

Pensions: Retire to the pool

The great pension buy out experiment looks over in the UK. Pension advisors are concerned that sponsors and trustees are left with few options but to tough it out. BRAVE Partners speculates whether risk pooling could be a solution.

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General corporates are not the best managers of the vast savings and annuity books that form the pension for the UK. The insurance buy out business does make sense as a life insurer should be the natural home for the risk. However, the buy out business does not make so much sense as a monoline, UK onshore business. It boils down to the issue of what a monoline buy out company can bring to the table that one of the large incumbent players, Legal & General and Prudential, cannot.

Buy out business was the new black

As the markets recovered in 2002 (from sharp falls from the collapse of the internet bubble), the Pensions Act, 2004 made an occupational pension scheme even more onerous for its sponsor, a number of monoline insurance businesses sprang up. These were the pension buy out businesses, destined to profit from buying and managing the unwanted occupational pension schemes of corporate UK. Banks and hedge funds fell over each other to fund this business.

Black to black hole

Like many fashions, the buy out market faded over time. One start up failed to attract any business at all. The others were slower starting and wrote smaller volumes than predicted. Most important is the fact that the prices that these business accepted to take on pension liabilities were often significantly lower than originally touted. Competition was fierce, especially as all the start ups needed revenue to get going.

The facts of life

The facts of life were beginning to emerge. Selling a pension scheme is a very expensive business. In order to have a scheme bought out, sponsors, that have a scheme in deficit, have to produce cash to support that deficit as well as further cash to provide a return on the risk capital for the buy out company. The risk capital for a monoline buy

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There is a strong argument for smaller and mid-sized companies in the UK that are struggling with their occupational pension plans to club together to build their own captive, or pooled, insurance buy out company. This would provide them with both better and cheaper access to hedging, risk transfer and management expertise. Moreover, it would remove the pension from the company balance sheet – assuming that ownership is broad enough spread.

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out company is also quite substantial. Pension liabilities are long dates and riddled with uncertainties. Inflation and longevity are two things that can be hedged to some extent. Wage inflation and a large number of marriages to significantly younger spouses are two risks that cannot be hedged.

Risk premium

An investor needs a substantial risk premium in order to take on the uncertainties of a pension plan. Most straight annuity reinsurers will not look at deferred and active members of a pension plan. Certainly the emerging longevity swap market does not cover these members. This drives the price up even higher.

Risk pooling

Risk pooling is not a new concept. Lloyds, in its coffee shop days, started around a risk pooling concept and morphed into a full blown insurance market. Today the global oil and chemicals industry pool risks through two Bermuda companies Oil Insurance Limited (OIL) and OIL Casualty Insurance Limited (OCIL). Risk pooling works where a number of entities are exposed to a concentrated, complex risk that has no ready external market. UK occupational pension schemes fit the bill.

Benefits of risk pools

Risk pools have two benefits. Firstly, a risk pool gains some benefit from diversification. For example a risk pool of pension plans from all over the UK would have cheaper and more ready access to the longevity swap market because its risk will look like the UK standard tables. In contrast a small pension plan in Dorset, on its own, would have very limited and expensive access to this market.

Secondly, a risk pool allows the expenses to be spread more widely, allowing greater, and more sophisticated, resources to be applied to the problem – in this case pricing and risk managing pension liabilities.

A pension pool

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Creative buy outs

BRAVE Partners recommends careful consideration of the jurisdiction of the insurer. The partners believe that the problems in the UK monoline buy out companies stems from the fact that they are UK primary insurance companies. The UK regulation limits their flexibility. The fact that these businesses are also monoline bulk annuity businesses means that the regulation is even more restrictive than it might be for a larger carrier. EU pasporting laws allow a primary insurer from any EU state to issue policies in any other state. There are considerable potential advantages to setting up the business in Ireland, or another EU member country. The buy out specialists were set up in the UK partly because their founders believed that the insurer had to be in the UK to attract business. If the business is captive, then this argument no longer applies. The pensions can be bought out in any format permitted by regulation that is acceptable to the sponsors.

BRAVE Partners Services

BRAVE Partners can advise pension plans and their sponsors on hedging and transferring their risks. BRAVE Partners LLP can build a pooled risk insurance platform for a group of sponsors. Pensioners have a better quality of life when they can retire to the pool.

Interaction

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- The UK pensions buy out market failed to materialise.
- Pricing was too expensive for the sponsors.
- Risks and financial flexibility is restricted in the providers.
- BRAVE Partners can advise sponsors and trustees on hedging and risk transfer for pension plans.
- BRAVE Partners is keen to speak to a pool of pension plans about the benefits of establishing a 'captive' buy out company for their pension plans .

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