Presentation to:

The Actuaries Club of the Southwest

Market Impact of LOCs and Capital Market Alternatives

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Alex Cowley, FIA
Lehman Brothers
Insurance Solutions Group
(212) 526-9525
acowley@lehman.com

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Options for Capital Markets Risk Transfer

Transaction	Approx Cost	Highlight of Result	Market Considerations	
XXX Capital Relief	(L+) 75-125	◆ Frees excess reserves against term insurance products. ◆ Avoids reliance on LOC's.	**Capital Markets:**	Requires long term financing and stable rates.
Surplus Relief	(L+) 125-250	◆ Frees encumbered surplus capital AND releases some reserves in *Operating Company*. ◆ Reinsurer assumes catastrophic-like risk in conjunction with non-recourse "balance sheet" lending against future profits.	**Reinsurance Markets or Capital Markets:**	Requires short-term financing against a portion of embedded value.
Targeted Block Securitization	(L+) 75-300	◆ Raises new capital at *holding* company. ◆ Investor provides limited recourse term financing.	**Capital Markets:**	Requires long-term financing using cash against a portion of embedded value.

Options for Capital Markets Risk Transfer (Cont'd)

Transaction	Approx Cost	Highlight of Result	Market Considerations	
"Preferred Tracking Stock"	*7-10%*	◆ *Raises equity capital at holding company and shares targeted performance.* ◆ *Dividend payout can be an attractive feature.*	***Capital Markets:***	*Institutional or Retail.*
Risk Transfer	*10-15%*	◆ *Frees encumbered surplus capital AND releases all reserves in Operating Company.* ◆ *Reinsurer/Buyer assumes risk and capital requirements of the business.*	***Combination of Capital Markets and Reinsurance Markets:***	*Requires long-term financing against entire embedded value.*
True Sale	*12-18%*	◆ *Sale of legal entity or underlying insurance contracts.* ◆ *Buyers assume all, including new business production.*	***M&A Market:***	*Administrative burdens of reinsurance.*

Convergence of Insurance & Capital Markets

Areas of Focus

Completed

- Term Life Insurance
- Contingent Capital
- Property Catastrophe
- Embedded Value
- Credit Insurance
- Weather

Potential

- Universal Life Insurance
- Political Risk
- Reinsurance Recoverables
- GMDB Reinsurance
- Life Settlements
- Mortgage Insurance

Significant Challenges

- Terrorism
- Asbestos
- General Liability
- D&O
- Medical Malpractice

Life Insurance Securitization

Overview

- Focus is on books with significant embedded value.
- Additional source of capital for regulatory reserve and surplus requirements.
- Monetizing revenue streams not recognized as an asset on the balance sheet.

Structured Finance Approach to Raising Capital from a Block of Insurance Business

