Swiss Re

Swiss Re´s longevity value proposition

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Alberto Izaga
Head of Life & Health Products
Member of the Executive Board

Financial Times 23 March 2007

Sainsbury trustees warn of £3bn 'hole'

■ Pensions pressure for private equity investors

By Norma Cohen, Kate Burgess, Lina Saigol and Elizabeth Rigby

J Sainsbury's pension trustees have signalled to the consortium of private equity investors stalking the supermarket that it would have to tackle a hole in the pension scheme of up to £3bn to succeed in an acquisition.

The trustees' position presents a potential stumbling block to any sale, although it will also be seen as a negotiating position.

Their desire for a high value, upfront guarantee in the form of cash or assets reflects concern that a highly leveraged private equity owner would be unwilling or unable to make further contributions to the scheme.

They are also understood to be considering asking to be placed ahead of bank creditors in the event of insolvency.

"The pension issue is not a deal-breaker but it is a difficult issue and it is not easy to resolve unless there is a lot of money put on the table," a person close to the negotiations said.

Senior members of the CVC-led consortium to buy Sainsbury, which includes Kohlberg Kravis Roberts, Blackstone and Texas Pacific Group, met trustees and scheme advisers last week.

News of the scale of the pensions deficit comes as a second consortium stepped up efforts to put together a rival bid. Bain Capital and Apollo Management, the US buy-out funds, are understood to have appointed Deutsche Bank to advise. The bank would also provide financing for a bid.

The trustees are in a strong bargaining position. Under UK pensions law, the Pensions Regulator can in effect block any takeover that threatens the security of members' benefits by demanding cash upfront.

The pensions deficit identified by the trustees is considerably more than the shortfall of £477m reported last October after Sainsbury made a large cash injection to the scheme. It is thought that the consortium has offered to inject £300m-£500m.

According to people familiar with the talks, the trustees, who have yet to complete a valuation of the scheme as of March 2006, believe that a move to an investment policy based on bonds will raise the deficit to £1bn, even if no buy-out occurs. That calculation rises to £2bn-£3bn if a new corporate owner makes no further contributions.

The trustees are understood to be concerned whether a private equity buyer would be willing or able to make additional contributions over the next 60 years.

The Sainsbury trustees, who include two independent representatives of professional trustee firms, are said to be contemplating several structures to protect members' benefits. Among these is a request to rank the scheme ahead of senior lenders in the event of insolvency, a level of security that so far has not been sought by other trustees.

Under UK law, pension scheme members rank as unsecured creditors in the event of insolvency. Neither the Sainsbury scheme trustees nor its advisers, Penfida, would comment.

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Sainsbury in the grip of trustees

Any bid for the chain would have to meet John Adshead's terms, write Kate Burgess and Norma Cohen

When trustees were appointed to look after interests of staff in the J Sainsbury pension fund more than 30 years ago, little could they have imagined what power they would have over the company's future.

But in 2007 it is well within the grasp of the current trustees, chaired by John Adshead, to see off a bid for the £9.5bn supermarket chain.

In part their power rests in the size of Sainsbury's scheme. Latest figures show it has 87,313 members, assets of £4.25bn and a present day value of its future promises to employees worth considerably more.

Under new accounting regulations the pension scheme faced a £477m shortfall at the end of October. One adviser said to his surprise many would-be bidders often focus on these numbers.

But the shortfall will rise dramatically when the company signs off a new three-year revaluation of the pension fund in June that uses more conservative assumptions than the sums reflected in the company accounts.

That itself is a function of the Pensions Regulator, whose role is to see schemes are adequately funded. Sainsbury and its trustees must submit a plan to the regulator to fill its current shortfall by June, bid or no bid.

A plan sponsored by Sainsbury, a large employer with an investment-grade credit rating, and one sponsored by a debt-laden investment consortium, present very different risks to members.

The trustees must consider what would happen if that consortium became unwilling or unable to make additional contributions.

That means using a higher concentration of low-risk but lower-yielding investments. Lower expected returns over time, coupled with an assumption that no company contributions will be made, leads to the calculation of a deficit today of £2bn-£3bn.

The task facing trustees of Sainsbury's pension scheme is how to ensure scheme members, unwitting creditors of the company, do not lose their pensions under new, less financially-secure ownership.

