

Pensions and economic values

Cliff Speed

Bacon & Woodrow

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Three stages of information

Actuarial valuations

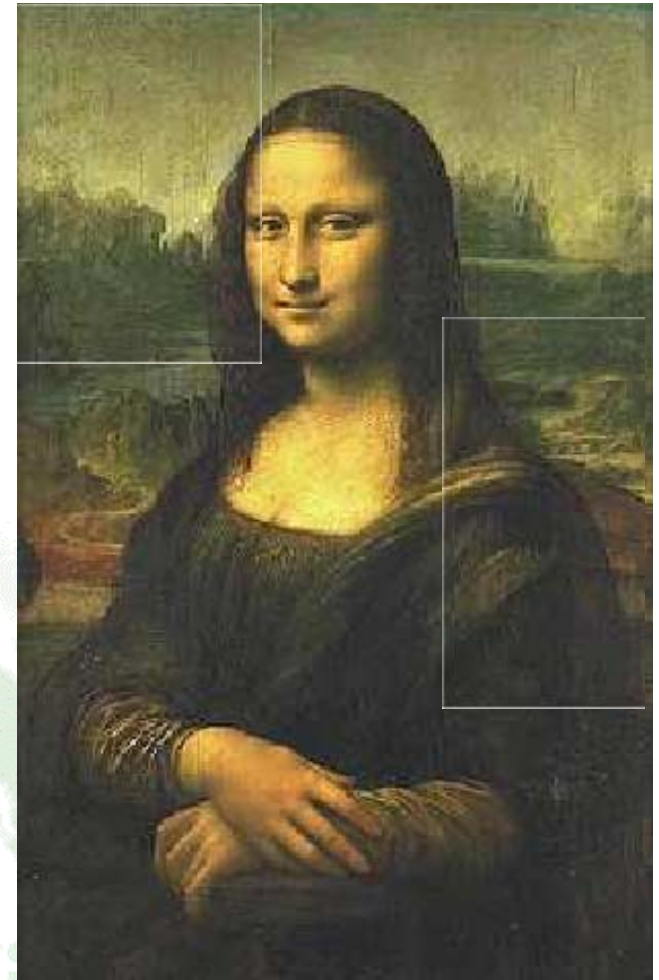
values of liabilities and assets

Asset liability modelling

interaction: liabilities vs investments

Model economic value

interaction: pension vs sponsor

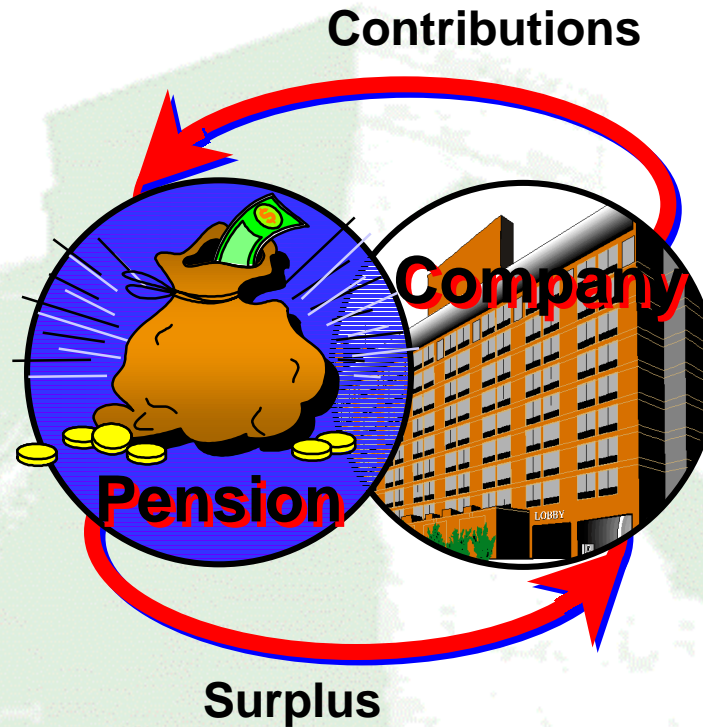


Legally ...



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But economically ...



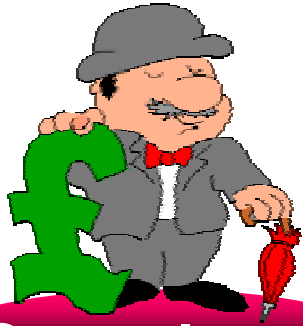
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Economic value modelling

- Models pension within company
- Identifies all stakeholders
- Values their stakes allowing for risk
- Uses market methods and no “free lunches”

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Who are the Stakeholders?