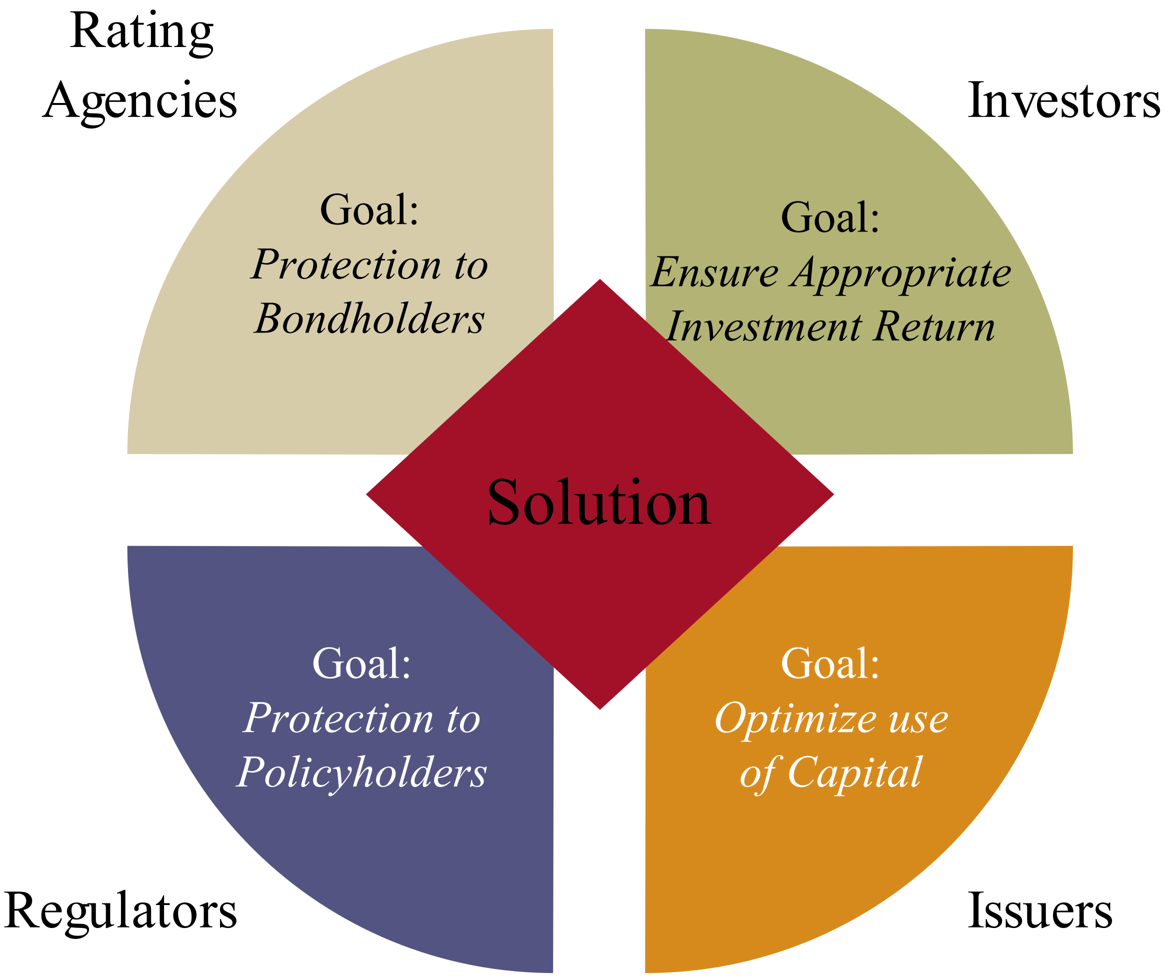
Liability Value	Financing
Catastrophic deviation from liability' expected value	"Debt" Capital
Moderate deviation from liability' expected value	Mezzanine Financing/Preferred Equity
Expected economic value of the liability	"Equity" Capital

Areas with Maximum Potential for Capital

- Closed Blocks of Participating Life Insurance.
- Non-Participating Traditional Permanent Life.
  - Industrial or Debit Insurance.
  - Pre-Need/Final Expense Insurance.
  - Direct Insurance.
- Extended Term Insurance.
- Level Term Insurance.
- Deficiency Reserves.

Structural Considerations

Structuring a capital markets solution for an insurance client requires finding the common ground between four different parties



Structural Considerations

Investors

- Investor demand will be driven by:
  - Robustness, predictability and modelability of cash flows.
  - Expected duration of securitization.
  - Existence of debt service coverage account.
  - Financial guarantee (wrapper from a bond insurer).
  - Legal form of transaction (accounting and tax implications).

Rating Agencies

- The use of securitization has recently been encouraged, but special focus is placed on whether the debt will count as operating or financial leverage.
- Securitizing embedded value is viewed favorably, but only when the unlocked value is reinvested in assets bearing a higher return.