As well as having to service large amounts of debt that the consortium will take on, the trustees must also consider it will want to pay its own shareholders substantial amounts of cash.

In these circumstances, trustees can and will demand additional security from bidders that they will honour the pension promises made to staff.

Formation of the Pensions Regulator in April 2005 strengthened trustees' hands.

A change in a company's financial circumstances gives the regulator the power to demand additional contributions. Owners of companies that become insolvent can be held personally liable for pension debts unless they received "clearance" from the regulator for the deal.

Trustees could simply ask for cash after the example of Marconi. It injected £185m and set up a £675m escrow account to cover its obligations to 69,000 staff when the bulk of the business was sold to Siemens.

The trustees could also demand pledges of assets or letters of credit to cover the funding needed. They could also demand first charge over specific company assets, such as Sainsbury's £7.5bn property portfolio, although this would have to be valued as if vacant, thereby reducing the value of the security.

Sainsbury has already raised £2bn by securitising more than half of its properties last year and paying £350m to the scheme.

The demand that may resonate loudest is that schemes rank above the banks lending to private equity firms. That way, in an insolvency, scheme members are most likely to be paid in full.

If Sainsbury's trustees manage to secure this demand they would probably be the first to do so.

Additional reporting by Pan Yuk

POWER PACK – SUPERMARKET TRUSTEES

John Adshead chairman of the pension scheme trustee board since 1993. Former human resources director at Sainsbury

Richard Chadwick company-appointed, joined board in 2005. Previously worked as director of internal audit and director of corporate finance at Sainsbury. Former deputy chief executive at Sainsbury's Bank

Law Debenture Trust appointed by the company to be an independent trustee on the board in 2005. Mark Ashworth, director of Law Debenture's pension trustee company, acts as the main representative. He is a barrister and is on the council of the Society of Pension Consultants

Hamish Elvidge company-appointed, since January 2006. Worked at Sainsbury since 1980. Posts included finance director of Sainsbury supermarkets and director of finance and IT systems at Savacentre

John Adshead: former human resources director at Sainsbury

BESTrustees, independent pension trustee company. BESTrustees' website lists Sainsbury as a client of Peter Thompson, a director of BESTrustees with 30 years' pensions experience

Ian Dewnes member-nominated, since 2005

Robert Connolly member-nominated, since 2002

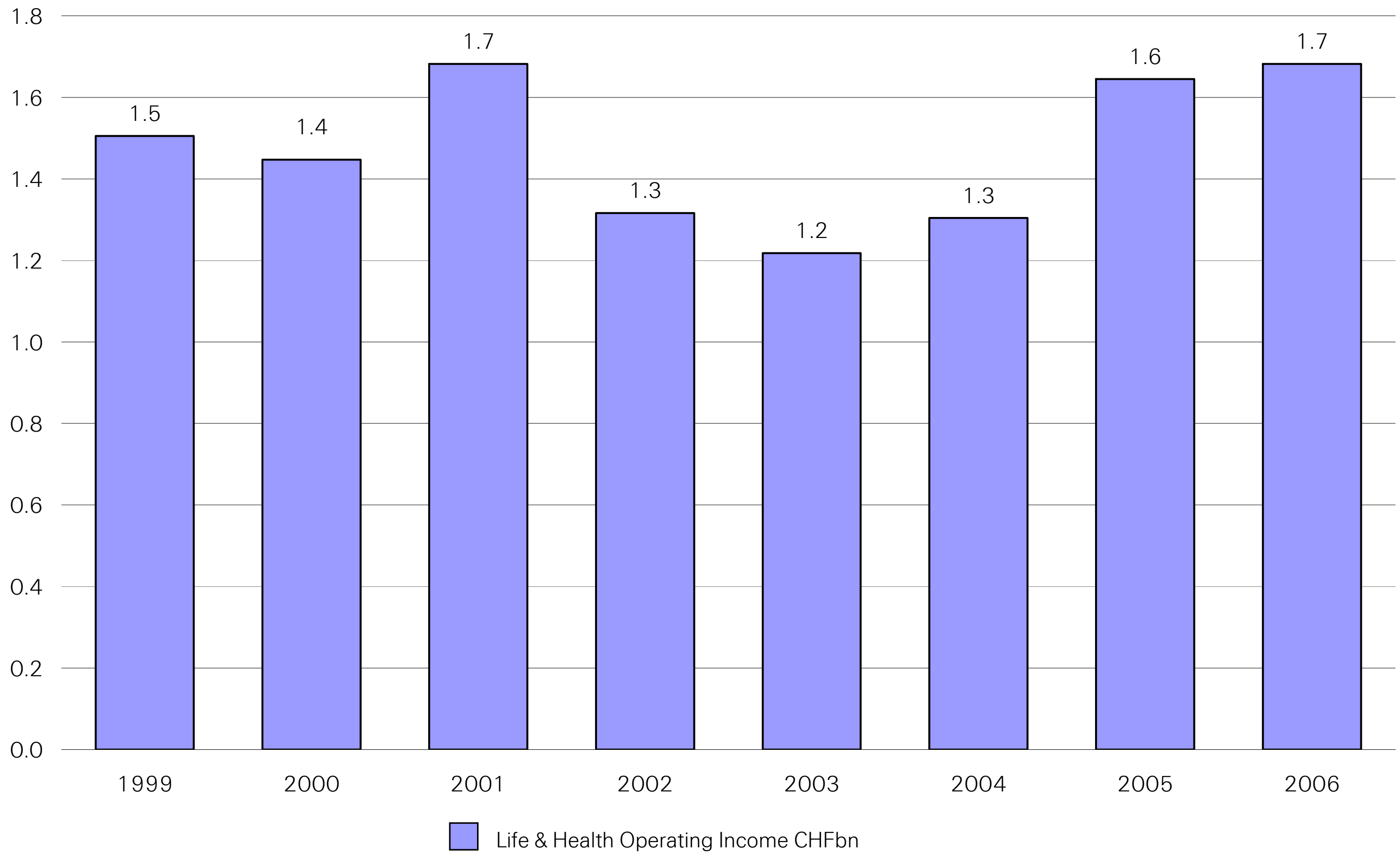
Kirsty Klaczkowski member-nominated, since 2004

