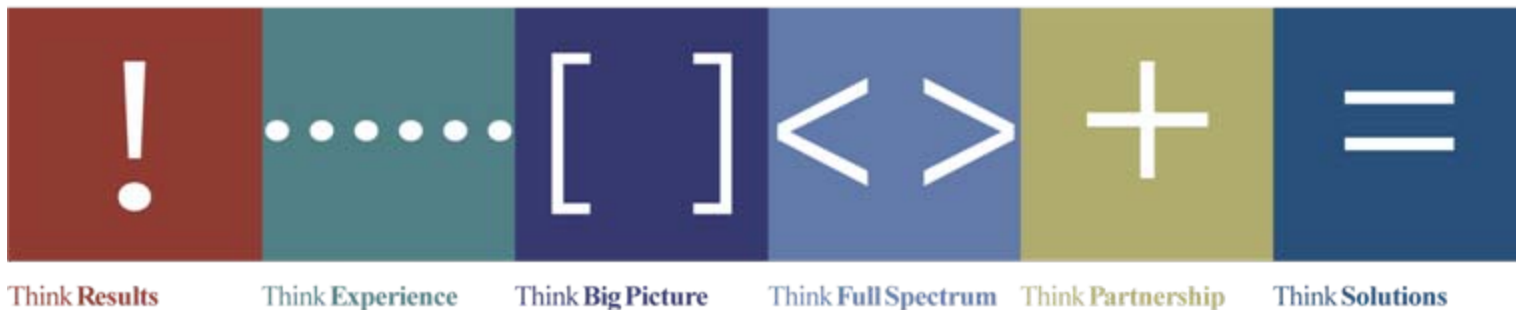


ACA Sessional Meeting The New Buy Out Market

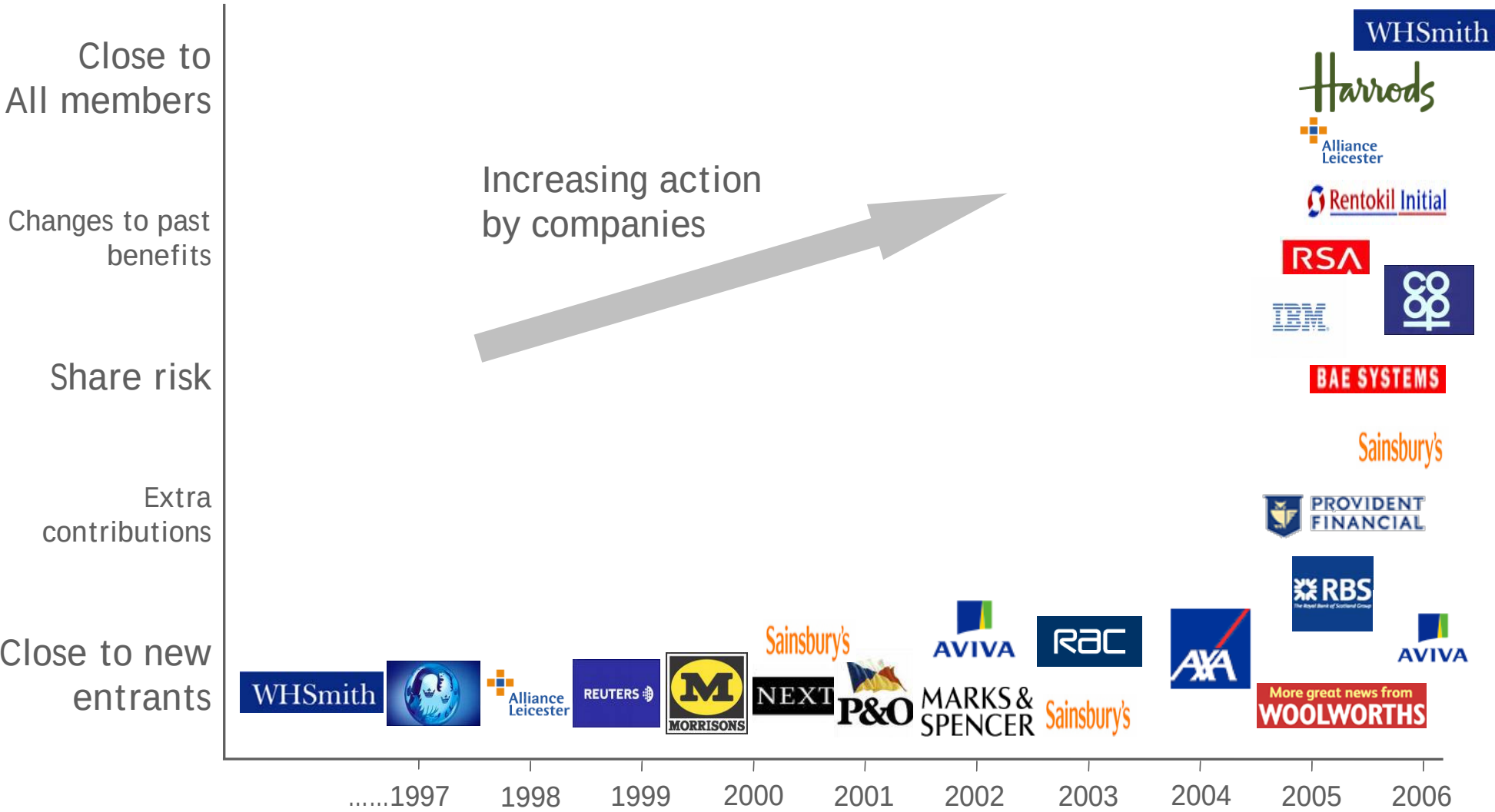
Stuart Southall - Birmingham - 2 July 2007

(based on Kevin Wesbroom's presentation to the
ACA Sessional Meeting in April 2007)

