

# Pension Insurance Corporation

Pension Risk Transfer Index  
Q2 2011



PENSION  
CORPORATION

# Highlights



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## ■ A sovereign default spells trouble for pension funds and risks a re-run of the credit crunch

- ▶ As credit and equity markets continue to diverge in their views pension funds should check their potential exposure to a sovereign default
- ▶ A flight to quality – for example into UK Gilts – could drive down a pension fund's funding position as Gilt yields fall
- ▶ Should Gilt yields fall back 30 bps and equity markets drop 20% following a sovereign default, funding positions may drop 10%

## ■ Deficits continue to narrow

- ▶ Volatility in the markets remains very high, despite the seemingly inexorable rise in affordability
- ▶ The FTSE 100 suffered a dramatic sell-off during much of June – dropping almost 300 points - yet by July it was almost exactly where it had been at the start of June
- ▶ However, deficits could grow by 45% following any sovereign default, costing an estimated £190 billion

## ■ Pension insurance remains at most affordable for more than three years

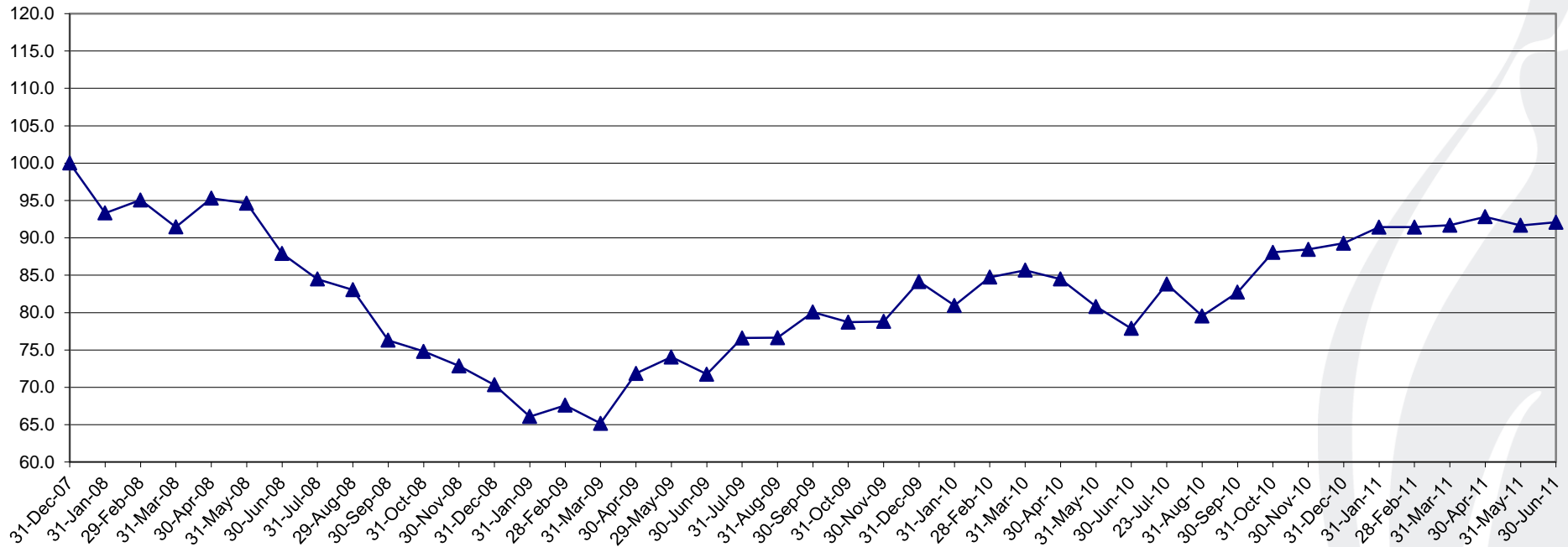
- ▶ In spite of recent market volatility trustees are more able than ever to derisk
- ▶ This is reflected in high levels of activity in the market, with pension funds with an aggregate £25 billion of liabilities looking to derisk
- ▶ Affordability for pensioner-only transactions continues to run at marginal cost over funding levels

