Recent Media Comments 2006

DMO has 'no plans' for mortality bonds, by Jonathan Stapleton, Professional Pensions, 01-12-2006

The Debt Management Office has "no plans" to issue mortality bonds to help kick-start a planned market in longevity risk.

A spokesman for the agency that issues debt for the government told Professional Pensions that while it did not rule out issuing mortality bonds in the future, such a launch was not currently planned or under discussion.

The DMO has previously had informal discussions with asset managers, trustees, consultants and actuaries about issuing such a bond but said that any issue would involve a "significant" risk transfer to government and could increase financing costs.

Its denial came after *PP* revealed that a group of investment banks were set to launch a longevity risk market early next year (November 2).

Cass Business School professor of pension economics and Pensions Institute director David Blake – who has been preparing research papers to promote the start of a traded market in longevity risk – said that government issuance of longevity bonds would make a private sector longevity risk market much easier.

He said: "If the government issued longevity bonds to provide the same kind of mortality term structure as for nominal or real interest rates, then this might help to provide a kind of reference point.

"At the moment there is no market in longevity risk and if the government issued longevity bonds, this would help establish the riskfree mortality term structure and the private sector could come in and trade off that."

JPMorgan eyes new pension markets, By David Wighton in New York, Financial Times, Companies: The Americas, November 29 2006

JPMorgan Chase is working on plans to create a new securities market that will give pension schemes an easy way to lay off the risk that members will live longer than expected.

Other banks, including Deutsche Bank and BNP Paribas, are also rushing to develop new securities and derivatives to hedge so-called longevity risk, creating a new asset class some experts believe could one day outstrip the booming credit derivatives market.

Bill Winters, co-head of JPMorgan's investment bank, said: "We expect that many billions of dollars of pension liabilities will transfer to the capital markets in securitised, derivatised and raw form. We hope to be instrumental in developing those markets."

While previous efforts to create a market have had limited success, many pensions experts believe next year will finally see it start to take off.

David Blake, professor of pension economics at London's City University, forecast the new market would eventually outstrip credit derivatives, which have ballooned to $26,000bn. "The potential is enormous and it will start to happen very soon."

The area is attracting keen interest from hedge funds and Ed Giera, head of JPMorgan's pensions advisory group, said there was enough capital seeking to take positions on both sides of the longevity trade to create a market. The key to creating a liquid market has been to devise products that are sufficiently tailored to hedge the exposure of a particular scheme but sufficiently standardised to generate liquidity.

The products could be used both by pension funds to hedge longevity risk and by life insurers to hedge the opposite risk of unexpectedly high mortality.

Mr Giera said JPMorgan's approach was to use standard building blocks that could be combined to create tailored solutions. "We are working on an early set of transactions that will become an interesting model for others to look at." JPMorgan is hoping to set the pace in the new market as it did in credit derivatives in the 1990s. The market is expected to develop first in London, partly because of a favourable regulatory climate. In the US, pension schemes are more cautious about innovative use of capital markets because of prescriptive pensions legislation and the threat of class-action lawsuits.

A number of new vehicles have been formed in the UK in recent months to buy out frozen corporate pensions schemes and these will help drive the development of the new market, experts say.

The US has also seen the formation of the first such company. Called Retiree Benefits, it has backing from Cerberus and Lightyear, two private equity firms, and from Amaranth, the hedge fund that was brought to its knees by disastrous natural gas bets in September.

Pensions: The holy grail of the asset classes, By David Wighton, Financial Times, Special Report: Corporate Finance, November 29 2006

In recent years, financial markets have found ways to trade everything from the outcome of elections to the weather. But one risk has defeated the best minds in the business – the risk faced by pension funds that their members will live longer than expected.

“It is the holy grail,” says Dan Ozizmir, head of insurance-linked securities at Swiss Re. “It’s a risk facing everyone, not just insurers and pension funds but governments, corporations and individuals.”

Some industry experts believe the holy grail is at last in sight.

The sums involved are enormous. The amount exposed to longevity risk in the UK pensions industry alone was estimated at £2,500bn at the end of 2003, according to last year’s report by the Pensions Commission.

In the UK, a large part of the risk falls to companies through their defined benefit pension schemes. And as Lord Turner, chairman of the commission puts it, companies "want out of it".

Historically, the main option has been to transfer the risk of a closed scheme to an insurance company, using the pension fund's assets to buy annuities to pay the promised benefits.

As more companies have looked to take this route, a raft of new insurance vehicles have been set up in the UK to compete for the business with the traditional providers of such "bulk annuities", such as Prudential and Legal & General, as well as new entrants among established insurers. Most recently, Goldman Sachs announced plans to set up such a vehicle.

Some bankers say it is inevitable that the capital markets will also play a role in taking on longevity risk. Caitlin Long, head of the insurance solutions group at Credit Suisse, says: "Capital markets to trade longevity and mortality risk will develop soon. There is simply not enough capital in the life insurance industry to absorb the entire longevity exposure in pension plans."

It is likely that the new entrants will be keen to sell off some of their longevity risk into the capital markets. Lord Turner, who is a director of one the new vehicles, Paternoster, said it could at some stage be an issuer of liquid instruments carrying longevity risk.

Moreover, some established insurers are eager to reduce their exposure to longevity as they are to other risks.

Axa, the French insurer, is leading the way in the securitisation of insurance risks. Last November, it launched the first securitisation of motor policies with a €200m issue. Two weeks ago, it sold €345m of "mortality" bonds, which will default if mortality levels exceed a predefined mortality index.

The bonds, which help reduce the risk of a sudden rise in mortality caused, for example, by a pandemic, on Axa's life business, were four times subscribed.

David Blake, professor of pension economics at the London City University's Cass Business School, said this reception showed there was a healthy market for such products if correctly structured.

Mortality bonds – the opposite of longevity bonds, which rise in value as longevity increases – were pioneered by Swiss Re but have been relatively slow to take off.

Longevity bonds have been still less successful. BNP Paribas launched an issue in 2004 but the bonds flopped. Critics blame poor design and marketing, and the fact that they were too early. Now the proponents of longevity bonds, such as Professor Blake, believe the time has come. "I've been saying this for five years. But it really is going to happen very soon," he says.

Mr Ozizmir says he expects to see new longevity-based securities start to appear in the latter part of next year. Meanwhile, Deutsche Bank and BNP Paribas are working on "mortality derivatives", which allow investors to bet on death rates.