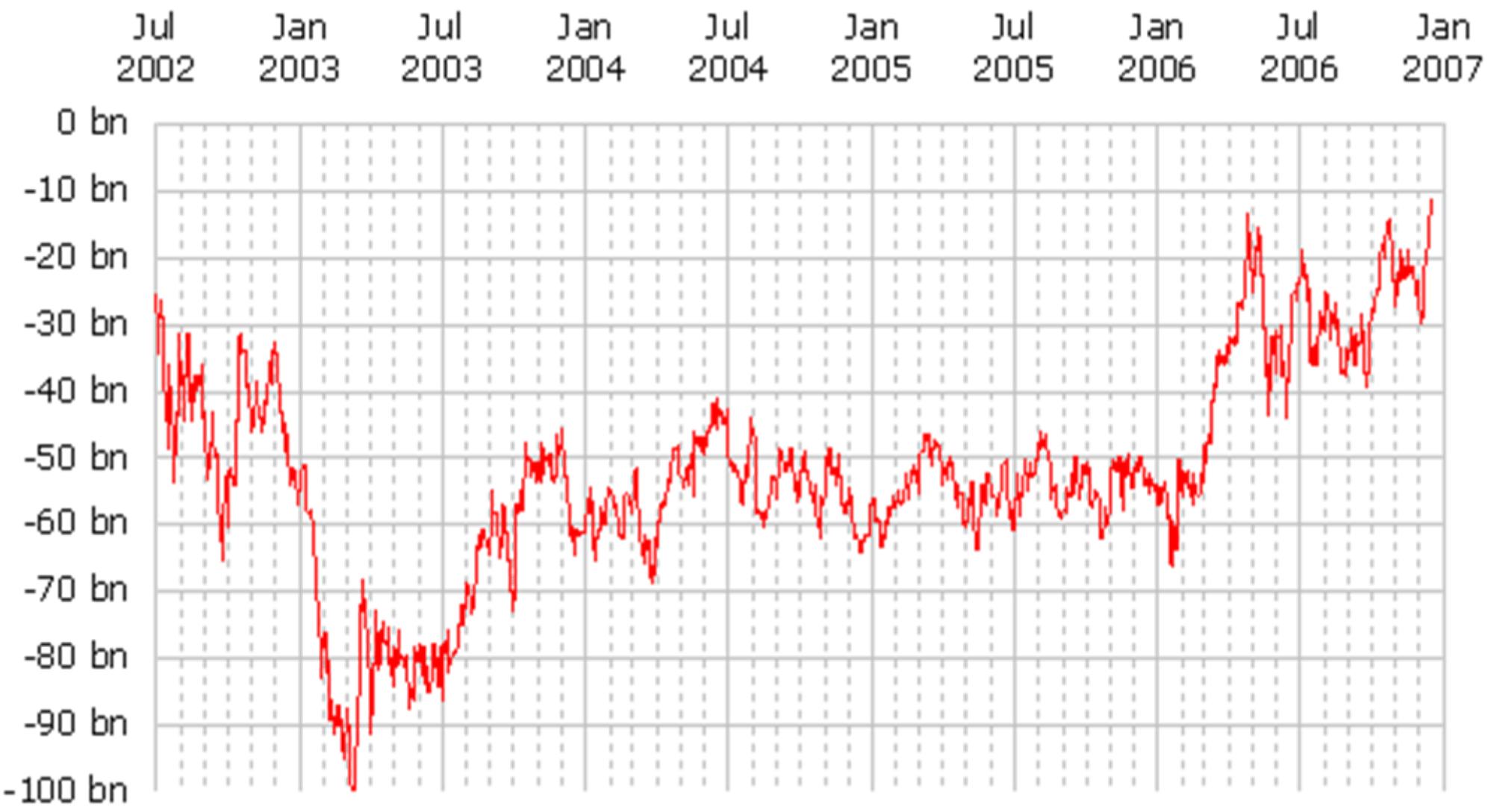
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Responses to the “Perfect Storm”



The Calm after the Storm ?



Still some clouds on the horizon ...

- Disclosure
 - member disclosure
 - accounting disclosures
- Regulatory Convergence
 - Regulat**or** convergence
 - Basle II for pension plans
- Mortality
 - actuarial profession still not got to grips
 - the potential to surprise still
 - and accounting disclosures

Speculation

BBC NEWS WORLD EDITION

Last Updated: Friday, 3 December, 2004, 00:01 GMT

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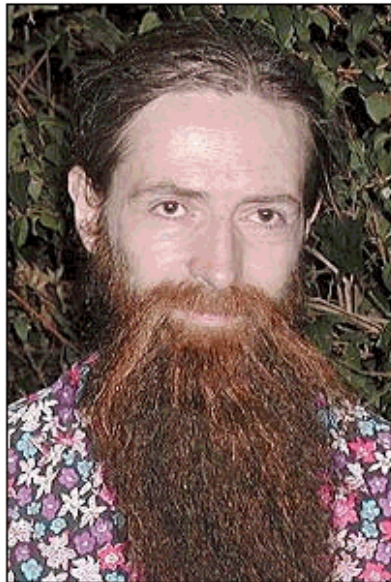
'We will be able to live to 1,000'

By Dr Aubrey de Grey
University of Cambridge

Life expectancy is increasing in the developed world. But Cambridge University geneticist Aubrey de Grey believes it will soon extend dramatically to 1,000. Here, he explains why.

Ageing is a physical phenomenon happening to our bodies, so at some point in the future, as medicine becomes more and more powerful, we will inevitably be able to address ageing just as effectively as we address many diseases today.

I claim that we are close to that point because of the SENS (Strategies for Engineered Negligible Senescence) project to prevent and



Aubrey de Grey: "The first person to live to 1,000 might be 60 already"

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Last Updated: Thursday, 12 April 2007, 18:10 GMT 19:10 UK

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Clear obesity gene link 'found'

Scientists say they have identified the clearest genetic link to obesity yet.

They found people with two copies of a "fat" version of a gene had a 70% higher risk of obesity than those with none, and weighed 3kg (6.5lb) more.



Scientists have found a clear genetic link to obesity

The work in Science by the Peninsula Medical School and Oxford University studied data from about 40,000 people.

The findings suggest that although improving lifestyle is key to reducing obesity, some people may find it harder to lose weight because of their genes.

Half of white Europeans carry one copy of the variant and one in six has two copies, experts estimate.

