

The latest *Professional Pensions* Conjecture debate looked at the key issues surrounding buyout and risk reduction

Charting the way ahead

Joining *Professional Pensions* editorial director **Lawrence Gosling** were **Legal & General** sales development director **Hugo James**, **Prudential** director of defined benefit solutions **Andy Reed**, **MetLife Assurance** chief executive **Dan DeKeizer**, **Lucida** corporate development director **John Smitherman-Cairns**, **Watson Wyatt** head of settlement solutions **Michael Chatterton** and **Pension Corporation** partner **Jay Shah**.

Lawrence Gosling: As many people are aware, the buyout market topped £10bn in 2008. But I think like most parts of the financial markets, we have had a perfect storm in the last nine months and traditional buyouts have become more expensive to perform. Despite this, the whole issue of dealing with deficits is not going to go away.

Hugo, to start with you, how can trustees who are new to the debate start the whole buyout process and what are the considerations that they need to think about?

Hugo James: I think importantly they must start by thinking about what their goals are and then sit down and think about whether they are realistic. They need to think about what risks are they seeking to take off the table, what is the time frame over which they are trying to achieve it, and then work with their advisers and come up with a realistic plan.

Trustees need to make sure they have the buy-in of their sponsors, because without that, I think it is difficult to achieve a great deal, particularly in the current market. Agendas will undoubtedly have changed significantly over the course of the last six months. Trustees need to have a good plan and then look at what the available options are for them, be realistic and have a good project plan to get through.

Lawrence Gosling: Hugo talked about buy-in and sponsors, I guess, Michael, from your perspective that this is an area you think is crucial, that you need early buy-in, get all the discussions out in the open so everybody knows what the process is and where you are coming from.

Michael Chatterton: Absolutely. From our perspective, we could see a project being led either by the corporate or the trustee. And I do not think it particularly matters who starts it to begin with. But I think the key is, as Hugo says, that whoever is going to lead the project gets the other party on board – they have come to understand that they have a shared problem.

They may have a slightly different perspective on that problem, but they are both working together in order to reach the solution.

Lawrence Gosling: John, what time process are we talking about here? When it comes onto the agenda of the monthly or the quarterly trustee meeting, what would be the time-frame that the people need to have a full discussion about the various issues?

John Smitherman-Cairns: I think current financial market conditions have probably stretched that timetable for a lot of

processes. I think people went in, certainly in 2008, with an expectation of being able to go through the process of quantifying what they were trying to deliver, getting quotes from the market and executing a solution in a timeframe of around six months.

But what we are seeing in the financial markets has stretched a lot of that quite significantly. I think there are solutions out there that can deliver a quick process but it needs quite decisive decision making to deliver that and getting buy-in from both trustees and corporate is critical in that.

Lawrence Gosling: Jay, some of the audience may think a lot has changed in the last nine months. Did we miss the boat last year? Is it a good time to start now?

Jay Shah: Yes, I think so. And the comment I would make is that – while it is very important that trustees and corporates make the right decision, take the right views and get the right advice – what is really important is to implement your decision as quickly as possible once you have made it.

Once you have made your decision, you are running a risk against yourself, a timing risk. And that is what we really saw, people had decided they wanted to do something but they did not implement it quickly enough. And what they had intended to do was no longer feasible.

So what I would suggest is take your time in making the decision, but once you have made it, implement it as quickly as you can.

Lawrence Gosling: Andy, you were nodding there, what do you think is worth highlighting?

Andy Reed: My advice would be that, if you have made the decision, then delegate authority to some sort of investment body so that, when prices and asset classes are working for you and it looks like a good opportunity, you can transact very quickly and take advantage of the markets.

Lawrence Gosling: So get a smaller group of people tasked with making the decision process in order to make it more efficient? Decide you want to do it and then put that over to a smaller group of people?

Andy Reed: I think that is correct. I think there is the basic strategic decision: you wish to de-risk, you wish to de-risk in this way, and who is the provider you are selecting. For this, you can go through the normal process. However, the decision about when to actually transact – and transfer the assets to the manufacturer – could, in my opinion, be made by a small sub-committee.

