Towers Watson cuts out middleman in longevity risk transfer deals

By Editorial Staff *Mon, Dec 15, 2014*

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Towers Watson has launched a service aimed at removing the need for insurance intermediaries when UK defined benefit (DB) funds transfer longevity risk, IPE.com reported.

The consultancy has set up ready-made "insurance cells," which allow pension funds to deal with reinsurance companies directly in longevity swap arrangements.

Reinsurers only transact with insurance companies or banks, meaning DB funds wishing to hedge longevity risk have to access the market via an intermediary firm. Longevity swap deals have reached £32bn in 2014 as DB schemes continue to use the insurance market as a prime source of de-risking.

The move by the consultancy comes after its involvement in advising the trustees in BT Pension Scheme's (BTPS) mammoth £16bn (€20bn) longevity swap. In that deal, BTPS transferred its longevity risk to a newly created and wholly owned insurer, which then transferred the risk to US-based Prudential Insurance Company of America, avoiding significant intermediary fees.

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This, Towers Watson said, would reduce the costs of entering a longevity swap arrangement by cutting the intermediary fee and removing the need for price averaging.

It said the costs of a typical transaction of £2bn in liabilities could come close to £30m in intermediary costs, with Longevity Direct having the potential to save "several million pounds".

Shelly Beard, senior consultant at the firm, said DB schemes not being charged price averaging would lead to significant savings. Price averaging occurs when insurers or banks typically engage with several reinsurers to spread credit and counterparty risks, and exposure limits.

This means pension funds end up paying several levels of fees, which deteriorate as the intermediary engages each additional reinsurer. However, via a single transaction and where the pension fund is comfortable with a single counterparty, it could select the best pricing in the market.

Beard also said the offering was much more stripped out in terms of intermediary costs charged to pension funds, allowing for further savings. Keith Ashton, head of risk solutions at Towers Watson, said: “Pension scheme and reinsurer interests are typically very aligned. A direct agreement can be much less complex than the longevity swaps we have seen in the past.”