

Future shock

Predicting is a dangerous game. Reviewing previous predictions is an even more dangerous game. Before making predictions for 2012, BRAVE Partners reviews its 2011 predictions for the insurance industry, energy industry and pensions.

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The book, "Future Shock" grew out of an article entitled "The Future as a Way of Life". Whilst the future is not necessarily a way of life at BRAVE Partners, it is important to a progressive, forward looking firm. At this time of year many, including BRAVE Partners, will publish some predictions for 2012. BRAVE Partners is also brave enough to review its 2011 predictions.

The predictions

BRAVE Partners made three predictions for each of the three sectors in which the firm operates: Insurance, Alternative Energy and Pensions.

Before seeing how well the BRAVE partners' predictions fared, it is worth mentioning that these predictions are not made on the basis that the firm has a superior crystal ball. They are made to provoke thought about the underlying trends within the industries that the firm tracks.

Insurance sector predictions

BRAVE Partners made the following three predictions for the insurance sector.

- A major block of payout annuities in the UK will be placed into formal run-off
- A major P&C reinsurance carrier will fail
- A diversified financial risks insurer will be established

Taking each in turn, BRAVE Partners reviews each prediction.

A major block of payout annuities in the UK will be placed into formal run-off

This prediction has not happened. However, the prediction was based on a view that the combination of the following bases were progressively making annuities an unattractive and unnecessary product: tax changes that gave pensioners the freedom not to annuitise their pension saving by the age of 75; low interest rates driving down annuity rates; and high and increasing (due to Solvency II capital requirements) expense.

BRAVE Partners fared worst in their predictions for the insurance industry, but the firm believes that the predictions were just ahead of their time and that time is still on their side here.

However, Metropolitan Life, the US life office and the largest in the world has recently launched new pension products in the UK that are set to compete directly with the traditional annuity market. These

The fact that Met Life, the world's largest life insurer, is bringing new retirement products to the UK is an important milestone in the UK life and pensions market.

products offer shorter term guaranteed income levels and more exposure to equity investments. These products are better suited to the income / investment needs of today's pensioners. BRAVE Partners continues to believe that the days are numbered for the traditional annuity as a large scale product in the UK pension market. At some point a major carrier will withdraw and place its book into run-off.

A major P&C insurance carrier will fail

This prediction has not happened. It was based on the premise that rates were extremely low and a single, major natural disaster could push one into insolvency.

Whilst there have been several major natural disasters (the Sendai earthquake in Japan and; flooding in Thailand to name two) none has yet pushed a major reinsurer into insolvency.

The lack of insolvencies might well be a product of the excess capital in the industry which has been consumed by the disasters, leaving many carriers vulnerable. Moreover, price increases will be limited by capital flowing into collateralised reinsurance vehicles as prices rise.

P&C reinsurers remain vulnerable to major losses into 2012. A bad hurricane season, or continued unexpected major events could see a major carrier fail.

A diversified financial risks carrier will be established

BRAVE Partners has long identified a market need for a diversified financial risks insurer. 2011 did not see one established, but a number of teams continue to work on establishing businesses in this area. Some of the businesses are reasonably specialist covering specific financial risks, such as residual values.

BRAVE Partner continues to strongly believe in the business case for a financial risks insurer and believes that one might well emerge within 2012.

Alternative energy predictions

BRAVE Partners made the following three predictions for the alternative energy sector.

- EU carbon credits to trade at or below €5 a tonne
- EU legislation will be introduced requiring the installation of smart meters
- The USA will lift the offshore drilling ban

Taking each in turn, BRAVE Partners reviews each prediction.

EU carbon credit to trade at, or below, €5 a tonne

Whilst €5 is an outrageously low price prediction, many of the downside risk factors to the EU carbon market that BRAVE Partners identified to make this prediction have materialised. The EU carbon credit

market did trade down to as low as €6.50 per tonne, which is substantially lower than many, some of whom ridiculed this prediction, might have foreseen. EU credits ended 2011 at €6.97

BRAVE Partners continues to see downward pressure on EU carbon prices from the factors that the firm identified.

The economic turmoil in Europe is barely into Act II and the firm predicts that the later Acts will be even more gruesome before the mutilated corpse settles down into a long period of stagnation. Recession places significant downward pressure on carbon prices as energy demand diminishes.

