PENSION CAPITAL STRATEGIES
Innovative Alternatives

Buyout Market Watch

An Update Report From Pension Capital Strategies as at 31 March 2010

A JLT Group Company

Executive Summary

Market activity in Q1 2010 was healthy. Total deals worth approximately £4.1bn were written by a variety of insurers, with a number of insurers having record starts to the year. The figure includes the longevity swap deal completed by Deutsche Bank, which totalled £3bn, and was the largest deal of its kind in the UK to date.

Key recent developments

- Bulk annuity prices have remained stable, and in some instances we have seen reductions compared with the latter part of 2009. This is a reaction to a more settled regulatory and financial environment.
- Insurers are continuing to carry out detailed due diligence on prospective cases to try and identify the deals which are of particular interest to them in terms of membership profile and likelihood to proceed.
- Many schemes are not adopting a "full market" approach; instead they are only obtaining quotations from insurers that they are willing to transact with.
- In common with most of the larger deals struck over the past 2 years the majority of the deals being sought in 2009 are pensioner buy-ins.
- It has become more affordable to insure deferred members; however for most schemes deferred pricing will continue to be unattractive.
- There continues to be an active market for smaller schemes with competitive pricing available even though most insurers operate a minimum quotation size.

Updates on various providers

- A definitive agreement has been reached to combine MetLife and ALICO (ex AIG), with the transaction expected to close by the end of 2010. Until the transaction has been agreed both insurers will operate as separate entities.
- MetLife has had a record start to the year and are the third most successful insurer in 2010 to date. They continue to focus on the buy-out market and are currently not active in the longevity swap market.
- Aviva has also had a record start to 2010 completing 10 transactions in Q1 worth almost £350m. Due to a large number of requests Aviva is currently unable to provide quotations for most schemes of £10m and under. They also are not currently active in the longevity swap market.
- Pension Insurance Corporation has also had a successful start to the year, completing the largest published buy-out transaction in Q1 2010 in respect of Aggregate Industries (two schemes worth £305m).
- Legal & General continue to consider all sizes of buy-out transactions. They have recently announced that they are now offering a longevity solution, which is aimed at pensioner liabilities in excess of £500m, although for some clients they may consider a minimum size of £250m.
- Aegon are continuing to actively seek a target number of transactions. A change in pricing strategy has led to a concentration on pensioner only transactions.
- Paternoster remains closed for new business. There has been no indication when, or whether, they will re-enter the market.

Longevity hedging

Q1 witnessed the largest pure longevity deal completed in the UK, as the growth in this market continues. The £3bn deal was between BMW UK Operations Pension Scheme and Abbey Life (a Deutsche Bank subsidiary). Paternoster provided the longevity modelling and structuring expertise for Abbey Life, who are insuring the longevity risks of the scheme. Abbey Life have already reinsured some of the risk by offloading this to a consortium of reinsurers including Hannover re, Pacific re and Partner re.

A trade group has been launched by a number of insurance companies and banks to promote the development of this market. The founder members of the group, known as the Life and Longevity Markets Association (LLMA) are Axa, Deutsche Bank, JP Morgan, Legal & General, Pension Corporation, RBS and Swiss re. The objective of the LLMA is to bring benefits to insurers and reinsurers by bringing structure to the marketplace.

Our view of the market for the remainder of 2010

- As for most sponsors the de-risking of their defined benefit schemes remains a priority, we expect the interest in insured products to remain high. Although a full buyout may only be affordable for a minority of schemes, many sponsors will consider a partial buy-out or buy-in as part of a long term strategy to de-risk their pension scheme.
- Longevity swaps will continue to create interest for sponsors, although for many smaller sized schemes this option will not be available due to the high minimum transaction levels currently in place. We would expect the minimum transaction levels to reduce over time as more longevity swap business is written.
- Provided that the encouraging signs seen in the markets are not a false dawn and that the economy continues to pick up in the medium term we believe that the market will remain active in throughout 2010, with deals around the £1bn mark for buy-out transactions each quarter, together with a few large longevity deals transacted through the year.

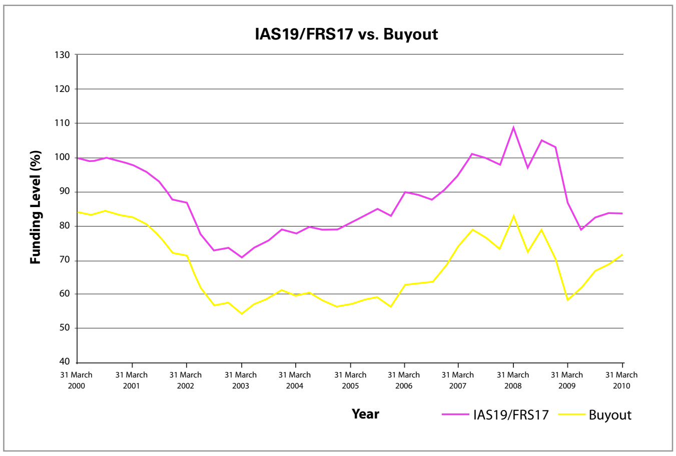
PCS Affordability Index

Some of the most recent developments affecting the prices and attractiveness of a bulk annuity solution are considered below:

Regulations
There have been no substantial regulatory changes in 2010.

