

Pension Fund Investment

– post crisis

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Pension Protection Fund (PPF) was established to protect members of defined benefit pension schemes

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Fund

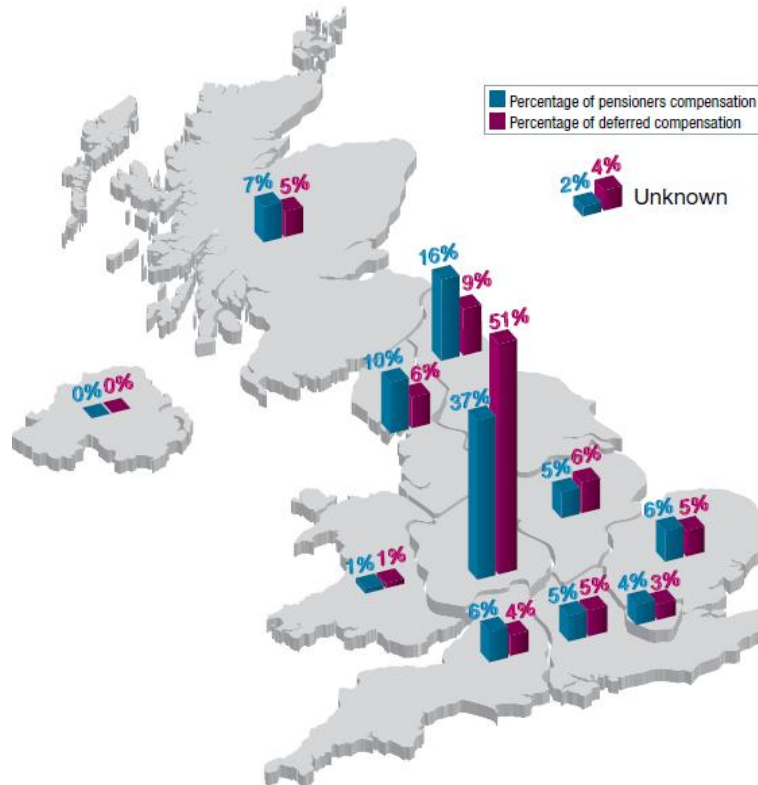
- PPF pays compensation to members of DB pension schemes where the scheme sponsor becomes insolvent and there are insufficient assets to buy compensation on the open market
 - PPF compensation is 100% of pensions in payment and 90% of pensions in deferment
 - There is a cap in the case of deferred members and indexation/escalation is also capped
- PPF is funded by:
 - A levy on eligible pension schemes currently £720 million per annum
 - The assets of schemes that it takes over
 - Recoveries from insolvent scheme sponsors
- PPF is a public corporation established by Act of Parliament but it has no Government guarantee

Vision: Protecting people's futures.

