

Pension Insurance Corporation

Pension Risk Transfer Index
Q3 2011



PENSION
CORPORATION

Highlights



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■ Pension insurance buy-ins become focus of trustees' de-risking options

- ▶ Pension fund deficits have grown further and faster than in any recent period
- ▶ Double whammy of falling Gilt yields and falling equity prices took many by surprise
- ▶ Many buyout processes that had been underway will now not complete before the end of the year

■ March 2012 will be a critical period for sponsors and trustees

- ▶ A second leg to this crisis – perhaps triggered by a sovereign default – will push deficits even wider
- ▶ The c.40% of pension funds that had a triennial valuation in March 2009 could face a similar situation
- ▶ This will further weaken the corporate covenant at a time of real economic danger

■ A pension fund liquidity crunch could be developing

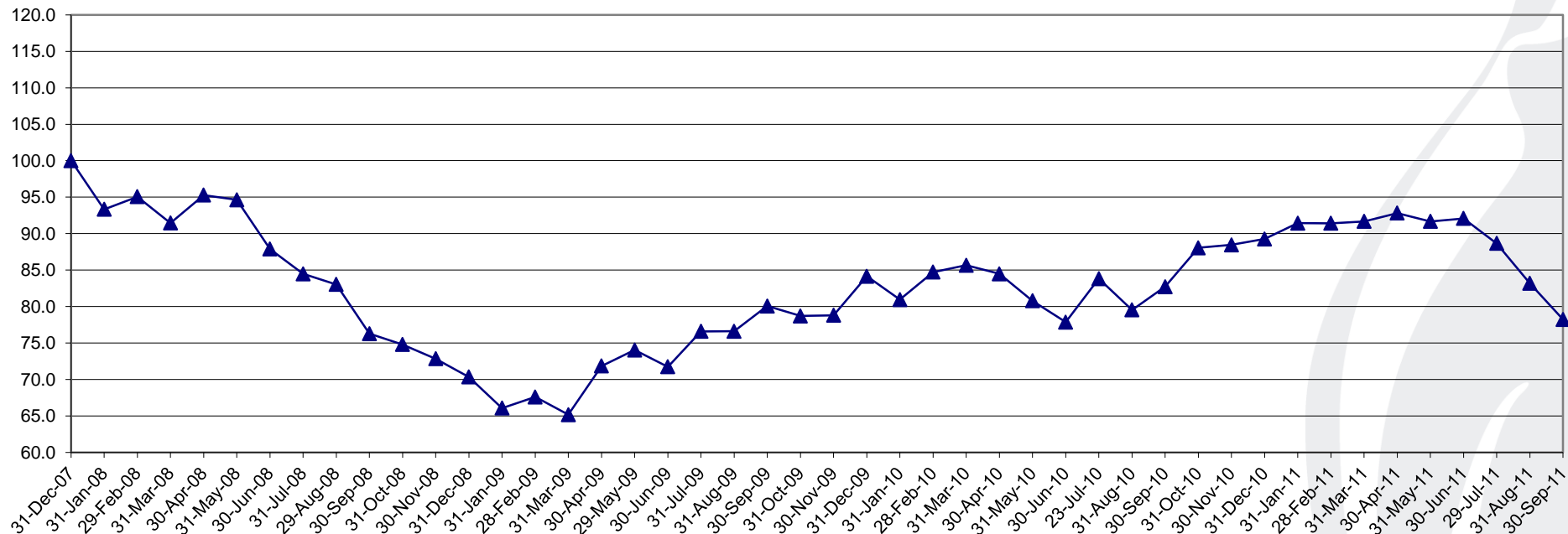
- ▶ Some pension funds may be looking to re-invest in equities, chasing returns
- ▶ This reverses the long-term de-risking trend
- ▶ In the longer term, closed pension funds, with shorter durations, should be careful they do not become forced asset sellers at the bottom of the market

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)
- 65-35% is the starting asset allocation and would equate to approximately 57-43% at the end of September 2011 after allowing for changes in values of equities and gilts. This compares to the average equity weighting of 43% during 2010 based on the PPF purple book November 2010

