

OFFSHORE PENSION PLANS – UNDER THE MICROSCOPE

Last year, some 40,000 investors around the world chose to start saving for retirement through pension plans with offshore insurance companies, investing £200m pa in doing so.

Given the scale of these numbers it is germane to analyse:

- what offshore pension plans offer;
- their merits compared to other forms of retirement planning; and
- what sets one pension plan apart from another?

The following paragraphs will, I hope, help to answer these questions and give the reader an independent insight into the uses of offshore pensions.

For most investors, the first encounter with offshore pensions will be through recommendation by a financial adviser (be it a bank, broker or personal financial planner), although direct investment is possible too. A healthy degree of cynicism is advisable, given that intermediaries are remunerated through commission. Nonetheless, packaged pensions do have a useful role in expatriate retirement planning, provided their pros and cons are properly understood. Furthermore (and see later) some useful pointers can be given to getting the best possible deal.

Although many insurance companies have offshore operations, only a minority of them have products aimed at the needs of regular savers. In this respect, the main pension companies are:

Company	Location	Web-site	Product
Eagle Star International	Isle of Man	www.eaglestarintlife.com	<i>Vista</i>
Friends Provident International	Guernsey	www.fpinternational.com	<i>Guernsey International Pension</i>
Hansard	Isle of Man & Dublin	www.hansard.com	<i>Universal Retirement Programme</i>
Royal Skandia	Isle of Man	www.royalskandia.com	<i>Managed Pension Account</i>
Royal & Sun Alliance IFS	Isle of Man	www.rsaiifs.com	<i>International Pension Plan</i>
Scottish Provident International	Isle of Man	www.spila.com	<i>Momentum</i>

A number of other insurance companies (Generali International and Canada Life International in particular) offer general-purpose savings plans, which can be used equally for retirement planning purposes. These savings plans are simpler, and often are more flexible, but are outside the scope of this particular study.

Product Features

All of the pensions plans listed above have one thing in common, in that the pension contributions buy “units” in the investment funds offered by the insurance company. In this respect, being unit-linked, they resemble unit trusts or offshore funds, where each investor’s capital is pooled to form a collective fund which is then invested by the investment manager in a diversified portfolio of shares, bonds, deposits and other asset types.

One area where pension plans differ from unit trusts is that the choice of investment funds in the former is much, much wider. Normally, the insurance company will offer funds from a range of investment managers (Fidelity, Invesco, Gartmore etc) in addition to its own range of in-house managed funds. Pension plan savers can freely switch between different funds, (over 100 in the case of some pension plans), fund sectors and asset managers, and generally at little or no cost.

Most pension plans are intended for investors with 10 or more years to retirement. Stopping or reducing contributions is normally not possible or advisable in the first 2-3 years of commencement, though this is very much a function of the savings term selected at outset. In general terms, investors should commit for the least possible term, as this offers the best value and the most flexibility. It is easier to extend the contribution period than it is to shorten it (which is purely a by-product of commission being linked to the savings term or years to retirement).

In some cases, pension plans offer links to with-profit funds, managed funds or other funds whose asset allocation is suited to retirement fund purposes. Some companies also offer “LifeStyle” funds whose asset mix changes with age and/or proximity to retirement.

Insurance Benefits

As previously seen, one notable difference between offshore pension plans and offshore funds is that the former offer a “multi-manager” solution (i.e. funds from a range of managers, not just one). A second major difference is that insurance companies can, uniquely, offer insurance risk benefits within the pension plan. These protection benefits come in various forms and combinations:

- Life assurance - an optional extra sum assured payable on death (any cause) or in some cases an enhanced sum payable on *accidental* death
- Major illness insurance (“critical illness”) where a sum insured is received on diagnosis or incidence of a serious medical condition (heart disease, stroke, cancer etc)
- Disability benefits, where pension contributions are met by the insurance company if the insured is unable to work on account of disability
- Hospitalisation benefit, where a set sum is payable for each day in which the insured is hospitalised.

These risk benefits are generally available, regardless of where in the world the insured is working, and as such can be ideally suited to expatriates. The benefits are, of course, medically underwritten at outset, and meet many real financial planning needs.