There are still plenty of sceptics who think the market will develop very slowly. They point to the fact that the mortality risks faced by life insurers and the longevity risks faced by pensions funds are far from symmetrical making it very hard to develop instruments that will net them off. In addition, the longevity risks faced by pensions funds vary significantly according to the make-up of the scheme, making it difficult for even a combination of securities to reflect those risks.

More fundamentally, say the sceptics, while everybody seems to want to get rid of longevity risk who wants to buy it?

After all, in recent years, it has been a one-way bet, with longevity steadily increasing, ahead of expectation, causing huge losses for the holders.

But Rob Procter, who with fellow former Morgan Stanley analyst Espen Nordhus, runs a London-based hedge fund, Securis Investment Partners, investing insurance risks, says there are now competing views about future longevity.

Their fund is part of the flood of hedge fund money looking for investments that are uncorrelated with leading financial markets.

Longevity risk represents a potentially huge new asset class. "There are plenty of people who want to be on the other side of the longevity risk if it is priced correctly," says Mr Procter.

But there's the rub, according to Julia Coronado, US economist at Barclays Capital in New York. She is sceptical that investors will offer a price that is sufficiently attractive for pension funds. She is particularly doubtful that much of a liquid market will develop in the US where longevity risk is less of an issue because fewer pension schemes have inflation-linked benefits. In addition, many companies are succeeding in transferring the risk to individuals by offering lump sum payout options. The regulatory climate also makes US pension schemes very nervous of innovation. Mr Ozizmir also believes that pricing remains a problem at the moment but says the longer term potential is clear. "It could be one of the largest asset classes in the world. But its going to take time."

London set for longevity risk boom, by David Wighton in New York and Gillian Tett in London, Financial Times, November 22nd 2006

London is set to become the centre of a potentially huge new global market in trading so-called "longevity" risk faced by pension funds, industry experts predict.

Leading investment banks and insurance companies are working on the design of new securities expected to be launched next year. The moves come as the pension industry is frantically looking for ways to meet its growing obligations.

David Blake, professor of pension economics at City University, forecast the new market would eventually outstrip credit derivatives, which have ballooned to $26,000bn. “The potential is enormous and it will start to happen very soon.”

The market is expected to start in London rather than New York partly because of a favourable regulatory regime. Analysts say prescriptive pensions legislation and the threat of class-action lawsuits make US pension schemes nervous of innovation.

This week, Hank Paulson, US Treasury secretary, warned the rule-based approach to regulation in the US was undermining the competitiveness of its capital markets.

Partha Dasgupta, head of the UK Pension Protection Fund, the statutory safety net for schemes, said the fund was encouraging investment banks to co-operate in designing the securities.

He is optimistic that a market will develop to allow pension funds to offload some of the risk that their members live longer than expected.

The new securities are likely to include variations of “mortality bonds” (whose value falls if deaths occur earlier than expected) and “longevity bonds” (which move the opposite way). Banks such as Deutsche Bank and BNP Paribas are working on so-called “mortality derivatives”.

The move comes as the pension industry is facing a growing asset-liability mismatch, partly because pensioners are living longer, and new accounting rules are encouraging companies to reduce their exposure to pension risks.

A wave of new insurance companies has been formed to take over UK corporate pension schemes and these are expected to have a more creative attitude towards managing risk than traditional pension trustees. At the same time, a flood of hedge fund money is looking for new investments. Hedge funds have piled into catastrophe bonds, which bet on natural disasters.

Rob Procter, a former Morgan Stanley analyst who now runs Securis Investment Partners, a hedge fund investing in insurance risk, said the buy-out vehicles would look to securitise some of their pension-related risk. “Financial buyers like us are interested in taking on the longevity risk.”

Changing attitudes mean there is more life left in longevity bonds, Financial Times, November 22nd 2006

The concept of longevity bonds is not new: bankers at BNP Paribas first launched the idea in 2004, after more than a year of working on the scheme.

But though the bonds were announced with great fanfare they did not found a single buyer. As a result, the bank stopped marketing them last year.

The main difficulty in meeting the longevity risk in this BNP Paribas plan was finding a counterparty that would take it on. The £550m of 25-year bonds were to have been issued by the top-rated European Investment Bank.

Annual coupon payments would be reduced over time from the base of £50m, reflecting the percentage of the population aged 65 in 2003 who had died by the coupon date.

So why didn't they sell? One key reason seems to have been the price. The cost of the longevity hedge, coupled with the top AAA rating of the borrower, meant the bonds yielded the equivalent of 35 basis points below London interbank offered rates.

Moreover, one banker who worked on the deal says the bond was launched at a time when many pension funds were still assessing their strategies. And many appear to have decided against using funded instruments such as longevity or index-linked bonds to hedge their risk.

Instead they were pursuing strategies that use unfunded hedges, such as interest rate and swaps, and then seeking higher returns with the funded portions of their portfolios.

Nevertheless, the timing for longevity and mortality bonds may now look better, as shown by the recent successful sale of the €345m Axa bond.

Pension funds are becoming more knowledgable and more willing to embrace innovation and there is also rising appetite for purchasing new risk products from the ever-expanding pool of hedge funds.

Death rates spark the birth of a new market, by Gillian Tett, Joanna Chung and David Wighton, Financial Times, November 22nd 2006

In this world – as Benjamin Franklin once said – "nothing can be said to be certain except death and taxes".

However, a third feature might be added to this list – the ability of bankers to create profitable arbitrage opportunities from these events. For after years of creating structures to handle tax, the financial industry is now turning its attention to the matter of death.

More specifically, some of the sharpest banking minds in London and New York are engaged in a race to create products that enable investors to place bets or hedge risks on death rates (or, to use the more tasteful phrase, "longevity risk".)

There are at least two factors driving this trend. One is that, as Detica consultancy recently noted, "the insurance and derivatives industries are beginning to converge".

Although derivatives were initially developed as a tool to manage interest rate and currency risks, financial engineers are now applying these techniques more broadly.

Deutsche Bank and BNP Paribas, for example, have recently been developing "mortality derivatives", which allow investors to bet on death rates.

Meanwhile, cash instruments are increasingly being used alongside synthetic techniques to spread insurance risk into the capital markets.

In recent years, there has been a wave of issuance of “catastrophe bonds” – a security that essentially allows an insurance group to offload part of the risk of a natural disaster to other investors, such as hedge funds.

