JP Morgan Hedges U.K. Workers' Longevity Risk

By Editor Test *Thu, Feb 3, 2011*

If the life expectancy of its pensioners improves at a greater rate than specified in the contract, the Pall UK Pension Fund receives an insurance payout from JP Morgan.

In the first deal to hedge against higher life expectancy for a company pension plan's working members—as opposed to retirees—JP Morgan has taken on £70 million ($113 million) of longevity risk of the Pall UK Pension Fund, Reuters reported.

The index-based longevity swap with the trustees of the Pall Pension Fund, part of global manufacturer Pall Corp., has a 10-year term. If the life expectancy improves at a greater rate than specified in the contract, the fund receives an insurance payout.

The first longevity risk bond was issued by Swiss Re in December, which passed on $50 million of its own longevity exposure to the capital market in a bond format.

How does it work? According to a 2008 article in, "In a swap, the pension scheme or annuity provider agrees to pay a fixed sum (based upon the sum–or principal–that the scheme is seeking to protect from erosion by a specific risk) at certain times to the other party, usually an investment bank. In return, at certain times, the scheme will receive a payment that is calculated upon a floating basis. This is the difference between the assumptions used when determining the scheme's payments, and the actual position of that risk," said a 2008 article in *Engaged Investor* magazine.

"In a longevity swap," the article continued, "the fixed leg is based on projected mortality rates, while the floating leg is based on subsequently realized mortality rates. If realized mortality rates are lower than projected, the swap involves a net payment to the buyer (i.e., the pension scheme) and, if the swap has been appropriately designed, this will be approximately sufficient to compensate the pension scheme for the additional pension payments it has to make on account of the mortality of its members being lower than anticipated."

JP Morgan said on Tuesday the Pall swap contract was based on future values of its LifeMetrics longevity index—a toolkit for measuring longevity and mortality risk in England and Wales, United States, Netherlands and Germany.

"Index-based hedges are particularly well suited to hedging the longevity risk of pension plans with significant deferred and active members," David Epstein, head of longevity structuring at JP Morgan, said.

JP Morgan is the hedge provider and collateral custodian for the deal, which was structured by investment manager Schroder, to cover the British pension scheme liabilities related to about 1,800 members, with assets of £120 million.

Only a handful of longevity swaps have been formatted to work for a pension scheme in Britain—around £8 billion worth in the past five years, according to specialist insurer Pension Insurance Corporation.

In the biggest swap so far, German carmaker BMW offloaded £3 billion ($4.6 billion) of risk from its British pension scheme to Deutsche Bank's insurance subsidiary Abbey Life last December.

Previous longevity deals have focused solely on pension plan members who have already retired, as hedging against increased life expectancy of members still working has been difficult to measure, JP Morgan said.

JP Morgan belongs to the Life & Longevity Markets Association, an organization of investment banks, insurers, brokers and pension providers set up last year to construct capital market instruments to slice longevity risk into tradable portions. Other current members of the LLMA are AVIVA, AXA, Deutsche Bank, Legal & General, Morgan Stanley, Pension Corporation, Prudential PLC, RBS, Swiss Re and UBS.