The authors say their work

“ The typical message has been that if you are overweight it is due to sloth and gluttony and it is your fault ”

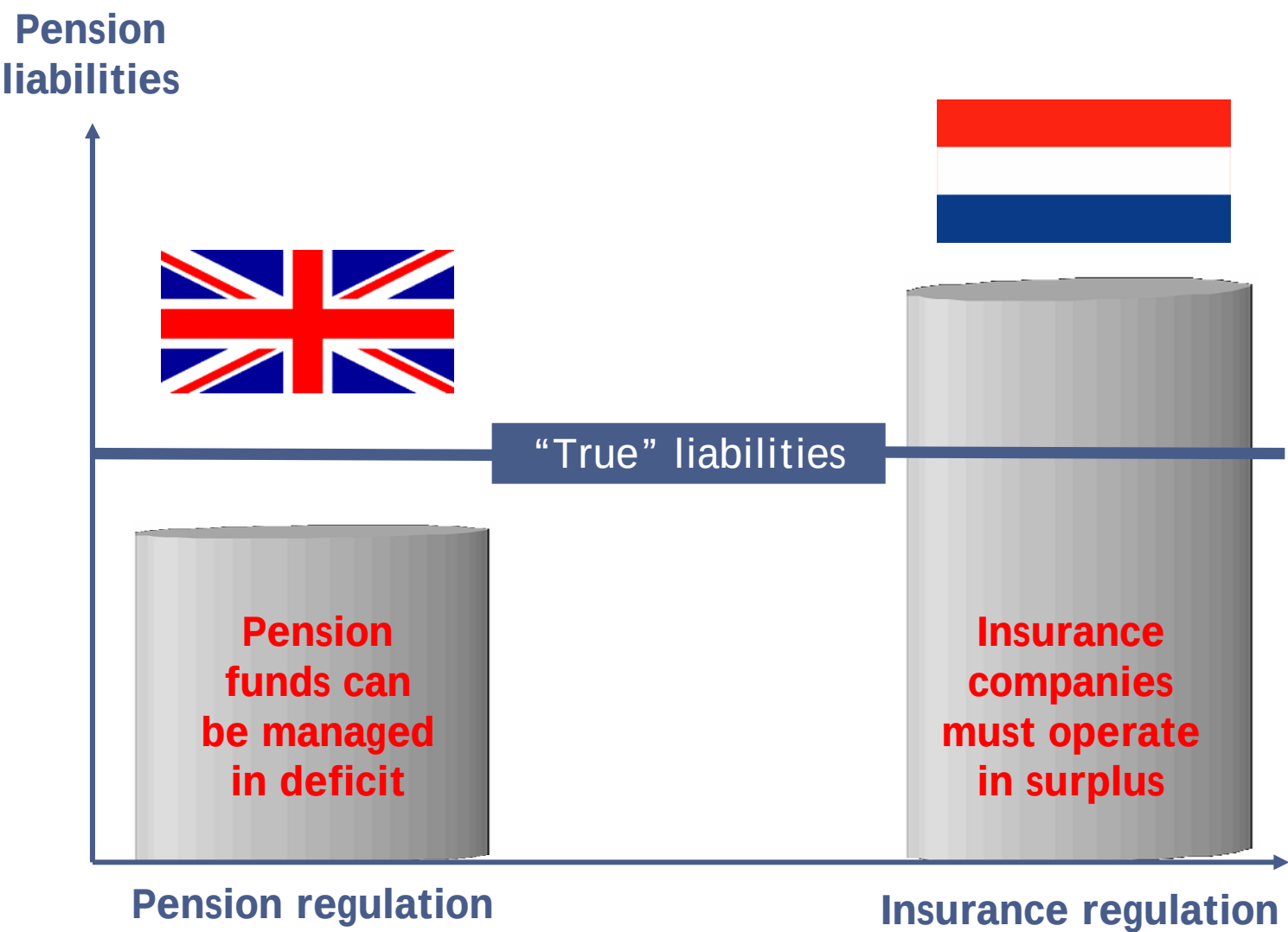
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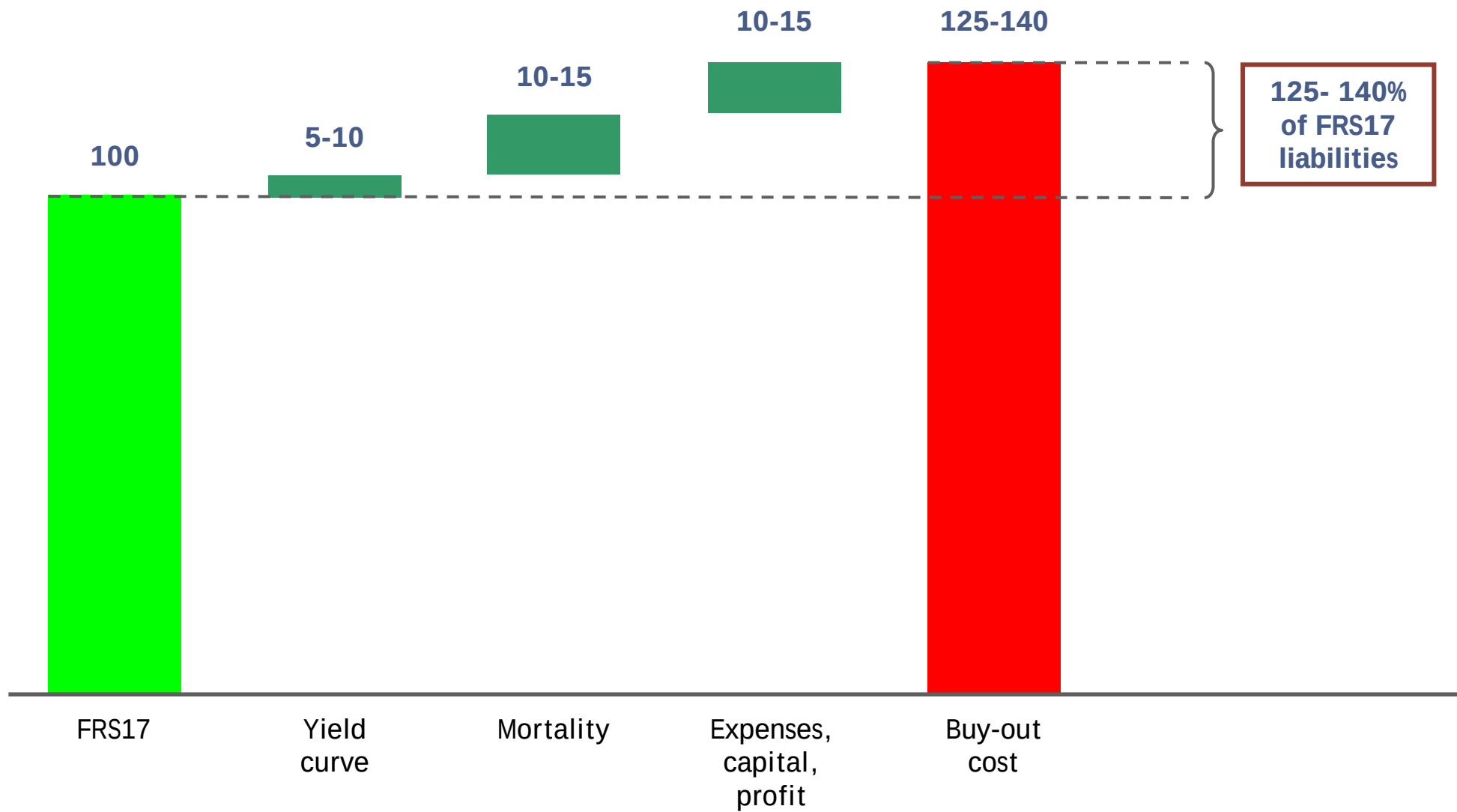
Regulatory Convergence