Mission: Pay the right people the right amount at the right time

PPF is growing in scale and maturity

Chart 11.10 | Pensioner and deferred member compensation by UK region

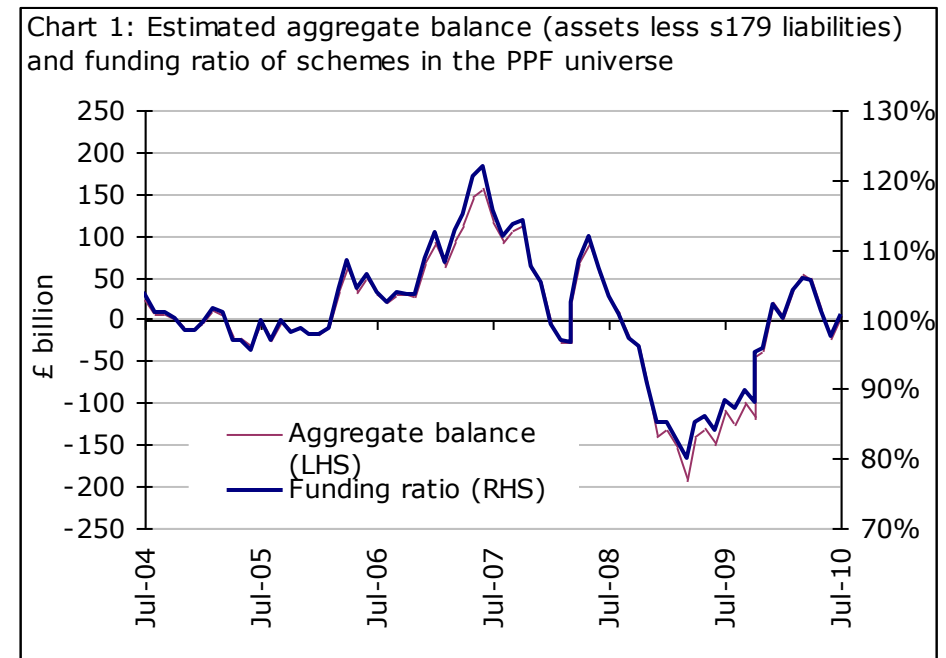


Source: PPF/The Pensions Regulator

- 50,000 members transferred into PPF from over 150 schemes
- £10m compensation paid per month
- 200,000 members in assessment from over 350 cases
- Balance sheet liabilities £12bn

Managing investments or managing risk?

- Measured on an economic capital basis the risk to PPF is massive – over £10bn
- Risk is the volatility of scheme deficits and the insolvency risk of sponsors
- The division is approximately 50:50 investment and insolvency risk
- “PPF risk” is only about one fifth of total risk in system
- Unhedged interest rate risk is larger than other investment risks



So how was the crisis for you?

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- **How are the mighty fallen**
 - 4 of these insolvencies arose in Q1 2009
 - Potentially our two largest claims on this list
 - And some never made it at all thanks to intervention by HMG
- **Poor funding made worse by crisis**
 - Visteon went bust at lowest point in markets
 - Underfunded schemes tend to have higher exposure to equities
- **Unhedged risk crystallised**
 - One of these schemes deferred an interest rate hedging decision that would have saved tens of millions
 - None hedged their downside equity risk
 - Some had credit exposure too
- **Highly rated sponsors can fail**
 - Lehman Bros were well-rated until under a year before their collapse



WOOLWORTHS

**NORTEL
NETWORKS™**

LEHMAN BROTHERS

**W
WEDGWOOD**

And for us?

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	2005/06	2006/07	2007/08	2008/09	2009/10*
Assets	£2,086m	£4,409m	£5,554m	£9,330m	<i>TBA</i>
Liabilities	£2,429m	£5,018m	£6,071m	£10,560m	<i>TBA</i>
Funding Ratio	86%	88%	91%	88%	<i>TBA</i>
ROR on PPF assets	5.8%	1.9%	15.8%	13.4%	<i>TBA</i>

- Assets and liabilities include schemes in assessment likely to enter PPF
- 2010 Balance sheet approximate but funding has improved since FY08/09
- Rate of return includes swaps

*2009/10 figures are yet to be published

www.pensionprotectionfund.org.uk

Clear trend to limit the growth in liabilities making pensions risks increasingly a legacy financial issue

- The clear trend to reducing balance sheet risk to sponsors by closing schemes to new entrants and new accruals has accelerated post crisis
- The strategy of many more schemes is to target buy out over a short, medium or long term timescale

Percentage of schemes	2006	2007	2008	2009	2010*
Open (plus part open in 2006)	43%	36%	31%	27%	22%
Closed to new members	44%	45%	50%	52%	56%
Closed to future accruals	12%	16%	17%	19%	20%
Winding Up	1%	2%	2%	2%	2%

Source: Purple book. * 2010 PPF forecast

The trend towards de-risking of investment strategies was evident before the crisis but has accelerated

	2006	2007	2008	2009	2010*	
Equities	61.1%	59.5%	53.6%	46.4%	42%	
Gilts and fixed interest	28.3%	29.6%	32.9%	37.1%	40%	
Insurance policies	0.9%	0.8%	1.1%	1.4%	1.5%	
Cash deposits	2.3%	2.3%	3.0%	3.9%	4%	
Property	4.3%	5.2%	5.6%	5.2%	5%	
Other investments	'Other'	3.1%	2.5%	3.8%	4.5%	5%
	Hedge Funds	N/A	N/A	N/A	1.5%	2.5%

Source: Purple Book. * 2010 PPF estimate

- **Asset allocation** 70:30 (equity / bonds) now more like 50:50. Trend towards global mandates to diversify risk
- **Risk reduction strategies.** LDI etc continue to gain ground. Buy-outs and buy-ins slow burn
- **Diversification** Alternatives becoming more common particularly amongst larger schemes. Large schemes can capitalise on their liquidity premium in secondary markets
- **Fiduciary management** Mandates are becoming more common to improve decision making. May target funding level

PPF will shortly be consulting on a new approach to levy that reveals our current thinking and experience of risk and pricing

