LCP PENSIONS DE-RISKING 2015

BUY-INS, BUY-OUTS AND LONGEVITY SWAPS

De-risking opportunities in 2016 as insurer capacity increases to over £15bn.

DECEMBER 2015

LCP INSIGHT CLARITY ADVICE

LCP Pensions de-risking 2015

Buy-ins, buy-outs and longevity swaps

This is LCP's eighth report for finance directors, trustees and the other senior decision makers responsible for managing the costs and risks associated with pension plans. It captures key developments and opportunities in the market for buy-ins, buy-outs and longevity swaps.

Video: Charlie Finch explains the key findings

Visit our dedicated report site **www.lcp.uk.com/deriskingreport** for a video on key findings, market review infographics and case studies.

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#lcpderisking

LCP's commitment to providing clients with market leading advice has been recognised, winning 6 out of 7 de-risking adviser awards since 2011.

CONTENTS

Welcome to LCP's eighth annual report on the buy-in, buy-out and longevity swap market in the UK.

As I write these words, the nine insurers operating in the buy-in and buy-out market in the UK are finalising their preparations for the new "Solvency II" reserving regulations that come into force on 1 January 2016. Intensive lobbying by insurers has meant pensioner buy-in pricing will be little changed from now and is set to benefit most from the extra £5bn of insurer capacity that we expect to be available in 2016.

This year we have case studies on some of the award-winning work that LCP has been carrying out for our clients. We start with the phased buy-in strategies that helped the ICI Pension Fund be awarded the Professional Pensions "Large Pension Scheme of the Year" – a strategy that we anticipate will become a blueprint for pension plans wishing to de-risk using buy-ins.

We then look at the four buy-ins carried out by the Philips Pension Fund, where three initial buy-ins meant the fund was ideally placed to actively engage with a proposal from Philips to complete a full buy-out of the £3.5bn fund.

The report also includes four further case studies of innovative transactions, both large and small.

Looking forward to 2016, all the ingredients are in place for the market to break new ground and we look forward to helping our clients benefit from the latest the market has to offer. Page 10 sets out some pointers on what pension plans should be thinking about now to make the most of the opportunities available.

Clive Wellsteed

Partner &
Head of Practice
LCP

FOR ICI AND PHILIPS PENSION FUND CASE STUDIES **SEE PAGE 15**

£10bn is the new normal

For the second year running, buy-in and buy-out volumes have exceeded £10bn in 2015 – the "new normal" we forecast last year.

£10bn+ Buy-in and buy-out volumes for 2015 (2014: £13.2bn)

£9.3bn Longevity swap volumes to date in 2015 (2014: £21.9bn)

£15bn+ We forecast insurer capacity for 2016 will be over £15bn, a £5bn increase on 2015.

+ See page 6

New entrants and leavers

There are nine active insurers in the market – a record high.

- Scottish Widows, part of Lloyds Banking Group, joined the market in November 2015 with a £400m buy-in with Wiggins Teape
- Partnership and Just Retirement, after dominating the medically underwritten market, are due to merge once their Solvency II approvals are complete. Competition at the smaller end should be helped by the arrival of Canada Life and potentially LV=

+ See page 6

A de-risking blueprint for pension plans

LCP has worked with pension plans such as the ICI Pension Fund and the Philips Pension Fund using a series of buy-ins to achieve cost effective de-risking at scale.

- The ICI Pension Fund has used an innovative "umbrella" buy-in structure to insure over £5bn of liabilities through six buy-ins
- The Philips Pension Fund followed up three initial buy-ins in 2013 and 2014 to implement a proposal from Philips to insure the remaining liabilities and achieve a £3.5bn full buy-out in November 2015

+ See page 15

Pricing levels under Solvency II to settle down in early 2016

Despite initial concerns, insurer pricing will be only marginally changed in 2016 as a result of Solvency II

- Pensioner buy-in pricing will be broadly unchanged
- Non-pensioner pricing to increase by c3% but varying by insurer

+ See page 9

Solvency II to make the market place more crowded

Pension plans will be in direct competition with insurers for capacity.

Solvency II encourages insurers to hedge more of their longevity risk. We are already seeing increased activity between insurers and reinsurers and expect this to increase further in 2016. In particular:

- More longevity reinsurance by insurers on their back-books will use up reinsurer capacity
- More insurer-to-insurer transfers of annuity portfolios will use up insurer capacity for buy-ins and buy-outs

+ See page 10

Making effective decisions about transferring longevity risk

Longevity risk has historically been hard to measure and often underestimated.

However it is becoming the dominant risk for pension plans that are well progressed with their investment de-risking strategies.

- LCP LifeAnalytics helps pension plans measure longevity risk in a more sophisticated and robust way than has previously been possible
- This allows pension plans to compare de-risking options and identify those that provide the best value for the risk reduction achieved

+ See page 12

After a record-breaking 2014, 2015 volumes reflect the "new normal" of over £10bn

Despite the uncertainty from the imminent implementation of Solvency II, 2015 has proved to be the second year running that buy-in and buy-out volumes have exceeded £10bn.

Buy-ins and buy-outs

Last year, we predicted that buy-in and buy-out volumes in the UK of £10bn or more would become the "new normal". With over £10bn of business written so far in 2015, it is set to be the second highest annual volume after last year's record £13.2bn.

The largest transactions to date in 2015 have been the £2.4bn full buy-out by the Philips Pension Fund with Pension Insurance Corporation, the £1.6bn buy-in by the Civil Aviation Authority Pension Scheme with Rothesay Life and the £680m buy-in by the Northern Bank Pension Scheme with Prudential.

The recent £400m buy-in by the Wiggins Teape Pension Fund with Scottish Widows (part of Lloyds Banking Group) marks Scottish Widows' entry to the market. Canada Life has also entered the market writing a small buy-in in the third quarter of 2015.

The market will also be impacted by the merger of Just Retirement and Partnership due to complete at the end of 2015 once their Solvency II approvals are complete. In the short term this might reduce the level of competition for medically underwritten buy-ins, but LV= are considering entering this market in 2016 which would bring extra competition. Overall the competitive dynamics across the market are set to remain strong going into 2016.

Longevity swaps

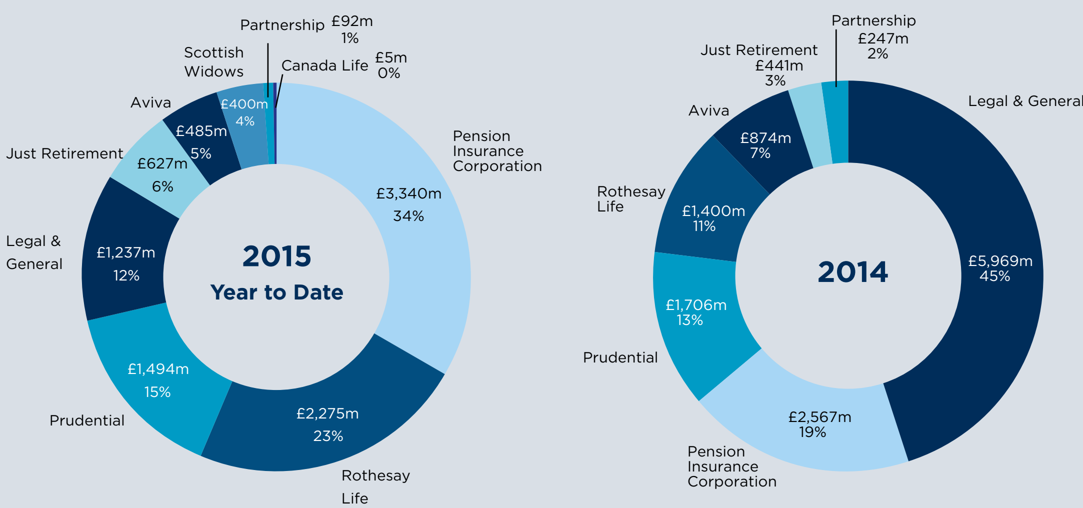
There have been five longevity swaps executed by pension plans to date in 2015, hedging the longevity risk associated with £9.3bn of liabilities.

2015 has also seen increased variety in the structuring of longevity swaps, being written through traditional intermediary insurers and non-intermediated routes (such as the £2.8bn longevity swap by AXA's UK pension plan in July 2015).

Charlie Finch
Partner LCP

We expect over £10bn per year of buy-ins and buy-outs to continue to be the new normal into 2016 and beyond.