The Pensions Regulator (tPR) has set out its Corporate Plan for 2010-2013. It has stated that regulation will work to protect members' benefits and it will continue to direct resources to areas of greatest risks. In this document tPR has also confirmed its aims to reduce calls on the PPF. TPR is in the process of a consultation with regards to poor record keeping.

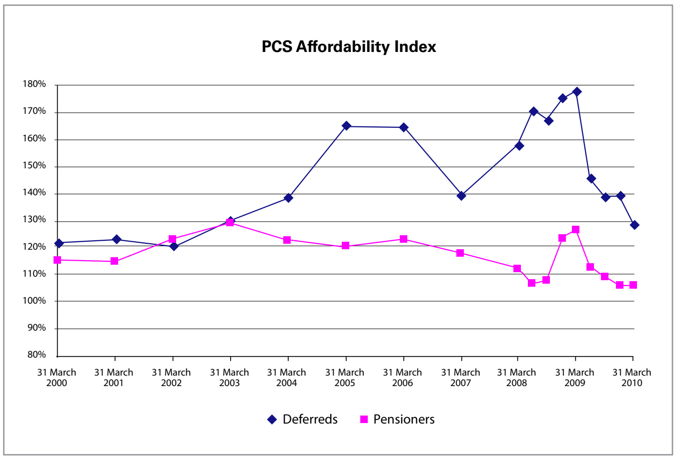
With regards to future pricing the big issue continues to be how the introduction of the Solvency II regime (an EU Directive to harmonise funding and reserving requirements for insurance companies) is likely to affect insurers' reserving requirements and the consequent impact on buyout prices. Lobbying from insurers continues; however our conversations with various insurers suggest that many have already included margins in their current pricing basis to cover their expectation of additional requirements stemming from Solvency II.



Financial health
We regularly track the funding position of a typical pension scheme on the accounting RS17/IAS19) basis and the buy-out basis to monitor how relative prices move with changing financial conditions and assess how attractive a buy-out type solution is at a given time.

Our figures show that over the last quarter there has been little movement in accounting liabilities and deficits as credit spreads have remained relatively stable. The buy-out gap has reduced very slightly during Q1 2010, which is a result of an improvement in prices during this quarter.

Affordability index
Our affordability index tracks prices in the buyout market against FRS17/IAS19 values. Our figures show that buy-out pricing has improved slightly over the last year as insurers' underlying bases have become more secure. This is possibly a consequence of a more stable economic outlook together with a comfort from insurers that they are adopting tightened reserving regulations in light of Solvency II.



Affordability for deferred members has improved over the last twelve months, although deferred members still remain less attractive than pensioners.

It remains unclear at the current time how gilt yields will move in the short and medium term and the impact this may have on buyout prices. Gilt prices have proved resilient, with the most recent auctions being over subscribed by some margin. Increasing inflationary pressures are also likely to impact the interest rate strategy followed by the Bank of England.

Market sentiment
Market sentiment towards buyout deals continues to be favourable.
There is a widely held view in the industry that a buy-in or buy-out can have a positive effect on M&A activity, with Pension Corporation's Jay Shah particular vocal about this. His view is that pre-planning a buy-in or buy-out deal can lead to an improved valuation of a firm. An example of this may be Kraft's takeover of Cadbury, who completed a buy-in transaction just days after the takeover was agreed.

PCS Market Analysis

Buyout deals during 2009 totalled almost £3.7bn. Including swap deals brings the total overall business written to approximately £7.5bn.

Almost £1.1bn of buyout business, together with a £3bn longevity swap were transacted in Q1 2010. This is an excellent start to the year and evidences a healthy market, building on a relatively successful 2009.

The top 10 largest bulk annuity deals struck over the last 12 months are illustrated in the table below.

