

# Pension Insurance Corporation

Pension Risk Transfer Index  
Q2 2011



PENSION  
CORPORATION

# Highlights



# Highlights

---

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

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

## ■ Deficits continue to narrow

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

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

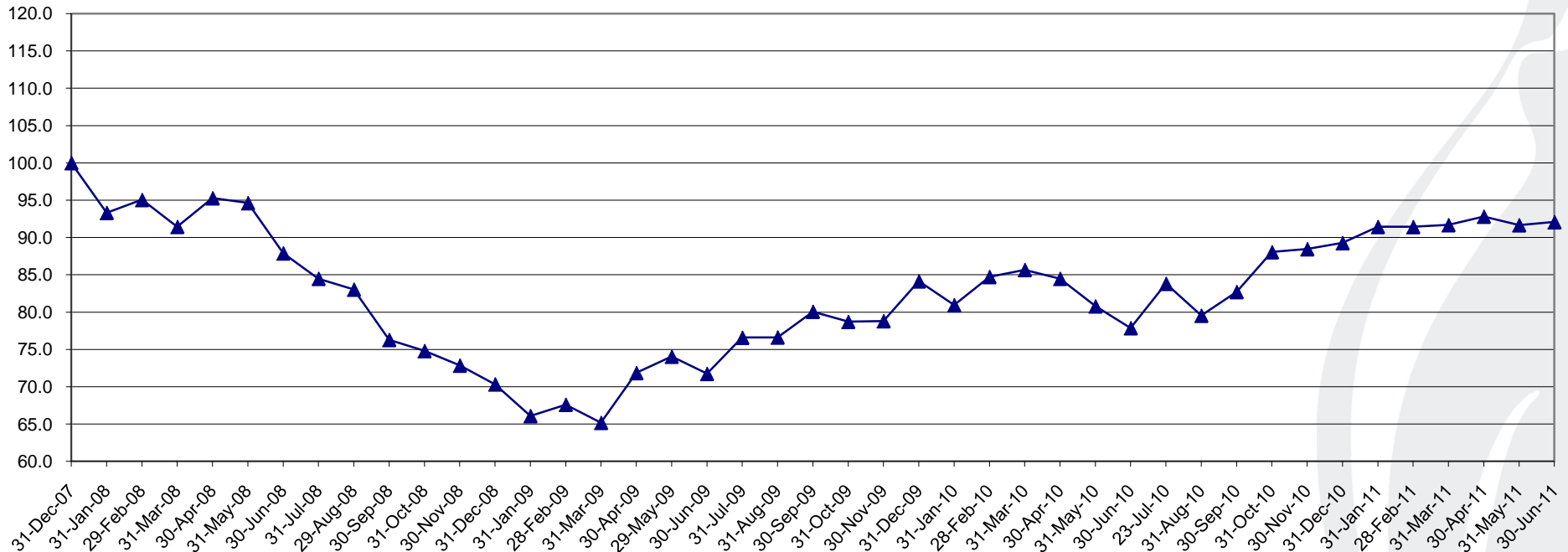
- ▶ In spite of recent market volatility trustees are more able than ever to derisk
- ▶ This is reflected in high levels of activity in the market, with pension funds with an aggregate £25 billion of liabilities looking to derisk
- ▶ Affordability for pensioner-only transactions continues to run at marginal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