Adrian Page member-nominated, since 2003. A store manager in Bournemouth

Swiss Re & longevity

- Historically Swiss Re has avoided longevity risk. Why?
  - Historical trends in mortality experience
  - Significantly different price expectations between buyers and sellers
- Swiss Re's mortality strategy has 'paid off'

Swiss Re Life & Health operating income
1999 - 2006



Source: Swiss Re annual report

Operating income includes net realised investment gains on non-participating business

Total accumulated L&H operating income 1999-2006 CHF11.8bn

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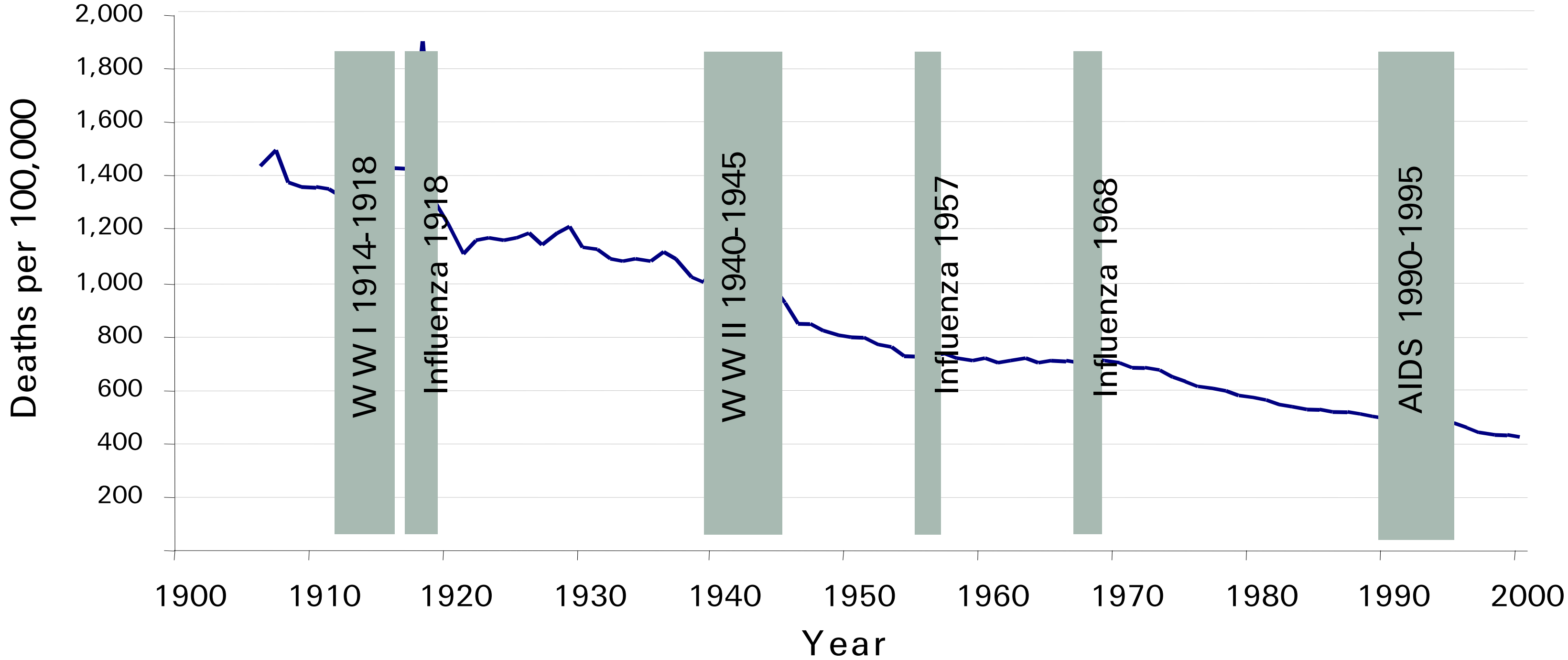
Historical trends in mortality experience