# Pension Risk Transfer Index

# Overall affordability – scheme as a whole

The development of asset values expressed as a percentage of buyout cost

## Overall affordability



### Key:

Chart shows 'overall affordability' for a scheme with a blend of deferred and pensioner liabilities, and invested in a 65% equities / 35% bonds mix. 'Affordability' considers the cost of insuring the pension risk compared to the value of the assets held by the scheme. A higher value in the index means that insurance is more affordable for pension schemes (insurance costs have fallen and / or asset values have risen)

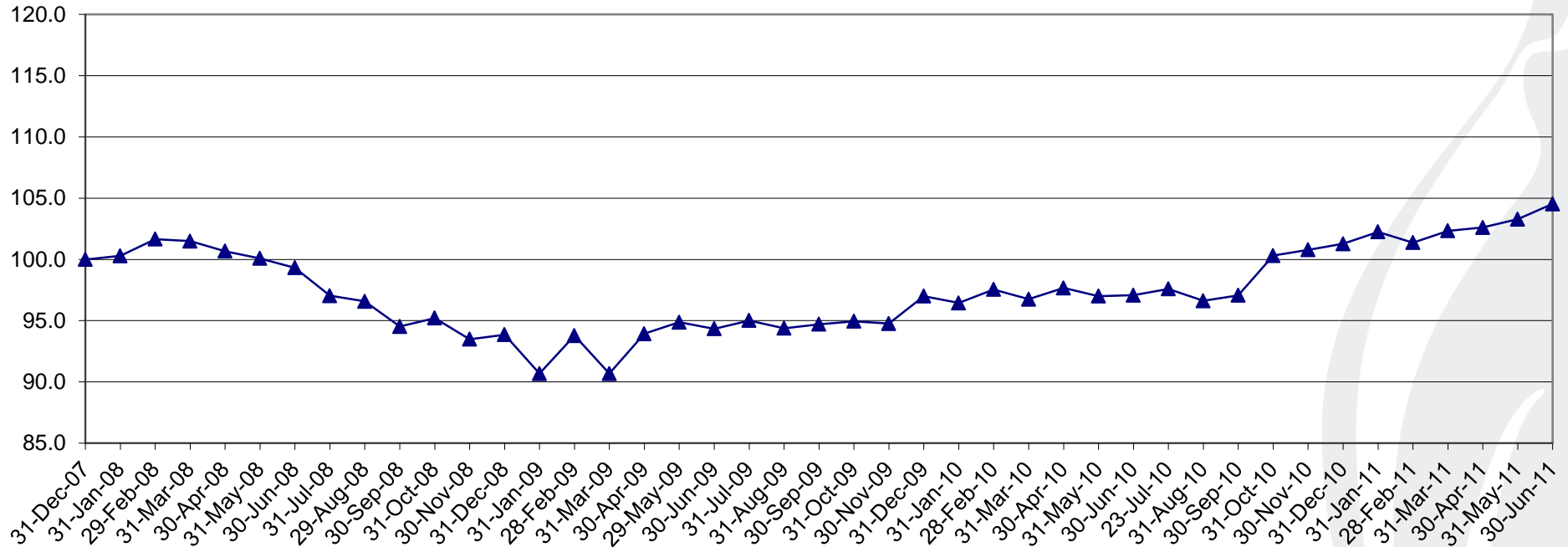
### Commentary:

- ▶ Affordability remains good for many pension funds, but trouble may lie ahead given the divergence in outlook between credit and equity markets
- ▶ Many processes are underway and are expected to complete by the end of the year

