THE TIMES
Tuesday February 13 2007
UK Business

New bond will open pension fund door to private equity

Christine Seib

Pension Insurance Corporation (PIC), the latest company to join the pensions buyout market, is developing a new type of longevity bond that would allow private equity firms to take on chunks of Britain's pensions liabilities.

Led by John Fitzpatrick, former chief financial officer and head of the life and health business at Swiss Re, the world's second-largest reinsurer, PIC is examining the possibility of securitising extreme longevity risks to pass them on to fixed-income investors.

Mr Fitzpatrick's experience at Swiss Re, where he helped to develop the world's first extreme mortality bond, is likely to prove invaluable. In an interview with *The Times*, he said that this year companies would begin looking seriously at the solutions offered by the buyout market for offloading their pensions liabilities.

"They want to get back to operate the core business without the threat that the Pensions Regulator could limit their ability to make an acquisition, buy back shares or issue dividends," he said. "There's no value premium in running a leveraged investment fund in addition to their day jobs of running their core business."

But Mr Fitzpatrick said that it would take more than a year to develop a new fixed-income answer to the pension liability problem. "The first step will be to build a large, diversified portfolio, which will certainly take more than a year. We could then move certain types of risks into special purpose vehicles and allow investors to buy units of risks that fit their risk appetite. It's a market that would develop over time. It wasn't that long ago that people wouldn't have imagined a lethal epidemic bond, but in a few years I think longevity bonds will be commonplace."

Final salary pension fund liabilities have rocketed as improvements in mortality have dramatically increased the number of years that schemes must pay retirement benefits. On average, Britons are adding an extra two years to their lifespan every decade.

At the same time, a more powerful Pensions Regulator and new rights for pension fund trustees have increased companies' enthusiasm for offloading their pension funds, sparking a boom in the bulk annuity market. In the past year, at least three start-ups, including PIC, and two existing insurers have joined the sector.

The most simple method of creating bonds to protect PIC from huge improvements in longevity would be to hive off the most extreme risks. In return for handing over a principal sum to PIC, investors would receive an attractive yield. If the large improvement in life span did occur, investors would forgo their principal.

The proposition would appeal to firms already invested in businesses that benefit from people living longer — such as private equity firms with investments in the leisure, health and care industries — because the risk of losing their principal would be offset by gains from their other investments and the lure of a healthy fixed income.

PIC, which is backed by investors including JC Flowers & Co, ABN Amro, Swiss Re, HBOS, RBS, Sampo Life, as well as private equity firm Coller Capital and hedge funds including Cycladic Capital, raised £1 billion at its launch last October.

Mr Fitzpatrick said that this was sufficient to buy liabilities of up to £20 billion, and that the company had no plans to raise any more cash.

He said that PIC had supplied quotes on a number of fund sales between October and December and was waiting for a response. "The gestation period is very long for these transactions," he said. "It can take up to six months for a decision to be made."

The company has not yet appointed a panel of asset managers to handle the assets it will take on. "We've given it a considerable amount of thought, we'll be deciding what we want to own and what we don't," Mr Fitzpatrick said.

Profit and loss

£1,000bn
Pension fund liabilities in the UK

£130bn
Total deficit of final-salary pension schemes in the UK

£120bn
Annuities currently in payment by insurers

£1bn
Cash raised by PIC on launch

£20bn
Liabilities PIC could buy with launch cash

Source The Times

PAUL ROGERS

Just his cup of tea: John Fitzpatrick loves finding solutions to seemingly intractable problems

Quiet American who revels in risk

Christine Seib

John Fitzpatrick looks like the quiet American accountant of his CV. But appearances are deceptive, for the 51-year-old thrives on extreme risk.

As chief executive of Pension Insurance Corporation (PIC), a company set up to take on established insurers in pension fund buyouts, he will need all his ingenuity to compete in an increasingly crowded market.

The decision to join PIC followed a chance meeting with founder Edmund Truell, the chief executive of private equity firm Duke Street Capital. After more than eight years as chief financial officer and head of life and health at Swiss Re, Mr Fitzpatrick was looking for something new.

"As a former finance director of two publicly traded companies, I've been there for the emotional discussions with trustees and management about why pensions liabilities are one of the most difficult expenses to have in an organisation," he said.

"I could see that the issue was one that was going to create a lot of opportunities."

A specialist in creating financial solutions for seemingly uninsurable risks, Mr Fitzpatrick is well placed to tackle Britain's pensions problem. While at Swiss Re, he helped to create the first extreme mortality bond, in which the reinsurer transferred to fixed income investors the risk of its reserves being hit by a lethal epidemic.

He said: "I was first exposed to catastrophe bonds in 1996 but these were real caveman-era bonds. When I moved to Swiss Re, we focused on making a number of improvements in the structure of transferring non-life risks from the insurer to the capital markets and in 2003 we sold a life risk for the first time."

As well as stints at Kemper Corporation and Zurich Insurance Group, Mr Fitzpatrick worked on solutions for two other notoriously difficult risks: setting up companies to sell hurricane cover in Florida and earthquake cover in California.