

Scotia Capital Raised \$500M to Launch Canadian Reinsurer

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Before the ink was dry on his \$43.5-million contract, Pittsburgh Penguins' management negotiated life insurance for hockey great Sidney Crosby. Soon after, the company that was stick-handling Crosby's hefty policy passed their risk to a secondary firm.

Insurers to the stars are always in the market for insurance themselves. Welcome to the little-known, complicated world of reinsurance.

Reinsurance is an obscure business involving future risk models and a lot of number crunching. But a private equity deal brokered by Scotia Capital has made the sector sexy again.

In November, Scotia Capital announced that it had raised \$500-million -- the third-largest offering in Canadian history -- to create a new reinsurance company, Aurigen Capital. This is only the second time in a decade this kind of financial services firm has been launched.

Aurigen Capital, headed by Alan Ryder -- the former president of Employers Reassurance Canada -- is poised to step into the Canadian marketplace. The major international players in Canada, including Munich Re and Swiss Re, only have, respectively, \$1.3-billion and \$1.25-billion in capital invested here. Given that they have been in business for decades, Aurigen's \$500-million is not that much less, says John Sherrington, vice-chairman, head of financial services for Scotia Capital. "In effect, we have a start-up in Canada that's not materially smaller than the largest reinsurance company in the world."

So how did such a complex deal attract four major private equity players? Through a lot of preparation and paperwork.

The origin of the deal began in 2001, when General Electric, spooked by events around 9/11, decided it was time to get out of the life insurance business. First, it spun out its U.S. life insurance and reinsurance business, Genworth Financial, as an IPO, and sold its shares into the market. In 2006, GE sold off its property and casualty insurance business to Swiss Re. That left the Canadian reinsurance business. "In Canada, the initial plan was to spin it out [the reinsurance division] as a standalone entity, but GE backed out for internal reasons," says Mr. Ryder.

Faced with the disappointment of having spent two years on developing an IPO without reward, the players at Scotia Capital could have walked away and licked their wounds. Instead, the principals, vice-chairman Mr. Sherrington and managing director David Skurka, nudged Mr. Ryder into taking a different route.

The team had already made the rounds of the big insurance companies, and had received the thumbs up; all the primary insurance firms wanted another competitor in the market. Based on the demand, Scotia put the valuation of a fourth company in the business at \$1-billion. Valuation was the key, and in reinsurance, getting it right is a complex process. For starters, a large amount of capital is required to be invested upfront, and the profits must flow in a regular and predictable manner, though initially they may take a few years to emerge. This is known in Canada as "embedded value."

With that in hand, team Scotia signed the private equity firm, Maple Financial Alternative Investments, as an angel investor to help subsidize the months of paperwork necessary to educate the investor base.

"Given this was going to be one of the largest fund raises in Canadian history for a startup, we wanted to have a [complete] professional package for investors to take the opportunity seriously, and to some degree limit the post-commitment due diligence," says Mr. Skurka.

With package in hand they started knocking at doors. Although the business is suited for pension plans, none of the big Canadian players bit.

"The business model made sense for the zero beta asset class, but the problem, of course, is that it's a complicated business," says Skurka.

Scotia approached 15 investment firms. Edgestone Capital Partners became the lead investor, and managing director Gilbert Palter brought in Pine Brook Road Partners and Soros Strategic Partners, both based in the United States. Scotia Capital brought in the European player, Englefield Capital Partners.

By getting out of Canada, GE had created a real hole in the business, Mr. Ryder said. "We think this is an outstanding investment from a risk-return ratio," he adds.

If it's such a good investment, then why didn't someone else do it?

Simple, says Mr. Ryder: "There are high barriers to entry. Canada has high capital standards in the financial services space, and the existing players are well established. If this hadn't been an experienced team, I don't think we would have raised the money."

In fact, Mr. Ryder's experience is so valuable that his own company has taken out a \$10-million life insurance policy on him. Although Mr. Ryder won't say who's holding his policy, he has no doubt that they've already diversified their risk by parceling it out to other reinsurance companies. Even Mr. Ryder can appreciate the irony: "My competitors have a piece of me."