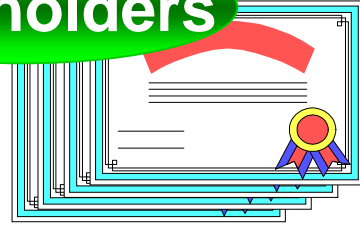


Consultants

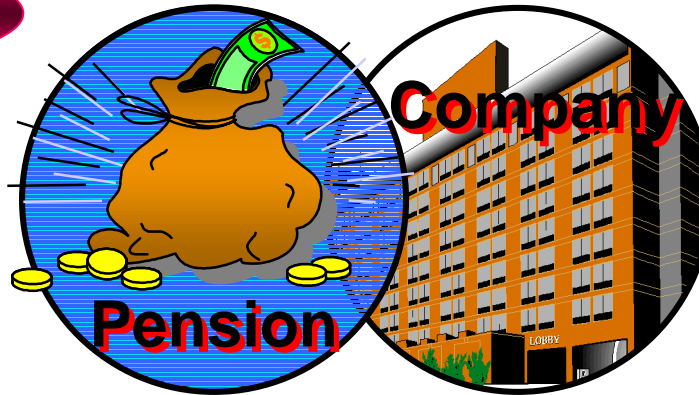
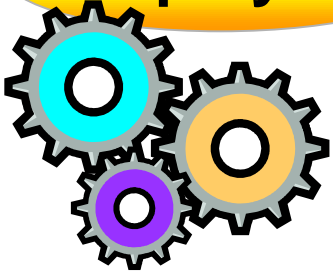
Shareholders