And in a subtle modification of this technique, Axa, the French insurer, recently sold up to €1bn ($1.3bn) of “mortality bonds”, which reflect the risk of a sudden rise in death rates.

This concept was first pioneered by Swiss Re but the Axa deal marks the first time that a primary insurance group has sold such instruments to investors.

However, the second factor driving the “longevity” innovation, is the pension industry’s urgent need for better ways of handling risk.

With people in the Western world living longer – and conventional investment returns falling – many pension funds face a growing mismatch between assets and liabilities.

Some are trying to address this by raising their investment in long-dated fixed income instruments. In one sign of this, banks said they wanted more issuance of long-dated gilts in their latest consultation with the UK Debt Management Office.

This has affected asset prices. “As [pension fund managers] started to understand the [risk] issues, the prices of the instruments they needed to buy became extremely high earlier in the year,” says Keith Jecks, head of the pensions unit at ABN Amro, who points out that recent gains in equity markets have neverthless changed the picture recently.

This also prompts many bankers to look for alternative ways of managing risk. If a pension fund buys mortality bonds, for example, it can use this to hedge itself against the risk of an unexpected rise in the longevity of its pensioners.

Other “longevity bonds” are likely to be launched next year, which would have a similar effect in reverse.

Investment bankers are also scrambling to offer bespoke derivatives solutions to those running pension schemes, such as trustees (the officials overseeing a pension scheme).

“The trigger puller [for buying a product] is the Trustee. We can and indeed do speak to sponsors, but ultimately the trustee must be happy that any solutions work for the interests of the beneficiaries,” says Richard Boardman, head of Liability Driven Investments at UBS, which – like its rivals – is trying to sell its innovative ideas to trustees and pension consultants.

This sales job is not easy: trustees tend – as one banker notes – to “be very conservative” and thus wary of the derivatives world. As a result, earlier attempts to launch longevity bonds have failed.

In spite of the challenges, some bankers say it is inevitable that the capital markets will play a big role in taking on longevity risk.

Caitlin Long, head of the insurance solutions group at Credit Suisse, says: “Capital markets to trade longevity and mortality risk will develop soon. There is simply not enough capital in the life insurance industry to absorb the entire longevity exposure in pension plans.”

Meanwhile, **David Blake**, professor of pension economics at City University’s Cass Business School, who has been one of the most vocal proponents of longevity bonds, believes the market will start to take off in 2007.

“I’ve been saying this for five years. But it really is going to happen very soon,” he says.

TPAT eyes link with metropolitan archive, by Jonathan Stapleton, Professional Pensions, 16-11-2006

The Pensions Archive Trust is considering joining up with the London Metropolitan Archives to collate and preserve historical documents relating to the UK pensions industry.

The cross-industry group said the aim would be to establish the archive within the LMA’s existing facilities on Northampton Road in London. This is near City University with which the trust has been working closely, through its **Cass Business School.**

TPAT chairman Alan Herbert said the LMA was the second largest archive in the UK, with 79km of existing collections which include the archives of many businesses, charities and local authorities.

Herbert added: “These collections also hold a large untapped source of information relating to pensions which could be added to the new material on pensions coming to the LMA through TPAT.”

Herbert said the LMA would be able to provide the infrastructure and management expertise to support TPAT.

TPAT’s document collections would be stored in archive rooms run to national standards and would be catalogued onto the LMA’s special archive cataloguing software.

Herbert also said TPAT was in talks to produce a website for the archive in conjunction with the LMA.

The first collections it hopes to place at the LMA are those of The National Association of Pension Funds and of the late George Ross Goobey, the former pensions manager of the Imperial Tobacco Pension Fund who pioneered the cult of the equity in the 1950s.

TPAT and the LMA will be setting up a joint liaison group to take the proposals forward and to plan special events and activities around the pensions archive.

TPAT originally considered establishing the pensions archive in the library at City University but following a review of the project had decided to look at existing faclities in order to divert the savings on capital and running costs to meet the cost of digitising material for easier access to it on line.

The Pensions Archive Trust has been in planning since January 2003 when Herbert, a former head of pensions at BP, launched a steering group through PP. It was formerly incorporated as a company limited by guarantee in September 2005.

Investment banks set to launch longevity market, by Jonathan Stapleton, Professional Pensions, 2-11-2006

INVESTMENT banks are planning to launch a longevity risk market as early next year, *PP* can reveal.

Cass Business School professor of pension economics and Pensions Institute director David Blake said a group of investment banks was looking at starting a market in a bid to profit from the growing interest in bulk annuities “some time early next year”.

Such a market would have a profound effect on pension schemes as it would give companies a ready way to value liabilities.

Blake declined to name any of the investment banks involved. However Goldman Sachs has already confirmed its intention to enter the buyout market following the appointment of Addy Loudiadis to head a subsidiary to buy closed schemes (PP, September 28).

Blake – who has been preparing research papers to promote the start of a traded market in longevity risk – said investment banks had seen firms such as Paternoster and Synesis Life entering the market and wanted to have part of the business, but wanted to create a market to ensure they could sell on the liabilities.

He explained: “Investment banks are now thinking if the government does not want to kick-start this market, they will have to do it themselves.

“They are going to use derivatives to do that and they are going to use survival swaps, longevity swaps or mortality swaps as a way of gaining the ability to hedge longevity risk exposure.”

Blake said such a longevity risk market would be set-up in a way similar to other derivatives markets – such as credit derivatives, collateralised debt obligations and credit default swaps.

He added that such derivatives would be strongly sought after by investors wishing to diversify their portfolios.

He said: "The beauty about longevity risk is that it has a very low correlation to financial risk – therefore it is a great diversifying asset and exactly what hedge funds are looking for."

Blake added: "This is simply a way of bringing pricing transparency to the longevity risk market and that has got to be good news for everybody."

UK pension lottery idea sparks debate, by Steve Johnson, FTfm, 30 October 2006

A suggestion in these pages two weeks ago that the UK government should offer deferred index-linked annuities to allow workers to escape the "lottery" of defined contribution pension schemes has provoked debate in the industry.

John Nugée, head of the official institutions group at State Street Global Advisers and a former reserves manager at both the Bank of England and the Hong Kong Monetary Authority, argued that more needed to be done to help individuals who are increasingly being locked out of defined benefit pension schemes, and thus face great uncertainty in providing for their retirement.