Age-standardised death rates, US males



Source: Stanford University, US Food & Drug Administration, US Civil War Centre.
Centers for Disease Control and Prevention (US)

What has changed?

- Significantly greater awareness of changes in life expectancy by
  - Trustees
  - CEOs, CFOs
  - Media
  - M&A professionals
- Price expectations between buyers and sellers have converged
- Mortality improvements have started to slow down .... unfortunately ‘immortality’ is not achievable

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Life expectancy at birth

	World	USA	UK	Europe	France	Germany	Latin America	Japan
1950-1955	47	69	69	66	67	68	51	64
1960-1965	53	70	71	70	71	70	57	69
1970-1975	58	72	72	71	72	71	61	73
1980-1985	61	74	74	72	75	74	65	77
1990-1995	64	75	76	73	78	76	68	80
2000-2005	65	77	78	74	79	79	72	82
2010-2015	68	79	80	75	81	80	74	84
2020-2025	70	80	81	77	82	81	76	85
2030-2035	72	81	82	79	83	82	78	87
2040-2045	74	82	83	80	84	83	79	88

Source: United Nations, World Population Prospects, 2004 Revision

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Swiss Re´s longevity value proposition

- Swiss Re´s ‘longevity’
- Swiss Re´s financial strength
- Swiss Re - the mortality expert
- Swiss Re´s financial services expertise
- Longevity is a good balance to our mortality portfolio
- Potential sellers are our clients

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Swiss Re's 'longevity'

1863	Founding of the company
1906	San Francisco Earthquake, Swiss Re establishes its reputation
1910	First branch office in New York
1950-1956	Opening of offices in South Africa, Canada, Australia, Hong Kong
1968-1976	Creation of several advisory and service companies in Asia and South America
1994	Refocus on core business - selling majority shares in several insurance companies
from 1995	Development of financial services offerings
1996-2001	Strengthening of life and health business through several acquisitions
2003-2004	Strengthening market position in Asia
2006	Successful acquisition and integration of GE Insurance Solutions

Swiss Re´s financial strength

Standard & Poor's	AA- (Very strong) / Stable Outlook[1]
Moody's	Aa2 (Excellent) / Negative Outlook[2]
A.M. Best	A+ (Superior) / Stable Outlook[3]

- Life & Health market share[4] 21% - world ranking 1
- Swiss Re available capital[5] CHF40.6bn
- Swiss Re 2006 net income CHF4.6bn, ROE 16.3%

