FT.com FINANCIAL TIMES

Pensions have billions in toxic assets

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Published: October 20 2008 03:00 | Last updated: October 21 2008 17:07

Pension funds across Europe, Asia and North America stand to lose hundreds of billions of dollars from investment in so-called "toxic" assets.

Concern is also growing that clients of European private banks have also been left holding tainted mortgage-backed assets, potentially triggering a wave of litigation.

The International Monetary Fund has estimated that worldwide losses from structured products such as collateralised debt and loan obligations, asset-backed securities, commercial paper-backed securities and structured investment vehicles will hit $945bn (£546bn, €705bn), with some private estimates far higher still.

Banks have so far announced more than $400bn of writedowns related to these toxic assets, with much of the rest likely to be held by pension funds and wealthy individuals as well as insurance companies.

Amin Rajan, chief executive of Create Research, a consultancy, calculates that structured products such as CDOs, CLOs, ABS, SIVs, CPBS and capital protection products accounted for 8 per cent of the $15,000bn of global pension fund assets when the credit crunch hit last year. Of this, up to $700bn could be toxic.

"There is about $400bn to $700bn of this toxic waste sitting on the balance sheets of pension funds, especially in Denmark, Germany, France, Sweden, Japan and the US. As a percentage of total pension assets it's not great, but at the margin it's a huge sum of money. It's localised to some pension funds but for them it's going to be a problem," said Mr Rajan, who argued that the triple A ratings once enjoyed by much of this toxic alphabet soup would have lured pension funds in.

"On the continent and Japan equity culture is less powerful than bond culture and the idea of a triple A rating is a powerful driver, as it is in the US."

Defined contribution pension schemes may also be caught up in the maelstrom with, for example, members of Danish schemes often buying monthly deferred annuities that may have been backed by assets that have now plunged in value.

However, the UK appears to have escaped relatively unscathed. David Norgrove, chairman of the Pensions Regulator, said a survey of the UK's 80 largest schemes found "relatively limited exposure" to toxic assets.

For US funds, there appears to be some uncertainty as to whether they could benefit from the government-sponsored troubled asset relief programme.

The US Treasury told FTfm that, in consultation with the Federal Reserve, it can purchase "any troubled asset if it determines that is in the interest of market stability".

Jenny Eller, partner at Groom Law Group, a US law firm that represents a host of major pension plan sponsors, said: "It seems to us that it is broad enough to cover pension plans," but she added that this was still to be confirmed.

"From the Treasury viewpoint they could say pension plans are long-term investors so it doesn't make any sense to purchase this stuff from them," said Ms Eller.

Mr Rajan forecast that a number of US pension plans would be likely to launch class actions against the investment banks that sold them toxic assets.

Ray Soudah, founder of Millenium Associates, a Swiss advisory firm, said legal action was also likely against private banks.

"There are huge portfolios of structured products in private banks. Some of those have collapsed and are worthless and some of them cannot be marked to market," he said. "Clients are saying 'You did not tell me all the risks. I want my money back'."

Abu Dhabi Commercial Bank has already filed a lawsuit against Morgan Stanley, BNY Mellon and two rating agencies over losses resulting from a collapsed $6bn SIV managed by London-based Cheyne Capital - paper that also appears to have been placed by private banks with their clients. "A lot of [Cheyne Finance paper] was sold to private banks' clients. I think we have a contingent problem of huge proportions," said Mr Soudah.