Lawrence Gosling: Michael, who would be the kinds of individuals that should be on that sub-committee Andy is talking about there?

Michael Chatterton: Yes, I completely agree. And I think they ▶



Buyout may not be the end goal for all schemes

Hugo James, Legal & General



are obviously a subgroup of trustees, but I would say that there would probably also be a corporate involvement in that. But certainly where there is funding, or additional funding, required from the corporate, they are going to need to be involved.

Lawrence Gosling: Dan, who do you think ideally is placed at a corporate level to drive some of these decisions forward? Is it the finance director, who clearly holds the purse strings, or does it come from somebody like the chief executive?

Dan DeKeizer: I think it could be either of those – and could be the human resources director or even the pension plan administrator. But I will actually pick up on something that Hugo said earlier about the goals of entering into this transaction – which I think is fundamental for moving forward, both in a timely fashion and getting the right decision makers.

If the corporation has decided that the pension plan no longer is critical for attracting and retaining employees, if they have taken steps to close it to new entrants, if they have taken steps to close it to new accruals, then having the vision of a complete de-risking, of discharging these liabilities, of fulfilling the promises to the pensioners in the way that is most efficient for that corporation, those decisions are typically made at the top of the corporate house, possibly even at the board of director level.

Making those decisions, implementing what is a corporate goal, is pushed down to the trustees, or to a sub-committee of the trustees.

Lawrence Gosling: John, talk us through some of the questions that trustees should be asking themselves, Dan used the expression there “goals”. What are the questions they should be asking themselves so they move towards the decision of which route they do go down? And then we will talk about the various routes, buy-in, buy-out, longevity solutions. So what questions should they be asking themselves?

John Smitherman-Cairns: I think the first one is what is their ultimate de-risking goal? Where do they want to get to? And how can they afford to get there?

For certain schemes, they can get there in a single leap – especially if they have got a well funded corporate sitting behind them or if there is a transaction that is pushing that agenda.

For most schemes, I think we are talking a phased approach over a number of years where we deal with parts of the issue along the way. And then it is a question of how much risk they can afford to get rid of at any point in time? And what risks is it most effective for them to get rid of – both from a cost perspective and from a funding volatility perspective.

I think once you have made that decision, I think there is a key role for the advisers and the providers in terms of talking through options for de-risking, different structures that will deliver that structure and what most closely fits with the needs of the corporates and the trustees.

Lawrence Gosling: Hugo, just describe some of those options to people who are not particularly familiar, or who are just beginning to consider this.

Hugo James: In its simplest terms, you start with a pension scheme that is backing its liabilities just with equities, corporate credit or gilts. You may slowly move a higher proportion of your assets into corporate credit and gilts, which are

perceived as being less volatile. You then may start to look at reducing or removing inflation risk and interest rate risk from the scheme. Moving on from there, you might move towards an liability-driven investment strategy.

At this point, some schemes may look at doing a buy-in for either all of their retired members or a tranche of their retired members, or for a tranche of the benefits.

They may want to consider other options such as a longevity swap, which I am sure we will talk about more later. And then slowly move so that they have got less and less volatility, they can see where their gaps are, and are able to go to the corporate sponsor with a realistic plan as to how they would use additional funding. And then move slowly towards an end goal of buyout.

But buyout may not be the end goal for all schemes. If you have got a relatively small scheme and a very big corporate sponsor, that may not be what a trustee needs to do. Alternatively, if you have got an incredibly large scheme, it may not be practical to get there.

I think some time has to be spent at the beginning thinking through what is – in a sense – a process of wind-up. Now that process may be a two-year process, it may be a 25-year process.

It is important to understand that pensions are a complicated issue that many people, many individual members, will find confusing

Michael Chatterton, Watson Wyatt

But it is about understanding that and accepting that and then looking at all those different steps along the way.

Michael Chatterton: Another way of speaking about the problem is to say that most pension funds and their sponsor are interdependent. The corporate is concerned about a high and volatile cost going through the balance sheet and onto the profit and loss account. And the trustees are presumably concerned about the ability of the sponsor to continue to make the contributions that are required so that they can make the benefits that are due.