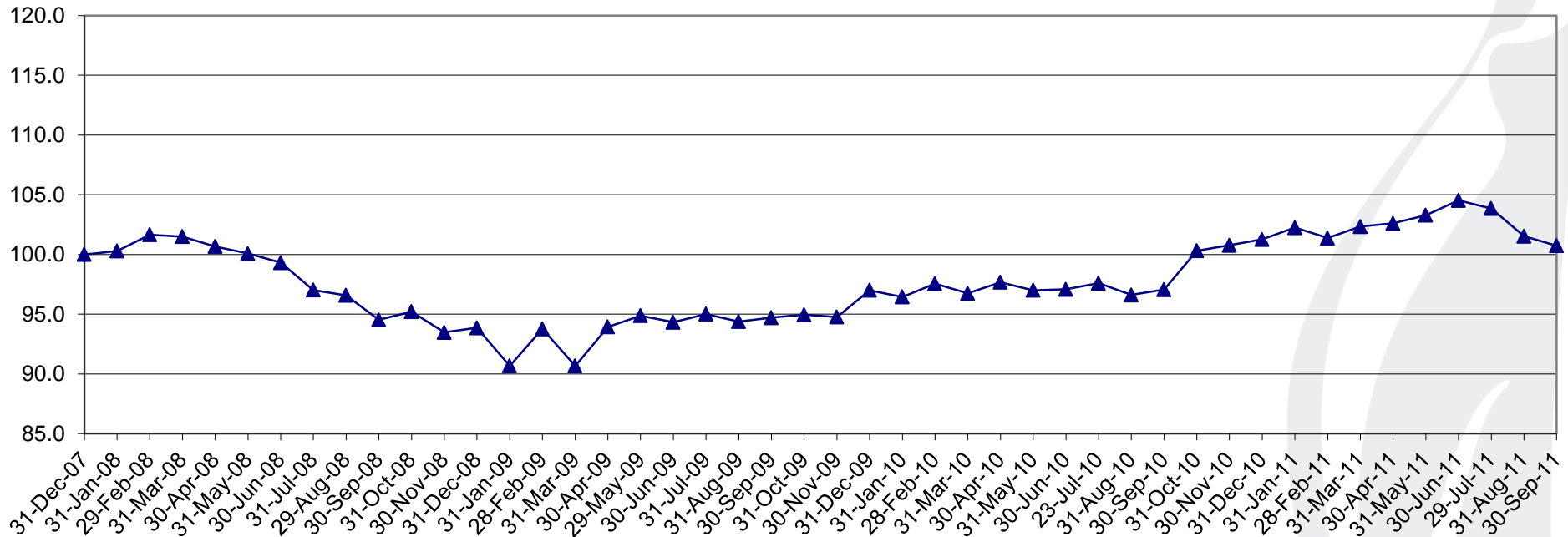
Commentary:

- ▶ Bulk annuity affordability has plunged over the three months to the end of September, following the recent market volatility
- ▶ Many processes that had been underway will not now complete before the end of this 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)

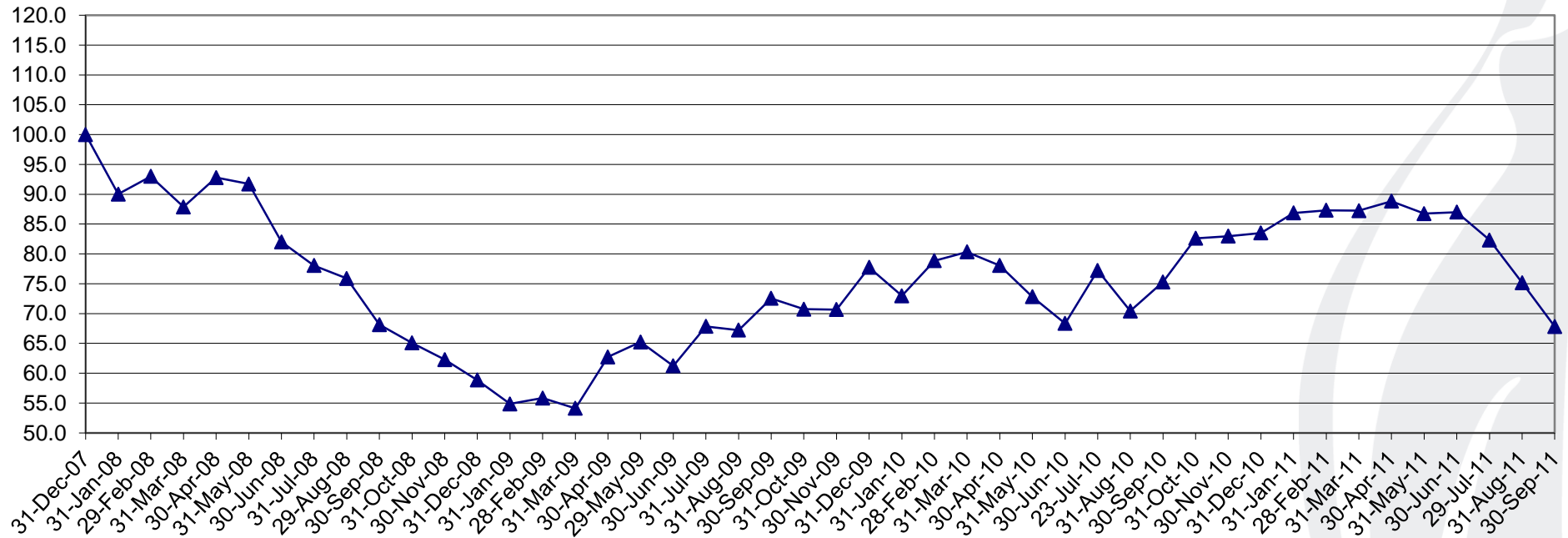
Commentary:

- ▶ Although bulk annuity insurance solutions for pensioners, who are often matched by gilt holdings, remain affordable, they have dropped from highs seen during the summer
- ▶ However, 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:

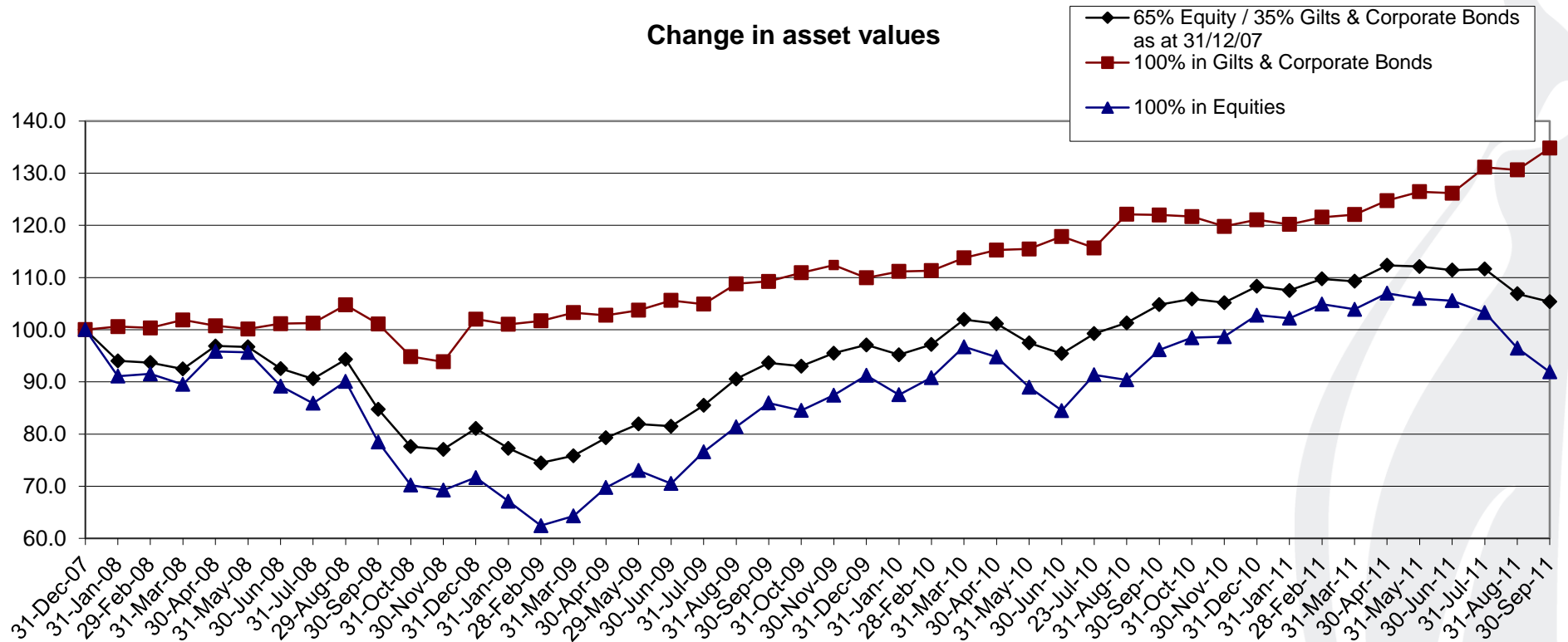
Chart shows 'overall affordability' for a scheme with deferred liabilities only and invested 100% in higher return-seeking investments, such as equities. 'Affordability' considers the cost of insuring the pension risk compared to the value of the assets held by the scheme. A higher value in the index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

Commentary:

- ▶ Affordability for deferreds is now at its worst level since Q2 2010, although it still remains above the all time lows of March 2009
- ▶ 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
- 65-35% is the starting asset allocation and would equate to approximately 57-43% at the end of September 2011 after allowing for changes in values of equities and gilts. This compares to the average equity weighting of 43% during 2010 based on the PPF purple book November 2010

Commentary:

- ▶ Equity markets continue to cause concern for pension funds invested in the asset class, with the impact of potential sovereign defaults still at the top of investors’ minds
- ▶ Long-term these pension funds risk a liquidity crunch

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