Debtholders



Employees



Pension

Tax man



Suppliers

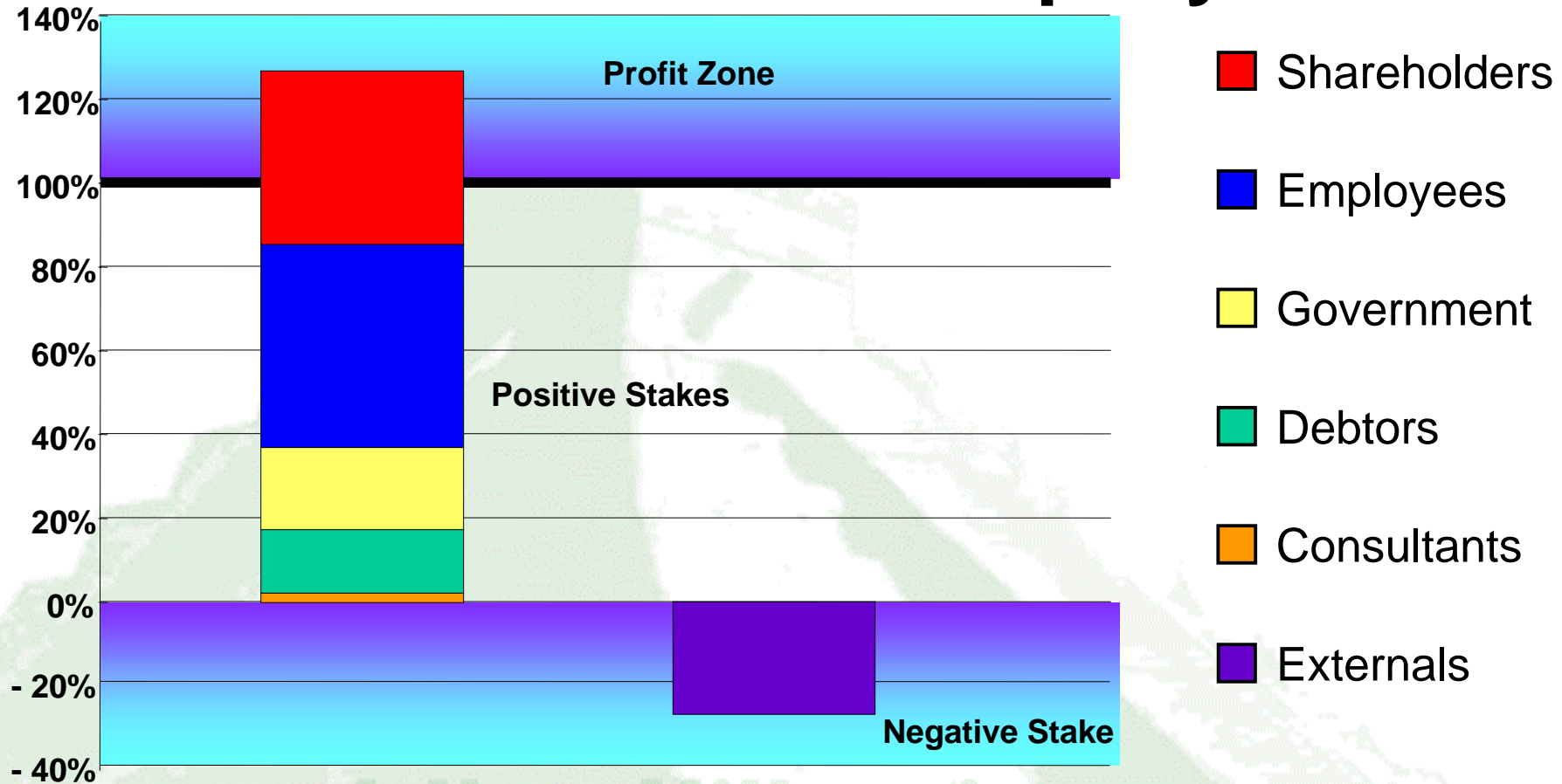


Customers

Cash flows are the key

- Identify **all** company and scheme cash flows
- Project for 10 years
- Apportion to stakeholders
- Discount to get value of stakes
- Check: Total = Company + Pension (MV)

Results – XYZ company



10-year windup probability: **4%**

Now do strategy testing

Base strategy \Leftrightarrow Stakes A

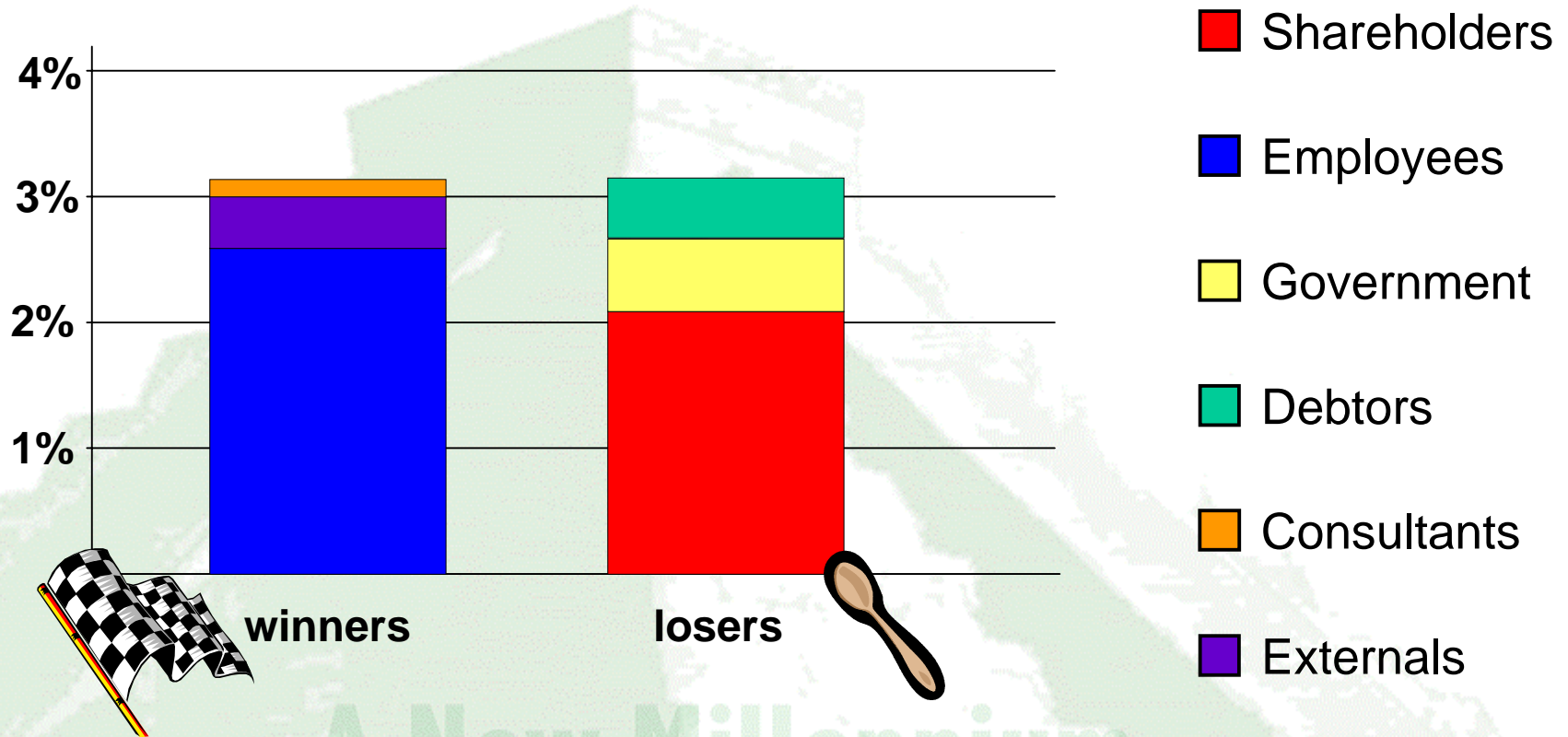
New strategy \Leftrightarrow Stakes B

- compare change between Stakes A and Stakes B
- to give winners and losers
- and effect on credit rating

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What if ...