Other Investments Compared

In the space available, it is impossible to compare offshore pensions with all other forms of regular savings, so offshore funds and unit trusts - being the closest popular alternative - are used for comparison. All offer regular savers an investment in stock-market assets (which doubtless will soon go up in value and not just down!) and take regular savings typically of £100 per month (or currency equivalent) and above.

In this comparison, pension plans have a number of advantages:

- **fund choice** - a wider choice of funds (e.g. 100+) and investment managers (10+) within a single savings product
- **switching** - switching between different funds and different managers is inexpensive and easy, with the insurance company taking care of all fund administration, settlements and currency conversions

- **discounts** - insurance companies buy offshore funds and unit trust on wholesale terms, so their policyholders are able to benefit from discounted investment terms that would not be available to direct fund investors
- valuable **insurance benefits**, as noted above, can be optionally included within the pension plan
- most insurance companies offer a comprehensive range of **trust services**, enabling the accumulated pension saving to be written easily and cost-effectively under trusts designed to mitigate inheritance tax, forced heirship and other estate planning problems
- offshore pension plans can easily accept regular savings in **most major currencies**
- depending upon country of residence and other factors, pension plans (and life assurance policies generally) can benefit from possible **taxation concessions**
- **investor protection** - most of the pension plans available are written by Isle of Man insurance companies. As such, investors (wherever resident) can benefit from the policyholder protection and financial ombudsman schemes established under Manx government statute.

On the negative side, offshore pension plans:

- are less flexible (in terms of stopping/starting regular savings) and less transparent in charges.
- are more expensive, particularly in the early years when charges are generally highest.

On balance, before taking account of complications such as free switching (which can reduce the cost difference) and early termination charges (which significantly increase the cost difference) we would generally say that pension plans over the medium to longer term are 1.0-1.5% pa more expensive than investment in offshore funds. This price differential varies by company. The differential is accounted for in part by commissions, and in this regard increasingly more and more advisers are prepared to negotiate reduced commissions. Any commission savings will be rewarded with improved investment terms, so it pays to haggle – particularly if you are saving a large sum of money.