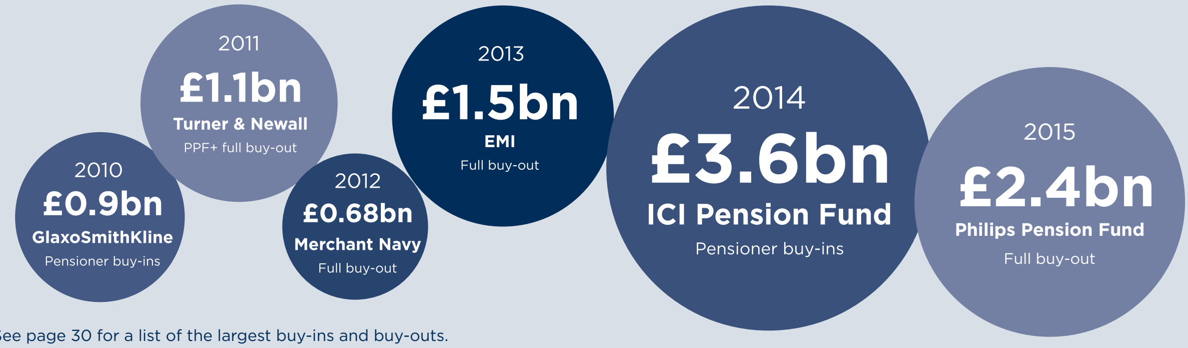
Buy-in and buy-out volumes by insurer



Source: Insurance companies. 2015 includes Q1 to Q3 plus publicly announced transactions in Q4. See full data in appendix 1 on page 28.

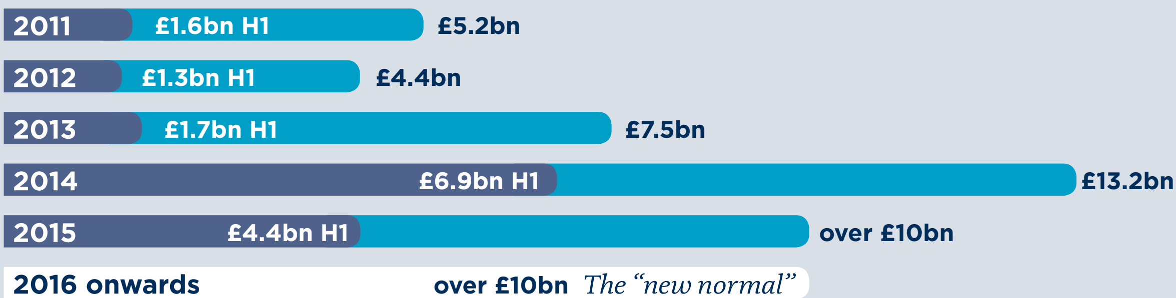
FAST FACTS: UNITED KINGDOM

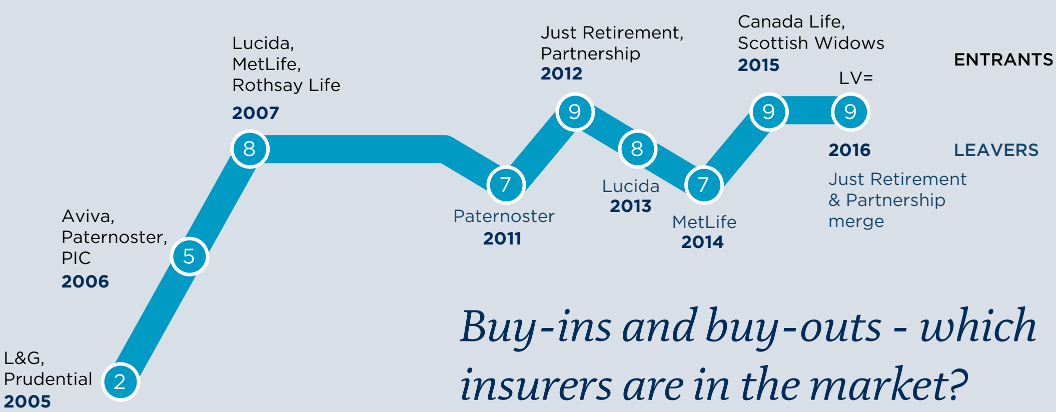
Largest buy-in and buy-out transactions each year



See page 30 for a list of the largest buy-ins and buy-outs.

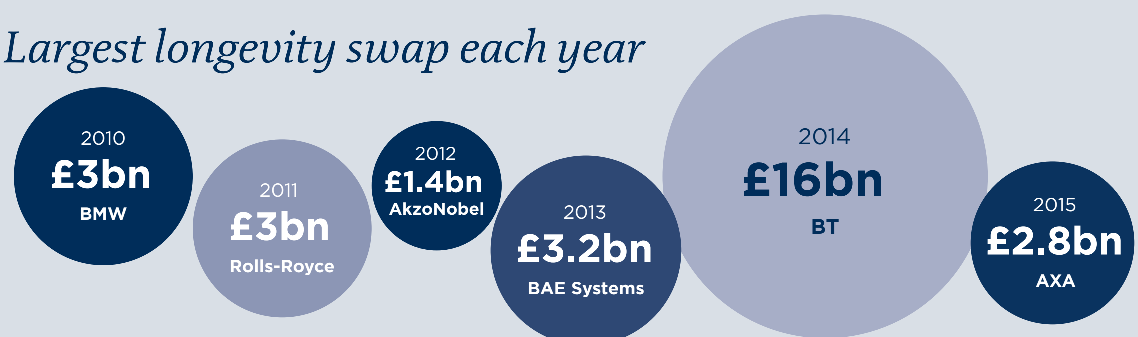
Buy-in and buy-out volumes





Buy-ins and buy-outs - which insurers are in the market?

Largest longevity swap each year



See page 28 for a list of longevity swaps.

FAST FACTS: NORTH AMERICA

The North American longevity de-risking markets have been very busy over 2015 with a number of large buy-out deals in the USA and the first longevity swap executed in Canada.

Both countries have large, rapidly maturing private sector DB pension plans and we expect them to take an increasing interest in pension de-risking over 2016 and beyond.

Estimated private sector DB pension assets

Source: Investment Company Institute, Statistics Canada and The Purple Book

Canada

2014 transaction volumes

CAN$2.5bn

2015 expected

CAN$7-8bn

(including CAN$5bn Bell Canada longevity swap)

- Bell Canada deal with Sun Life Financial was the first longevity insurance transaction for a North American pension plan
- Increased competition as RBC Insurance entered the market in early 2015
- Steady flow of small and medium sized buy-ins and buy-outs

MAR 2015
CAN$5bn
Bell Canada
longevity insurance

United States

2014 transaction volumes

US$8.5bn

2015 expected

US$10bn plus

- Continued appetite for large pensioner buy-out transactions
- New entrants to market and large deals being split across more than one insurer
- Focus will continue to be on pensioner buy-out rather than longevity insurance