His solution was for the government to issue index-linked deferred annuities that individuals could buy every year of their working life, allowing them to build up a guaranteed income in retirement tranche by tranche.

Mr Nugée argued that only the public sector could meet this need, as an annuity may still need to be paying out 70 or 80 years after it was purchased.

Any radical change in the UK's annuity regime could have repercussions elsewhere, given that the UK is the undisputed leader of the industry, accounting for around half of the $20bn of business written every year.

Mr Nugée's proposals have been broadly welcomed. "I think this idea is a very good one, although it needs refining," says Professor **David Blake**, director of the **Pensions Institute** at London's **Cass Business School**.

"It's an interesting idea. We all need to look more imaginatively at the annuity market," adds Michelle Lewis, pensions officer at the TUC. "We are not keen on the whole risk being put on an individual's shoulders."

Commentators from both sides of the political spectrum agree that more needs to be done to allow individuals to annuitise their savings pot in several stages to reduce risk. Mr Nugée himself quoted the example of an individual retiring and buying an annuity in 2002 who would have received just 40 per cent of the retirement income of someone with an identical payment history retiring two years earlier, due to lower annuity rates and the equity market slump.

“It is very good news that people are talking about the annuities crisis and he has done a great service by raising this issue,” says Philip Hammond, Conservative spokesman on work and pensions.

“It does seem to me that there must be a way of avoiding the risk that you have to annuitise at a point in the cycle that disadvantages you. We need to be spreading the risk by annuitising over a period of time.”

However there is a broad view that if deferred annuities were to be created, individuals should only be encouraged to drip-feed their pension savings into them during the final five to ten years of their working life, rather than throughout their career, in order to retain exposure to equities.

“I suggest that people do this in the five years before retirement,” says Mr Blake, who points out that the UK government did issue its own annuities until it gave way to the private sector in 1928.

“The problem [if you annuitise earlier] is that you are out of the equity markets and you forego the equity risk premium for a very long time.”

Alan Brown, head of investment at Schroders, agrees, saying: “This would be an almost ideal asset to buy in the final decade before retirement. For longer investment horizons the cost of being in government bonds rather than higher returning assets means you don’t want to do that for too long.”

Alan Rubenstein, European head of pensions advisory at Lehman Brothers, was more critical, describing any move into bonds by a 30 or 40-year-old worker as “reckless conservatism”.

Mr Nugée accepts this point, but believes some people would still benefit from purchasing tranches of guaranteed annuity throughout their working life.

“In an ideal world, if you can rely on people to invest wisely you would hope that they would follow a lifestyle approach, starting mostly in equities and as they age switching to fixed income,” he says.

“But there are also people who would benefit from the fact that, whatever else, they have made a start, they have an absolute bedrock on which they can build. I think that the task of getting people into the savings habit is so difficult that we need to try innovative ideas.”

Ms Lewis of the TUC can also see both sides of this coin. “An individual could be tying up money that could be generating better returns, but there is an issue of growth versus certainty. People do like to have a degree of certainty.”

Another concern raised by many commentators is that the proposal would be unfair to future generations. Because the government would receive the funds immediately, but would not need to service this debt for decades in some cases, some saw this as unfair on those who would be left to pick up the bill for earlier spending.

However, Mr Brown of Schroders refutes this argument. “GDP is consumed in the year that it is made. Whether income is transferred to pensioners via taxation and benefits or government bonds and interest payments, there is no greater problem of inter-generational equity,” he argues.

Perhaps the most intractable problem would be persuading a government that is already exposed to significant longevity risk through state pensions, unfunded public sector pensions and the health system, to take on still more risk.

“I think from the government’s point of view it is extremely unattractive. You have a government that is trying to move the responsibility from the state to the individual. This clearly runs counter to that,” says Mr Rubenstein.

“The idea that the government can readily absorb all the risk of the private sector is a big step,” adds Mr Hammond. However, two years ago, the government’s Debt Management Office did consult on the possibility of issuing longevity bonds that would have allowed pension funds and insurance companies to offload some of their longevity risk to the government, a proposal that only remained on the drawing board because of a “lukewarm response” from the industry, according to Robert Stheeman, chief executive of the DMO.

And Mr Nugée remains convinced his logic is infallible. “I can understand the government’s reluctance, but to be perfectly honest they have got very little choice.

“The wider [longevity risk] is spread the easier it is to bear. I don’t think they can escape this.”

Prudential sees bulk annuities competition, IPE.com, 19 October 2006

Prudential says there’s more competition in the bulk annuities market – and that it won’t budge on price.

After a slow first half in 2006, activity within the wholesale bulk annuity market has picked up in the third quarter, however, Prudential's sales for the first nine months have remained lower than the corresponding period last year,” the firm said.

It added: “Prudential has seen increased competition in the bulk annuity market during 2006 and although it remains committed to this market it will only participate where there is an acceptable return on risk adjusted capital.”

There have been several new entrants to the market recently, including the Paternoster business set up by its former UK chief executive Mark Wood.

Speaking in September, Wood highlighted what he termed “gamesmanship” in the market as providers seek to win business.

There was “internecine” competition between providers, Wood said in a lecture at the **Cass Business School.**

Meanwhile, Prudential today said net institutional fund inflows increased 39% to £2.6bn.

It said: “Strong fund inflows were seen across M&G's institutional business, especially in the area of segregated fixed income.

“The continued growth in assets under management in the Collateralised Debt Obligation (CDO) programme and Episode global macro fund in the first nine months of the year clearly demonstrates M&G's success in developing skills in external markets originally built up for internal funds.”

Paternoster gets first five DB funds under its belt, By Matthew Craig, Pensions Week, 15th September 2006

Paternoster, the new defined benefit (DB) buyout firm founded by Mark Wood, the former chief executive of Axa and Prudential, has secured its first five pension scheme clients, Pensions News can reveal. The schemes’ names will not be announced until all members have been notified over the next few weeks. Pensions News understands that some of the buyouts are partial and will only cover benefits above the Pension Protection Fund’s upper limit on benefit payments. Paternoster chief executive, Mark Wood, said that the firm is currently quoting for £7bn-£8bn of scheme buyouts. In one case, Wood said that nine other firms were also pitching for the business. Wood put the total potential size of the UK DB buyout market at £1 trillion. He added that the DB market had now changed fundamentally and the number of buyouts would take off over the next few years. “In the future, it will be anachronistic to have DB liabilities on a company balance sheet. This is the final step in a restructuring process [at UK corporates] over the last 20 years,” Wood commented. A realisation among trustees that they ranked as unsecured creditors and a desire by companies to shed DB risk are driving the buyout market, Wood said. He added that FRS 17 understated mortality risk at many schemes at present. When FRS 17 reflected increasing longevity more closely, the gap between a scheme’s FRS 17 value and the buyout cost would shrink to a premium of 10%-15% to transfer out DB risk.