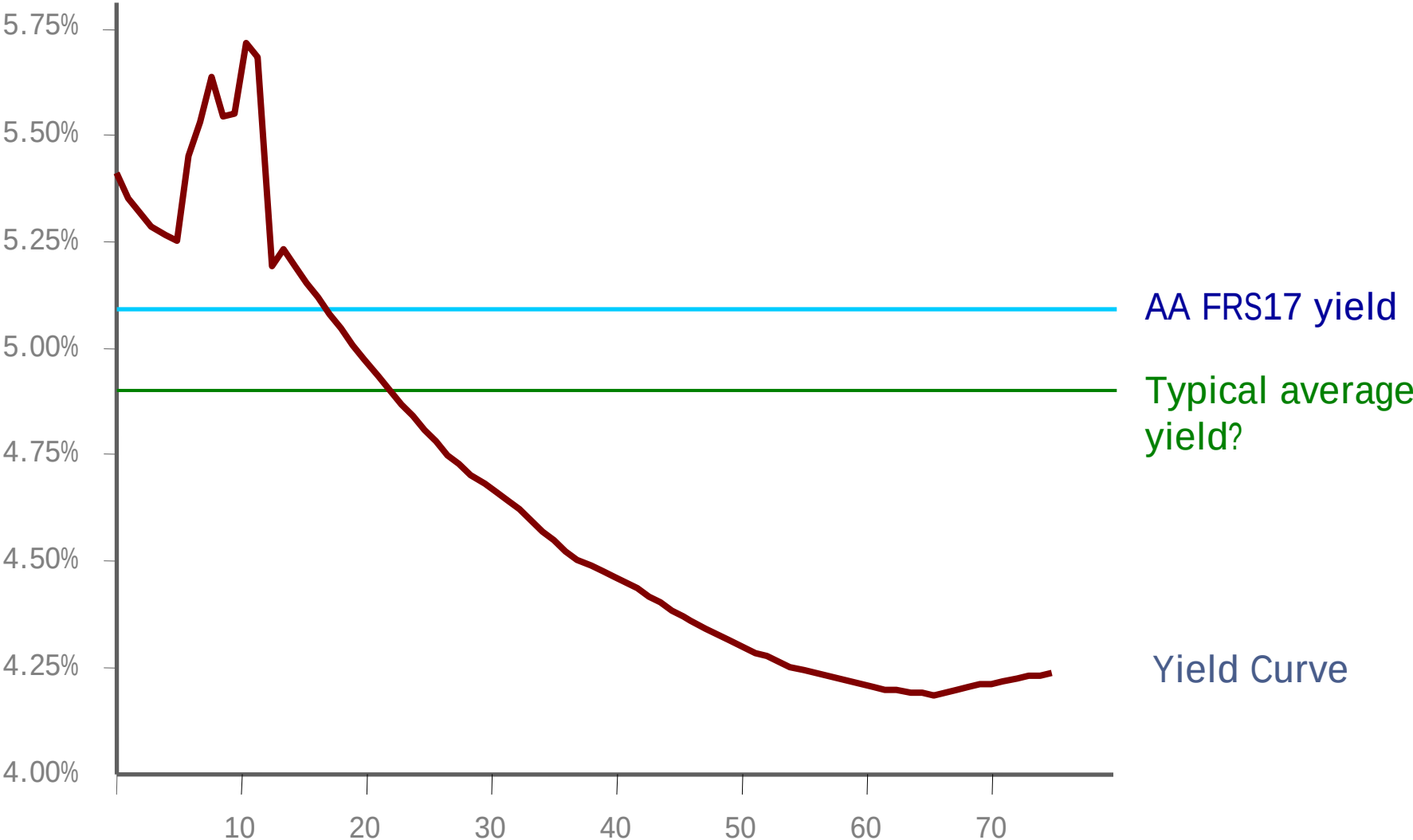
Convergence – or why Buy Out is so expensive

Item	Pension Funds	Insurance Companies
Regulator	The Pension Regulator	The Financial Services Authority
Technical Provisions	Weak, as a result of “Flexible” rules regarding choice of assumptions. No allowance for expenses and weak allowance for mortality improvement	Strong, since underlying assumptions are subject to regulatory scrutiny. Liabilities include allowance for expenses and full allowance for mortality improvement
Deficits	Deficits are allowed (compulsory?) Rectification over 10 years is “encouraged” by tPR	No deficits allowed. Capital upfront so that assets match liabilities. Monitored by the FSA; breaches of solvency capital level must be reported and rectified immediately
Additional reserves	Value of liabilities does not include stress tests	Insurers have to hold additional solvency capital to withstand a “1 in 200 year” event
Member protection	Pension Protection Fund offers 100% protection for pensioners (limited index linking) and 90% for deferred & actives capped to £25K	Financial Services Compensation Scheme covers 90% of all liabilities without limitation (importantly includes full index linking)
Typical reserving	100	125 - 140