FEB 2015
US$2.5bn
Kimberly-Clark
Buy-out 21,000 participants

OCT 2015
US$1.1bn
Philips
Buy-out 17,000 participants

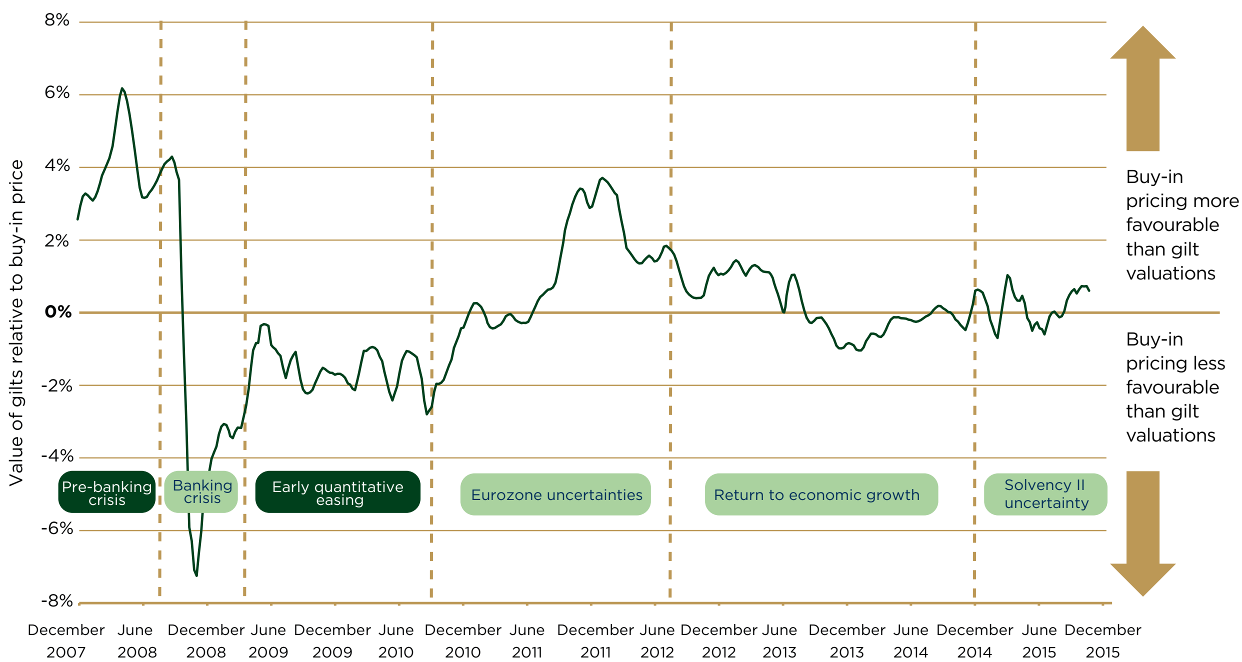
LCP would like to thank Sun Life Financial and The Prudential Insurance Company of America for their input.

Buy-in pricing in a Solvency II world

LCP Analysis

Over 2015, many pension plans have continued to complete pensioner buy-ins at a pricing level similar to a valuation reserve based on gilt yields. Where assets would otherwise be held in gilts or LDI portfolios (and not used as collateral) this has provided a cost-effective way of hedging longevity risk.

The chart below shows the pricing of a pensioner buy-in compared to a gilts-based funding valuation for a typical pension plan. When pricing is above the 0% line this means a pensioner buy-in would typically improve the funding position if the buy-in price is met from gilt holdings.



2015 saw increased price variation between insurers and some insurers were noticeably more selective in pursuing transactions as they worked through the emerging details on Solvency II. However, price competition overall remained strong.

Solvency II – what will be the pricing impact in 2016?

Any business written in 2015 will benefit from "transitional protections" but business written next year will need to comply with Solvency II in full. This creates the potential for a step-change in pricing on 1 January 2016. Our expectation for pricing from January 2016 is that:

- Pensioner buy-in pricing will be broadly unchanged
- Non-pensioner pricing is expected to increase by c3% with the impact varying by insurer.

We expect any pricing impact will diminish over time as insurers optimise their capital models and asset strategies under Solvency II.

The outlook for 2016 and beyond

LCP Analysis

Insurer capacity for buy-ins and buy-outs

With Solvency II coming into force in 2016, several years of uncertainty will come to a close. The final position is towards the more favourable end of the range of possible outcomes and this positive news will influence the development of the market over 2016 and beyond.

Looking forward, we expect insurer capacity to increase by £5bn in 2016. The key drivers are:

- Easier access to new capital once investors have clarity on Solvency II financials
- New capacity being provided by insurers such as Canada Life and Scottish Widows
- Renewed management focus and risk appetite compared to 2015 as Solvency II settles down

This is positive from a pension plan perspective, but there are some competing dynamics – for example, some insurers with legacy annuity portfolios may seek to transfer them to other insurers as they refocus priorities under Solvency II. Rothesay Life's acquisition of Zurich's £1.2bn annuity portfolio is an example of this from 2015.

Impact of Solvency II on longevity reinsurance

Solvency II also encourages insurers to hedge more longevity risk than before. This is likely to have two main impacts going into 2016:

- Insurers making more use of longevity reinsurance on their annuity back-books, leading to competition for reinsurer capacity for longevity swaps with pension plans
- Insurers making more use of longevity reinsurance as part of a buy-in or buy-out transaction, as PIC did with Hannover Re following the full buy-out of the Philips Pension Fund

What should pension plans be thinking about now?

1. QUANTIFY LONGEVITY RISK

By robustly measuring longevity risk, pension plans can take an informed decision on whether and when to transfer longevity risk. LCP LifeAnalytics can help pension plans measure longevity risk over different time periods and for different liability subsets.

2. BUILD LONGEVITY RISK TRANSFER INTO YOUR DE-RISKING FRAMEWORK

This allows joined-up decisions to be taken across different investment and longevity hedging options.

3. PREPARATION

Presenting a well-prepared case to an insurer across data, benefits, investments and governance will improve engagement and pricing and increases the likelihood of a successful transaction.

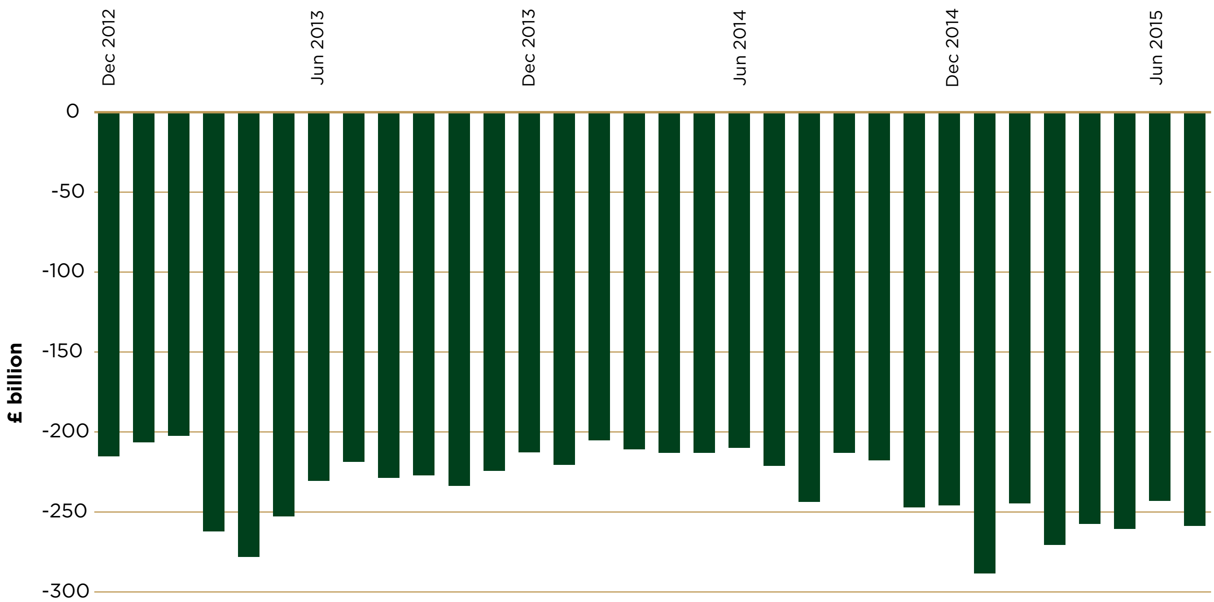
4. ENGAGE WITH THE INSURERS

The benefits of this are shown by the successful phased buy-in strategies that we developed with the ICI and Philips pension plans.

Pension plan demand

A key driver of the level of demand for de-risking from pension plans is their funding level. This has been largely static over recent years.

The chart below shows how the estimated buy-out deficits of the UK pension plans of the FTSE 100 have grown over the past three years despite contributions of £10-15bn pa over this period.



Over recent years, this has meant relatively subdued demand for full buy-outs and a greater volume of pensioner buy-ins as a stepping stone towards full buy-out. We expect significant growth in demand for full buy-outs if markets improve.

80%
buy-out funded

At 80% funded on buy-out, pension plans will typically be targeting a lower risk investment strategy. This makes longevity risk more dominant and so increases the attractiveness of hedging it through a buy-in or longevity swap (or even full buy-out).

Ken Hardman
Partner
LCP

Helped by intensive lobbying, Solvency II is set to have little impact on pensioner pricing and we expect there to be significant price competition between insurers in 2016.

1in10 FTSE 100 companies

have UK pension plans that we estimate are **over 80% funded** relative to the buy-out cost.

If return-seeking assets rose by
15%
then we estimate
1 in 5 of FTSE 100 companies with UK pension plans would exceed 80% funding on buy-out.

If return-seeking assets rose by
30%
then we estimate
1 in 3 of FTSE 100 companies with UK pension plans would exceed 80% funding on buy-out.

