



Sovereign Annuities

IAPF Breakfast Briefing
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Background

- Scheme Funding Difficulties
 - Equity Underperformance
 - Pensioners Living Longer
 - Lower Interest Rates
- Balance of Risk between Actives & Pensioners
- High Irish Bond Yields
- Opportunity for Schemes



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Insurer's Perspective

- Traditional Annuities
 - Insurer retains full Credit Risk
- Sovereign Annuities
 - Balances market view of Credit Risk and Price



Interested Parties

- **Trustees**
 - Re-distribution of Risks between Members
 - Alternative to Benefit Reduction / Wind Up
- **Employer**
 - Opportunity to discharge a liability at a lower price
 - Pensioner Liabilities removed
 - Some Relief from Funding Standard
- **Members**
 - Alternative to Benefit Reduction / Wind Up
 - More Proceeds for Active Members



Scheme Example

Current Situation

Assets	200
Pension Liability	(180)
<u>Active Liability</u>	<u>(100)</u>
Deficit	(80)

Active Coverage 20%

Sovereign Annuity Use

Assets	200
Pension Liability	(130)
<u>Active Liability</u>	<u>(100)</u>
Deficit	(30)

Active Coverage 70%

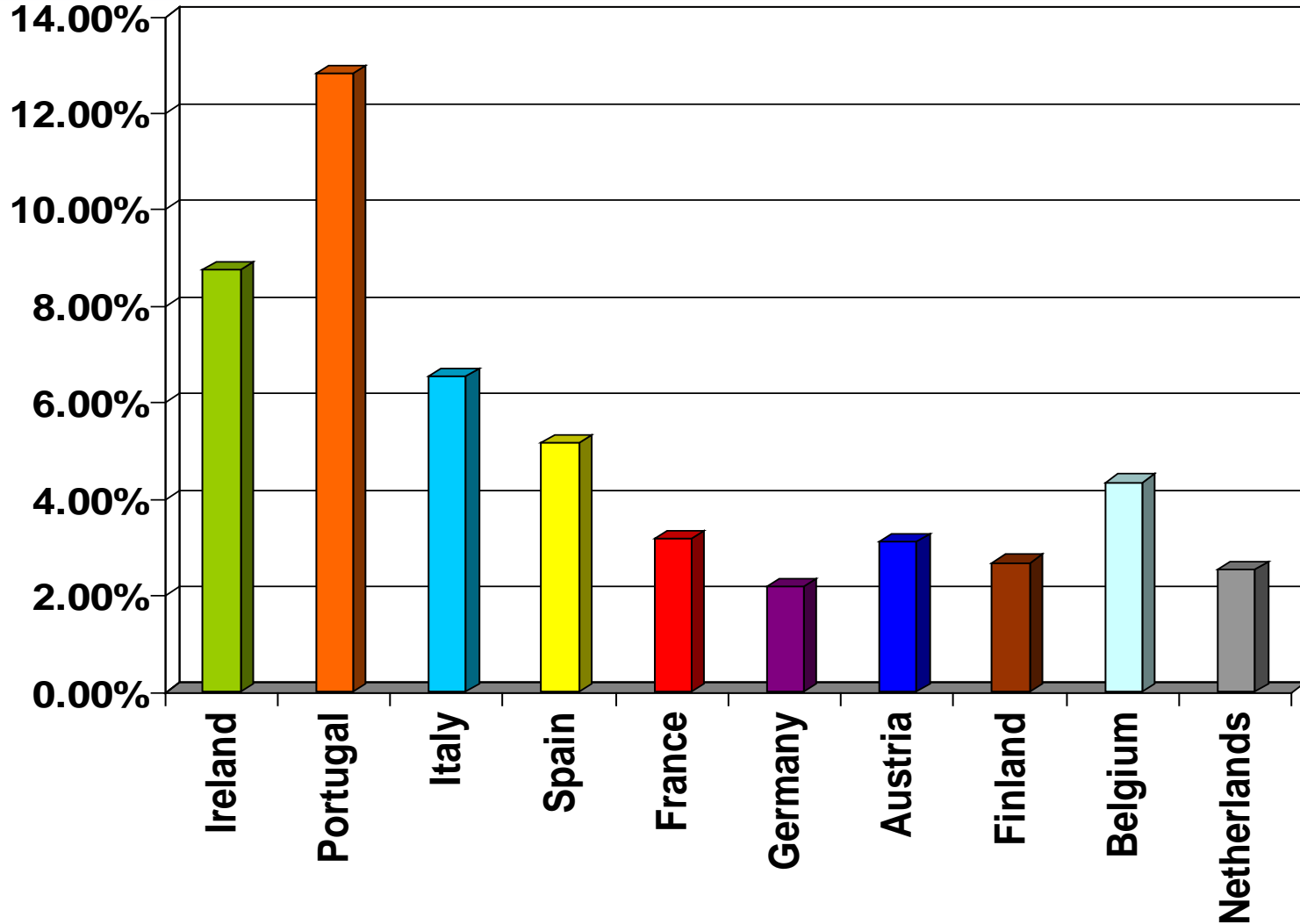


Risks

- Conditionality dilutes Pensioner Guarantee
- Transfer of Risk and Assets between Members
- How to achieve Equity between Members
- Market price for Risk is not always right
 - Bond Yield movement from 6% to 14% in last 15 months
 - Is there too cheap a price?