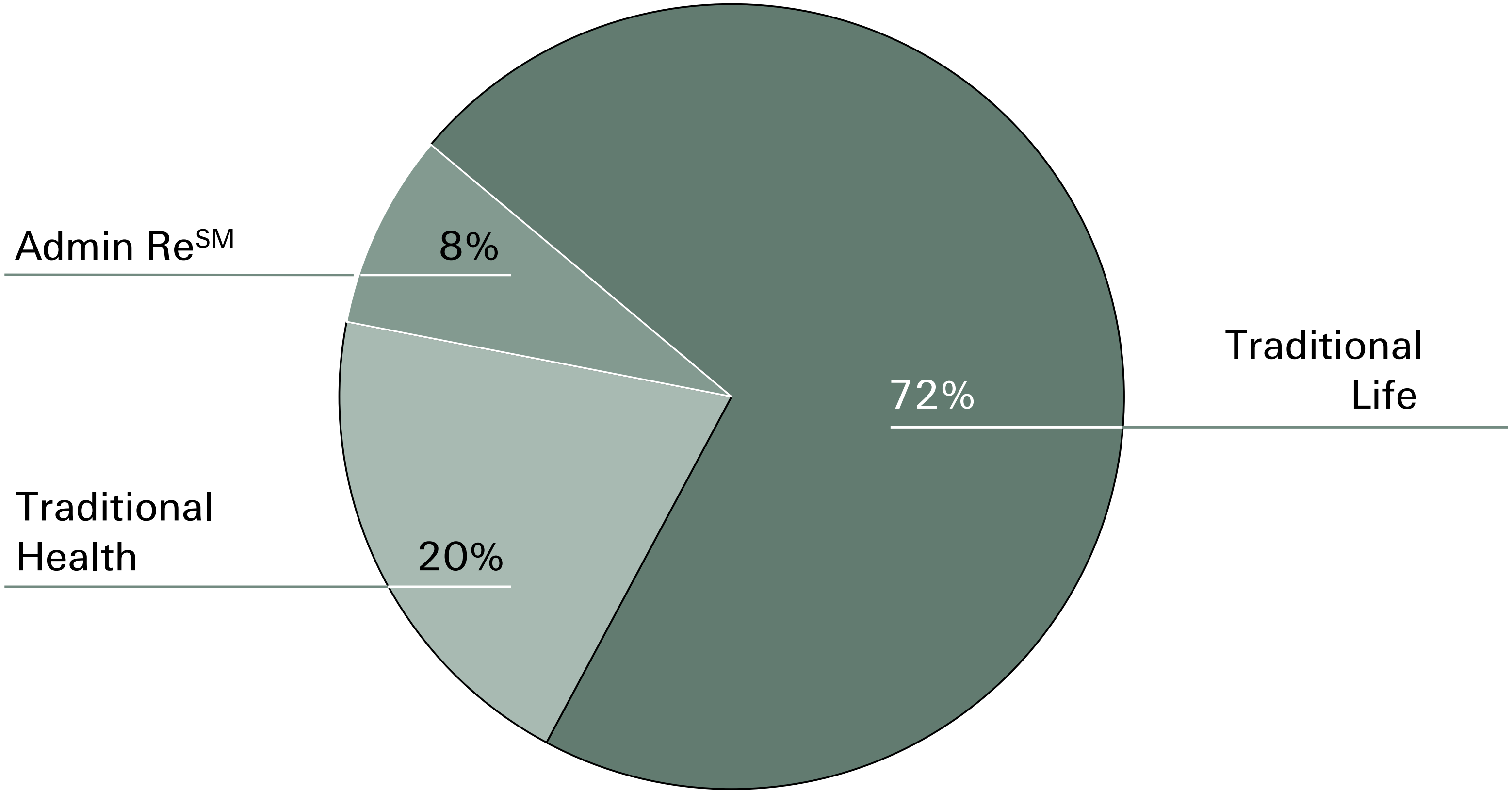
(1) As of 12 June 2006
(2) As of 19 May 2006
(3) As of 23 August 2006

(4) Market share measured by premiums earned 2005 Source: Swiss Re, Economic Research & Consulting and Strategy Development

(5) Available capital mid 2006 on Swiss Gaap basis including GE Insurance Solutions. Source Swiss Re annual report