Making effective decisions about transferring longevity risk

LCP Explains

A key cornerstone of effective risk management is risk measurement.

In general, most pension plans are comfortable with measuring the investment risks they are running. However, the unique and unusual nature of longevity has to date made longevity risk harder to measure, with longevity commonly being excluded from risk analysis altogether.

But as pension plans reduce their investment risks, longevity risk becomes proportionately larger and, for an increasing number of pension plans, it is becoming the dominant risk. It is therefore important to be able to measure and manage longevity risk effectively.

LCP's new longevity tool, LCP LifeAnalytics has been designed to help pension plans understand their own longevity risk better and more robustly assess the value for money offered by longevity hedging options such as buy-ins and longevity swaps.

LCP LifeAnalytics uniquely allows pension plans to measure longevity risk:

- Over any time horizon
- For any confidence level
- For any liability subset (eg when considering buy-ins or longevity swaps for a subset of the membership)

As well as quantifying risk, it also allows pension plans to determine their longevity assumptions using the same sophisticated techniques as used by insurers or reinsurers. This gives pension plans valuable insight into how a longevity swap or buy-in transaction is likely to be priced before approaching the market, and provides an objective measure of the 'economic value' of the liabilities against which the value for money of such transactions can be assessed.

Richard Willets
Director
Longevity Analysis Ltd.

LCP LifeAnalytics enables pension plans to determine their best estimate longevity assumptions using the same sophisticated modelling techniques used by insurers and reinsurers when pricing a buy-in, buy-out or longevity swap.

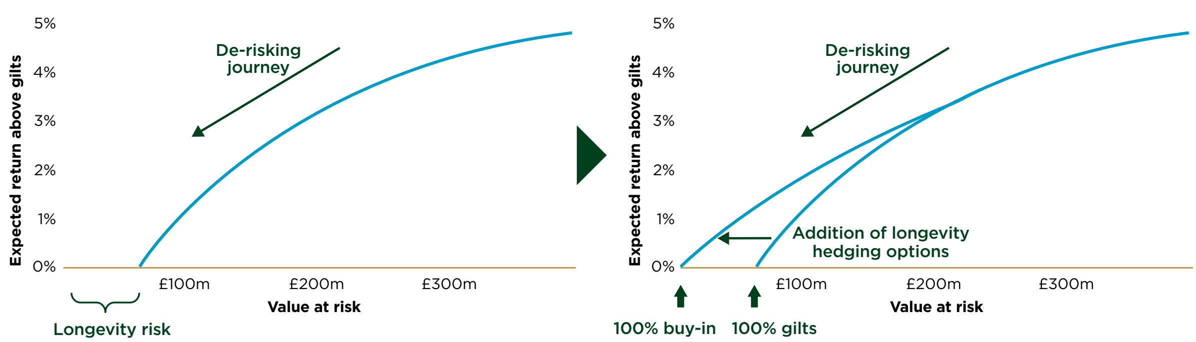
An integrated framework for de-risking decisions

LCP LifeAnalytics allows pension plans to measure longevity risk in a more sophisticated way than has previously been possible. A key advantage of this is that it enables pension plans to make better investment strategy decisions by adopting a more integrated approach to addressing longevity and investment risk.

The blue lines in each of the charts below show typical efficient frontiers – the maximum expected return from a portfolio of assets for a given level of risk. Pension plans on a de-risking journey will generally be aiming to reach the bottom left-hand side of this efficient frontier. The first chart shows a pension plan considering only assets that hedge financial risks, and the second chart includes assets (such as buy-ins or longevity swaps) that hedge longevity risk too.

The charts show that when buy-ins and longevity swaps are included, the pension plan is able to access a new efficient frontier closer to the bottom left-hand side of the chart. In other words, for a given level of expected return, the pension plan can access a lower risk position than a pension plan hedging only financial risks.

The addition of cost-effective longevity hedging options opens up a new range of optimal investment strategies for pension plans, similar to when LDI was first employed.



As investment risk is reduced, longevity hedging becomes necessary in order to ensure an optimal asset strategy on the efficient frontier.

Pension plans can remain on the efficient frontier by reducing longevity risk in parallel with other financial risks. Large and medium-sized pension plans in particular can take advantage of this by adopting a strategy of staged buy-ins or longevity swaps over time, in line with the approach adopted by the ICI and Philips pension funds (see page 15).

WORKING WITH INDUSTRY EXPERTS

LCP LifeAnalytics has been developed in conjunction with Richard Willets, Director of Longevity Analysis Ltd. Richard is a former chair of the CMI Projections Working Party and Executive Committee Member of the CMI. Richard has more than 15 years' experience of analysing the mortality experience of DB pensioners, including for a number of leading UK bulk annuity providers.

Michelle Wright
Partner
LCP

For the ICI and Philips plans it was optimal to hedge longevity through buy-ins. The blueprint strategy of phased de-risking works equally well for pension plans using buy-ins, longevity swaps or a combination of the two.

A de-risking blueprint for pension plans

For larger pension plans seeking to insure all their liabilities, a phased approach of buy-ins over time forms a flexible and cost-effective strategy. A series of buy-ins up to around £500m each will typically achieve very competitive pricing.

ADVANTAGES OF PHASED BUY-INS:

MORE EFFICIENT RISK REDUCTION

Longevity risk is steadily reduced in parallel with reducing financial risks

GREATER PRICE COMPETITION

More insurers compete at the under £500m size level

BETTER PRICING

For smaller buy-ins, the insurer has less transitioning risk moving to their preferred assets and so can price more attractively

OPPORTUNISM

Pension plans can move quickly to lock in pricing opportunities, especially where contractual documentation is already in place from existing buy-ins

THE APPROACH

- Establish a de-risking plan for longevity and financial risks that is integrated with the overall investment strategy
- Appoint a specialist who understands the market and desired approach and can work collaboratively with the scheme actuary and investment consultant
- Allow a period of preparation, including building relationships and credibility with insurers
  - Data cleansing and collection (eg marital information)
  - Careful documentation of benefit specification (including codification of trustee discretions)
  - Established governance framework designed to enable rapid and robust decision-making
- Consider required contractual terms early in the process

ICI PENSION FUND

6
TRANSACTIONS
Innovative umbrella contracts

PHILIPS

4
TRANSACTIONS
Phased de-risking: be buy-out ready

On the following pages are case studies for two LCP Trustee clients, the ICI Pension Fund and the Philips Pension Fund, who have used phased buy-in strategies to insure significant amounts of risk.

Innovative umbrella contracts

Case study: ICI Pension Fund

Background

The ICI Pension Fund is one of the largest and most mature DB pension plans in the UK.

- £10bn UK pension plan with c56,000 members
- 80% of liabilities are in payment with £500m of annual pension payments
- Broadly 95% hedged against interest rates and inflation
- Longevity identified as dominant risk

Initial transaction

The initial transaction in March 2014 comprised a £3bn buy-in with Legal & General and a £600m buy-in with Prudential. Both were collateralised and completed within six months of LCP's appointment.

The Fund was able to achieve scale and favourable pricing by carefully targeting liability subsets between insurers and by transferring a significant portfolio of credit assets that L&G wished to retain longer term. This also left the Fund with a more liquid residual investment portfolio.

The graphic below shows how LCP is working with the ICI Pension Fund to progressively insure longevity risk at attractive levels.

ICI PENSION FUND 1

Initial review

- Large £10bn pension plan
- Mature with £500m of annual pension payments
- Strategy to de-risk over time

UMBRELLA BUY-IN CONTRACTS 2

An innovative platform

- £3bn buy-in with L&G and £0.6bn with Prudential in March 2014 designed to achieve scale and favourable pricing
- Umbrella contracts permit additional buy-ins on the same terms and security arrangements

SEPTEMBER 2013

LCP appointment

MARCH 2014

£3.6bn buy-in
Legal & General and Prudential

Umbrella contracts

Umbrella contracts were put in place with both Legal & General and Prudential permitting the existing buy-ins to be extended with the same contractual terms and security arrangements.

The umbrella contracts allow the Trustee to move fast to take advantage of market opportunities when insurance pricing is favourable. This is supported by robust monitoring and governance processes to ensure future de-risking opportunities can be captured quickly and effectively.

Clive Wellsteed
Partner
LCP

This innovative umbrella contract structure, which is analogous to the framework used to document swaps and derivatives, is a first for the buy-in market.