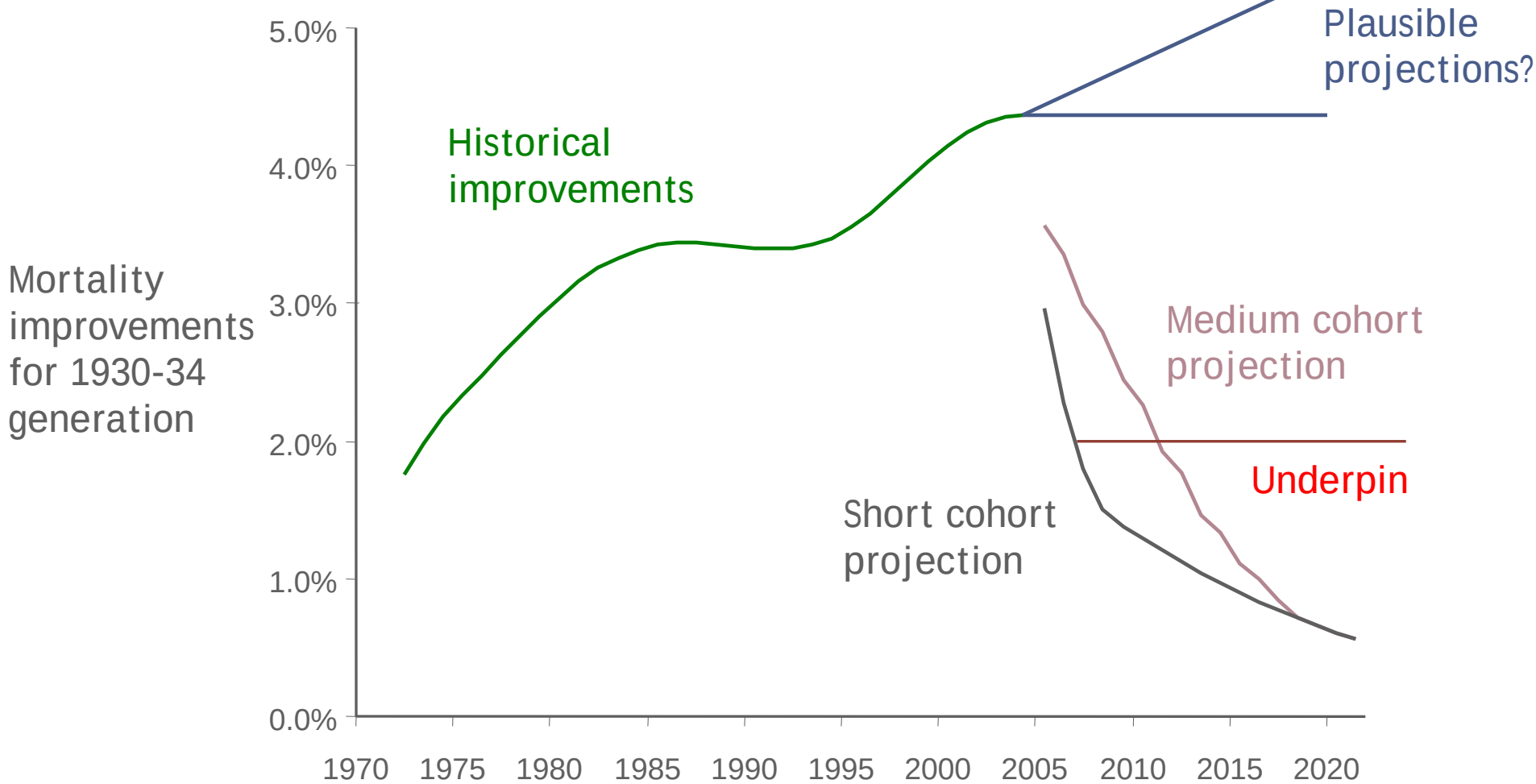
Reconciliation?



Cheating on Technical Provisions?



Cheating on Mortality?



Conclusions?

- 41% of the analysts believe that pension liabilities are underestimated by the accounting under IAS19.
 - PCS: Survey of Analysts Views on Pensions – January 2007
- “In our view, the true “fair value” of pension liabilities is probably greater than currently disclosed accounting measures (due to underestimates of longevity improvements, among other factors), but less than the buy-out measure.”
 - JP Morgan (European Equity Research – December 2006)
- “Pension accounting is flawed (and confusing)... The accounts do not reveal the risks being taken – the buyout liability does”
 - Peter Elwin, Cazenove – March 2007.
- **Convergence is Coming!**

A change is coming



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Buy-out market will be a big disappointment, report claims

By Kalpana Fitzpatrick - 18th April 2007

The pensions buy-out market will not be as big as predicted, with only 10% of UK companies expected to remove their pensions liabilities.

A report from Aon Consulting found that the pensions buy-out market could be more of a slow burner than expected.

Among those schemes that are considering it, the average buy-out time is likely to be more than 12 years, Aon found.

Forty per cent of schemes in Aon's survey said they expect to remove liabilities over a period longer than 10 years, with larger schemes taking longer, with 20% saying they expect to take over 20 years.

Sixty eight per cent said they were not interested in buy-out. For those that were interested, only 10% said they would pay more than 120% of the liabilities calculated under FRS 17 – the typical cost of buyout is currently 130% of the liabilities under FRS 17.