Out and about with Pensions News, By a staff reporter - 14th September 2006

To the **CASS Business School**, for a presentation on pension buy-outs by Paternoster’s Mark Wood. During a fairly heavy Q&A, light relief was provided when Wood was asked if setting up Paternoster was a breeze and if this was also the case for being the chief exec at both Axa and Prudential. Wood replied that not many chief execs would think that running a life office was a breeze, but that he had had one very bleak moment last November when he realised the full implications of leaving the Pru. “I was due to attend a dinner in the West End and I was unable to get a cab. It was raining and I ran from Cheapside to Mansion House tube. I was half-way across the road when my old chauffeur-driven car went past with an interloper in the back.” It would be nice to say that the audience was deeply moved by this, but actually everyone laughed.

Paternoster sees gamesmanship in buyout market, Daniel Brooksbank, IPE.com 14 September 2006

Mark Wood, the chief executive of defined benefit pensions buyout firm Paternoster, reckons there's "gamesmanship" going on in the market as providers seek to win business.

There was "internecine" competition between providers, Wood said in a lecture at the **Cass Business School** last night.

Wood said Paternoster had had a transfer volume of £2.5bn-£3bn in 2005 which he predicted would be increase many times this year.

There was a £16bn "pipeline" on which it had quoted on £6bn.

Wood said DB pensions would be an anachronism in five to 10 years, and that taking them off balance sheet was similar to other business outsourcing decisions.

He explained that Paternoster makes its money by managing assets efficiently. Assets would likely be Public Finance Initiative issues and Collateralised Debt Obligations. The firm was "very unlikely to have a material long term equity exposure".

Stressing the long-term nature of the industry, he pointed out that Paternoster's backers, including Deutsche Bank, have no right to claim a dividend in the first five years.

And he called on dominant players Legal & General and Prudential, where he was formerly UK CEO, to take their own DB pension funds off balance sheet.

'Immigration could pay for soaring costs of pensions' by Jennifer Hill, Personal Finance Editor, Scotsman, 24/6/06

A HUGE upturn in immigration to the UK might be needed to stem the country's pensions crisis, a controversial new report claims today.

Up to ten million migrant workers might need to enter the UK between now and 2025 to ensure pensioners can continue to receive the basic state pension, according to the study, published in the latest issue of the Economic Journal.

The forecast - one of the key findings of the study by Professors **David Blake** and **Les Mayhew** - is one of a number of possible solutions to the pensions problem, derived from a model of demographic projection developed at **Cass Business School** in London.

Due to increasing life expectancy and falling birth rates, there are not enough workers to support pensioners: in 1990, there was one pensioner for every four workers in the UK, but this is projected to climb to nearly two pensioners for every five workers by 2030.

Blake said the government's pensions white paper, published last month, would not go far enough to relieve "pensions pressure". It proposed an increase in the state retirement age and aims to encourage people to save more for their retirement via auto-enrolment in a national pensions savings scheme.

"All these things may need to occur - working longer, increases in migration and increases in contribution levels," added Blake.

Ten million immigrants 'could help crisis', By Edmund Conway, Daily Telegraph, 24/06/2006

The pensions crisis could be solved by allowing an extra 10 million migrants into the UK in the next 20 years, leading economists have suggested.

Experts from the Royal Economic Society said that the population in the UK was ageing so fast that the workforce - as it currently stands - would not be able to afford to pay the pensions bill for their elders.

Professors **David Blake** and **Les Mayhew** have produced a study which also concludes that the Government should raise the pension age to 70, and must lift it beyond 65 sooner than it already plans.

In 1990 there was one pensioner in the UK for every four workers, but by 2030 there are expected to be two pensioners for every five.

Prof Blake said: "From a wider perspective, all these things may need to occur - working longer, increases in migration and increases in contribution levels.

"Expecting everybody to work longer may be unrealistic as activity rates among the over-50s have hardly changed in 25 years, and to make any difference there would have to be a significant change in working habits. This cannot simply be assumed."

According to the study, any realistic increases in productivity or pension contributions by the indigenous population will not be sufficient to compensate for the combined problems of population ageing and declining fertility.

Prof Mayhew added: "Our work shows that the pension age needs to increase sooner than the Government proposes."

The pensions White Paper, published earlier this year, proposed that the retirement age should be raised to 66 between 2024 and 2026, to 67 between 2034 and 2036 and 68 between 2044 and 2046.

The Government also plans to reintroduce the link between the basic state pension and earnings, but the professors said the crisis would be eased if they delayed this change.

NAPF worried about NPSS ‘fourth pillar’, IPE.com 6/Apr/06

The National Association of Pension Funds has expressed its fears about the proposed National Pensions Savings Scheme becoming an unnecessary “fourth pillar”.

“We probably wouldn’t need a fourth pension pillar if the first three were stuffed into one, and it worked,” said NAPF chairman Robin Ellison. He told IPE: “The creation of a fourth pillar is likely to create even more confusion.”

He declined to comment on how much the system could cost, amid suggestions it could rise to £3bn (€4.3bn). “There is government risk for running one centralized system. Its track record for operating central systems has been mixed.”

One global custodian approached by IPE declined to comment on how much a centralized system would cost. “I have no idea,” he said.

Speaking at London’s **Cass Business School** today, Ellison labelled government promises of simplification as “disingenuous” in his presentation. This follows in the wake of increasing regulations in an already very complex pensions system.

“We [the NAPF] want a simpler, better, cheaper administered state system for everyone,” he said. “Let’s have a simple state system.”

Furthermore, according to Ellison, Turner has crossed the boundary in telling others what is good for them.

The NPSS calls for 8% of low-income workers’ income to be placed in a pensions pot.

“But it might be better for low income workers to pay off their credit cards or pay for extra training,” said Ellison.

