

PENSIONS: FROM CRISIS TO OPPORTUNITY

BY BARRY RILEY



Once a cornerstone of compensation structures throughout the developed world, the private sector defined benefit (DB) pensions scheme is in steep decline. Although for most big employers this will be hugely welcome – DB schemes have hobbled the financial wellbeing of scores of plan sponsors and even whole sectors of industry – but the coming transformation will offer little immediate comfort to those still facing enormous pension deficits.

But help is on hand, at the right price. With pension sponsors and trustees now far more focused on asset/liability management, and with a far greater range of investment instruments available to them than ever before, the opportunities for the investment banks, specialist consultants and the new breed of buyout life companies to win new business are excellent. And with over £1trn of liabilities in defined benefit schemes available to be refinanced during the next few years in the UK alone, those opportunities could be immense.

Pensions: from crisis to opportunity is a comprehensive analysis of the development of the defined benefit pension market, of the enormous challenges facing the sector, and of the opportunities in this area for investment banks and other capital market specialists.

Key issues examined include:

- Market and regulatory developments that have shaped pension provision
- Risks facing defined benefit schemes and their restructuring options
- Investment strategies favoured by pension schemes
- Capital market solutions for the hazards of rising longevity
- Opportunities in a rapidly changing pensions environment for investment banks and other service providers.

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Unusually high investment returns on both equities and bonds in the 1980s and 1990s fuelled strong growth in funded occupational pensions across many developed countries. But the same boom encouraged a complacent attitude to risk, with funds being invested purely on the basis of return, not on any more sophisticated matching of assets and liabilities. This attitude changed in the wake of the solvency crisis triggered by the 2000-2003 bear market in equities.

A lot of valuable business is at stake. The existing powerful groupings within the pensions industry will not allow their businesses to be snatched away without a struggle and a highly competitive exchange between the various factions is to be expected. Actuarial firms, for instance, will try to build on their co-operative past relationships with sponsors; investment consultants will seek to deliver more ambitious portfolio strategies to their pension trustee clients, including derivatives-based structures and complex risk control approaches; asset managers will back away from promising unrealistic 'alpha', or market-beating investment return, and many are already offering comprehensive 'solutions' straddling both assets and liabilities. Meanwhile, the new buyout life companies offer the ultimate temptation – an opportunity for sponsors to get rid of the pension problem altogether.

Whoever wins out will need to take care they are not being handed a poisoned chalice. While the upside could be tremendous, longevity risk is notoriously difficult to model and manage, and the consolidators of the pensions sector will face considerable challenges if they are to avoid the problems that first brought the corporate sponsors to their door.

Pensions: from crisis to opportunity, an intelligence report from IFR, explores how the reconstruction of the British sector, worth some £1,200bn, is likely to develop, and what the implications will be for corporate plans on a worldwide basis. While focusing on UK pension provision, it also looks at significant developments elsewhere, notably the US and the Netherlands, and should be of interest to anyone involved in pension provision.

WHO SHOULD READ THIS REPORT?

- **Sponsors and trustees** saddled with pension scheme deficits and troubled by a variety of risks, together with conflicts of interest which, in the light of new regulations, can no longer be ignored;
- **Life insurance companies** seeking to persuade trustees to buy out scheme liabilities, allowing the companies to control the assets within a framework set by insurance regulations;
- **Investment bankers** aiming to deal more directly with pension schemes (and even gain control of them) and make use of their capital market skills to achieve the benefits promised to scheme members more efficiently (and potentially more profitably for the banks);
- **Asset managers** seeking to adjust to the newer, risk-controlled strategies required by today's trustees and sponsors, and hoping to avoid the worst of the damage that may result from the consolidation of the pensions industry
- **Entrepreneurial operators** who may be able to exploit particular situations (involving mergers and other deals, for example) in order to innovate, outsourcing specialist functions where necessary;
- **Service providers** such as **actuaries, investment consultants** and **lawyers**, who face the challenge of survival within a pensions industry entering a phase of upheaval.

Featuring additional contributions from:

Mark Wood, chief executive of the Paternoster buyout company

Jeremy Stone, corporate financier at Rothschild and chairman of the W.H. Smith pension scheme

John Ralfe, independent pension consultant, former head of corporate finance at Boots from 1991 to 2002

Phil Page, client manager, Cardano, one of the new breed of specialist consultants

ABOUT THE AUTHOR

Barry Riley is a financial journalist who spent 34 years at the Financial Times, where his job titles included Financial Editor and Investment Editor. He was editor of the Lex column in the late 1970s and early 1980s and subsequently for many years he wrote a weekly column on investment matters called *The Long View*, which appeared on Saturdays. In his later years he was an associate editor of the paper.

Taking early retirement at the end of 2001, aged 59, he subsequently pursued a freelance career, continuing to contribute regularly to the FT in the FTfm section on Mondays but also for other publications. These included *Financial News*, for which he wrote on a wide variety of financial market topics, including regulation, financial aspects of politics and the credit boom and bust, until 2007, and *Money Observer*, in which he has advised readers on personal investment strategy.

He has contributed articles to the privately-circulated publications of a number of financial companies including the wealth managers Rathbone Brothers, the Royal Bank of Canada Capital Markets and the pension fund managers SEI. He has also given lectures in London, Edinburgh and New York on the history of fund management for the Stewart Ivory Foundation, a Scottish educational charity.