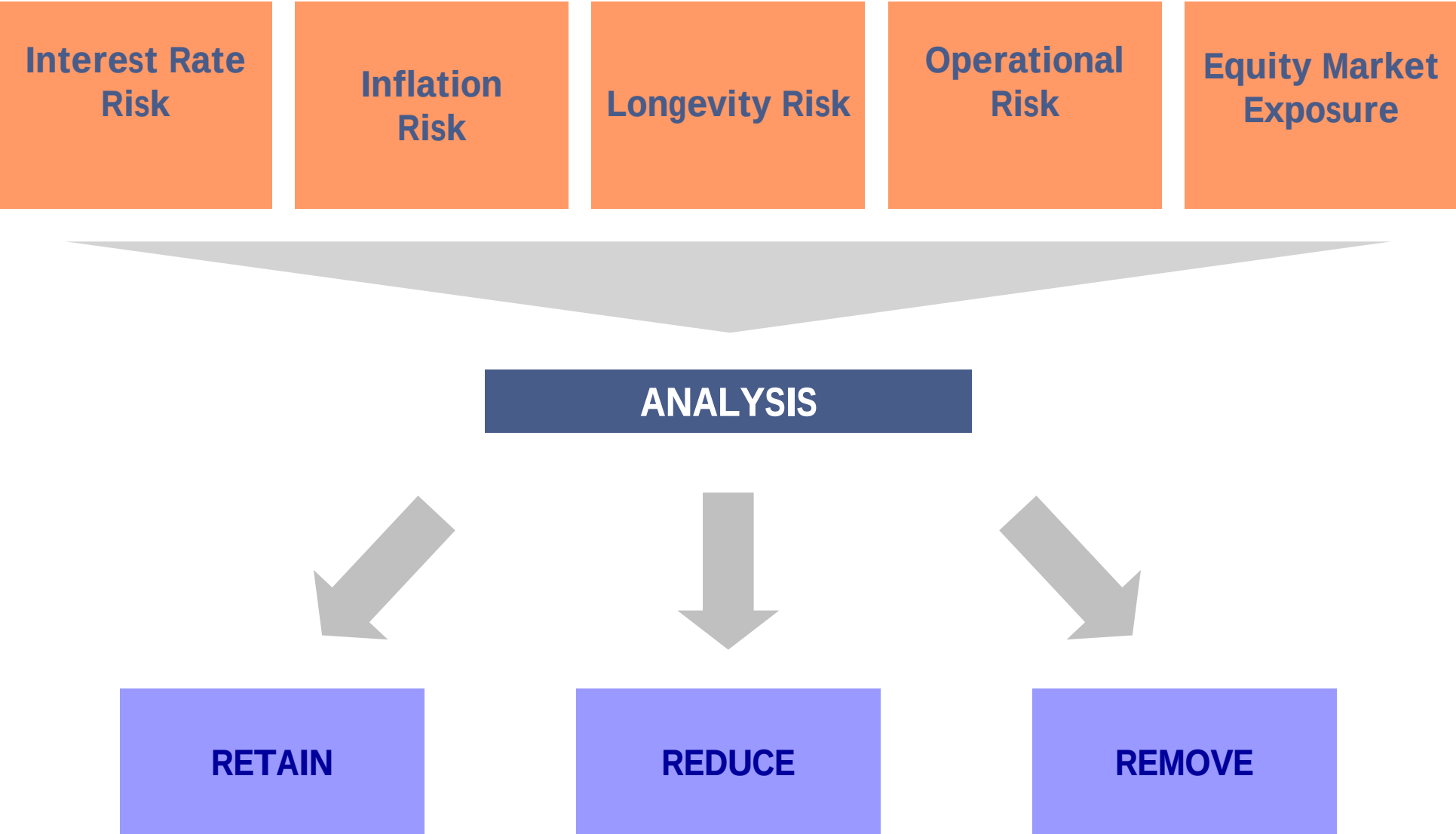
It's all about Risk



Objectives

	Return Seeking (Back to the Future)	Risk Reduction (Terminator)
Philosophy	Strong employer, well able to withstand volatility	Not rewarded by shareholders for operating DB pensions
Ultimate goal	Provide DB benefits as a source of competitive advantage	Buy out all DB pension liabilities, subject to price
Contribution strategy	Pay in the minimum (cash invested in the business will generate higher returns than portfolio investments)	Greater contributions, heading towards buy out (pension funds are debt which should be repaid as soon as possible)
Investment policy	Return orientated (eg equities)	Risk averse (eg bonds)
Accounting implications	Low but variable pension costs. Volatile balance sheet (deficits) – not material at the entity level	Higher pension costs. Balance sheet deficits minimised
Member security	Security of strong employer backing	Greater funding and eventual buy out

Action – the 3 R’s



Action - Retain



ANALYSIS



RETAIN



REDUCE



REMOVE

Action - Reduce



ANALYSIS

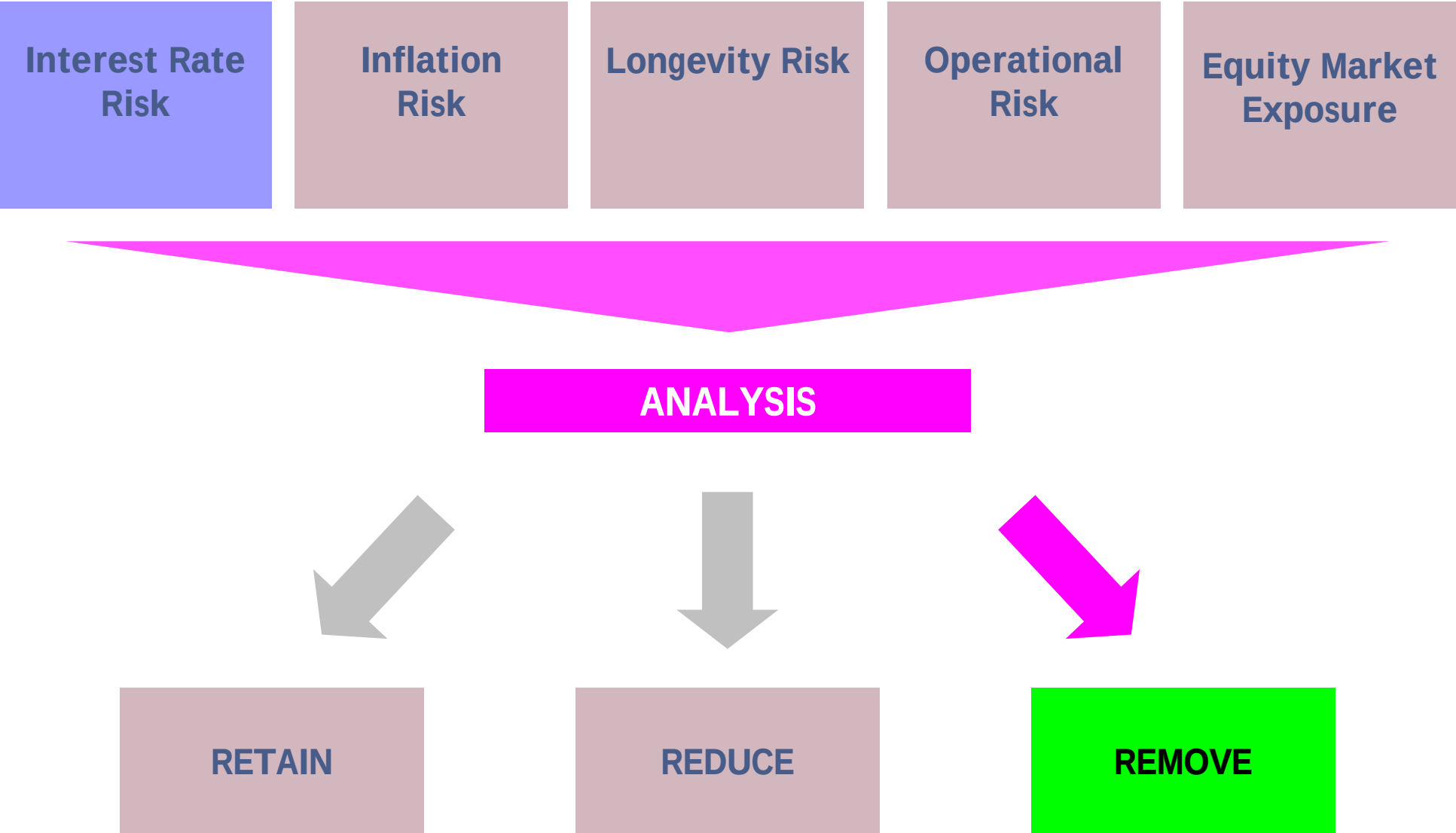


RETAIN

REDUCE

REMOVE

Action - Remove



Now even mortality fits in



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Research

Risk Management

LifeMetrics

LifeMetrics is a toolkit for measuring and managing longevity and mortality risk, designed for pension plans, sponsors, insurers, reinsurers and investors. LifeMetrics enables these risks to be measured in a standardized manner, aggregated across different risk sources and transferred to other parties. It also provides a means to evaluate the effectiveness of longevity/mortality hedging strategies and the size of residual risk.