Regulators

- Regulator approvals will be driven by their evaluation of the reinsurance contract and the on-going viability of any involved insurance companies, whether existing or newly created.
  - Policyholder benefits must maintain their priority in the capital structure
  - Reinsurance contract must be arms length

Issuers

- Utilizing the capital markets enables insurers to optimize the capital structure in several ways, including:
  - Using leverage, where appropriate
  - Lower weighted average cost of capital
  - Decreasing the equity needed to fund redundant reserves

Reg XXX

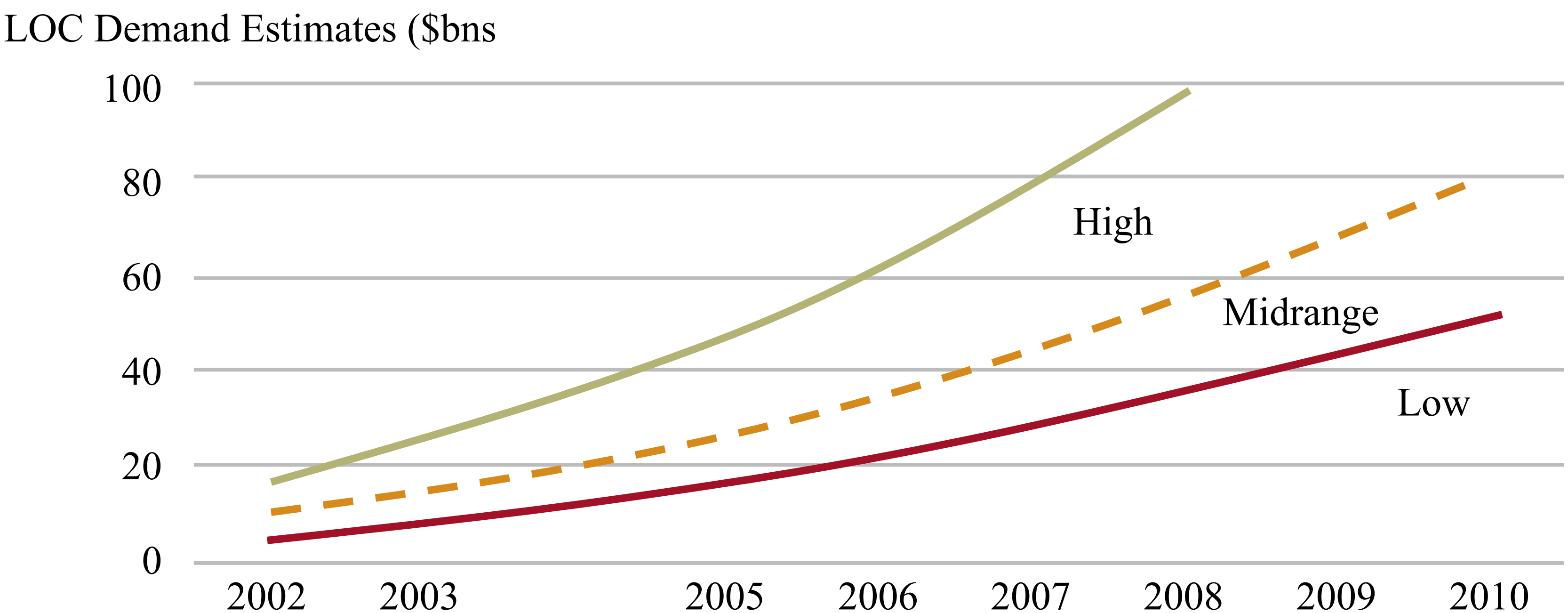
The introduction of Regulation XXX puts an uneconomic reserve burden on writers of term insurance

Negative ROE Impact	◆ The life insurance industry is becoming increasingly aware of the negative ROE impact of XXX/AXXX reserve requirements as traditional letters of credit continue to become more expensive and difficult to obtain.
Reserving Requirements	◆ Reserving requirements for guaranteed level premium term products cause a "hump-backed" capital strain, which will exacerbate with time.
Reserve Burden	◆ Companies that write (and reinsure) significant "preferred" term life insurance are expected to bear a disproportionate reserve burden.
2001 CSO Table	◆ Although the introduction of 2001 CSO tables will provide some relief, states are not expected to adopt this retroactively, and the 2001 table, while less conservative, will continue to result in excess reserves.
LOC Reliance	◆ Commercial banks are increasing their focus on single name concentration risk, reducing capacity. ◆ 364-day LOCs are subject to annual roll-over risk and increasing costs