During the 1990s he was for several years a trustee director of the Pearson Pension Plan. Until 2007 he continued as a member of the Plan's investment committee, serving a total 14-year period monitoring a wide variety of investments including equities, bonds, private equity and hedge funds in a portfolio recently totalling some £1.5 billion.

After taking a long active interest in the pensions sector, both as a journalist and a trustee, he was appointed an honorary fellow of the Institute of Actuaries in 2000. In 2007 he was also appointed an honorary fellow of the CFA Society of the UK.

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CONTENTS

C01 Overview

The quality of the promise
 Defined benefit under pressure

C02 How we arrived here

The first state pensions
 Workers gain more bargaining power
 Surviving the 1974 bear market
 Rising longevity becomes expensive
 Controversy among the actuaries
 Another Pensions Act

C03 A statistical summary

C04 Sponsors and solvency

The approach to funding
 Pioneering US legislation
 The objectives of the accountants
 Actuaries versus accountants
 Governance issues
 Risk-related regulation
 Impact on credit ratings
 Flexibility versus security
 Sponsors in conflict with trustees

C05 Risks of defined benefit schemes

Financial Assistance Scheme
 Investment risk
 Interest rate risk
 Inflation risk
 Longevity risk
 Political risk
 Regulatory risk
 PPF risks
 Trustee risks
 Standard & Poor's
 Competitive risks

C06 Opportunities for investment banks

The control of absolute risk
 Dealing with the Pensions Regulator
 The roles of investment banks
 Pressures on the investment banks
 Derivatives
 Bond yields
 Inflation hedges
 Equity derivatives
 The image of investment banks

C07 Options for restructuring

The pension haves and have-nots
 A search for options
 Example 1: BAE Systems
 Sharing of risk
 Example 2: British Airways
 Example 3: Co-operative Group
 Example 4: Barclays Bank
 Public sector pensions may be unaffordable too
 Example 5: Royal Mail

C08 The buyout option

The 'with-profits' parallel
 Regulatory inconsistencies
 Longevity factors can create distortions
 Cross-border regulatory issues
 Caution over the Boots precedent
 Responses to the M&A factor
 Buyouts versus the opportunists
 Waiting for favourable conditions
 Some of the buyout contenders
 Defined benefit pension scheme risk transfer: the new market establishes itself
 Cost issues
 Is buyout cheaper now?
 Financial security for scheme members
 Economies of scale
 Market size
 Advantages to sponsors

C09 Asset managers

The styles largely ignored risks
 Cheap and cheerful tracker managers
 Death of the balanced style
 Managers of managers
 The challenge of low market beta
 The objectives of LDI
 Scope in the defined contribution sector
 The need for decumulation products
 Alternative asset classes
 Derivatives: vital but also dangerous

C10 Consultants

Under new ownership
 Fitting within global HR giants
 Relationships with investment banks
 The relentless search for 'alpha'
 The long-term scope for consultants
 Looking at 401(k) experience in the US
 Default and lifestyle strategies
 Facing the advice vacuum
 A view from the Trustee

C11 The new contenders

Differences between life and pensions
 Varied approaches to pensions restructuring
 Some examples of the new entrants
 Pension Corporation
 Occupational Pensions Trusts
 PensionsFirst
 Aleva Advisor
 Insurance sector entrants
 BrightonRock Insurance
 Tactica Assurance
 Corporate finance entrants
 Penfida Partners
 Gazelle

C12 Longevity risk

Hedging longevity risks

Pension schemes have important differences
 The Continuous Mortality Investigation
 Building a derivatives market
 The reinsurance route
 Attracting in buyers and sellers
 The precedent for a longevity bond issue
 The huge volume of longevity risk
 There is potential but it will take time
 Incentives to target longevity risk

C13 The long-term provision of pensions

An opportunity for product providers
 From collective to individual
 Turner and the NPSS
 The means-testing obstacle
 The inadequacy of 8% contributions
 Life companies fear subsidised competition
 Investment options in DC schemes
 Dealing with the mis-selling factor
 Annuities and the Treasury

C14 What will happen during the next two or three years?

Key examples of current risks
 Financial volatility
 Accounting changes
 Political pressures
 Beneficiaries of upheaval
 Squeezing out the retail sector
 Developments in decumulation
 Some final observations on the public sector

TABLES AND CHARTS

- T3.1:** Pension fund assets as at end-2006
- T3.2:** Number of active members of occupational pension schemes 1953–2006
- T3.3:** Number of pensions in payment 1953–2006
- T3.4:** Pension schemes by foundation date
- T3.5:** Employer contributions
- T3.6:** More contribution levels
- T3.7:** Employer concern at the regulatory environment
- T3.8:** Overall funding levels
- T3.9:** Asset allocation
- T3.10:** The top 500 asset managers 2006
- T4.1:** Overall funding levels at end-March 2007 (Ebn)
- T7.1:** Anticipated future changes in pension schemes
- T9.1:** Evolution of the 'balanced' style
- T9.2:** Pension fund investment returns, 1980–1999
- T9.3:** UK leaders in balanced pension fund management – assets at end-2004 vs. end-1998
- T10.1:** The future pension and investment landscape
- T10.2:** Pension consultants
- T10.3:** The leading global passive managers
- T14.1:** Average total contributions to DC plans
- F3.1:** Recent solvency trends