And that is another way of speaking about the shared problem. The corporate wants to reduce that volatility and the level of expense, and the trustee wants to be certain that they can make promises that they have made due. And it may be, as others have said here, that the buy-in, or any of the other solutions may be part of that risk reduction.

However, in terms of communication, if a buy-in is part of the solution, I think it is important to understand that pensions are a complicated issue that many people, many individual members, will find confusing.

And should any of these solutions involve any type of decision making by the individuals, you can't expect them to make a decision without a long period of communication.

So just trying to write one letter and say this is a decision that you might want to make, if there is, it's their choice, just won't work.

Lawrence Gosling: We were going to come on to communication a bit later but you have raised it now. Dan, clearly member communication is key. Arguably it is more crucial in this area because it is very complex and we are talking

about very, very long term decisions that affect the members. Would you agree?

Dan DeKeizer: I would. I will actually take the issue maybe one step higher and talk about the operational risk of running a pension scheme. The economic risks or the longevity risks are well known but the operational risk of being able to identify who the members are and the size of the liabilities are important.

We frequently talk to trustees and see schemes coming to market seeking to de-risk without having a really clear understanding of what their liabilities actually are. And so this is certainly a step that trustees can take even before engaging with their corporate sponsor or beginning a broader process.

Trustees need to ask if they are really comfortable with the data they have? If they know where their members are? Do they know the benefits are being calculated and paid correctly?

Having that thought process will really help them as they move to mitigating or removing the other risks that they face in that scheme.

Lawrence Gosling: So essentially you are saying a two way communication is necessary – upwards towards the corporates and down to the members?

Dan DeKeizer: Yes. In a way the trustees' job could almost be defined as that: making sure that the corporate sponsor is aware of the consequences of the pension plan and how it is being run, and making sure that the members are equally aware of it. And then obviously running the plan well so that both sides are satisfied with what they are getting.

Lawrence Gosling: Jay, would you agree with that? That the trustee is really the crucial part of this equation or has a very crucial role to play.

Jay Shah: Yes, the trustees' role is obviously central and crucial to the whole debate. I think in terms of communications to members, in our experience, the key thing is to provide

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Dan DeKeizer, MetLife Assurance

firstly comfort that nothing much has actually changed from most people's perspective.

All they want to know is that they are going to receive the pension they thought they were going to receive – it is then a secondary issue as to where it is coming from.

Lawrence Gosling: Do you think it really is a secondary issue? Because most ordinary members expect their pension to be provided by their employer. So they suddenly hear that actually that sum of money is going to come via a different route, does that not change the way he thinks about the whole scheme?

Jay Shah: I think the situation is often far more complicated than that. Most people have several pension pots. Some of ►

The panel



Chairman: Lawrence Gosling, editorial director, Professional Pensions



Michael Chatterto, head of settlement solutions, Watson Wyatt



Dan DeKeizer, chief executive, MetLife Assurance



Hugo James, sales development director, Legal & General



Andy Reed, director of defined benefit solutions, Prudential



Jay Shah, partner, Pension Corporation



John Smitherman-Caims, corporate development director, Lucida





them are from successive employers they have been with, some could be with other insurance companies. On top of this, they have other financial products.

So people are used to having a range of financial assets. What they want to make sure of is that firstly, they don't have to do anything. There is nothing adverse that can happen if they take no action. They are going to get what they thought they were going to get. And indeed, most of the questions we get when pension funds are transferring to us as an insurance company, are much more around confirming which phone number people need to ring. Whether it the old one or the new one or a combination of the two? It is practical things like that.

One of the other things we do at that initial communication stage is confirm details. And that provides an element of comfort as well.

Hugo James: Jay's points are all very valid, but we must remember that for most trustees, what we are going to be talking about mainly at the moment are de-risking steps on the way to buyout and the communications around that.

I think sometimes people get overly hung up about communicating loads of things to our members around a de-risking strategy when in reality a de-risking strategy does not actually change anything to do with the members' pensions, and doesn't change how that pension is going to be paid. That may be confusing and potentially disturbing for members when in reality trustees do not consider sending a letter to their members when they buy a new stock or share. So I think we need to put it into perspective.