Swiss Re - the mortality expert

Total premiums earned 2006: CHF 11.0 billion



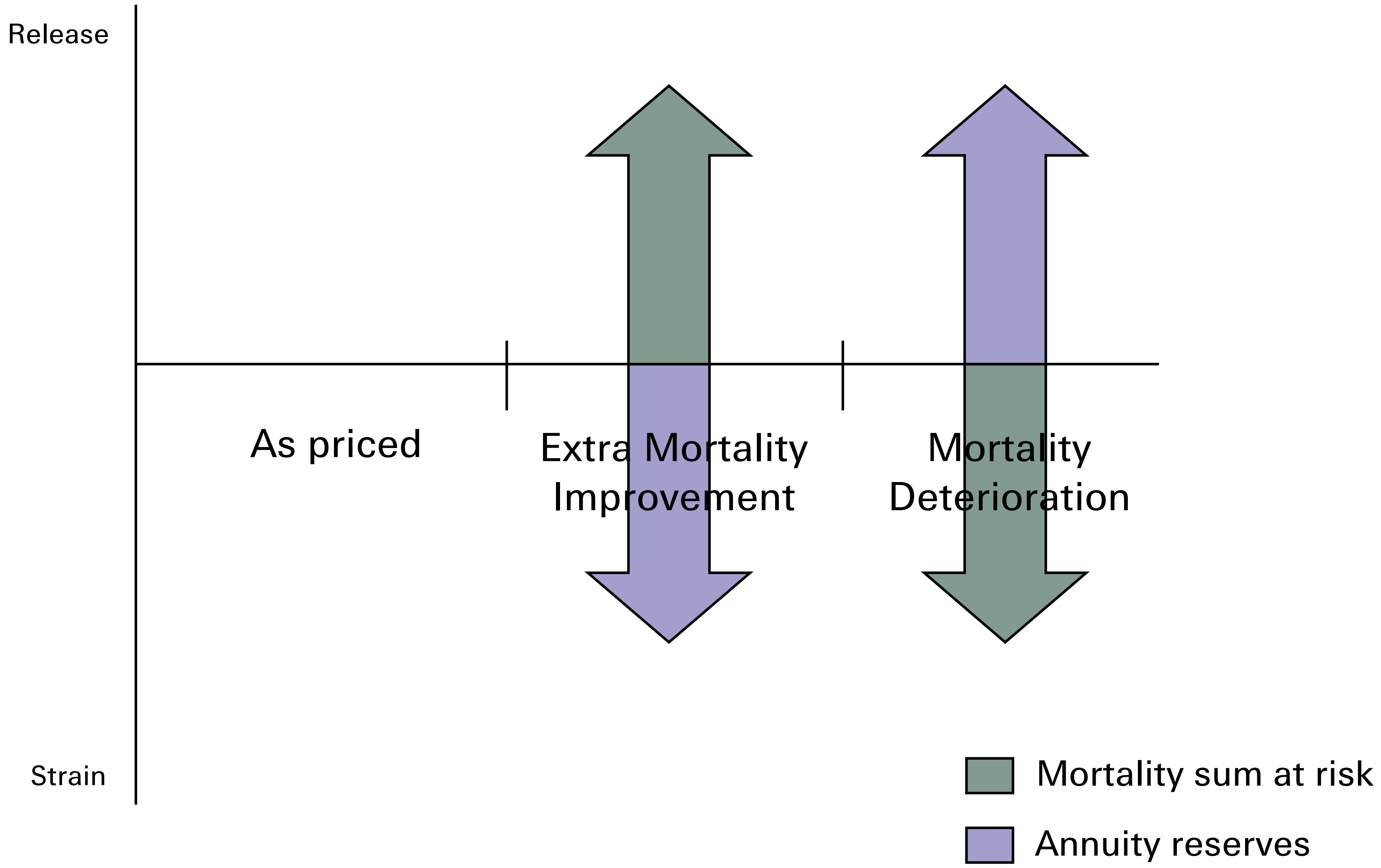
Source: Swiss Re 2006 Annual Report

Swiss Re´s financial services expertise

- Leading position in credit solutions and hedging techniques
- Assets under management of CHF172.5bn
- Excellent track record for third-party asset management through Conning Asset Management
- Leading position as structurer and underwriter of insurance-linked securities
- Capital markets

Longevity is a good balance to Swiss Re´s mortality portfolio - illustrative

Swiss Re



Potential sellers are our clients

- Property and casualty insurance companies
- Life insurance companies
- Captives
- Public sector / governments
- Large corporations
- Financial institutions
- Institutional investors

Key messages

- Historically we have focused on mortality
- Significantly greater awareness of changes in life expectancy
- Price expectations between buyers and sellers have converged
- Swiss Re is uniquely placed to succeed
- We will do deals shortly