Heath Mottram
Chief Executive
ICI Pension Fund

I have no doubt that the governance and execution structure has delivered additional value through improved pricing and added security for members.

BE READY TO MOVE 3

Price monitoring

- Regular pricing feeds from insurers on the Fund's own liabilities to identify opportunities
- Allows insurers to actively seek out investments that will deliver the best price for the Fund

TO THE FRONT OF THE QUEUE 4

Streamlined execution process

- Umbrella contracts facilitate execution of buy-ins in under three weeks
- Ease of execution makes the Fund a preferred transaction partner
- Locks in attractive pricing opportunities promptly as they arise

NOVEMBER 2014 — *£300m buy-in Prudential*

MARCH 2015 — *£500m buy-in Legal & General*

JUNE 2015 — *£500m buy-in Legal & General*; *£500m buy-in Prudential*

Over 50% of the Fund's total liabilities are now insured

Phased de-risking leading to full buy-out

Case study: Philips Pension Fund

Background

- £3.5bn UK pension plan with c30,000 members
- Mature plan: two thirds of liabilities in payment
- Nearly fully hedged against interest rates and inflation
- Complex benefit structure: long history with numerous amendments to trust deed and rules
- Three Trustee-led buy-ins completed in 2013/2014 as stepping stones towards full buy-out
- In September 2014, Philips announced a demerger to separate its lighting division and its healthcare and consumer lifestyle division which is due to complete in 2016
- Proposal from Philips in 2015 to make a substantial cash injection to facilitate a full buy-out with Pension Insurance Corporation

£1.1BN OF SUCCESSFUL BUY-INS: BE BUY-OUT READY

- High-standard "buy-out ready" contracts: residual risk cover (including data and benefits)
- Attractive pricing: all three buy-ins priced to generate funding surpluses when exchanged for gilts
- Liability subsets carefully chosen: residual population was no less attractive to insure than the whole profile

1 £484M BUY-IN

- "Large pension" pensioner subset
- Focus on residual risk cover

Rothesaylife

AUGUST 2013

2 £300M BUY-IN

- Subset of younger pensioners
- Focus on consistency with existing contract

PRUDENTIAL

JUNE 2014

3 £310M BUY-IN

- Cross-section of pensioners
- Mirror contract to transaction 2

PRUDENTIAL

SEPTEMBER 2014

Trustee initiatives advised by LCP

Myles Pink
Partner
LCP

LCP helped the Trustees to be a "go-to" pension plan: ideally positioned to seize pricing opportunities on strong terms through preparation, experience and relationships with insurers.

Initial review

- Decision to use buy-ins rather than longevity swaps as part of the broader de-risking plan (driven by investment strategy and time horizon)
- Identified optimal size and types of transactions
- Aligned investment strategy to a portfolio an insurer would wish to receive

Residual risks cover

Initial buy-ins included carefully structured protections:

- Protect members from any errors in data and benefit specification
- Suitable approach for GMP equalisation
- Ensure historical discretions and augmentations protected

Final transaction dove-tailed with the initial transactions to provide comprehensive risk removal for the Trustees and Philips

David Jordan
Chairman of Trustees
Philips Pension Fund

LCP worked with the Trustees to set a high bar for the first three buy-ins and helped us to actively engage with the full buy-out proposal from Philips to achieve the right outcome for our members.

£2.4BN FINAL BUY-IN 4

- Company proposal leading to full buy-out
- Covering all uninsured members
- Member options provided on a targeted basis ahead of buy-out

PENSION INSURANCE CORPORATION

CONSIDERING LONGEVITY SWAPS? **SEE PAGE 23** FOR HOW TO ENSURE THESE ARE BUY-OUT FRIENDLY

NOVEMBER 2015

LCP helped the Trustee respond to the buy-out proposal from Philips

DECEMBER 2015

Full settlement of liabilities following approx £225m corporate contribution

Member benefits insured in full

David Stewart
Partner
LCP

Over 2015 we have worked with clients both small and large to design longevity transfer solutions tailored to their objectives. The pace of innovation is showing no signs of slowing and most pensions plans will find there is a solution that can help them manage longevity risk.

CASE STUDIES

Longevity risk in financial institutions

Financial institutions have to hold capital against the longevity risk within their own DB pension plans. In the case studies on the following two pages we show how two financial institutions (Northern Bank Ltd and AXA) have taken different approaches to addressing longevity risk.

Case study: Northern Bank Pension Scheme

£680m collateralised pensioner buy-in with Prudential

FACTFILE

Background

- Bank-sponsored DB pension plan with assets of c£1.25bn
- Approx. 5,000 members (1,000 active; 2,000 deferred; and 2,000 pensioner)
- Open to accrual and rapidly maturing
- Young pensioner population (average age 62)
- Strong focus on de-risking
- c70% hedged against interest rates and inflation, but longevity risk not yet addressed
- CPI and RPI pension increases in payment

Objectives

- Reduce longevity and investment risks
- Enhance cashflow matching of pensioner liabilities
- Enhance member security
- Reduce volatility of pension risk capital requirement for Bank sponsor
- Value for money in pricing and terms
- Flexibility to insure new retirees on competitive terms

Approach

Collateralised buy-in

- A ring-fenced pool of assets held in the Trustee's name by its own custodian
- Prudential maintains excess collateral
- The Trustee has recourse to these assets in certain circumstances, for example should Prudential's financial position deteriorate beyond pre-defined triggers or should it fail to meet its obligations

Pension increase mismatch

- Whilst all RPI-linked increases were perfectly matched, to obtain better value for money the Trustee purchased fixed 2.5% pa pension increases where these would otherwise be subject to CPI capped at 2.5% pa
- The value of the over-insurance created when CPI is less than 2.5% in a year can be used to add new members to the policy, or the surplus cash refunded to the Trustee
- The policy has flexibility to move to CPI pension increases in future - eg when the market for CPI assets is more developed so offers better value

In brief

- Security structure to maximise protections for members' benefits and Bank sponsor
- Innovative provisions and flexibilities to add future retirees to the policy on efficient terms
- Carefully constructed pension increase mismatch to maximise value for money without creating additional risks for Trustee
- Reduced volatility of pension risk capital requirement for Bank sponsor

Case study: AXA UK Pension Scheme

£2.8bn captive longevity swap solution

FACTFILE

AXA UK £2.8BN

- £2.8bn longevity swap by AXA's UK pension plan
- Improved the risk management and capital position for AXA UK
- Longevity risk transferred to Reinsurance Group of America
- Structured using AXA's own insurance company as the intermediary
- This approach reduced cost versus using a third-party insurance intermediary

A captive longevity swap solution

- Few sponsors have their own UK insurer through which to write a reinsurance transaction, but they can instead use a captive insurer
- These are typically set up as Incorporated Cell Companies (ICCs) or Segregated Account Companies (SACs) based in jurisdictions such as Guernsey and Bermuda, which are subject to captive-friendly solvency rules
- It is relatively standard process to set up a captive insurer with the appropriate legal advice

LCP Explains

A common concern for pension plans contemplating a longevity swap is whether they will be able to pass it to an insurer if they decide to move to buy-in or buy-out. Murray Blake shares his top tips from the reinsurance industry for ensuring that your longevity swap is buy-in or buy-out friendly.

What is the issue?

Longevity swap contracts typically include portability clauses to facilitate future transfer to an insurer. However, if agreement cannot be reached, the pension plan may face costly penalties to unwind the swap.

Planning and preparation

- Set yourself clear de-risking objectives, so the strategy and circumstances for converting to a buy-in are understood
- Discuss the practicalities of converting the longevity swap to a buy-in and buy-out, so that insurer requirements are taken into account at the structuring stage

Structuring

- Structure the swap in a way that insurers will find convenient to price and take on
- Use of a dis-intermediated structure can simplify the conversion process by minimising the number of counterparties and potential costs

Dialogue

- Maintain regular dialogue with potential buy-in or buy-out insurers, as insurer views on counterparty exposures to different longevity swap providers may change over time
- Keep abreast of changes in your swap provider's circumstances that might make the swap difficult to transfer at an acceptable cost

Murray Blake
Consultant
LCP

Murray Blake has recently joined LCP's de-risking practice from Pacific Life Re where he completed longevity reinsurance transactions covering over £4bn of pension liabilities, including a dis-intermediated swap with the MNOPF.

Innovation by smaller pension plans

Whilst larger pension plans grab the headlines, there continues to be plenty of innovation for smaller pension plans as shown by these two case studies.