# Overall affordability – pensioners only

The development of asset values expressed as a percentage of buyout cost

## Overall affordability (pensioners only)



### Key:

Chart shows 'overall affordability' for a scheme with pensioner liabilities only and invested 100% in gilts and corporate bonds. 'Affordability' considers the cost of insuring the pension risk compared to the value of the assets held by the scheme. A higher value in the index means that insurance is more affordable for pension schemes (insurance costs have fallen and / or asset values have risen)

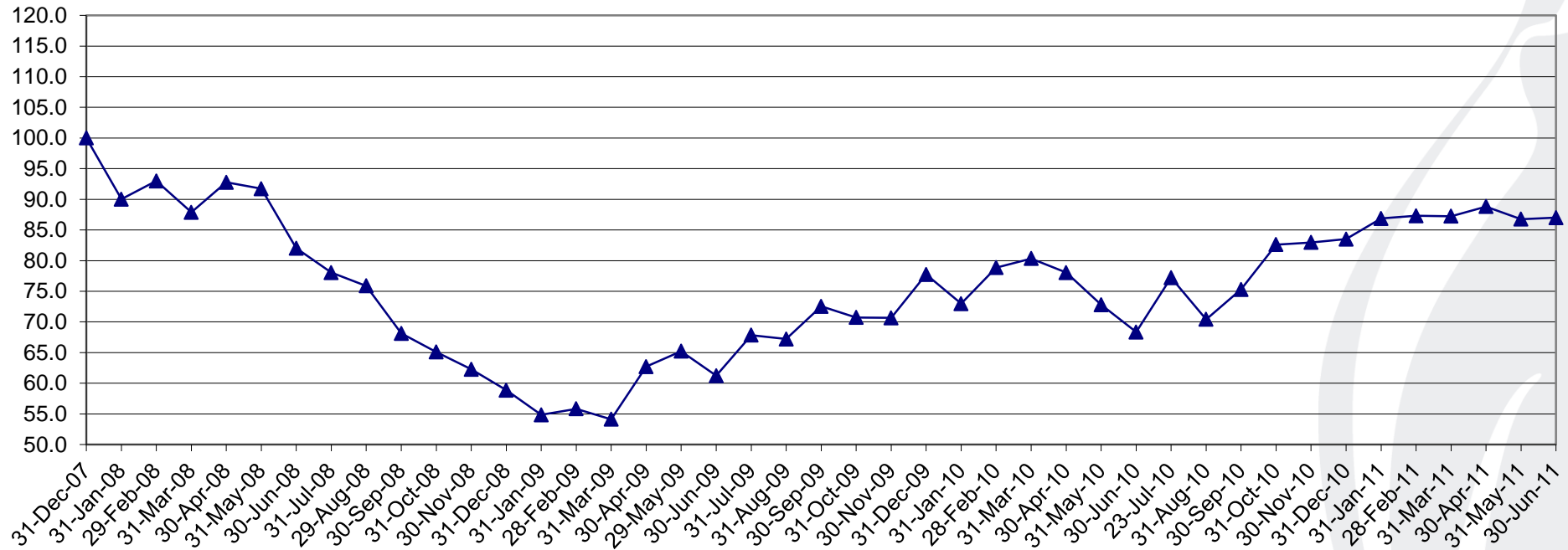
### Commentary:

- ▶ Insurance solutions for pensioners, who are often matched by gilt holdings, continue to remain at their most affordable and now stand at almost 105% of funding levels
- ▶ Specific tranches of pensioners, such as the over 75's, can currently be insured for a marginal cost above the pension scheme's funding target