If we are moving to a full buyout and the person that is paying that pension is going to change, pensioner and member communication is very, very important. If we are talking about investment decisions, I think that we should make sure that it is put into perspective and is communicated in the normal way, rather than making a bigger thing out of it than it necessary, because this can lead to confusion.

John Smitherman-Cairns: I agree totally. I think the only thing that can throw a spanner in the works is that transfer of assets and risk to an insurance company is newsworthy. And the press will report that as they see fit. And you can not necessarily control how that is going to be brought out into the market and brought to the attention scheme members. And that can create confusion in and of itself.

So it is important to be on the front foot in that. And I think Hugo's point is right, nothing has really changed if it is just an investment decision. But you need to communicate that proactively rather than reacting to market chatter and member reaction to that.

Andy Reed: Sometimes these transactions are so large that they have to be disclosed under stock exchange rules. When we did our large transaction with Cable & Wireless, it was

on the front page of the *Financial Times*. And we spent a huge amount of time talking with the trustees about how they were going to explain and communicate this sort of press coverage with the members. While their situation hasn't changed, people don't really fully understand these things.

We work very hard with the trustees in terms of that communication so that it can land correctly with the members and they understand what is happening. Otherwise, they can become confused and concerned. It is a process that you need to work through with the manufacturers. Sometimes there is not a lot you can do because it will be picked up by the press or will have to be disclosed, simply due to the size. So it is important to get that concept right.

Lawrence Gosling: Hugo, it is really about the simplicity and the clarity of the communication isn't it? I think probably

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Jay Shah, Pension Corporation

everyone here would accept that you don't want to bombard members with communications for the sake of it, but if you have got a nice clear communication that says your scheme is now backed by the Pru, L&G or whoever, surely that is good news for the average member.

Hugo James: I think that Jay's point is a very good one. Communication is about reassuring members that nothing has changed, they have got nothing to worry about, they don't have to do anything, their pension is still going to be paid in the same way and this is part of the strategy to increase the security of their pension over time. And if you can get that message clearly across to most members, that addresses their major concern.

Lawrence Gosling: Michael, if you communicate something like this, is it spin to say it is a positive for the member? That the scheme has come up with a solution that does take away the risk?

Michael Chatterton: No, I don't think so. I completely agree with all that has been said. Behind that communication the trustees obviously have to convince themselves, with advice, that they are doing something that maintains the security, or enhances the security, of the promises that are being made. And I don't imagine there would be a trustee group in the

country who would make the decision to effect a buy-in or a buyout, without being certain of that.

Lawrence Gosling: Moving on to longevity swaps. Andy, what are your top-line thoughts?

Andy Reed: My top line thought is this is still a relatively new market in terms of solvent sponsors, insolvent schemes, de-risking. And so there will be new innovation coming into the market all the time.

I think the view I would have is that longevity insurance needs to be thought through very carefully – it may well be appropriate for a number of schemes but I think it is a) relatively new and b) I believe the major market will be the secondary market in terms of the large insurers and large providers, trading insurance between themselves.

I suspect they will be quite expensive and it is probably worth thinking through whether you are locking yourselves into a strategy by taking one of these transactions out and whether it could restrict you in terms of where you ultimately place the annuity or the full buyout?

Ultimately, the only way to buyout and close the scheme down at the moment is to buy annuities with an insurance company. That is it, there is no other way if you think about the ultimate goal.

Lawrence Gosling: Is that one of the areas that you think potentially could change going forward?

Andy Reed: It could well change, like I say, it is a very innovative market. There are £1.2trn of assets there. There will be lots of companies, organisations and individuals thinking of ways that they can get access to that pool of assets. And that is all great. New innovation is great for the market. But I think one needs to be careful about what you are buying, and whether that will restrict you going forward? Is it the right thing for you? Does it work for you?

Hugo James: I have a very good example of one of the points that Andy makes about whether a longevity swap or a longevity insurance restrict you in the future.

Many trustees will be aware a few years ago there was a lot of talk about total return swaps and how total return swaps could reduce investment volatility and enable trustees to lock into a very safe return. And a number of schemes went ahead and transacted total return swaps – passing assets to a third party and that third party guaranteed to give them a return.