Increase pace of funding



10-year windup probability:

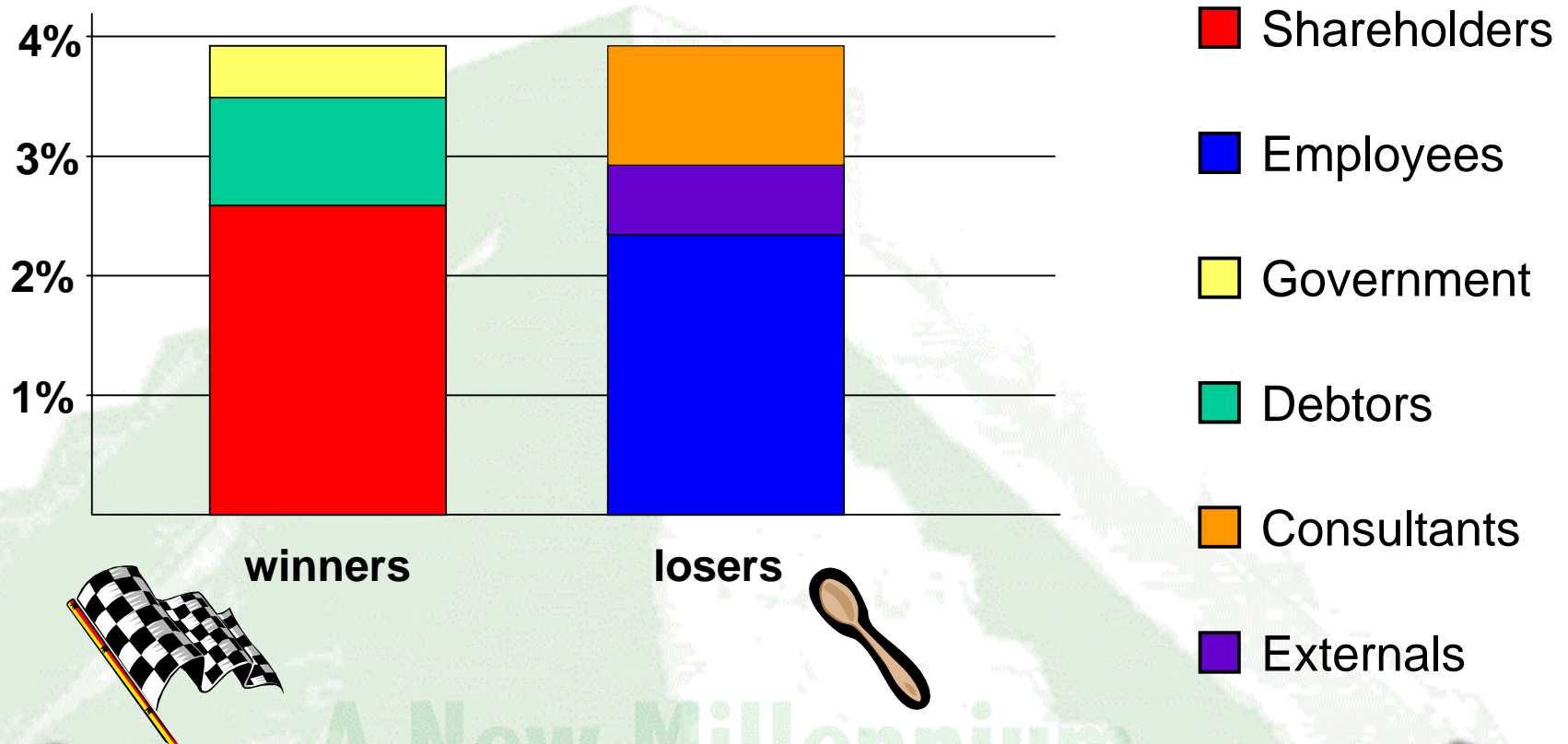
5.3%

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What if...

Invest more in bonds



10-year windup probability:

2.1%

EVM Strengths

- It is objective
 - “marked to market”
 - no actuarial judgement
- Automatic allowance for financial market risks
- It deals with complicated options and interactions

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Conclusion

- Pensions are debt
 - sponsor's financial strength important
- Investing in a company
 - solvency of pension scheme is important
- Pension scheme is
 - part of the capital structure
 - often largest tranche of debt
 - relevant to valuation of debt and equity

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