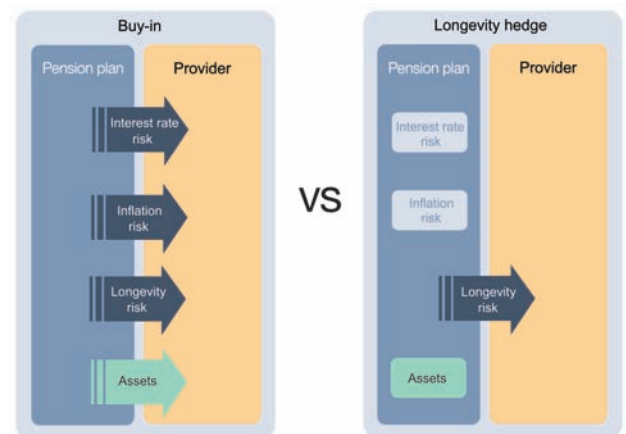


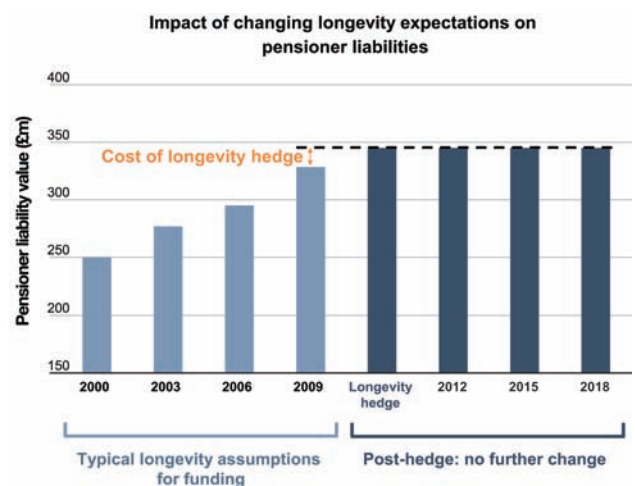
Longevity hedging: 10 things you should know

Longevity hedging is attracting increasing attention as a new tool to remove a major risk for pension plans.

1. A longevity hedge allows a pension plan to transfer the risk that members live longer than expected to a third party – typically a bank or insurer. The pension plan keeps direct control of its assets, which helps minimise counter-party risk.
2. A longevity hedge provides an opportunity for pension plans to close out (or reduce) longevity risk when transferring all risks to an insurance company (e.g. through a "buy-in") is not affordable or practical.
3. With a longevity hedge in place, a pension plan can deal separately with the other key risks, such as inflation and interest rate risk. This results in what is sometimes described as a "DIY" or "synthetic" buyout and is an alternative to dealing with all the risks at the same time through a buy-in.



4. The longevity hedges recently announced by Babcock International and RSA Insurance Group for their current pensioners (see bottom) are the first by UK pension plans.
5. Financial institutions in the UK have been using longevity hedges for a number of years. Examples include the deal struck in April 2007 between Friends Provident and Swiss Re to re-insure longevity risk on £1.7bn of annuities. More recently, in March 2009, Norwich Union entered into a swap with Partner Re, passing across longevity risk on around £475m of annuities.
6. Longevity hedges come in two main forms: bespoke and index-based. A bespoke hedge can offer a full transfer of longevity risk for pensioners, typically only where pensioner liabilities are over £100m. Index-based hedges, which only protect against changes in longevity for the general population, have to date received much less interest from pension plans.
7. Longevity hedge pricing has become keener over the first half of 2009 mainly due to increased competition between providers.
8. Over the last ten years, pension plans have seen liabilities for pensioners rise by over 25% as a result of changes in longevity assumptions. Implementing a bespoke longevity hedge today may result in a modest further increase, however, a pension plan is then protected against the impact of further adverse changes in longevity on pensioner liabilities for the next 50 years or more.
9. Some hedge providers can combine longevity and inflation hedging in one arrangement. This provides a halfway house between a standard longevity hedge and buyout with an insurance company.
10. Quotations have been issued by longevity hedge providers on over £30bn of pension liabilities in the last 12 months, for bespoke longevity hedges alone. This includes quotations for at least six FTSE100 companies.



On 26th June, Babcock International announced completion of a £300m longevity swap deal between one of its pension schemes and Credit Suisse. Further similar deals totalling £450m for two of Babcock's other pension schemes are expected to be completed by October.

On 14th July, RSA Insurance Group announced completion of a £1.9bn risk transfer arrangement with Rothesay Life and Goldman Sachs, which included a longevity swap.

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