Insight INVESTMENT

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HEDGING LONGEVITY RISK
THE BENEFITS OF AN OFFSHORE INSURER

UK PENSION SCHEMES SEEKING TO PASS LONGEVITY RISK TO A REINSURER ARE REQUIRED TO USE AN INSURANCE INTERMEDIARY, WHICH MAY BE ONSHORE OR OFFSHORE. WE OUTLINE THE KEY BENEFITS OF AN OFFSHORE INSURER COMPARED WITH AN ONSHORE UK INSURER.

While an onshore UK-authorised insurer may offer a more recognisable insurance approach and brand to trustees, there are advantages to pension schemes in utilising an offshore approach (most commonly via a Guernsey-domiciled entity):

- **Control:** The offshore entity is owned by the pension scheme and typically supports only a single longevity hedge transaction, meaning that it is dedicated to the needs of the scheme and not subject to the risks associated with the competing business interests of a UK insurance company.
- **Capital efficiency:** Not beholden to the stringent Solvency II requirements placed on onshore insurers, offshore insurers have lower capital requirements, which can reduce costs for pension schemes.
- **Ease of novation:** When novating to buy-in or buy-out, an offshore insurer and its servicers terminate with no further payments due. An onshore insurer may have retained some of the longevity risk, making the novation process more complex; impose a termination payment equal to the value of all future intermediation fees; and/or have opposing interests if they compete with the bulk annuity provider.

FREQUENTLY ASKED QUESTIONS

How do the ongoing costs compare?

Although costs will inevitably vary depending on the specifics of a given transaction, it will typically be the case that the offshore approach is cheaper than the onshore structure. This is a result of the capital efficiency of the offshore structure and the fact that the services provided are primarily administrative.

How complex is setting up an offshore vehicle?

The processes for setting up an offshore insurer are well tried and tested, with Guernsey-based structures having been around for decades. A new vehicle can typically be set up within weeks or months, with the majority of the work being done by the appointed insurance manager.

Does the implementation approach differ?

The implementation process is broadly the same regardless of whether an offshore or an onshore insurer is being used, not least because most of the work will be focussed on the reinsurer rather than the insurer.

An offshore structure is likely to require a small number of additional legal documents compared to the onshore approach. However, the legal documentation of the onshore approach may be more complex in the event that the insurer wishes to retain some of the longevity risk.

How does the ongoing governance compare?

The governance requirements under the offshore route can be very similar to those of an onshore structure, if that is the trustees' preference.

However, the offshore route also offers trustees the ability to have more control over the structure. For example, trustees can be on the board of the offshore insurer, giving them influence over how the insurer is managed.

Is the offshore route commonly used?

Since the British Telecom Pension Scheme first used an offshore insurer for their £16bn longevity swap in 2014, over 40% of all pension scheme longevity swaps have used an offshore approach (over 60% by volume), typically via a Guernsey-domiciled structure.

FURTHER READING

Insight's longevity platform uses a Guernsey-domiciled offshore structure to transfer pension schemes' longevity risk efficiently and effectively.

More information is available in our paper and on our website.

IMPORTANT INFORMATION

RISK DISCLOSURES

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ASSOCIATED INVESTMENT RISKS

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Institutional Business Development
businessdevelopment@insightinvestment.com
+44 20 7321 1552

European Business Development
europe@insightinvestment.com
+49 69 12014 2650
+44 20 7321 1928

Consultant Relationship Management
consultantrelations@insightinvestment.com
+44 20 7321 1023

@InsightInvestIM
company/insight-investment
www.insightinvestment.com