One such scheme then came to the market last year to look at doing a buy-in. They went round and they talked to a number of the different providers and, as far as I am aware, all the providers said they were not prepared to accept that asset as part of the deal.

The trustees and their advisers then went back to the paperwork regarding the total return swap and found that

there was a very large break fee involved in getting out of that product.

So the trustees were then stuck in a difficult position, they faced either paying a very large fee to enable them to move forward with the buy-in, or an inability to do that transaction.

That is not a reason to discount longevity swaps or longevity insurance but I think it does highlight some of the issues that need to be considered and the fact that trustees should not rush towards these things because they are being heavily promoted or heavily discussed in the newspapers. They should really consider what the longer term implications are for their long term strategy. It may be the right thing to do but really consider what the implications are of doing it.

Lawrence Gosling: Jay, what is the balance? A lot of trustees will be aware of the example Hugo has just cited or will now hear about it. What are the thought processes that a trustee needs to go through so they do not miss out on innovation but equally they don't get caught in a situation which is quite costly to extract themselves from?

Jay Shah: Hugo and Andy's points are perfectly valid. But the points are addressable. There is no question mark over that.

Lawrence Gosling: Would you like to address them?

Jay Shah: Yes, we have seen exactly the same aspects addressed in the interest rate swap market, the inflation swap market – and most insurers actually couldn't live without those sort of swaps. So the technology is there, it needs to be adapted to this particular new product class. But some of the technical aspects can be addressed, they will be addressed and they are being addressed. Which then takes you to the issue of is it a good thing for longevity swaps to have come to the marketplace?

We have tended to see interest in this particular product line, which we are keen to promote.

The interest coming for two reasons, firstly as a step-

If you don't have a clear decisive decision making process, you run the risk of missing a market opportunity or not actually being able to deliver your ultimate de-risking goal

John Smitherman-Cairns, Lucida

ping stone towards an ultimate longer term or significant de-risking of the pension scheme. So in much the same way as we saw buy-ins as a variant of buy-outs, as a taking risk out of the scheme in steps rather than in one go, this is just another example of that. ►



The second reason is that while most trustees and finance directors understand investment risk – may choose to retain it, not retain it, or do something about it. They can see the FTSE going up and down, they have vast experience of that. However, they don't understand longevity risk. It is something that is far more esoteric and seems only ever to go in one way. Longevity is that "unknown unknown" issue and many people would like to get rid of this risk at a reasonable price.

Lawrence Gosling: Do you agree with that? That people understand investment risk but don't understand longevity risk?

John Smitherman-Cairns: I do. But I agree with Jay, we are very supportive of the development of the market and actively quoting in the market. I think the only word of caution I would put out there is the cost. It is a complex solution, taking a major risk off the table. And there is a cost involved in it.

The capital markets are not known for their generosity. And if you take a risk on, there is a cost involved.

In a buyout or a buy-in solution, you get that risk taken off, potentially, well, probably subsidised by some of the asset outperformance that the provider expects to earn. If you take or strip away the assets, and take pure longevity risk off the table, there is a cost and it may not be the right solution. And it is a very complex solution which again it might be appropriate to certain schemes, it is probably not appropriate for all schemes.

Lawrence Gosling: Dan, would you generally agree with the view that this is a route we should look at. Or should we just step back and wait until it gets cheaper?

Dan DeKeizer: I think you go back to the question of what is your purpose in entering into that transaction. Are you attempting to manage volatility on the corporate balance sheet during the time in which you are developing a full buyout solution or winding up your scheme? Or are you intending to run that scheme as a standalone pension scheme for the lifetime of its existing members and seeking to transfer or hedge the true longevity risk? These are two very different objectives and would tend to take you down a different path with respect to a longevity swap.

It is a complex structure, you do have to pay for the risk that you are transferring if you go down the route of either an insurance contract or a longevity swap. But I think that for the vast majority of pension schemes the ability to access that longevity swap market, cost effectively, is probably not there.

However, the majority of pension schemes is not necessarily the same thing as the majority of assets that are managed in pension schemes. I think your multi-billion pound schemes, active schemes, may find it a more attractive solution than a scheme which is already closed to new

you are asked about it with clients?