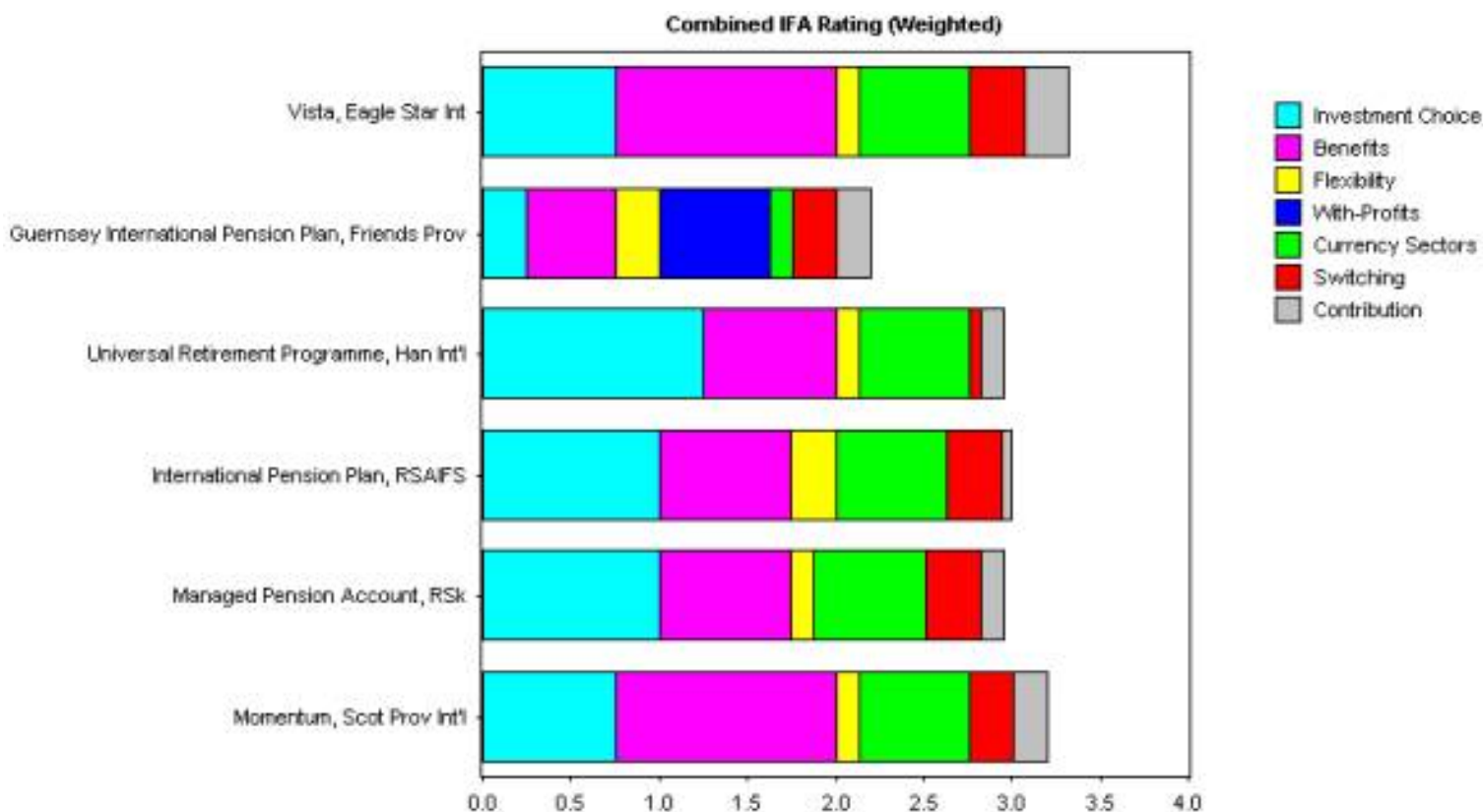
A LifeBase Analysis

“*LifeBase Offshore*” is a widely used software system developed by Boal & Co to analyse pension plans and other offshore insurance arrangements. By means of in-depth analysis and powerful software, it is possible to compare different products from perspectives such as:

- price;
- performance; and
- features.

As an example, Figure 1 below analyses products from a qualitative aspect, looking at matters such as features, investment, choice, flexibility and protection benefits. (It does not allow for cost or for performance.) The larger the bar, the “better” the product (from a qualitative perspective).

FIGURE 1 – QUALITATIVE COMPARISON



However, this type of analysis by itself is incomplete. It is all very well knowing what the features of a product are (be the product a television, washing machine or whatever); what is equally pertinent, or perhaps more so is - what is the performance relative to the price? In other words, what is the best performing product, taking into account cost?

An Overall Performance measure would ideally take account of *all* product charges and each product's achieved performance record – which is exactly what LifeBase Offshore does. A number of different views are possible, based upon the type of funds (managed, equity, fixed interest etc, or indeed all funds taken together), and different performance periods (1, 3 or 5 years for example). The following example shows historic annual returns for each product over a 5-year period, based upon investment in International Managed Funds.

Company	Overall Performance
	<u>% per annum</u>
Eagle Star International	+7.9% pa
Hansard International	+4.8% pa
Royal & SunAlliance International	+2.9% pa
Friends Provident International	+1.1% pa
Royal Skandia	+0.9% pa
Scottish Provident International	-0.2% pa

Source: LifeBase Offshore+: figures are annualised returns as at 30th April 2002, net of all charges, assuming an investment of £400 per month invested in each company's International Equity range of funds.

Naturally, different performance periods and different types of funds produce different results, and the relative ranking can and does change over time (though some trends are evident). As regulators are quick to say, past performance is not necessarily a guide to the future.

What *is* beyond all doubt, however, is that the difference between a high performing product and a low performing product can be as much as 8% per annum in the net return on capital. For someone saving over

10 years, that can mean a difference of **50%** in the accumulated fund at retirement.

In summary, offshore pension plans are more flexible than their UK counterparts and do have a very useful role to play in saving for retirement. Pension plans offer a number of advantages, compared to other potential forms of saving, but care should be taken to negotiate the best possible terms with your adviser and to avoid over-committing on term. The products on offer do differ noticeably in terms of features, price and performance, so ensure that your adviser (if you have one) is able to justify any recommendation having regard to these all-important aspects.

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