Reg XXX Demand Forecast

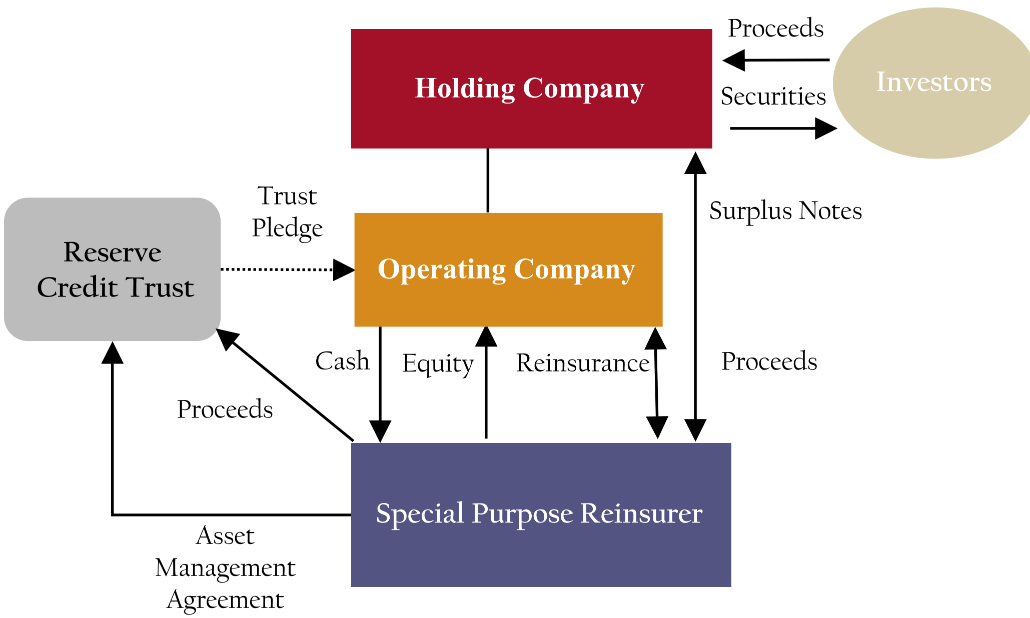
- "Moody's estimates that the potential collateral needs for the life insurance industry for level term and UL with various forms of secondary guarantee products to be between $50 and $100 billion over the next five years. Moody's believes that the majority of this amount is required for level term insurance policies; however, a nonsubstantial portion is required to satisfy the collateral needs for UL policies with secondary guarantees." – Moody's Special Comment, July 2004

Forecasted Reinsurance LOC Market Demand



* *Graph Source: Moody's Special Report: "Hidden Credit Risk of Regulation XXX / Guideline AXXX Reinsurance Programs," January 2004.*

