risks it could be rewarded for holding and the opportunity to remove unwanted risks

Questions



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