Case study: MIRA Retirement Benefits Scheme

£70m PPF-plus buy-out: putting members' interests first

FACTFILE

Background

- MIRA Ltd - the Motor Industry Research Association - was the sponsoring employer of the MIRA Retirement Benefits Scheme (MIRARBS) and participated in the Universities Superannuation Scheme (USS)
- The size of the pension obligations relative to the business was such that the trustee and MIRA concluded that a corporate restructuring was necessary to protect members' benefits
- Without a corporate restructuring the most likely outcome would be eventual company insolvency, with the pension plan falling into the PPF

Objective

- Secure benefits in excess of PPF compensation for all members, with the protections of a regulated insurance company

Chris Martin
Independent Trustee Services, a director of the MIRARBS Trustee

The robust insurance process, led by LCP, led to very competitive pricing and risk transfer. The alternative would have been to fall into a PPF assessment process, which would have prolonged the uncertainty, added to costs and so depleted the assets available to provide benefits to members.

Approach

Debt compromise and PPF-plus buy-out

- MIRA sold its business and assets to HORIBA, a Japanese company. The sale proceeds were divided between MIRARBS and the USS in agreed proportions.
- LCP conducted a buy-out insurance process simultaneously with the business sale process. The pension plan's share of the sale proceeds were used to enter into a £70m buy-out contract with PIC, securing benefits in excess of PPF compensation.
- Innovative price-lock mechanism using leveraged gilt funds to lock the buy-in price relative to the pension plan's assets plus expected sale proceeds. This provided certainty on the level of uplift that could be secured until the sales proceeds were received and the buy-out completed.
- The pension plan compromised the statutory debt due from the sponsor, which rendered the pension plan ineligible for the PPF but meant that the insurance contract with PIC could be entered into immediately.

In brief

When does a PPF-plus buy-out make sense?

- Where deficit contributions are potentially unaffordable for the sponsor
- Where the pension pension plan is preventing the company from raising investment or capital
- Where eventual insolvency appears otherwise inevitable

Case study: Visiocorp UK Limited Pension Scheme

£20m full buy-out in rapid timescale

FACTFILE

Background

- £20m pension plan
- Put in place a buy-out target and aligned assets to pricing
- LCP highlighted that buy-out was potentially affordable within contributions committed under the recovery plan
- In August 2014 the Trustees decided to use LCP's streamlined service to execute a full buy-out by the year-end

In brief

Streamlined service for buy-out

A key challenge for companies and trustees running a buy-out exercise is achieving competitive pricing and commercial terms for smaller transactions with certainty on costs.

Our streamlined service which specifically meets these objectives offers:

- Pre-negotiated contracts with insurers
- Certainty on professional fees (including legal advice from a leading lawyer firm, if desired)
- Streamlined process – by reducing the moving parts insurers are more willing to quote and offer competitive prices

This service is designed specifically for transactions up to £100m. It can also be used for larger transactions where trustees or sponsers wish to follow a more streamlined approach.

Approach

Preparation

The Trustees wrote to members to collect marital status information, which helped them price more accurately and competitively.

As easy as 1, 2, 3...

Streamlined process ensured three key meeting dates and milestones were agreed up-front, providing certainty to insurers. The resulting favourable engagement led to competitive pricing that achieved full buy-out within existing contribution commitments.

Price-lock

Price was locked to the plan's assets, to provide certainty that objectives would still be met at signing.

Efficient transaction

The Trustees completed the transaction within three months, seizing the attractive pricing available at that time.

Jacqueline Woods
Chairman of Trustee Board
Visiocorp UK Limited Pension Scheme

LCP's streamlined service provided a robust process within tight timescales and fixed fees that maximised insurer engagement and competitive pricing achieved.

SEP 2014	OCT 2014	NOV 2014	DEC 2014
Stage 1		*Stage 2*	*Stage 3*
Preparation	Invited insurers to quote on project	Price negotiation and selection	Signed contract and transferred assets to insurer

Conclusion

As the de-risking market continues to develop, it becomes ever more important to approach the market in the right way – doing so is worth many millions of pounds in terms of the final outcome.

Working closely with our clients, LCP is proud to have:

- been lead adviser (rather than associated in an ancillary role) on over 50% of all buy-ins and buy-outs over £100m in each of the last two years - see table below
- won six of the seven specialist de-risking awards since 2011 (Professional Pensions Risk Reduction Advisor of the Year and Financial Times De-risking Advisor for Buy-ins, Buy-outs and Longevity Swaps)
- has established the "specialist de-risking adviser" role - over 50% of transactions led by LCP are for clients where we had no prior relationship with the pension plan
- negotiated and structured buy-in and buy-out transactions for pension plans including General Motors, GlaxoSmithKline, ICI, Smith & Nephew, Tate & Lyle, Total, Trinity Mirror, Unilever and Warburtons

LCP does not manage assets or have products to sell – our sole aim is to provide unbiased advice to help each and every client make the right de-risking decision for them.

Number of buy-ins and buy-outs over £100m since 2010

Lead Adviser	2010	2011	2012	2013	2014	2015	Total
LCP	2	4	5	3	12	6	**32**
Mercer	1	2	2	4	1	1	**11**
Towers Watson	3	1	3	1	0	0	**8**
KPMG	2	1	2	1	0	1	**7**
Aon Hewitt	0	1	2	1	2	1	**7**
PwC	0	0	0	1	0	1	**2**
JLT	0	0	0	1	0	0	**1**
Xafinity	0	0	0	0	1	0	**1**
Undisclosed	n/a	n/a	0	2	5	2	**9**
Total	**8**	**9**	**14**	**14**	**21**	**12**	**78**

Source: Insurers and public announcements. Includes all disclosed transactions up to Q3 2015 and announced transactions up to 30 November 2015.

If you would like any further information about how LCP can assist you with the challenges facing your pension plan, please get in touch.

SPECIALIST
DE-RISKING
ADVISER

Over 50% of transactions

LCP selected as specialist de-risking adviser, where no prior appointment existed.

Appendices

Chris Martin
Managing Director
Independent Trustee Services

We appointed LCP as specialist de-risking consultant rather than the pension plan's long-standing incumbent advisers. This was a difficult decision, but absolutely vindicated by the quality and clarity of LCP's advice and the excellent result achieved.

Appendix 1: Buy-in and buy-out volumes by insurer

Insurer	Date of entry	Total size of transactions (£m) Q1 2014	Q2 2014	Q3 2014	Q4 2014	Total 2014	Q1 2015	Q2 2015	Q3 2015	Q4[2] 2015	Total 2015	Market share 2015
Aviva	May 2006	135	128	487	123	**874**	2	405	78	n/a	**485**	**5%**
Canada Life	February 2015	n/a	n/a	n/a	n/a	**n/a**	0	0	5	n/a	**5**	**0%**
Just Retirement	late 2012	37	50	25	330	**441**	93	161	104	269	**627**	**6%**
Legal & General	1986	3,051	82	228	2,607	**5,969**	644	501	92	n/a	**1,237**	**12%**
Partnership	February 2012	34	3	0	210	**247**	24	44	24	n/a	**92**	**1%**
Pension Insurance Corporation	October 2006	148	1,659	170	590	**2,567**	40	640	259	2,400	**3,340**	**34%**
Prudential	1997	730	300	376	300	**1,706**	0	1,174	320	n/a	**1,494**	**15%**
Rothesay Life	July 2007	259	325	305	510	**1,400**	0	675	1,600	n/a	**2,275**	**23%**
Scottish Widows	October 2015	n/a	n/a	n/a	n/a	**n/a**	n/a	n/a	n/a	400	**400**	**4%**
Total [1]		**4,394**	**2,547**	**1,591**	**4,669**	**13,203**	**804**	**3,600**	**2,482**	**3,069**	**9,955**	