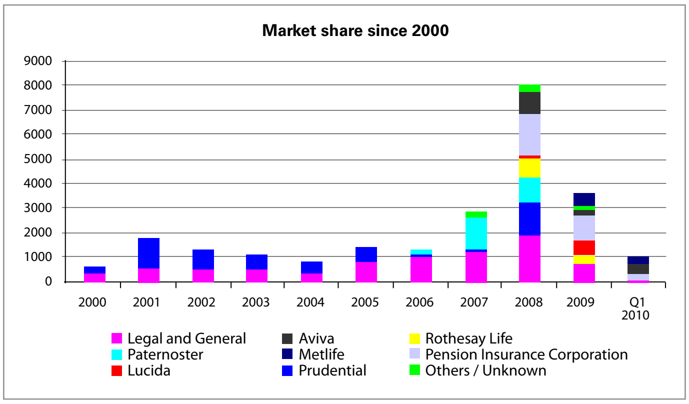
Scheme	Date	Value	Successful Insurer
Cadbury Pension Fund	Dec-09	£500m	Pension Corporation
MNOPF	Sep-09	£500m	Lucida
CDC Pension Scheme	Nov-09	£370m	Rothesay Life
Leyland DAF	Jan-09	£230m	Pension Corporation
Aggregate Industries	Mar-10	£210m	Pension Corporation
Dairy Crest	Jun-09	£160m	Legal & General
Unknown MetLife Deal	Q1 2010	£150m	MetLife
Unknown Aviva deal	Q1 2010	£105m	Aviva
Denso Pension Scheme	Sep-09	£100m+	Pension Corporation
Foster Yeoman	March-10	£95m	Pension Corporation

The major longevity swap deals struck over the last 12 months are illustrated in the table below.

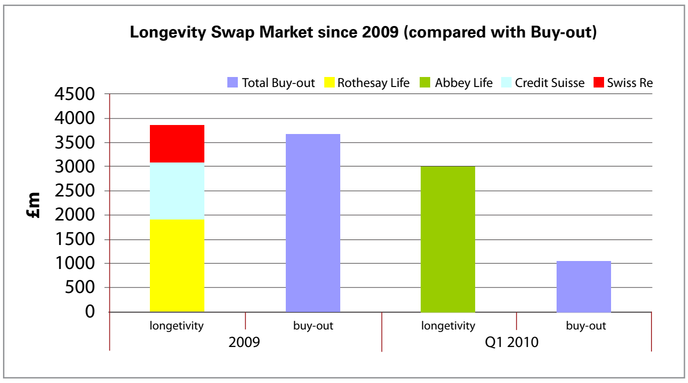
Scheme	Date	Value	Counterparty
BMW	Feb-10	£3bn	Abbey Life
RSA	Jul-09	£1.9bn	Rothesay Life
Babcock International*	May-09	£1.2bn	Credit Suisse
Royal County of Berkshire	Dec-09	£0.75bn	Swiss Re

* Completed longevity swaps for three of its schemes during 2009.

A breakdown of the various insurers' buy-out market share since 2000 is illustrated in the graph below.



A breakdown of the various insurers' longevity swap market share since 2009 is illustrated in the graph below. This graph also provides a comparison between buy-out and longevity swap business written during 2009 and 2010.



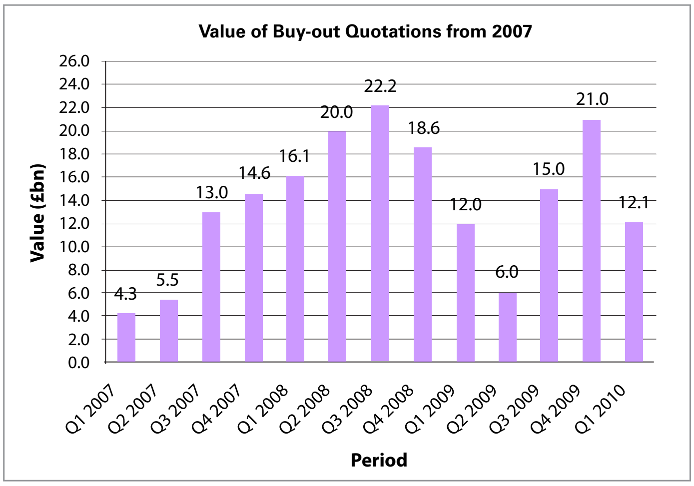
Commentary

Buy-out deals picked up in the latter part of 2009, and there has been a strong start to 2010. It is clear from our discussions with insurers that, while for some the pipeline is very healthy, for others it is not. This could be evidence of schemes choosing preferred partners at outset rather than opting for a full market review. Demand is such that smaller schemes (i.e. £20m and under) can still obtain quotations from a number of insurers.

We saw a number of deals completed in the longevity swap market during 2009, and already in 2010 the largest deal to date has been completed. One insurer has confirmed pipeline during Q1 2010 was a very encouraging £8.5bn. However there is still some way to go before longevity swaps become more prevalent in the market place, mainly due to this solution remaining available to the larger schemes only and therefore not providing a feasible solution for the majority of schemes in the UK.

Currently the outlook for 2010 is positive for both buy-out and longevity swap solutions. The need for pension schemes to de-risk remains; therefore unless changes in the economic situation dictates otherwise, we would expect that business levels will remain historically high.

The following chart shows an average cross section across the major players of the value of quotations requested during each quarter since the start of 2007.



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