# Pension Risk Transfer Index

# Overall affordability – scheme as a whole

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

## Overall affordability



### Key:

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

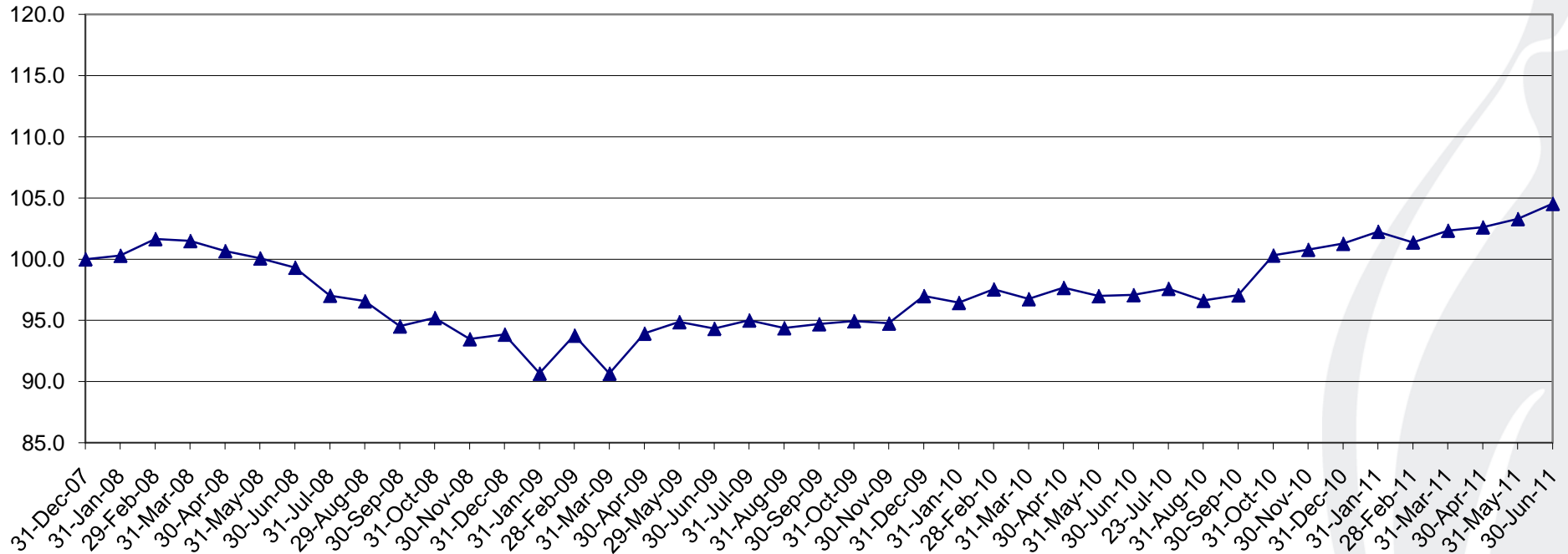
### Commentary:

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

# Overall affordability – pensioners only

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

## Overall affordability (pensioners only)



### Key:

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

### Commentary:

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

# Overall affordability – deferreds only

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

## Overall affordability (deferreds only)

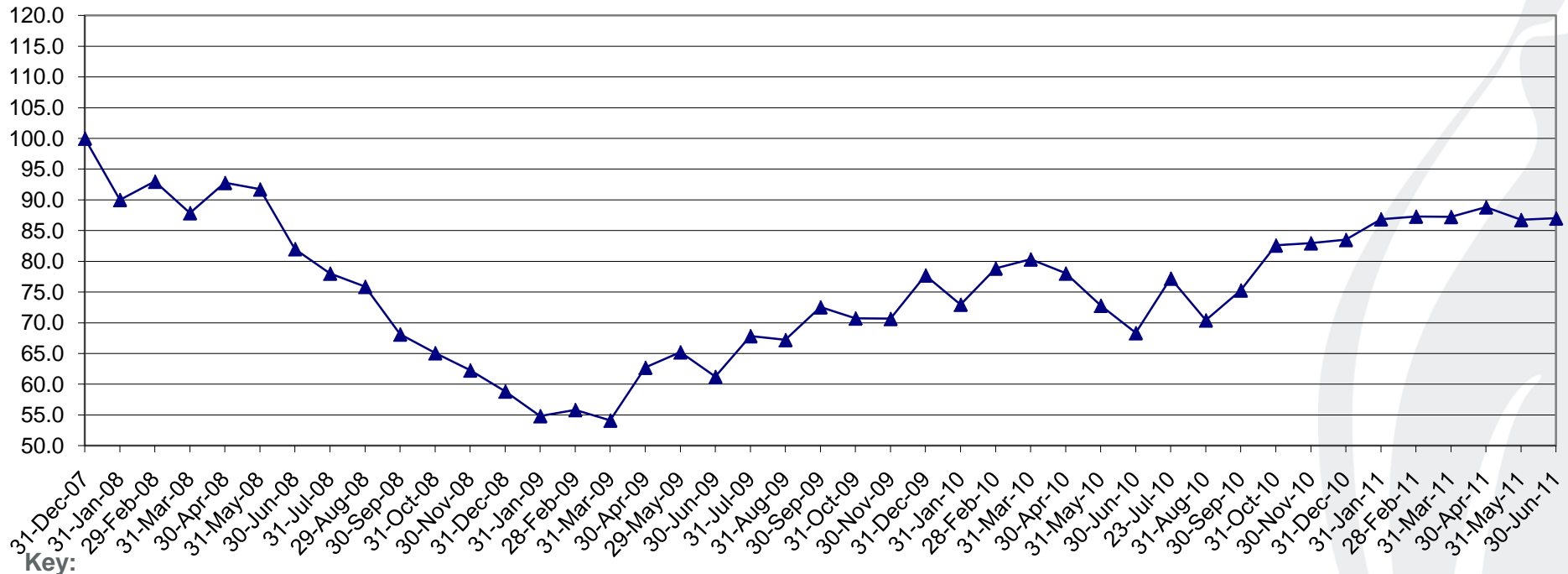


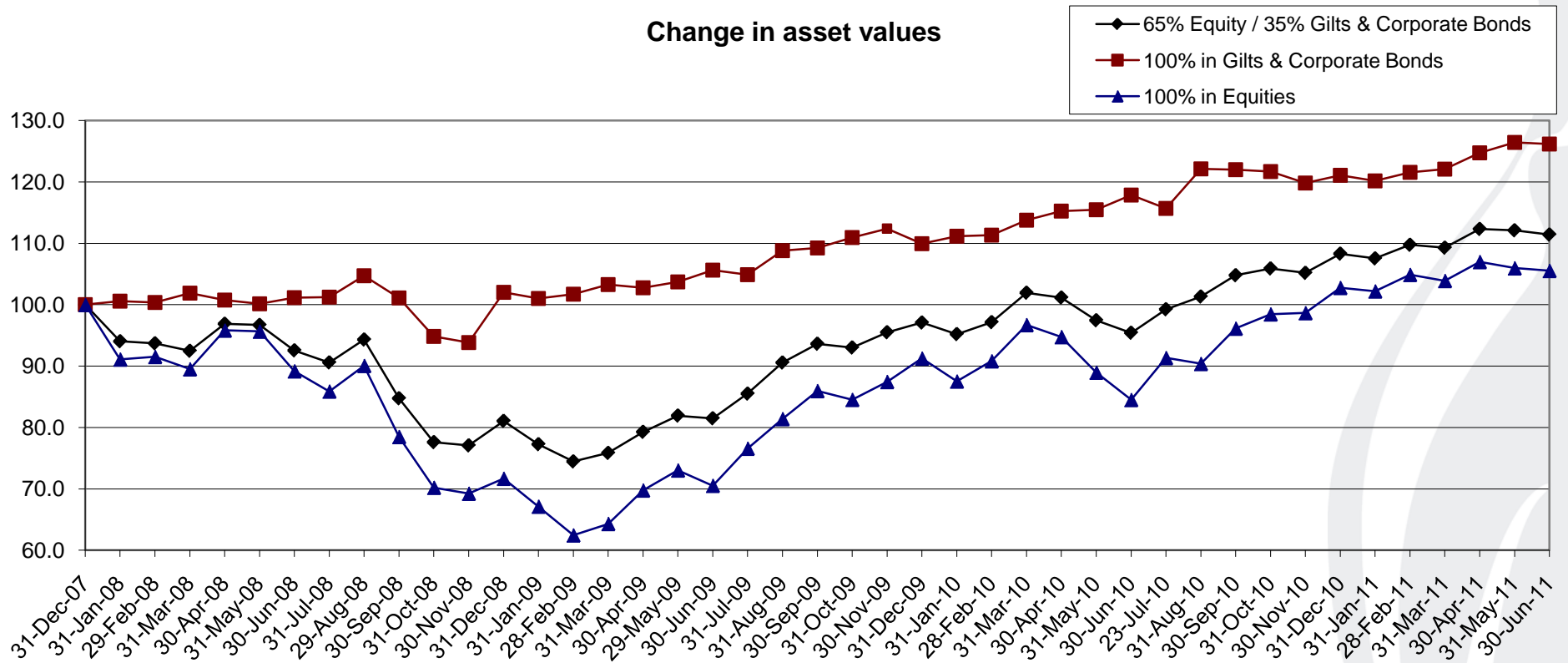
Chart shows 'overall affordability' for a scheme with deferred liabilities only and invested 100% in higher return-seeking investments, such as equities. 'Affordability' considers the cost of insuring the pension risk compared to the value of the assets held by the scheme. A higher value in the index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

### Commentary:

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

# Change in asset values

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



## Key:

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

## Commentary:

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



# Contact

---

Jeremy Apfel

Head of External Communications

+44 20 7105 2140

apfel@pensioncorporation.com

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, Pension Corporation, its members, employees and agents do not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.

'Pension Corporation' refers to the Pension Corporation LLP, Pension Insurance Corporation Limited and their affiliated entities