# Overall affordability – deferreds only

The development of asset values expressed as a percentage of buyout cost

## Overall affordability (deferreds only)



### Key:

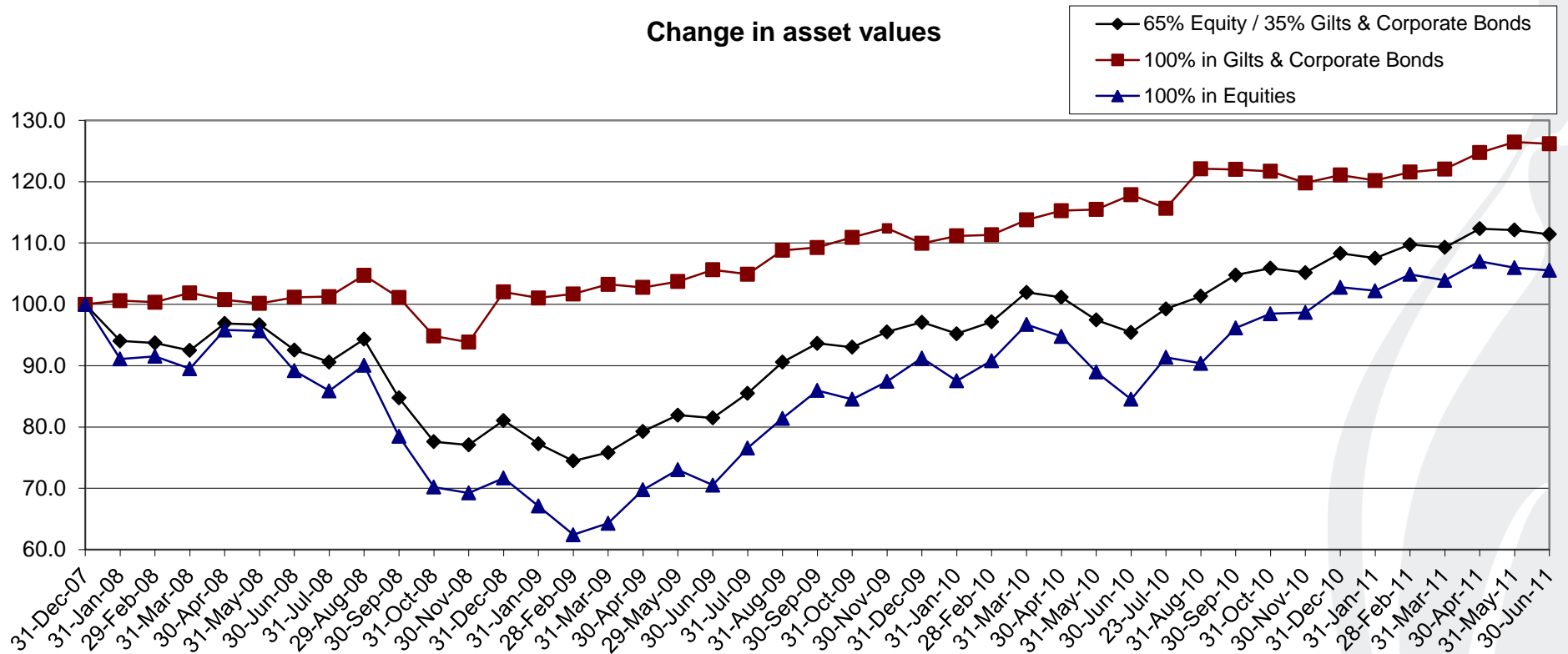
Chart shows 'overall affordability' for a scheme with deferred liabilities only and invested 100% in higher return-seeking investments, such as equities. 'Affordability' considers the cost of insuring the pension risk compared to the value of the assets held by the scheme. A higher value in the index means that insurance is more affordable for pension schemes (insurance costs have fallen and / or asset values have risen)

### Commentary:

- ▶ Affordability for deferreds made up some of the ground it lost at the start of the quarter, although affordability for deferreds remains at historically high levels
- ▶ As the duration of deferred liabilities is longer than for pensioners, insurance pricing is more sensitive to market fluctuations

# Change in asset values

How the scheme asset values have moved in absolute terms – ie not relative to buyout costs



## Key:

Chart shows relative movement in the value of a variety of investment strategies based on movements in common indices. 'Gilts' reflects a mix of Fixed Interest and Index-Linked gilts

## Commentary:

- Equity markets had another roller coaster ride in Q2, with potential sovereign defaults at the top of investors' minds

# Contact

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