

**SIAS Presentation: Tuesday 9<sup>th</sup> February 2010**

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# When Pensions and Insurance Collide

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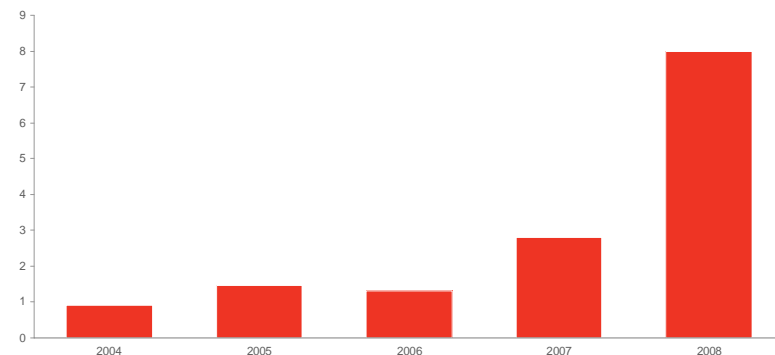
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# Introduction to the Pensions Insurance market

# Background

- Market growth from £1-2bn per annum to £5-8bn per annum
- More insurers competing for business
- Able to price on full swaps curve
- Emergence of PPF
- Pricing has improved relative to risk free
- Emergence of voluntary use of insurance by solvent funds
- Buy-ins growing in volume
- Resilience of insurance sector to credit crunch
- Impact of credit crunch on Pension funds

Volume of pensions buyout market 2004 - 2008



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# Why Insure?

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- **Insurance provides guarantees**
- **Basic reason for insuring:**
  - Remove all future liabilities
  - Hedge a volatile risk
- **Benefits of insurance:**
  - Pooling of risks, giving protection against extreme individual scheme experience
  - Access to a strict regulatory regime
  - Subject to additional layers of protection from “financial contract”
  - Access to insurers capital and free surplus as added protection for policyholders
  - Full time, dedicated and monitored management of assets and liabilities
- **If we re-designed pension provisions today....**

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## Pension vs. Insurance: The Debate

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# Asset Strategy

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- **Traditional Pension Scheme Approach**

- Diversified investment portfolio
- Manage inflation through real assets
- Long-term approach suited to liabilities
- Asset strategy consistent with employer covenant

- **Insurance Approach**

- Risk based capital
- Cash-flow matching
- Hedge duration and inflation risks through investment or capital
- Marked-to-market approach to capital resources

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# Valuation

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- **Traditional Pension Scheme Approach**

- Discount rate reflects longer term view consistent with duration of liabilities
- Prudence built into key assumptions
- Avoid frequent valuations to remove volatility in funding requirements

- **Insurance Approach**

- Captures reinvestment risk through lower discount rate
- Requirement to be solvent at **all times** therefore continuous solvency monitoring
- Real-time information allows effective and responsive risk management
- Pillar 1: sufficient to cover cost of providing benefits under all reasonable assumptions
- Pillar 2: to cover extreme events

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# Funding Deficits

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- **Traditional Pension Scheme Approach**

- Rely on sponsor to fund deficit under principle of long-term funding for long-term benefits
- Deficits do not need to be funded immediately allowing better management of overall scheme / sponsor entity
- A funding plan is created if a deficit occurs

- **Insurance Approach**

- Continual monitoring of funding position
- Not allowed to go into deficit – levels of capital to burn-through before benefits impacted
- Frequent external monitoring of solvency allows for quick response and attempts to avoid breach in capital requirements
- No reliance on corporate sponsor – risk management would dictate capital to cover credit quality of ‘sponsor’

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# Options

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- **Traditional Pension Scheme Approach**

- Treats all member in a ‘fair and appropriate’ manner
- Members earn benefits and share costs
- Trustees need to be able to exercise discretion in paying benefits so they can judge the merit of each claim

- **Insurance Approach**

- Clear rules on benefits being guaranteed
- Remove risk of anti-selection and cross-subsidies through individual policyholder assumptions
- Measure and monitor cost of providing “*discretionary*” benefits
- In a tightly managed interest rate & inflation pool, guaranteeing actuarial factors for any length of time carries risk and cost

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# Policyholder Protection

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- **Traditional Pension Scheme Approach**

- Prudent valuation of pension liabilities
- Sponsor covenant and funding plans
- PPF

- **Insurance Approach**

- Pooling of risks gives greater security for members
- Prudent valuation of liabilities irrespective of sponsor strength coupled with prudent approach on capturing future returns on assets
- Capital buffer gives added layer of protection
- FSCS

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## The Market: Now and in the future

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# What's happening in the market?

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- Developments in affordability
- Interest in large buy-ins growing
- Increase in PPF cases coming to market
- Longevity hedge interest growing now we have concrete transactions

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# What does the future hold?

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- Continued rise in demand
- Challenge for insurance sector to raise capital to meet expected demand
- Greater standardisation & liquidity in longevity risk transfer market
  - Leading to more capacity for capital and insurance markets to absorb longevity risk
  - Reducing cost of risks
- Solvency II – What impact will this have on the market?
- New pension insurance products?

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Questions?



**The Actuarial Profession**  
making financial sense of the future

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