However, beyond the recession there was the complete failure to replace the Kyoto Accord at the Durban Climate Change Summit during 2011. Ahead of the summit, the Chinese delegation had already said that a failure to agree on new carbon emission limits would dry up the future of the UN's carbon trading market. This is the first time that the fate of carbon trading has been linked to the emergence of an agreement on limits in a public forum. BRAVE Partners has long advocated that clear buy-in from China and the USA is essential for the longevity of traded carbon markets and that until this happens prices will always be suppressed.

At the time, prediction that EU carbon credits would trade down to €5, or less, was considered lunacy. BRAVE Partners deliberately picked a very low number to highlight the downside risk factors to carbon pricing.

Whilst the prediction was not met, the fact that carbon pricing did get so close (€6.50) means that BRAVE Partners considers this component a great success.

BRAVE Partners is a vocal advocate for new energy generation, but investors do have to carefully consider the risks of technologies that are too dependent on carbon pricing.

[EU legislation will be introduced requiring the installation of smart meters](#)

This prediction is reasonably accurate. In March 2011, the EU published their Energy Efficiency Plan 2011. This states:

“Smart grids and smart meters will serve as a backbone for smart appliances, adding to the energy savings obtained by buying more energy-efficient appliances.”

BRAVE Partners believes that smart grids and smart metering is essential if the electricity grid is to be balanced with a significant proportion of the generation coming from intermittent, renewable sources (ie wind and solar). The firm expects to see the continued development and deployment of the smart grid and smart metering technology.

[The USA will lift the offshore drilling ban](#)

Offshore drilling in the USA is such a political issue that it is hard to determine the outcome of this prediction. What is clear is that the USA is look to become more self sufficient in oil and gas production. The proliferation and success of shale gas will allow oil exploration to be slowed, but not halted.

The signals on lifting the moratorium are mixed. The ban on drilling in the Gulf of Mexico has been successfully challenged in the courts. How far the Administration takes the appeals process remains to be seen.

The five-year plan for offshore drilling was announced in November. This allowed for new areas on the Gulf of Mexico and Alaska to be drilled, but maintained the ban on drilling off the East and West coasts. Moreover, on August 4, 2011 Royal Dutch Shell was granted conditional approval to begin drilling exploratory wells in the Arctic Ocean next summer.

BRAVE Partners believes that the US will progressively allow deep water drilling, but this will remain a slow, controlled process. Sarah Palin will have to wait for the full “drill, baby, drill”.

Pensions predictions

BRAVE Partners made the following prediction for the alternative pensions sector.

- In 2011 the fixed annuity will be replaced by products that allow a variable income and continued investment throughout retirement.

BRAVE Partners reviews this prediction below.

In 2011 the fixed annuity will be replaced by products that allow a variable income and continued investment throughout retirement

Whilst it has not fully materialised, this prediction is clearly in progress. Traditional annuity products are alive and well within the UK market. However, as noted above, the US giant life office, Met Life, has launched a range of products that allow continued stock market investment whilst drawing some income for the UK pensions market. These products allow for various partial guarantees on the minimum level of income.

BRAVE Partners sees this as the start of a continuing trend. The UK life offices will need to adapt to the trend of suffer a significant loss of market share.

BRAVE Partners' services

BRAVE Partners is a boutique investment bank that serves the (re)insurance, alternative energy and pensions sectors.

The firm has seen significant success throughout 2011, including raising over £60m for a biomass project.

The firm excels where clients are seeking advice on transactions that lie outside the ordinary. The partners have advised a major US industrial firm on hedging their exposure to healthcare cost inflation. The firm has developed and arranged a number of transactions for insurance companies to hedge against the risk of rising commodity

- BRAVE Partners published a number of predictions at the beginning of 2011.
- Whilst these were intended to be speculative and served only to highlight trends within the sectors that the firm follows, it is still worthwhile reviewing them.
- The BRAVE partners have been pleasantly surprised by the accuracy of their predictions.
- In many ways the most speculative prediction, that EU carbon credits would trade down to €5 proved to be the most accurate.

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prices and other forms of inflation in both the non-life and life industries. The firm is committed to developing this business.

Interaction

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