Michael Chatterton: Well a couple of things. First off, if we are trying to help clients make a decision about what de-risking strategy they may want to take, we try and help them compare the price of every unit of risk that they are taking off the table. So for larger clients, you can certainly look at both buy-in, buyout and longevity swaps in parallel and try and strip out the bases that are being used in each of those calculations and allow the trustees to make a decision whether to transfer the entire risk, both investment and mortality, or whether the mortality alone makes more sense.

Turning to whether longevity swaps are expensive and likely to get more so or vice versa, we are seeing that more and more schemes are looking at longevity swaps. That market is growing, Babcock International have announced that they have actually done one. So that would be a proof point, that this can be done.

What we are seeing is that more and more of our clients are looking at this because, as trustees and their actuaries make more conservative assumptions about the mortality that will prevail in their funding calculations, we are seeing a closing of the gap that may exist between the insurer pricing and the reserve that is held in the pension trust, making it more affordable.

And another thing that we can only speculate that may happen is that early movers may well get a pricing advantage as providers are keen to do transactions. And I think if we look back, it is possibly true that some buy-in and buyout deals done by the early movers were more competitively priced.

Lawrence Gosling: Andy, would you agree with Michael's point there that maybe your pricing, or generally the market is pricing keener at the moment?

Andy Reed: To step back to a normal economic practice, if there are new entrants who maybe do not have a well established brand – and brand is incredibly important to trustees in this market – a reasonable entry strategy would be to price particularly competitively in order to gain market share.

That happens in all walks of life, in all industries. And so I would agree that may well happen within longevity swaps. So I don't think it is unreasonable to assume that could be happening right now.

However, my personal view is that they are expensive. I have had dealings with these, I have looked at these and they seem to be expensive for all but the largest schemes and the schemes with the largest amount of assets. I do personally struggle to see how they provide value for money. I think contractually also they are very, very difficult.

But I think now might be a good time for people to look at doing some of those as there could be some good deals on the table as providers start to kick start that market.

John Smitherman-Cairns: Yes, I think it is a very good point that Andy makes about market entry strategies. I think the slight counter to that is I don't expect what happened in the buyout market to necessarily happen in the longevity only space. Capital is more scarce now, capital players are being more disciplined. What we saw in 2008, I don't expect to be repeated.

Lawrence Gosling: Jay, two things Andy mentioned there, cost and complication. Do you want to address both those issues?

Jay Shah: Yes, in terms of cost, I think it probably is good, I

I do personally struggle to see how [longevity swaps] provide value for money. I think contractually also they are very, very difficult

Andy Reed, Prudential

members and is looking to do a wind-up or a buyout in a decade or less.

Lawrence Gosling: Michael, how do you look at this area when

think there is an early mover advantage. I don't think it is an issue around new participants in a market. Credit Suisse, which we assume is the counterparty to the Babcock transaction, is clearly not a new entrant to the financial services market. But it is a new product line and whenever you have a new product line, people are keen to see the market grow in order to recoup their investment. So I think you will see some pretty keen pricing in the early days.

In terms of complexity, I don't think it is complicated. The deal with the pension scheme is you pay to the insurance company a pre-agreed schedule that has been written down on a piece of paper, and we will pay back to you the amounts you pay to your pensioners. That is it.

Lawrence Gosling: That sounds far too simple.

Jay Shah: That is essentially what it is. There are complications around the collateral issues that Hugo mentioned, what happens if you want to unwind it. But all those complications are around things that you are probably not expecting to happen. What you are going to get out is pretty simple. We fix the schedule of payments and we will pay back what you are actually paying to your members.

Hugo James: I think firstly, pick up on cheap. Cheap is completely irrelevant. If you don't want a car, a cheap car is not good for you. You have got to get the right thing, there is no point in getting something just because it's cheap. So I think that is very important. And I think that if you enter into a longevity swap because, as Dan said, you have got a process where you want to manage the risk within your scheme for the foreseeable future, then potentially it is a very attractive tool. If it is a stepping stone towards a further de-risking and the ultimate de-risking of passing that to an insured entity, then it is vitally important that you understand the break cost or the ability to transfer that product.