“There is no simple single answer, but we do know that the answer we have at the moment is wrong,” said Ellison.

Equation solves puzzles of offset mortgages, by Victoria Thomson, The Scotsman, 18/03/06

A PUZZLING mortgage conundrum has been solved for the first time.

Intelligent Finance (IF) has teamed up with the **Pensions Institute** at **Cass Business School** to crack the code that mystifies mortgage holders throughout the country.

Each month consumers have to make a choice about what to do with their cash-pay off mortgage debts or save.

An offset mortgage allows you to offset savings against mortgage interest. But how much do you need to have in savings to make this worthwhile?

Now, the Cass Business School has devised a formula to show the potential benefits. Taking your monthly savings level and mortgage value, the formula will calculate how many months can be knocked off your mortgage term.

The equation, which covers the standard 25-year term mortgage, is (X / Y) x 20.33 + 9.71 = reduction in mortgage term in months, where X = monthly savings and Y = mortgage value in thousands of pounds.

Professor David Blake, director of the Pensions Institute at Cass Business School said "Like all great formulae, the cash conundrum is very simple on the surface, but with significant mathematical workings behind it".

"The formula works across a range of circumstance and we hope that it changes the way people look at how they spend their hard-earned money each month"

Using the formula, the average new mortgage customer could knock three years and seven months off their mortgage term, IF said.

Someone with £100 of monthly savings and a mortgage value of £150,000 could reduce the term by one year and 11 months, while a homeowner with £700 in savings per month and a £550,000 loan could reduce the term by three years via offsetting.

Mark Parker, managing director of IF, said: "Many people are confused about what they should do with their money."

"While it is generally accepted that credit card debt should be paid off, it's harder to gauge and quantify the relative benefits of putting money towards a mortgage, versus the stability of putting money into a savings account."

"This formula could change the way homeowners view the mortgage market. People's finances don't need to be an enigma, now Intelligent Finance has cracked the code."

Annuity call, Sunday Telegraph 19.03.06

All the insurance companies that sell annuities should be made to publish their rates in Financial Services Authority comparative tables under a plan, promoted by **Cass Business School** (CBS), to improve consumer access to the best deals. At present only 13 life insurers provide rates on a voluntary basis. CBS said a full list of rates would enable consumers to compare the quotes they receive from their pension company with those of top providers, which may offer 20-30 per cent more.

Need for annuity body to help consumer awareness, IFAonline.co.uk, 23 March 2006

Specialist annuity advisers should form a promote a trade body to help consumers shop around and take advantage of the open market option (OMO) on annuities, claims a new report by the Pensions Institute.

Speaking at the National Association of Pension Funds (NAPF) Investment Conference in Edinburgh, Debbie Harrison, co-author of the report: "Annuities & Accessibility: How the industry can empower consumers to make rational choices" said most consumers understand the importance of shopping around and apply this to most of their purchases.

But at the moment two in three people do not use the OMO when choosing their annuity, this is because, according to Harrison, consumers build up a learning curve with property purchase, as they do with cars, holidays and other "big ticket" items. But as the annuity purchase is a one-off transaction, there is no chance to learn through experience.

The report makes six recommendations to try and improve the number of people using the OMO when looking at buying their annuity. First is for specialist annuity advisers to form a trade body along similar lines to the Safe Home Income Plan (SHIP) companies which operate in the equity release area.

It suggests a specialist trade body would be able to apply strict entry criteria, and a code of conduct to solve the problem of consumers not knowing where to go for specialist advice.

According to the report, the Financial Services Authority (FSA), regulates around 5,000 IFAs which deal with savings and investments, but there are fewer than a dozen national firms which specialise in annuities, and there is no official way for consumers to find them.

Instead FSA annuity leaflets and website provide links to IFA trade bodies which provide search engines which in most cases are based on postcodes, and once a firm is found they may not be annuity specialists, which means the advice and service offered may be below the level offered by a specialist for the same price.

The report also asks for all the insurers and friendly societies which sell annuities either in the open market or to their pension customers, to list their rates in the FSA website comparative tables.

At the moment only 13 companies voluntarily publish their rates, and the report argues a full list would enable consumers to compare directly the quotes they receive from their existing provider with those of competitors which may offer an income between 20-30% higher.

Harrison says: "These two simple steps alone could transform the way consumers buy their retirement incomes. At present, while all companies must send details of the OMO to customers, the information is buried in long and complex documents, which suggest implicitly the consumer will buy direct from their current provider."
She also points out telling people to seek independent advice is not effective because only a minority of the regulated firms which offer pensions and investment advice provide a low cost full market search, and the chance of finding a specialist through an adviser trade body with a postcode search engine is slim.

As a result the report also recommends the "wake-up" information on the OMO should be clear and direct explaining the benefits in monetary terms, while a short standardised letter on the OMO should also be sent separately to clients to try and provoke an active response.

It also suggests pre-retirement literature, including those produced by providers and regulators, should include a more direct discussion of the choice between level and indexed annuities, as although level annuities may be appropriate for most people, they may only be choosing it for the short-term income, because they do not understand the basic issues.

The report goes on to recommend trustees of occupational DC schemes and employers with contract DC schemes, should hand the responsibility for an annuity purchase to specialist advisers, while employers should also be encouraged to provide generic workplace seminars and referrals on annuities using the tax-deductible £150 available for each employee per year for pensions advice.

Alastair Byrne, a Fellow of the Pensions Institute and co-author of the report, says: "The fact two-thirds of investors do not use the OMO is a result of something more than inertia. It is a paralysis which is triggered when consumers are faced with a range of complex decisions and are afraid of making a single irrevocable choice which is wrong."

Meanwhile, The Annuity Bureau has welcomed the report, and plans to invite specialist advisers, providers, government and regulatory bodies to meet to discuss the launch of a specialist annuity trade body.

Andy Oliver, regional director of The Annuity Bureau, says the Pensions Institute has come up with six well thought out recommendations to address the lack of shopping around by consumers, all of which should be given immediate and detailed consideration by the industry.

He adds: "We welcome the recommendation for the launch of a specialist annuity advisers" trade body, which could help to make a real difference to the take up of open market annuities and champion the consumers' cause.?

But he says such a body would only have teeth if it was backed by the regulator and the annuity providers, and calls on the whole of the industry to join in exploring the potential for such a body.

