

TOP TEN STRUCTURING CONSIDERATIONS FOR LONGEVITY SWAPS

This document has been drafted with the input of senior legal practitioners from firms actively involved in the longevity hedging market. It outlines 10 key structuring features that should be considered alongside commercial factors (e.g. pricing) when implementing a longevity swap transaction. It is intended to frame contractual negotiations and to simplify and streamline the documentation process.

1. Coverage: Which members are being covered (i.e., pensioners, deferred members, certain benefit sections/tranches of members)?
2. Structural options: An insurer is needed to pass the risk to the chosen reinsurer. Will the insurer be onshore or offshore or is either option being considered? What are the key structural considerations/issues for each option?
3. Limited recourse: Assuming a conduit insurer (rather than an 'intermediated' transaction), will a limited recourse structure be used (i.e., will the conduit insurer need to rely on limited recourse)?
4. Deal certainty: Will a term sheet summarising key terms, alongside price, be used to select the preferred reinsurer and highlight/avoid issues?
5. Termination: Do any of the parties specifically require any special termination rights? What are the consequences of termination (i.e. fault and non-fault based)? What is the termination process – will there be an initial termination settlement followed by a true-up (i.e. two-stage) or a single settlement?
6. Counterparty credit risk (both ways and taking into account transaction duration):
 - a. Collateral set-up and structure – collateral eligibility criteria (including concentration limits and haircuts); title transfer and/or security accounts (will the approach differ between experience and fee collateral?); and governing law (having regard to jurisdiction of reinsurer and location of any secured custody accounts). If security accounts are relevant, is there a preferred custodian?
 - b. Will settlement of payments and/or collateral be effected on a direct settlement basis between the reinsurer and the scheme? If so, (i) will direct settlement apply from day one or (ii) are there any situations where direct settlement would need to be switched off?
 - c. Are there any particular netting issues associated with title-transfer arrangements and is there a requirement to ensure that any security or title-transfer arrangements constitute a 'financial collateral arrangement'?
7. Transaction agents: Which agents are to perform the transaction services (e.g., calculation agent and valuation agent) and from what jurisdiction(s)? In what circumstances, if any, can such agents be removed (e.g., if the original agent has defaulted/is in a fault termination scenario) and which party will step in if they are removed (and on what cost basis)?
8. Operational aspects: Are there particular operational aspects that need to be factored into the process? Including:
 - a. Reporting of errors, lump sums, deaths, existence checks and/or suspensions
 - b. Collateral management – process and timings for valuing and reporting on collateral and then effecting any delivery/return amounts. At an early stage, the ability should be checked of: (i) the collateral manager to facilitate collateral set-up and to implement proposed operational processes, and (ii) the custodian to accommodate the desired instruction regime regarding withdrawals/substitutions of any posted collateral subject to security interests
 - c. The preparation of flow diagrams/operational schedules reflecting the preferred operational processes
 - d. Any specific existence checking, sanctions or audit requirements
9. Data: What will the data flows be on the transaction? Are there any special requirements for data transfer or the treatment of personal data, including where data can and cannot go?
10. Future proofing requirements: Do any of the parties have a need to deal with future events (e.g., events impacting the scheme such as buy-ins/ buy-outs, mergers, change of trustee or events impacting benefits such as GMP equalisation, liability management exercises, scheme related events, partial events)? If so: (i) what processes are required, and (ii) which of these could be negotiated at the time (i.e., to avoid over-complicated day-one contractual drafting)?

CONTRIBUTORS

| | |
|-------------------------|--------------------------|
| Allen & Overy | Pacific Life Re |
| Clifford Chance | Pinsent Masons |
| CMS | Sackers |
| Eversheds Sutherland | SCOR |
| Gowling WLG | Slaughter and May |
| Herbert Smith Freehills | Swiss Re |
| Insight Investment | Travers Smith |
| Linklaters | Willkie Farr & Gallagher |

IMPORTANT NOTICE

This document is the product of an extensive drafting process with contributions from leading law firms and in-house lawyers in the pensions and (re)insurance industry in the United Kingdom and is only intended to be used as a guide. It has been a collaborative process and no one firm, company or person is responsible for the drafting. None of the law firms or lawyers involved were engaged to provide legal advice – all their time was kindly volunteered.

The participating firms and lawyers have not individually approved the final draft and assume no duty of care to anyone in relation to the document or for any purpose to which the document, in whole or part, may be used. You should always seek professional advice as to whether the use of this document, in whole or part, is appropriate for you and your circumstances. By using this document, you acknowledge and accept the foregoing.

CONTACT

For more information on this document and the collaboration between longevity hedging specialists, please contact Natsai Gondo (Senior Lawyer) at natsai.gondo@insightinvestment.com.