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Toolkit components

- **Index:** Data for evaluating current and historical levels of mortality and longevity
- **Framework:** A set of tools, methods and algorithms for measuring and managing longevity and mortality risk. These are fully documented in the LifeMetrics Technical Document
- **Software:** Software for developing mortality projections

Differentiating features

- **International indices:** Initially we are publishing index data for the US and England & Wales based on national population data, but will add other countries in the coming months
- **Transparency:** All methodology, algorithms and calculations are fully disclosed and open
- **Standardization:** LifeMetrics is explicitly designed to facilitate the structuring of longevity

lifeMetrics

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Last Updated: Tuesday, 24 April 2007, 07:07 GMT 08:07 UK

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Centenarian celebrates with £25k

A man who bet £100 a decade ago that he would live to be 100 is celebrating his birthday with a cheque for £25,000.

Alec Holden said his secret to long life was to "keep breathing"

Alec Holden, from Epsom in Surrey, is picking up his winnings from bookmaker William Hill, which gave him odds of 250/1 that he would reach his century.

The retired engineer, born on 24 April 1907, joked he had been "very careful" about what he had been doing recently.

Mr Holden, who also used to work as a teacher and a carpenter, plans to take some friends to a hotel to celebrate.

He placed the bet on 10 December 1997, when he was aged 90, with the thought that he "would live forever".

“ These age wagers are starting to cost us a fortune and from now on we are going to push out the age to 110 ”

VIDEO AND AUDIO NEWS
The secret of living to 100 years old
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Action – the Exit Strategy

Get me out of here in ten years – but for less than buy out

- Hybrid solutions will rule the world
 - but not ACA shared risk hybrids!
- Regulatory hybrids
 - combinations of insurance and pensions solutions
 - exploit the best of what both sides can offer
- Range of insurance solutions now much wider
 - it's not all or nothing
- Look for the sweet spots
 - or more likely avoid the very heavy costs

Potential Solutions

Full buyout

- Transfers all risks – at a cost
- Cost reducing – slightly!
- All liabilities removed from the company balance sheet

Partial buyout

- Buy out pensions in payment
- Carry out Enhanced Transfer Exercise for deferred members
- Buy out residual deferred liabilities over time

Buyout with risk sharing

- Tailored risk-reward linked to liabilities and/or assets
- Reduces funding requirements, while removing most of the risks

Buyout/LDI solution

- Buyout the pensioners and reduce investment risks on the deferreds
- Use call options plus LDI to get some upside
- Target buy out over specified period

Insurance premiums can be phased – with or without credit insurance

Issues to consider

- Risk reduction strategies
 - Eliminate or reduce the exposure to longevity and investment mismatch risk
 - Eliminate or reduce the FRS17/IAS19 deficit volatility
- Interference reduction
 - Management can run a business not a hedge fund!
 - Eliminate or reduce expenses of running the scheme and PPF levy
 - Remove tPR ability to restrict corporate activity (M&A, dividends, debt raising)
- Accounting for buy out - SORIE rather than P&L?
- Member and Trustee perspective?
 - Increase the level of member security above that of “unsecured creditors”
 - Transfer members’ benefits into the insurance “safe haven”
 - Trustees discharged of their duties under a full buyout and wind up
 - Position in respect of partial buy out? Favouritism?

Global (US) perspective

- Plan freezes continue apace
 - soft freeze and hard freeze
- Funding more pressing than accounting
 - FAS158 limited impact
 - changes to P&L more fundamental
 - and will be fought!
- Interest in LDI growing
 - but still relatively muted
- Mortality assumptions hopelessly outdated
 - but not a problem!



Exiting the Business: A Dearth of Options

Ways to Get Out

- **Group Annuity Buyout**
- **Immunization**
- **Get Acquired**
- **Offload the Plan???**

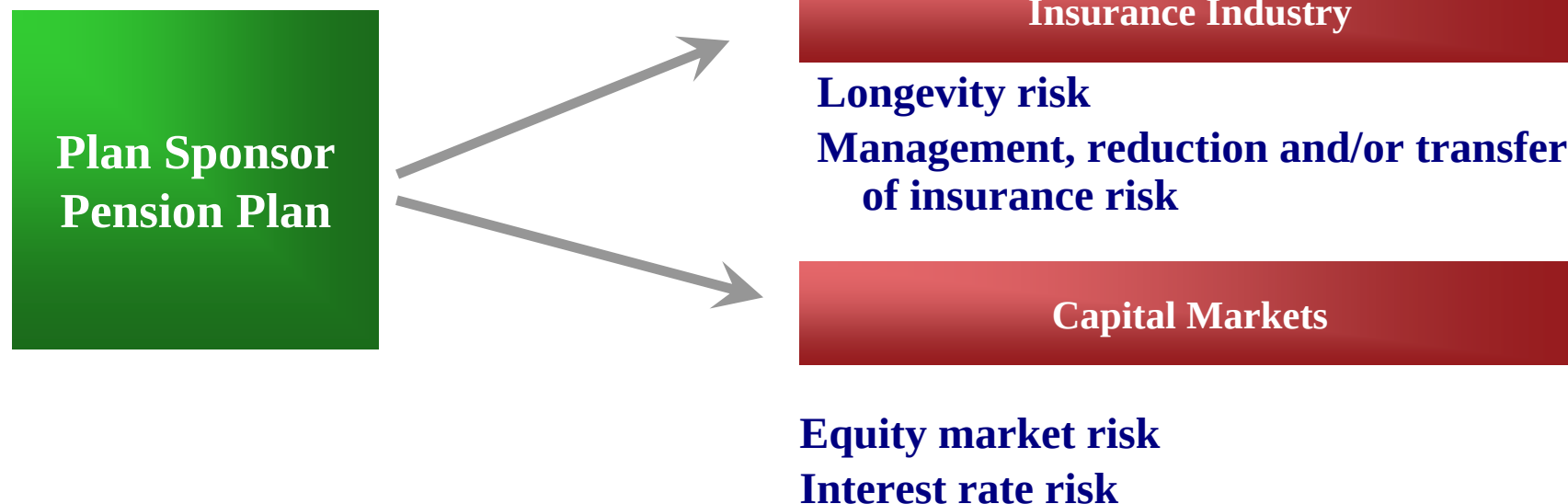
The Price of Entry

- **Very Expensive**
- **Capacity Limited**
- **Expensive**
- **Not Irrevocable**
- **Draconian Solution**
- **Your Company Is Gone**
- **Untested Model**
- **A Suite of Uncertainties**