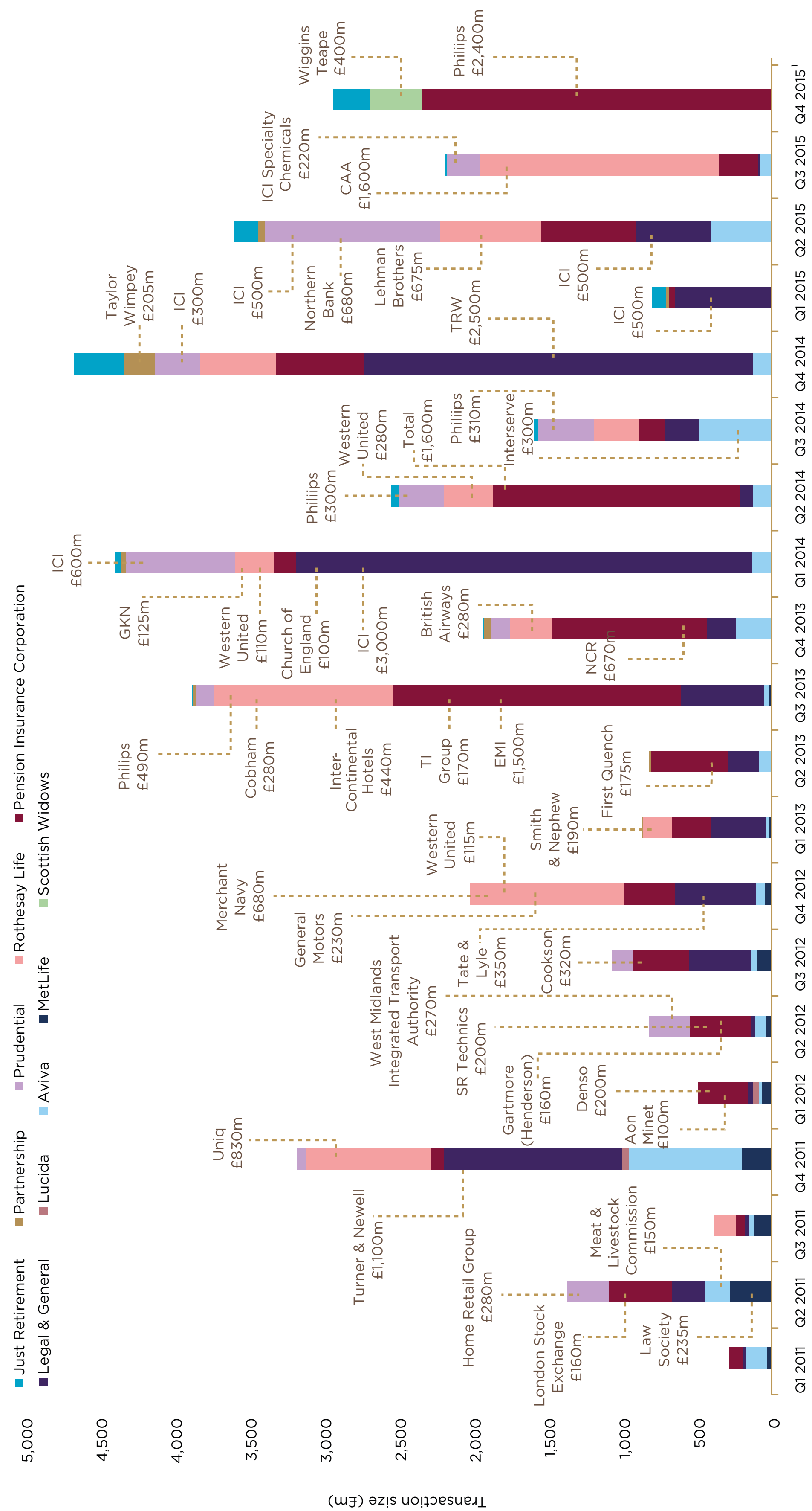
[1] Only business with a UK pension plan is included. [2] Q4 includes data published as at 30 November.
Notes: Rounding may mean that some numbers do not sum.

Appendix 2: Longevity swap volumes by UK pension plans

Sponsoring company	Date	Liabilities covered £m	Intermediary	Reinsurer (where disclosed)
RAC Pension Scheme	November 2015	600	Sponsor owned insurer	Scor
Heineken	September 2015	2,400	Friends Life (Aviva)	Swiss Re
AXA	July 2015	2,800	Sponsor owned insurer	Reinsurance Group of America
Scottish Power	February 2015	2,000	Abbey Life (Deutsche Bank)	Syndicate of reinsurers
MNOP	January 2015	1,500	Specially set-up captive	Pacific Life Re
Phoenix Group	August 2014	900	Sponsor owned insurer	Reinsurance Group of America
BT	July 2014	16,000	Trustee owned captive	Prudential Insurance Company of America
Aviva	March 2014	5,000	Sponsor owned insurer	Swiss Re / Munich Re / Scor
AstraZeneca	December 2013	2,500	Deutsche Bank	Syndicate of reinsurers
BAE Systems	December 2013	1,700	Legal & General	Hannover Re / Reinsurance Group of America
Carillion	December 2013	1,000	Deutsche Bank	Syndicate of reinsurers
Bentley Motors	May 2013	400	Abbey Life (Deutsche Bank)	undisclosed
BAE Systems	February 2013	3,200	Legal & General	Hannover Re
Liverpool Victoria Friendly Society	December 2012	800	ReAssure (Swiss Re)	Swiss Re
AkzoNoble	May 2012	1,400	ReAssure (Swiss Re)	Swiss Re
British Airways	December 2011	1,300	Rothesay Life	Pacific Life Re
Pilkingto	December 2011	1,000	Legal and General	Hannover Re
Rolls-Royce	November 2011	3,000	Deutsche Bank	Syndicate of reinsurers (including Scor)
ITV	August 2011	1,700	Credit Suisse	Pacific Life Re / undisclosed
Pall	January 2011	70	J P Morgan	undisclosed
British Airways	July 2010	1,300	Rothesay Life	Pacific Life Re
BMW	February 2010	3,000	Abbey Life (Deutsche Bank)	Hannover Re / Pacific Life Re / Partner Re
Local government	December 2009	750	ReAssure (Swiss Re)	Swiss Re
Babcock International	December 2009	300	Credit Suisse	Pacific Life Re / Reinsurance Group of America / undisclosed
Babcock International	September 2009	350	Credit Suisse	Pacific Life Re / Reinsurance Group of America / undisclosed
RSA Insurance Group	July 2009	1,900	Rothesay Life	Pacific Life Re / undisclosed
Babcock International	June 2009	500	Credit Suisse	Pacific Life Re / Reinsurance Group of America / undisclosed
	TOTAL	**57,370**		

Source: Insurance company data, company press releases and member announcements to 30 November 2015.

