

The private sector parachute?



As pension fund buyouts become more common and the UK Pension Protection Fund (PPF) levy struggles to find a settling level, a new player is poised to offer defined benefit (DB) pension funds another solution to risk management.

BrightonRock is the brainchild of twelve seasoned finance professionals from different sectors of the industry. When it officially launches in July, BrightonRock will aim to offer company pension funds an alternative way to secure their members' futures.

The basis for this venture lies in insuring a company against bankruptcy, a situation which could ultimately spell disaster for its pension fund.

Con Keating, analyst, BrightonRock, explained: "What we will be presenting is similar to the PPF, but we guarantee to pay the full pension promised to scheme members."

Keating added: "The PPF states members would receive 90% of their original pension promise if the company fails, but often schemes will not get close to that."

There are similarities between what this new company would offer and the PPF's current set-up. Indeed, by demonstrating a company has taken steps to manage its risk by buying into BrightonRock, its PPF levy may be reduced or even removed completely.

BrightonRock versus PPF?

BrightonRock offers an insurance policy to companies by charging a premium based on a percentage of their pension fund liabilities which would usually work out to less than 1% of that amount.

To qualify for the scheme, a pension fund should be at least 85% to 90% funded. Once the fund hits a surplus of over 15%, the premium would be eliminated. The PPF levy, on the other hand, would only be reduced once a company pension scheme reached a 140% funding ratio.

"There's no point in asking a company to pay as much to us if it is extremely over-funded. Through our risk management we can produce extremely cheap annuities. With the reduced risk a well funded company scheme offers, there is no need to charge them as much," clarified Keating.

Keating used the analogy of house insurance to illustrate how it would function differently to the PPF.

Keating explained: "With the PPF you are effectively paying to keep a Winnebago at the end of the garden. If your house burns down, that is to say, if your company or pension scheme fails, you have the Winnebago to live in and that's it."

"We're not offering that. Through the insurance premium companies pay BrightonRock,

they'll have their house rebuilt exactly to the same state it was. In other words, the pension would be paid as it was promised to members."

BrightonRock versus buyouts?

Unlike a bulk annuity buyout performed by Paternoster, Pensions Corporation et al, Keating claimed the BrightonRock solution would not require a company to find as much as 30% on top of its liabilities to indemnify its obligations.

Studies by Aon and other consultants have revealed there is appetite from companies to remove the risk posed by a pension fund from its books and everyday management, but a full buyout necessitates the defined benefit scheme to be closed or in wind up.

Keating quoted a CBI survey showing at least 40% of UK companies wanted to keep their pension schemes open, but found it increasingly difficult.

Partial buyouts allowing the scheme to remain open have become more popular, but such a bespoke solution also comes at price.

He went on: "If a company can afford to pay the extra 20% or 25% of the pension fund liabilities they would need to carry out a buyout, it must be in a very strong position, or have more money than sense."

Keating asserted BrightonRock would charge a smaller premium to the company and would allow it to keep the scheme open.

BrightonRock versus LDI or risk sharing?

As liability driven investment has been gaining more followers in recent times, could pension funds not avoid any type of insurance solution or risk indemnification through canny investing?

Keating didn't think so: "The problem of pension liabilities is institutional in nature and capital markets cannot predict the future and promise to offer a full solution to members, not even using LDI or derivatives."

With the Pensions Bill 2008 making its way through the UK parliament, the argument for a third way or a solution to share risk between sponsoring companies and their pension scheme members has been reignited.

The BrightonRock solution would seem to remove any need for this, however, which could appear, at least for some, too good to be true.

Could this insurance company shoulder all the risk it intends to take on and what are the practicalities for a company buying into this product?

Once a company buys into the BrightonRock solution, for as long as it pays the premium, the

Elizabeth Pfeuti talks to Con Keating and Andrew Slater of BrightonRock, a new company looking to bring a different insurance offering to the defined benefit marketplace

"Our strength is in time diversification and the belief not all the companies will go bust at the same time"

Con Keating, BrightonRock

insurer would cover all its future liabilities. Not only that, but the percentage premium would remain the same for the life of the policy.

Keating stressed that even if a company got into financial difficulties, BrightonRock could not increase its premiums or reassess its cover.

This puts the onus on the insurer to get its investment decisions right.

Keating commented: "Yes, we are taking on a lot of risk. However, our strength is in time diversification and the belief not all the companies will go bust at the same time."

The company taking on such a policy would have more freedom to leave the deal, however.

Keating illustrated how a company could deactivate a pension scheme by shifting assets and liabilities to another vehicle; by doing this, it could reduce its necessary payments to BrightonRock to nothing.

BrightonRock's target client base would be companies with funds no larger than £3.5bn but no smaller than £30m.

Keating said communication between them and the insured company was paramount.

He explained: "If a company finds itself in trouble, we are here to offer what help we can."

If an insured company were to collapse, BrightonRock could end up being a major creditor, so manoeuvres to prevent this happening would be a priority.

Keating claimed the insurer would even advance working capital to assist the company's recovery.

"We don't want to be involved in the day to day running of the company in times of prosperity, that's not the aim of what we're doing, but if we can help prevent a company blowing up, it's a win-win situation," he added.

Similarly, BrightonRock would not get involved with a company's pension fund investment.

Keating said: "We want to know where and how a company is investing its assets, but we have our own money to run."

"If they are investing in something we are not confident about, we can short it and be covered that way," he added.

But with a potentially huge liabilities bill to foot, where is BrightonRock looking to put its own money?

As with any regular pension fund, the directors have taken a long term view of investment and acknowledged the benefits of diversification within a portfolio. Alongside traditional assets, the BrightonRock fund also has stakes in private equity, hedge funds and timber.

However, the company would steer clear of commodities. According to Keating, this asset class, not being a capital asset, would not generate a productive return.

Where does the company plan to market its model and would it work in any market?

Andrew Slater, actuary, BrightonRock, said the product could be used in almost any country where there were DB pension schemes.

Said Slater: "What we are offering translates almost perfectly to the Irish and New Zealand markets. We have based the initial product on British bankruptcy laws, which have strong ties to these two countries' own."

He added that BrightonRock would consider the US market, but bankruptcy laws in that country were very different to those in the UK and the product would need adjustment.

The insurance company claims it has been reviewed and agreed to in theory by government ministries and official pension regulatory bodies, however, only time will tell whether BrightonRock will become a permanent fixture on the pension fund solution landscape.

With a team bench showing experience of the NATO, Credit Suisse-First Boston and Nomura pension schemes, not to mention backgrounds in trusteeship, investment banking, insurance and law, the company at least has a good launch pad.