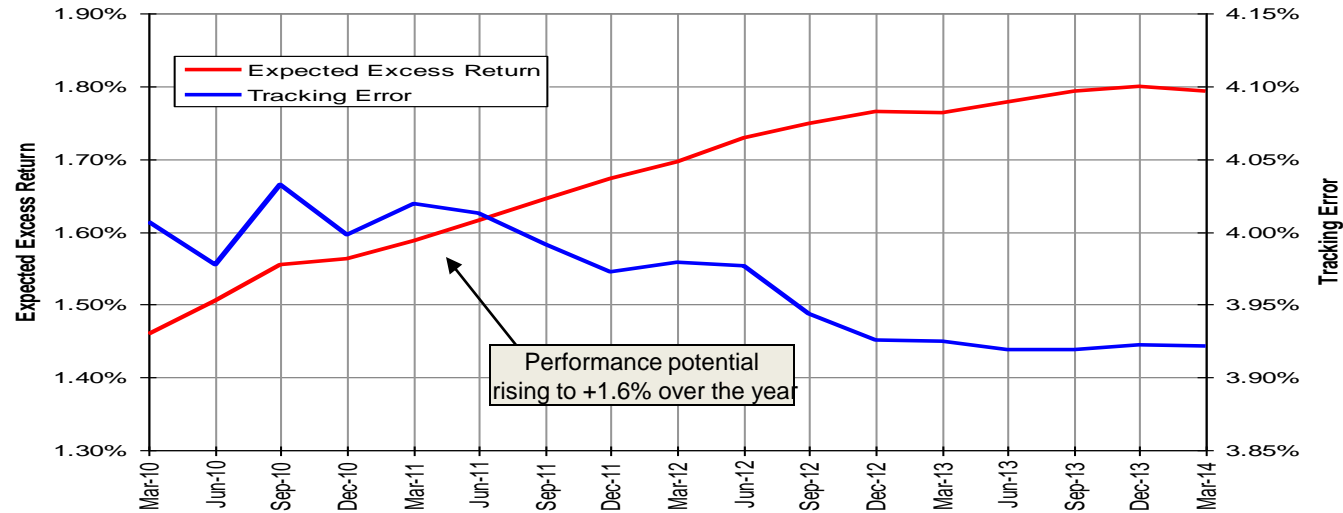
- Levy in future will vary less according to sponsor strength than now
 - Accords with our experience and also academic work that PPF sponsored
- More emphasis on funding levels
 - Our academic work on a theoretical levy suggests that funding levels are the primary determinant of risk in the system
- Stress test on funding level rewards low risk strategies
 - We are keen to reflect investment risk (or more properly funding risk) in the levy calculations
 - This is to be done via a stress test on assets and liabilities prior to the levy computation
 - A fully matched and fully funded (to PPF level of compensation) scheme would pay no risk based levy

Although this doesn't have a bearing on a talk about investment post crisis it does indicate the direction of travel that PPF as the backstop provider of protection for UK DB schemes thinks of investment risk

And PPF strategy evolving – built around a central objective of PPF being “self sufficient” by 2030

- 80:20 split return seeking and matching assets
 - Using swaps to leverage up a 20% collateral pool
 - 80% return seeking in mix of bonds, equities and alternates
- Return seeking portfolios diversified
 - Still low overall risk budget
 - Improved return prospects through diversification in suitable alternative assets
 - Bond and equities now global mandates and property heading that way
- Flexibility to manage risk/reward ratio within tolerances
 - Allocate risk budget to earn greatest reward
 - Use of hedges to protect downside risks
- Swap program covers both interest rate and inflation risks
 - Challenges with gilt swap spread on a leveraged portfolio
 - Change from RPI to CPI potentially adds uncertainty; market yet to develop
 - Mandatory central clearing of OTC instruments also challenging
 - Use of swaptions and repos

PPF has a target allocation of 20% to alternatives and a planned roll out to seek extra return in a controlled risk environment



Asset	Target Mar 2011	Progress
GTAA	£150m	Now seeded with £100m (2.5% target reached)
Private Equity	£300m*	£100m now committed (*=commitment) to Pantheon, expected drawdown of 10m. Lexington next
Real Estate	£450m	£288m UK allocation presently achieved, move to global over 3 years
Infra-structure	£150m*	OJEU process underway – nearing completion
Alternative Credit	£35m*	OJEU process initiated – IC approval December; seeding by 31 March

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