Full Recourse Solution

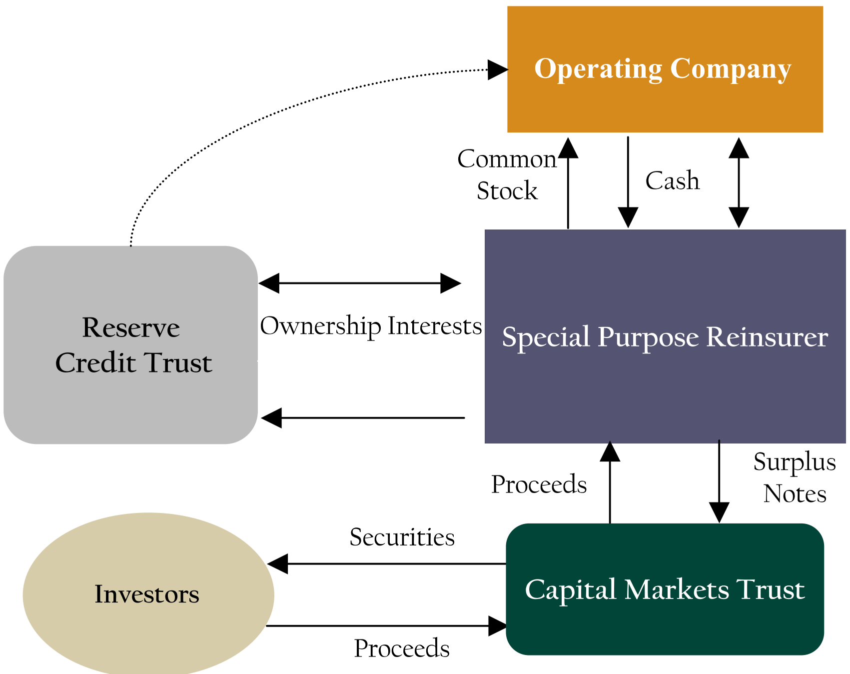


Evaluative Criteria	Onshore Full Recourse Solution
Rating Agency Leverage	Operational
Recourse	Full
Balance Sheet Treatment	On-Balance Sheet as Debt
Financing Pattern	Wedding Cake
Call Flexibility	Make Whole
On/Off Rating Agency Balance Sheet	On

Transaction Steps

1. Operating Company enters into a reinsurance contract with an affiliate Special Purpose Reinsurer.
2. Holding company issues securities to the capital markets.
3. Holding company uses the proceeds from the issuance of securities to purchase Surplus Notes from the Special Purpose Reinsurer.
4. The Special Purpose Reinsurer places the proceeds from the issuance of Surplus Notes into a Reg 114 Trust.
5. An Asset Management Arrangement is established for the Reg 114 Trust.
6. The Reg 114 Trust is pledged to Operating Company to secure reinsurance reserve credit.

Non Recourse Solution



Evaluative Criteria	**Non Recourse Solution**
Rating Agency Leverage	Operational
Recourse	None
Balance Sheet Treatment	On-Balance Sheet as Surplus Notes
Financing Pattern	Reserve Pattern
Call Flexibility	Every 28 days at Par
On/Off Rating Agency Balance Sheet	Off

Transaction Steps

1. Operating Company enters into a reinsurance contract, ceding its XXX reserves to a Special Purpose Reinsurer.
2. A capital markets trust is established, which raises capital by issuing securities to the capital markets.
3. Simultaneously, the Capital Markets Trust uses the proceeds of that issuance to purchase surplus notes from the Special Purpose Reinsurer.
4. The Special Purpose Reinsurer deposits the proceeds raised through the surplus note issuance in a Reg 114 Trust.
5. The Special Purpose Reinsurer (or an affiliate) enters into an asset management arrangement for the Reg 114 Trust.
6. The Reg 114 Trust is pledged to Operating Company to secure reinsurance reserve credit.

Sample Evaluation

XXX Structure	Standalone Total Adjusted Capital	Standalone General Account Assets	Standalone Capitalization Ratio	IIP Bucket Treatment
Fully Retained	2.0 – 0.5 = 1.5	20	7.5%	n/a
Reinsured w/ LOC	2.0 – 0.1 = 1.9	20 - 0.1 + 0.5 = 20.4	9.3%	n/a
Reinsured w/Parent Debt	2.0 – 0.1 = 1.9	20 – 0.1 + 0.5 = 20.4	9.3%	Counted
Reinsured w/Non-Recourse Securitization	2.0 – 0.1 = 1.9	20 – 0.1 = 19.9	9.5%	Excluded

- Insurer Capital & Surplus = $2.0 billion
- XXX reserves = $0.5 billion
- General Account Assets = $20 billion
- Offshore Reinsurer Capital & Surplus = $0.1 billion

* *Chart Source: Moody's Presentation: "XXX Reserves: Credit and Analytic Issues" May 2004.*

Any

Questions?