Frozen Plans: Transferring Pension Risk

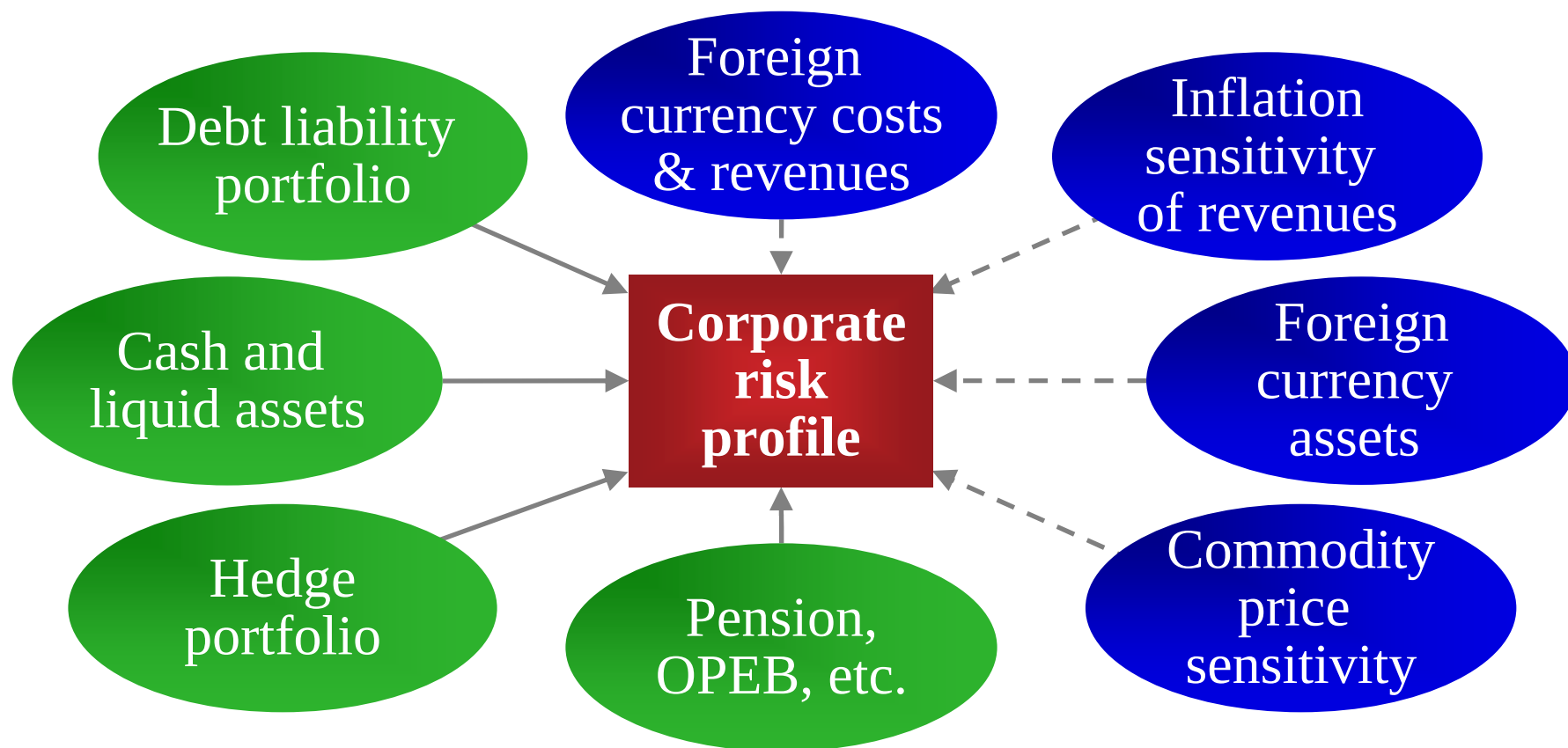


Decision to exit DB model made: Shift risks to those better-positioned



Subdividing the risks and transferring them to markets/companies structurally able to bear them

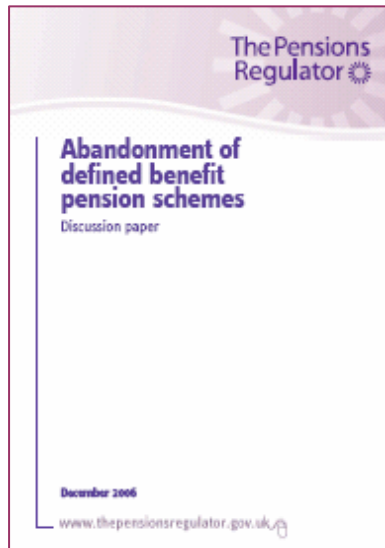
CALM—Corporate-Wide ALM—Takes an Holistic View of Risk and Return



Pension plans must be consolidated in economic terms

A global comparison?

<http://www.retireebenefitsco.com/>



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Retiree Benefits acquires and manages portfolios of pension benefits obligations from corporations that have frozen their plans and desire a more cost-effective and flexible alternative solution to plan termination

The seller benefits because the transaction is structured to achieve accounting "true sale" status thereby relieving the seller of further liability on its retiree defined benefit obligation

Retiree Benefits becomes the new parent of the existing plan sponsor and assumes mortality and investment risk associated with plan assets and liabilities as well as fiduciary responsibility for its retirees

We commit to maintaining the highest professional standards

Retiree Benefits' only business is the acquisition and management of pension plans. Our retirees benefit from having their assets in a bankruptcy remote, credit enhanced structure, managed primarily for their benefit. The guiding principle in our business is to enhance the wellbeing of our retiree customers. We do well if they do well and not if they don't. This is as it should be. We serve and protect our retirees.