News Release

Pension buyout prices stable despite market volatility

- Bulk annuity prices remain broadly stable in the midst of general market volatility
- Equity market variability underlines need for asset transition strategy
- Planning a buyout properly minimises the possibility of being caught out by the unexpected

London, 22 August 2011

Despite the lurches in the markets following the sovereign debt crisis, the price for pension schemes looking to buyout with an insurer remains broadly stable, says Mercer.

This is good news for schemes in the midst of a transaction as long as they have moved out of equities – as most schemes tend to do. However, Mercer says that recent volatility highlights that schemes planning a transaction should check that they have the right asset strategy to ensure they are not caught out by future market movements.

Worldwide investment markets have been heavily affected following rating agency Standard and Poors' decision to downgrade the US credit rating and in light of the ongoing Eurozone Sovereign Debt crisis. While bond yields, which primarily drive the price cost of buyouts and buy-ins - together known as "bulk annuities" - have fallen a little, so have inflation expectations. As a result, bulk annuity prices are little affected. Unlike in 2008, says Mercer, there is no perceived extra risk in the corporate bond sector. At that time, this had made insurers nervous resulting in rising bulk annuity prices.

Equity values have fallen by around 10% over the last month, with many other assets that are "high risk" relative to bonds, such as hedge funds, derivatives, commodities, being affected as well. Most schemes have some exposure to such assets – some significantly so. These schemes will have seen the value of their assets reduce materially relative to their liabilities. According to Mercer, this market volatility underlines the importance of a planned asset transition; a buyout transaction can take several months from inception to contract, so mitigating the impact of market movements is a sensible course of action. Insurers have complex investment models to back the cost of their pension liabilities and schemes need specialist advice to minimise the variability between the assets they hold and the premium charged by insurers for a bulk annuity.

"Schemes should consider as a matter of course how to manage the investment of assets leading up to the purchase of a bulk annuity," stated Akash Rooprai, principal in Mercer's de-risking group. "To minimise the impact that volatility has on the difference between assets held and insurance costs, a strategy consisting of a portfolio of corporate bonds, gilts and possibly with some relevant derivatives as the purchase approaches, would be prudent. This minimises the potential for market movements making the planned transaction unaffordable, although of course this also removes the potential for gains. That said, once a scheme has decided to purchase a bulk annuity, it is not investing for asset gains, but to achieve the objective of purchasing the bulk annuity at an affordable cost."

Mercer also advises that, as well as reviewing the investment strategy, there are many other actions that schemes can take in the lead up to a bulk annuity. This includes ensuring the data is free from gaps and errors, ensuring that there are no barriers or complications in the scheme's legal documentation and setting a combined funding and investment strategy to achieve the target level required to secure the bulk annuity.

Mr Rooprai observes that "Schemes that plan ahead and carry out work before a bulk annuity purchase will see a quicker, less risky and more cost-effective transaction – they will be able to move rapidly when a transaction becomes affordable."

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Notes for editors

Mercer is a global leader in human resource consulting, outsourcing and investment services. Mercer works with clients to solve their most complex benefit and human capital issues by designing, implementing and administering health, retirement and other benefit programs. Mercer's investment services include investment consulting, implemented consulting and multi-manager investment management. Mercer's 20,000 employees are based in more than 40 countries. The company is a wholly owned subsidiary of Marsh & McLennan Companies, Inc., which lists its stock (ticker symbol: MMC) on the New York and Chicago stock exchanges. For more information, visit www.mercer.com.

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