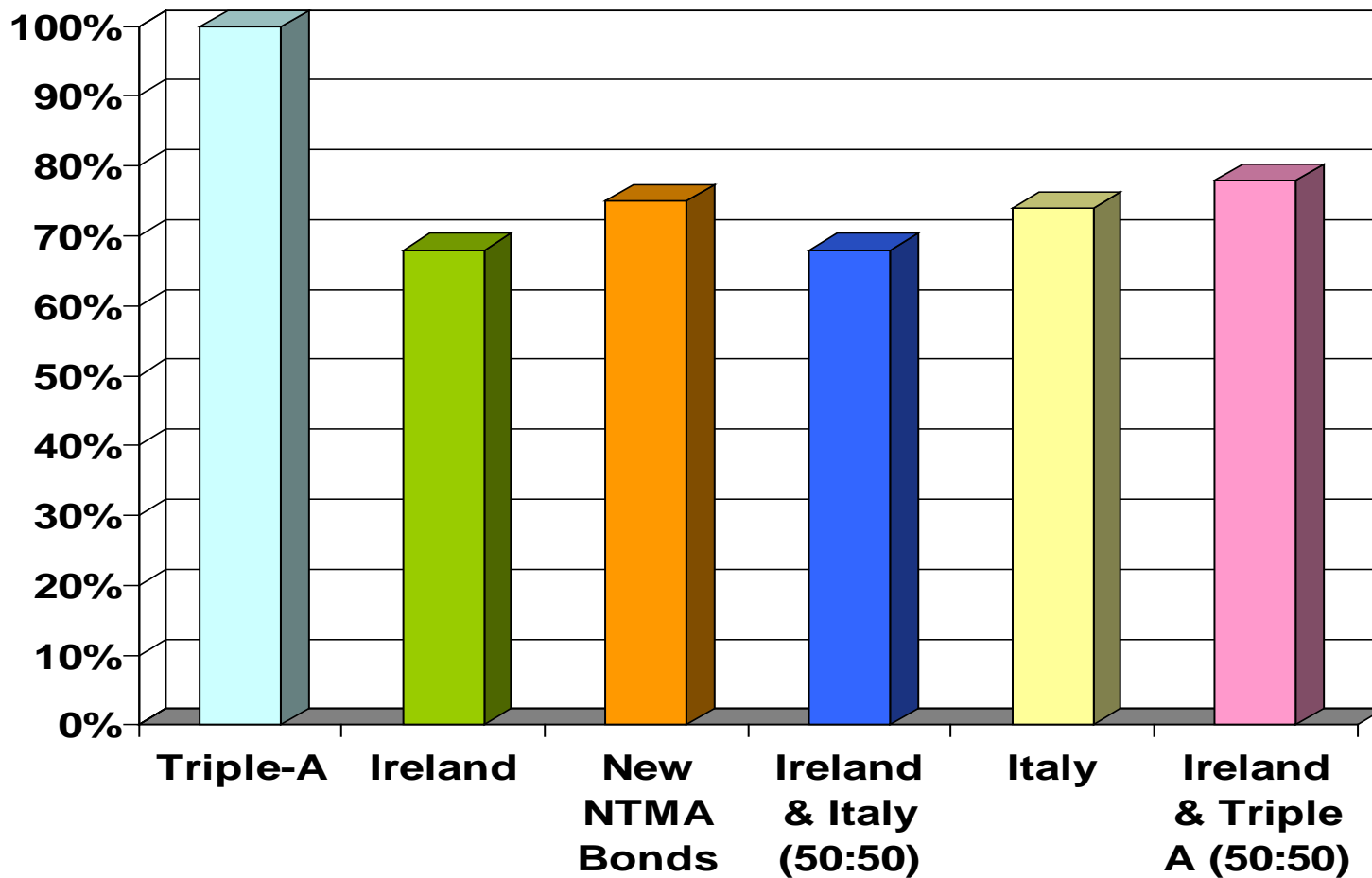


Bond Yields – 10 Yr Term





Estimated Savings





Non-Performance

- Definition of Non-Performance
- Two Approaches
 - Spread adjustment forward
 - Apply adjustment immediately
- Need to provide sufficient notice
- Subsequent Recovery allowed



Product Differentiators

- Price
- Conditionality on what Bonds
- What Percentage Conditionality
- Over what Term
- Calculation of Pension Reduction



Challenges for Insurers

Term of Current
Irish Bonds

Mis-match due
to schedule of
payments

Interest rate set
at outset
for non-
performance

Possibility of
Pension
Reductions

Volatility in
Euro Bond
Markets

Ensuring
Proper
Disclosure

Anticipating
how default
might look



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Conclusion

- Sovereign Annuities – a positive option
- But Challenges for Trustees
- Absolute Need for Clarity