Appendix 3: Buy-in and buy-out transactions since 2011



Notes: ¹ Q4 at 30 November 2015

Appendix 4: Buy-ins and buy-outs over £150m announced since 2008

Name	Size (£m)	Sector	Insurer	Date	Type	LCP lead adviser
ICI	3,000	Chemicals	Legal & General	March 2014	Pensioner buy-in	✓
TRW	2,500	Automotive	Legal & General	November 2014	Pensioner buy-out	
Philips	2,400	Technology	Pension Insurance Corporation	November 2015	Full buy-out	Trustee-side
Total	1,600	Oli and Gas	Pension Insurance Corporation	June 2014	Pensioner buy-in	✓
Civil Aviation Authority	1,600	Public	Rothesay Life	July 2015	Pensioner buy-in	
EMI	1,500	Music Entertainment	Pension Insurance Corporation	July 2013	Full buy-out	
Turner and Newall	1,100	Engineering	Legal & General	October 2011	PPF-plus buy-out	
Thorn	1100	Engineering	Pension Insurance Corporation	December 2008	Full buy-out	
Cable & Wireless	1050	Communications	Prudential	September 2008	Pensioner buy-in	Company-side
GlaxoSmithKline	900	Pharmaceutical	Prudential	November 2010	Pensioner buy-in	✓
Uniq	830	Food Producer	Rothesay Life	December 2011	PPF-plus buy-out	✓
Rank	700	Gambling	Rothesay Life	February 2008	Full risk transfer	
MNOPF	680	Shipping	Rothesay Life	December 2012	Full buy-in	
Northern Bank	680	Banking	Prudential	April 2015	Pensioner buy-in	✓
Lehman Brothers	675	Banking	Rothesay Life	May 2015	Full buy-out	
NCR	670	Technology	Pension Insurance Corporation	November 2013	Full buy-out	
ICI	600	Chemicals	Prudential	March 2014	Pensioner buy-in	✓
Undisclosed	535	Financial Services	Pension Insurance Corporation	April 2015	Full buy-out	✓
MNOPF	500	Shipping	Lucida	September 2009	Pensioner buy-in	
Cadbury	500	Food Producer	Pension Insurance Corporation	December 2009	Pensioner buy-in	
ICI	500	Chemicals	Legal & General	March 2015	Pensioner buy-in	✓
ICI	500	Chemicals	Prudential	June 2015	Pensioner buy-in	✓
ICI	500	Chemicals	Legal & General	June 2015	Pensioner buy-in	✓
Philips	484	Technology	Rothesay Life	August 2013	Pensioner buy-in	✓
Delta	450	Engineering	Pension Insurance Corporation	June 2008	Pensioner buy-out	
InterContinental Hotels	440	Hotels	Rothesay Life	August 2013	Full buy-out	
Powell Duffryn / PD Pension Plan	400	Engineering	Paternoster (now Rothesay Life)	March 2008	Full buy-out	
Wiggins Teape	400	Paper Manufacturing	Scottish Widows	November 2015	Pensioner buy-in	
CDC	370	Public	Rothesay Life	November 2009	Pensioner buy-in	
Undisclosed	370	Unknown	Rothesay Life	Q4 2014	Full buy-out	
Friends Provident	360	Financial Services	Aviva	April 2008	Pensioner buy-in	
Tate & Lyle	350	Food Producer	Legal & General	December 2012	Pensioner buy-in	✓
Undisclosed	340	Unknown	Legal & General	July 2013	Deferred buy-in	
Alliance Boots	320	Pharmaceutical	Pension Insurance Corporation	June 2010	Full buy-out	
Cookson	320	Engineering	Pension Insurance Corporation	July 2012	Pensioner buy-in	
Philips	310	Technology	Prudential	September 2014	Pensioner buy-in	✓
Aggregate Industries	305	Mining	Pension Insurance Corporation	February 2010	Pensioner buy-in	✓
Philips	300	Technology	Prudential	June 2014	Pensioner buy-in	✓
Interserve	300	Construction	Aviva	July 2014	Pensioner buy-in	✓
ICI	300	Chemicals	Prudential	November 2014	Pensioner buy-in	✓
Undisclosed	300	Unknown	Aviva	June 2015	Pensioner buy-in	
Home Retail Group	280	Retail	Prudential	June 2011	Pensioner buy-in	✓
Cobham	280	Aerospace & Defence	Rothesay Life	July 2013	Pensioner buy-in	

Appendix 4: Buy-ins and buy-outs over £150m announced since 2008

Name	Size (£m)	Sector	Insurer	Date	Type	LCP lead adviser
Western United	280	Food Producer	Rothesay Life	June 2014	Full buy-out	
West Midlands Integrated Transport Authority	270	Transport	Prudential	April 2012	Pensioner buy-in	
BBA Aviation	270	Aviation	Legal & General	April 2008	Pensioner buy-in	
Undisclosed	255	Unknown	Legal & General	January 2013	Full buy-in	
TI Group / Smiths Group	250	Engineering	Legal & General	March 2008	Pensioner buy-in	
TI Group / Smiths Group	250	Engineering	Paternoster (now Rothesay Life)	September 2008	Pensioner buy-in	
Undisclosed	250	Media	Aviva	December 2011	Pensioner buy-in	✓
Undisclosed	250	Unknown	Legal & General	August 2012	Pensioner buy-in	
Law Society	235	Legal	MetLife	June 2011	Full buy-out	
General Motors	230	Vehicle Manufacturing	Rothesay Life	October 2012	Full buy-out	✓
Pensions Trust	225	Charities	Paternoster (now Rothesay Life)	July 2008	Pensioner buy-in	
Leyland DAF	225	Vehicle Manufacturing	Pension Insurance Corporation	January 2009	Full buy-out	
Undisclosed FTSE 250	220	Unknown	Legal & General	June 2010	Unknown	
Undisclosed	220	Retail	Legal & General	March 2009	Pensioner buy-in	✓
Undisclosed	220	Unknown	Pension Insurance Corporation	November 2013	Full buy-out	
ICI Specialty Chemicals	220	Chemicals	Prudential	August 2015	Pensioner buy-in	✓
Aon	210	Financial Services	Pension Insurance Corporation	October 2014	Pensioner buy-in	
Taylor Wimpey	205	Housebuilding	Partnership	December 2014	Pensioner buy-in	
Denso	200	Automotive	Pension Insurance Corporation	March 2012	Full buy-out	
SR Technics	200	Aviation	Pension Insurance Corporation	April 2012	PPF-plus buy-out	
Undisclosed	200	Undisclosed	Pension Insurance Corporation	November 2014	Pensioner buy-in	✓
Smith & Nephew	190	Medical	Rothesay Life	January 2013	Pensioner buy-in	✓
Undisclosed	190	Unknown	Pension Insurance Corporation	August 2015	Full buy-out	
Makro	185	Retail	Rothesay Life	August 2014	Full buy-out	✓
Undisclosed	185	Banking	Aviva	December 2010	Pensioner buy-in	
M-Real Corporation	180	Paper Manufacturing	Legal & General	March 2008	Full buy-out	
First Quench	175	Retail	Pension Insurance Corporation	April 2013	Full buy-out	✓
TI Group / Smiths Group	170	Engineering	Pension Insurance Corporation	September 2013	Pensioner buy-in	
Undisclosed	170	Undisclosed	Pension Insurance Corporation	April 2011	Full buy-out	✓
Undisclosed	170	Unknown	Pension Insurance Corporation	July 2014	Full buy-out	
Gartmore	160	Financial Services	Pension Insurance Corporation	April 2012	Full buy-in	✓
Morgan Crucible	160	Engineering	Lucida	March 2008	Pensioner buy-in	✓
London Stock Exchange	158	Financial Services	Pension Insurance Corporation	May 2011	Pensioner buy-in	
Ofcom	150	Public	Legal & General	July 2008	Pensioner buy-in	✓
Dairy Crest	150	Food Producer	Legal & General	December 2008	Pensioner buy-in	
Dairy Crest	150	Food Producer	Legal & General	June 2009	Pensioner buy-in	
Aon Pension Scheme	150	Financial Services	MetLife	June 2009	Pensioner buy-in	
Meat & Livestock Commission	150	Food Producer	Aviva	June 2011	Pensioner buy-in	
TI Group / Smiths Group	150	Engineering	Rothesay Life	September 2011	Pensioner buy-in	

Source: Insurance company data, company press releases and member announcements to 30 November 2015

Notes

Notes

Notes

Unless otherwise specified, the source of information provided in the report is data provided by insurance companies and LCP research.

For further copies of the report, please download a PDF copy from our website www.lcp.uk.com/deriskingreport or email enquiries@lcp.uk.com or contact Nelly Geudin on +44 (0)20 7432 6710.

LCP INSIGHT CLARITY ADVICE

LCP pensions de-risking 2015

Buy-ins, buy-outs and longevity swaps

Clive Wellsteed
Partner
clive.wellsteed@lcp.uk.com
+44 (0)20 7432 6651

Charlie Finch
Partner
charlie.finch@lcp.uk.com
+44 (0)20 7432 0625

Myles Pink
Partner
myles.pink@lcp.uk.com
+44 (0)20 7432 3067

Michelle Wright
Partner
michelle.wright@lcp.uk.com
+44 (0)20 7432 3073

David Stewart
Partner
david.stewart@lcp.uk.com
+44 (0)1962 872785

Ken Hardman
Partner
ken.hardman@lcp.uk.com
+44 (0)20 7432 6629

Ian Mills
Partner
ian.mills@lcp.uk.com
+44 (0)20 7432 6736

James Fermont
Partner
james.fermont@lcp.uk.com
+44 (0)20 7432 6762

#lcpderisking

LCP is a firm of financial, actuarial and business consultants, specialising in the areas of pensions, investment, insurance and business analytics.

Lane Clark & Peacock LLP
London, UK
Tel: +44 (0)20 7439 2266
enquiries@lcp.uk.com

Lane Clark & Peacock LLP
Winchester, UK
Tel: +44 (0)1962 870060
enquiries@lcp.uk.com

Lane Clark & Peacock Belgium CVBA
Brussels, Belgium
Tel: +32 (0)2 761 45 45
info@lcpbe.com

Lane Clark & Peacock Ireland Limited
Dublin, Ireland
Tel: +353 (0)1 614 43 93
enquiries@lcpireland.com

Lane Clark & Peacock Netherlands B.V.
Utrecht, Netherlands
Tel: +31 (0)30 256 76 30
info@lcpnl.com

Lane Clark & Peacock UAE
Abu Dhabi, UAE
Tel: +971 (0)2 658 7671
info@lcpgcc.com