Break costs are relatively simple. Most third party reinsurers will look to recoup their expected profit on the transaction if you break that contract. That is entirely normal. If you enter into a fixed term mortgage and you try and settle it early, there is a break cost. If you discount that and say it doesn't matter because I am not going to do something for the next five or 10 years, you are just storing up a problem for somebody else to deal with. So I think it is really important that you understand that.

And it is not necessarily true that everybody will want to accept that asset. I go back to the total returns swap. The total returns swap was with a very high quality counterparty but if it doesn't work for the person you are looking to pass that risk to, it is an irrelevant asset. And you might end up tying yourself to only being able to go with one provider at the point at which you are looking to do the further de-risking. So while I definitely wouldn't want to say that longevity swaps are bad and you shouldn't consider them, you really need to think about how it fits into your goals and what the implications are for your long term goals.

Lawrence Gosling: Dan, you presumably would agree with Hugo's point that cost shouldn't be the main driving criteria you are using when you are looking for a solution, whether it is longevity insurance or anything else?

Dan DeKeizer: It is certainly true that, if you don't need something, then it doesn't matter what it costs. I think the ability to compare price of longevity risk, whether it is through a longevity swap or a guarantee product which exists in the

market place as well, versus an insurance solution, is complex. You need to have good advice and you need to have or put people on your trustee sub-committee that actually have the ability to understand those consequences and think it through very carefully. It is right that you think as much about how you are going to terminate the agreement as you do as to how you are going to start the agreement.

Lawrence Gosling: If we can move onto the issue of brand. I think that around the table we have a couple of, three players from big well known institutions, and then we have got two newer institutions. But it is a key issue from the ordinary members' point of view? Michael, how important is the brand, the company behind the solution that you may work with and then ultimately recommend to a scheme?

Michael Chatterton: I don't think it is the major issue. I think trustees need to be able to reassure members that they have done their due diligence and that the selected provider for the product will continue to make the payments that they have been making themselves. There may or may not be a change in the administrative arrangements, as others have said already. But you will find that this issue always comes up. And it is better to address it as early as possible in the process so that trustees can become more confident.

But equally, can they get confidence with a new provider and a new set-up and capital markets and so forth? So we would propose to introduce all providers to every process, we would propose to attempt to explain the virtues of all providers. And we would propose to produce a short list with whom the trustees would engage directly, where they can form their own view.

Dan DeKeizer: Just to follow up on that, I think as trustees look at their choice of provider here, you are going to look at whether that provider is sufficiently capitalised for the risks that you are giving them. You are going to look at the regulatory regime in which that provider is operating and whether you have any backstop, such as the Financial Services Compensation Scheme, which the insurer would have access to.

And then I do think you look at member reaction. When you go to wind-up, when you go to a full buyout, will my members be confident that this is an organisation that will pay my pension for the rest of my life and pay for my spouse after I pass on?

Lawrence Gosling: Jay, what would be the sort of things that trustees should look at to assess the financial strength of any provider they are doing business with?

Jay Shah: I think trustees need to do their due diligence on the various insurance companies they might be considering. The Financial Services Authority regulations essentially set out a minimum requirement and you can take it as read that any insurer you are dealing with has met the minimum requirements. But there is a level of subjectivity there in terms of the strength of your reserves. For example, in the current environment, it might be around the allowance that insurance companies are making for default on their bond portfolio or whatever asset portfolio they might be holding. And possibly also the potential for problems elsewhere within the group, which might impact the insurance subsidiary that you might be dealing with directly.

Those are the sort of things which I think trustees ought to look at. But I certainly endorse the need for trustees to get ►



comfortable with the insurance company that they are proposing to deal with.

Lawrence Gosling: Hugo, you wanted to make a comment there?

Hugo James: Yes, I think with the greatest will in the world, and it is not intended as any slight on trustees, it is incredibly difficult for any trustee body to be able to really understand the different risks held within the insurer, the reserving positions, and all the other different aspects of that.

Brand inevitably gives a degree of comfort but it shouldn't be relied on. Dan makes the best point, which is about trustees understanding the regulatory regime in which the insurer is working and questioning their ability to deal with any problem.