Rachel Vahey, head of pensions development at Scottish Equitable, says it is a very complete report and broadly agrees with the majority of what the report is trying to do.

She adds: "The annuity market is only going to increase further over the next few years, especially if an NPSS is introduced, and we need to get the annuity market working in the best possible way, making it efficient. If we can do that now it will be an advantage, and the recommendations the report makes is trying to do that, and to protect the consumer, and I would agree with the broad thrust of them."

NAPF Conference News: Cass annuity report requires insurers to show their rates, Pensions Week, 20 March 2006

A report into the annuities market from **Cass Business School** has called for all annuity providers to show their rates on the Financial Services Authority (FSA) website comparative table.

At present, only 13 providers show their rates on the website. **Debbie Harrison**, senior visiting fellow at the **Pensions Institute**, **Cass Business School**, said: "There are another 80 insurers not showing their rates. We think that the FSA should require all companies to show indicative rates."

The report, Accessible annuities: how the industry can empower consumers to make rational choices, also proposes a trade body for financial advisers specialising in the annuity market to help give consumers access to financial advice on annuities.

At present, insurance companies are obliged to inform customers that they have the right to buy an annuity on the open market when they retire - the open market option (OMO).

However, only a minority of individuals exercise their OMO and Harrison said: "While all companies must send details of the OMO to customers, the information is buried in long and complex documents. Telling people to seek independent advice is not effective because only a minority of 5,000 regulated firms that offer pensions and investment advice provide a low-cost full market search."

Harrison said insurers should have to send customers a simple, clear letter telling them of their OMO.

Commenting on the annuity market, Prudential annuities director Tom Boardman said the annuity market would be greatly helped if the government helped manage longevity by issuing longevity bonds that would pay annuities from 90 or 95.

"This would be relatively cheap for the Debt Management Office and due to the gearing effect, for GBP100m of longevity bonds from the government, the insurance industry and capital markets would be able to create GBP2bn in immediate annuities."

Actuaries lack enthusiasm for longevity bonds, by Daniel Brooksbank, IPE.com 28/Feb/06, UK

Actuaries have expressed scepticism about the potential for the longevity bonds market to take off.

There’s a “lack of enthusiasm for this developing too rapidly going forwards,” said Zurich Scudder Investment’s Malcolm Kemp as he summarised a meeting on the topic at the Institute of Actuaries last night.

There was “quite a degree of scepticism about whether this market would develop”.

The meeting was to discuss a paper on longevity bonds by David Blake, Andrew Cairns and Kevin Dowd, which concludes that such instruments could still be the next big thing for the financial markets once initial teething problems are overcome.

A so-called catastrophe bond from Swiss Re has taken off while the European Investment Bank/BNP Paribas longevity bond failed, the meeting was told.

"We can learn an important lesson, we hope, from these two instruments," Professor Blake said. He cited design and other factors for the BNP Paribas issue, including 'institutional issues' whereby consultants were reluctant to recommend it to trustees and fund mangers had no mandate to manage longevity risk.

One of the speakers from the floor asked: "Who are the natural holders of longevity risk? What price am I paid to bear this risk? Is my balance sheet the place for this as opposed to a hedge fund?"

Another speaker advocated swaps, not bonds, as a more flexible way for pension funds to manage mortality risk. But BNP Paribas' Denis Autier told the meeting that it was very easy to reverse the product into a swap.

Another speaker said the study amounted to "little more than re-arranging the lifeboats on the Titanic" – and that the crisis in pensions, caused by low yields and longevity, could be solved by higher interest rates.

"The actuarial profession needs to put the case for higher official interest rates," he said.

Credit Suisse's Nigel Knowles pointed out that schemes only buy assets that they like. "The key thing is to make an asset the people will want to buy in the first place."

France AFPEN working on longevity bond, by Daniel Brooksbank & Martin Hurst, IPE.com 2/Mar/06: FRANCE

AFPEN, the French association of pension funds and retirement regimes, is currently working on a longevity instrument based around annuity futures, IPE understands.

AFPEN head Vincent Vandier confirmed the project, but declined to give further details. He would be able to provide further information in about a month's time, he said.

Vandier and the association were name-checked in a recent academic paper on longevity bonds for their "ideas and thoughts" on annuity futures.

Andrew Cairns, Professor of Financial Mathematics in the Department of Actuarial Mathematics and Statistics at Heriot-Watt University in Edinburgh, told IPE he has had a couple of meetings with the relevant AFPEN committee in Paris.

He said: "My own feeling is that a futures contract would have to be relatively long term for the mortality risk to show through in a meaningful way, and that a market might take some time to develop.

“One way forward is for some organisation to develop an index rather like CSFB's longevity index but based upon market annuity rates.”

Credit Suisse First Boston launched the Credit Suisse Longevity Index in December – saying it is the first index “designed specifically to enable the structuring and settlement of longevity risk transfer instruments such as longevity swaps and structured notes”.

The index is intended for use by institutional investors, insurance companies, reinsurance companies and providers of post-retirement benefits as well as other longevity and mortality risk managers.

IPE reported earlier this week that UK actuaries had expressed scepticism about the potential for the market in longevity bonds – such as that marketed by BNP Paribas - to take off.

But Cairns, who presented at the meeting, told IPE: “The bottom line is that investment banks seem to be investing a lot of time and effort into developing mortality-linked deals.

“I don't think that they would be doing this unless a significant number of investment actuaries/consultants had expressed an interest.

“It would seem though that longevity bonds in their basic form don't seem to be hitting the target.”

DB/DC shift may be cyclical, says UK actuary, by Daniel Brooksbank, IPE.com 1/Feb/06

The shift from defined benefit to defined contribution pension arrangements may simply be a cyclical trend that could be reversed, says the president of the Institute of Actuaries.

There was a “strong possibility” that the shift from DB to DC could be a cyclical event, Michael Pomery said in a lecture last night.

Although it certainly felt like an irreversible trend, there might be reasons for a revival, he said at an event organised on behalf of the **Pensions Archive Trust** at Merrill Lynch in London.

But there would be no return to DB schemes with “bells and whistles”, but the pendulum could swing back. Referring to DC plans he said: “There’s going to be some very disappointed pensioners out there when these schemes mature.”

“It may not be long before a major company offers a DB scheme,” he added.

Pomery, who’s set to step down as the president of the Institute, also said he would retire from Hewitt Associates after 40 years with the firm. He will be succeeded at the Institute by Nick Dumbreck of Watson Wyatt.

Elsewhere, a group of investment analysts has called for the disclosure of companies’ longevity exposure.

“It is clear that many companies will have to revise their longevity assumptions upwards at the next actuarial review,” the group said in a letter to the Financial Times.

“As professional users of financial reports and members of the Corporate Reporting Users Forum we believe it is essential that companies begin to disclose information about their current assumptions in terms of life expectancy post retirement and also the sensitivity of the pension liability to changes in these assumptions.”

"Completely new market in mortality-linked securities beckons", says keynote paper to Actuarial Profession, Faculty of Actuaries, Edinburgh, 16 January 2006

Longevity bond teething problems will be overcome

In a paper to be discussed at a keynote meeting of actuaries this Monday night, three leading experts argue that the design faults that have cropeed up in the first tranche of longevity bond products will be solved. We can then expect a completely new market in these securities to develop.

The paper asserts that longevity risk will not simply disappear and should be a concern for everybody planning for their retirement - as well as those managing pension plans and life insurance companies. Part of the answer, say the authors, is to ensure that annuity providers, insurance companies and pension plans have access to suitable hedge instruments. These are not a substitute for good risk management but will enhance the capabilities of institutions that already have a strong commitment to management of their entire portfolio of risks.

The paper also analyses the two attempts to provide capital market solutions to short- and long-term mortality risk - the so-called 'mortality' and 'longevity' bonds.

A well-designed security will help hedgers to reduce substantially their exposure to longevity risk, so it is essential that the mortality experience of the security's reference population matches the hedger's mortality experience as accurately as possible.

Where perfect hedging of the mortality experience is not possible there is a basis risk. The authors argue that the higher basis risk gets, the less likely that pension funds will be to use these contracts for hedging.

The Swiss Re bond (which tackles short term catastrophic risk, such as an outbreak of Bird Flu) has proved a success. The EIB bond (which attempted to deal with longevity risk) failed because some of its design features probably discouraged investors, notably excessive basis risk and the fact the bond required a high level of upfront capital for the level of hedging it offered.

Andrew Cairns, one of the co-authors of the paper, commented: "Fortunately these design problems are not insurmountable. The basis risk problem can be overcome in a number of ways. Over-the-counter contacts can be tailored to the risk profile of a specific annuity provider and offer the easiest, but perhaps an expensive, solution. In the longer run, however, we expect that a range of suitably-graded mortality indices will be developed that can be referenced in traded securities.

"The problem of upfront costs could be dealt with by increasing gearing or by using derivatives rather than spot market securities.

"Further work obviously needs to be done to determine more fully the trade-offs and choices involved. However we must not forget that such problems arise with all new financial instruments - not just those launched in a blaze of publicity.

"We are entirely confident that these teething problems can and will be overcome. When they are, the prospect of a completely new market in mortality-linked securities beckons. Longevity risk is arguably therefore the next big frontier for financial markets."

Living with mortality: longevity bonds and other mortality-linked securities, by David Blake, Andrew Cairns and Keven Dowd was presented to a Sessional Meeting of the Faculty of Actuaries on 16 January 2006. The paper can be downloaded from the site, or hard copies may be obtained from Maria Lyons (e-mail: maria.lyons@actuaries.org.uk).

Longevity risk market is new frontier, Monday 16 January 2006

LONDON (Reuters) - A market for longevity bonds will emerge despite the difficulty of trying to accurately price the risk of people living longer and encouraging investors to expose themselves to such risks, researchers said on Monday.

"We are entirely confident that these teething problems can and will be overcome. When they are, the prospect of a completely new market in mortality-linked securities beckons," Professor Andrew Cairns of Edinburgh's Heriot-Watt University, co-author of a paper on longevity bonds, said in a statement.

"Longevity risk is arguably therefore the next big frontier for financial markets."

Governments and life insurers are facing a pension time bomb as people live longer, forcing them to pay out more to retired workers.

Employers such as pest control group Rentokil have stopped giving generous final-salary pension benefits to staff and analysts say other FTSE 100-listed companies are likely to follow suit, prompted by an ageing workforce and low investment returns.

France, Greece and the UK have issued ultra-long bonds to help pension funds better manage their liabilities but analysts say those bonds are inadequate as a hedge against the risk of people living longer than expected.

Longevity bonds, whose payouts would rise if life expectancy improved, could help pension funds reduce their risks but attempts to get them off the ground have failed because they were too risky and pricey.

Longevity bonds are still a new concept to most pension fund trustees and there is virtually no history of the price behaviour of this type of asset, which means discovering the prices that clear the market takes time.

Finding risk takers is also difficult due to a perception that everyone is affected by increasing longevity risks.

But analysts say that drug firms and businesses providing services for the elderly are examples of groups that benefit from people living longer and therefore could be natural issuers of longevity bonds.

"Further work obviously needs to be done to determine more fully the trade-offs and choices involved. However we must not forget that such problems arise with all new financial instruments -- not just those launched in a blaze of publicity," Cairns said.

Longevity bonds the 'next big thing' – study, by Daniel Brooksbank, IPE.com 9/Jan/06

Longevity bonds – such as the now discontinued EIB/BNP Paribas issue – could still be the next big thing for the financial markets once initial teething problems are overcome, according to a new actuarial paper.

"Few people doubt that mortality-linked securities are potentially very useful tools for managing longevity risk," argue researchers in a paper set to be presented next week.

The offerings so far have had design faults such as excessive basis and risk the need for high upfront capital, they say – although the problems are not insurmountable.

"Once these teething problems are overcome, the way will be clear for the markets in these securities to develop and mature," write David Blake, Andrew Cairns and Kevin Dowd.

"We would then be on the cusp of a completely new global financial market in mortality-linked securities. Longevity risk is arguably therefore the next big frontier for financial markets – unless of course someone ruins it all in the meantime and discovers the secret of eternal life."

Their paper is entitled ‘Living with Mortality: Longevity Bonds and Other Mortality-Linked Securities’ and will be presented to the Faculty of Actuaries on January 16.

The BNP Paribas/European Investment Bank offering, announced in November 2004, was pulled last year, with executives saying there hadn’t been enough interest.

“We didn’t have enough investor interest to make a full issue so far, which we regret because it’s a good idea,” said Denis Autier, the bank’s head of global risk solutions.