Should there be an extraordinary circumstance, then trustees need to look at how easy it would be for an insurer to raise capital when they need it.

Andy Reed: Sorry, I think Hugo has made the point very well. I think one of the key aspects of due diligence that I would suggest that trustees look at is that ability to access capital markets, or the ability of the organisation themselves to generate capital internally. Do they have a large with-profit fund, for instance, that may be coming down?

That does seem to be quite a critical point because the insurance regulations insure you are well capitalised etc, but how do you access additional capital is one critical area that I would suggest the trustees should look at.

John Smitherman-Cairns: I think there is a fairly key point around the ability to understand a monoline versus the ability to understand the complexity of an international insurer. And having worked for a big international insurer, they can be incredibly complex issues, I mean organisations where issues can come out of the woodwork, and I think we have seen that with AIG. I think it is not a simple problem of a big brand name versus a monoline, I think it is a very complex issue that advisers have a key role to play in the due diligence process.

Michael Chatterton: Yes, I completely agree with nearly everything that was just said. I think it is very important that specialist insurance advice, insurance practitioners' advice is sought in this area. And secondly an additional thing that trustees of large pension funds can put in place is collateral. So additional contractual terms which will enhance the security over and above all the good things that the gentlemen here have just spoken about.

Lawrence Gosling: We are down to our last five or six minutes. What is the key message you think people should take away from today?

John Smitherman-Cairns: That there are solutions and structures out there that can deliver effective de-risking or partial de-risking even in today's environment and those will evolve. For me, clear decisive decision making in the process is critical to delivering those. And if you don't have a clear decisive decision making process, you run the risk of missing a market opportunity or not actually being able to deliver your ultimate de-risking goal.

Dan DeKeizer: I will actually touch back on a point that we spoke about earlier in our conversation, around the communication between trustees and financial directors. We did a survey of finance directors recently. Three-quarters of them

said that, from a corporate perspective, they are not considering de-risking strategies right now. 10% of them were looking at some kind of de-risking strategy and only about 2% thinking about doing a buyout.

If you interviewed trustees, you have almost a complete reversal of that. More than half are doing some kind of de-risking, almost half say they would like to be able to do a buyout or a buy-in, some kind of insured solution to secure member benefits. And so that conversation between trustees and their corporate sponsors really needs to be happening and for the trustees that are listening today, I think that is where I would encourage you to start. Sit down with your pension contacts at your corporate sponsor and start talking about what is our goal here? What is our plan over the next five years or 10 years, or 60 years for this pension scheme? And that may be enlightening to both sides of the table.

Jay Shah: I think my overall message would be take great care in deciding what risks you are running, how you want to address them and the selection of insurer. But once you have made that decision, be decisive and act quickly.

Andy Reed: I agree with the previous speakers. But my observation would be that all pension schemes are slightly different, they have different goals, they have different structures, different assets, different liabilities. So it is not a one size fits all process. And there are solutions in the market that take a phased approach to de-risking and you can do something now. It may be that a large one-off transaction is beyond the reach of you and your sponsor right now, due to the external conditions, but at least you can start the ball rolling and get on the route map to buyout if that is where your objective is. So don't just think in terms of just single, big, large, one-off transactions, think about doing things in stages. Think about getting moving and edging ever closer towards your goal.

Hugo James: There is a horrible danger of agreeing with all of my competitors. I completely agree, there is more than one way to skin a cat. Understand what your plan is, what

Communication is about reassuring members that nothing has changed

Hugo James, Legal & General

your route is. Understand how you are going to measure your progress against it. Understand what you will do when you deviate, who are the decision makers, who you need to go back to. And, most importantly, recognise that a decision to do nothing or a decision to defer is just as big as decision as the decision to do something. And that is the biggest danger the trustees see.

Michael Chatterton: I agree entirely with all that was just said, and trying to say something different. I think if you are going to do something, get started. I think pension plans have been running for many years, have many members, many of whom have left. We have had whole rafts of legislation and corporate action, which means that the entitlement of individuals are complicated. So while the data you hold may well be appropriate for running the ongoing plan, and generally is, you may well need additional information to secure those liabilities with any third party and you should begin to collect that. ■

