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Extreme Mortality Protection
Extreme Mortality Exposure

- Extreme mortality risks have been the focus of many life insurance companies due to earnings volatility and potential impact on solvency.

- Risks to life insurance companies can be significant. For example:
  - Increase in claims volume
  - Depressed asset values
  - Potential liquidity crisis
  - Ratings downgrade

- Important for a top-tier life insurance company to demonstrate sound mortality risk management.
## Risk Management Strategies

- While companies recognize the need for sound mortality risk management mitigation strategies remain limited and relatively costly.

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Self Insurance</td>
<td>Hold capital at levels sufficient to withstand mortality shock. Very costly from a capital point of view.</td>
</tr>
<tr>
<td>Holistic Approach</td>
<td>Recognize natural hedge provided by combination of mortality and longevity products. Hedge may be ineffective as insurance and annuity products target different age groups.</td>
</tr>
<tr>
<td>Traditional Reinsurance Solutions</td>
<td>Transfer peak mortality exposure to third party reinsurer (&quot;cat cover&quot;). Coverage typically excludes certain risks and is provided for a short period only.</td>
</tr>
<tr>
<td>Capital Markets Solutions</td>
<td>Issue ILS tied to a mortality index or company experience. Such solutions address some of the shortfalls in other alternatives and may provide capital benefits.</td>
</tr>
</tbody>
</table>
Extreme Mortality Securitization
Structure

Structure addresses the shortfalls of traditional reinsurance:
- Cover is provided without carve-outs or exclusions
- Eliminates counterparty credit risk
- Well-defined triggers allow for a clean and timely payout

- Sponsor enters into a financial contract with a newly-formed special purpose vehicle ("SPV")
  - Risk covered is that a pre-determined mortality index in one or a number of countries exceeds a certain threshold on the same index calculated in a reference period

- The SPV issues Insurance-Linked Securities to capital markets investors up to the amount of the mortality cover

- Proceeds of the issuance are placed in a trust account managed by a highly-rated counterparty subject to a total rate of return swap

- If the mortality index reaches or exceeds the trigger level, the collateral is sold and a claim is paid to the Sponsor

- If the mortality index does not reach the trigger level during the risk period, the collateral is liquidated and principal is returned to investors
<table>
<thead>
<tr>
<th></th>
<th>VITA I</th>
<th>VITA II</th>
<th>Tartan</th>
<th>Osiris</th>
<th>VITA III</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sponsor</strong></td>
<td>Swiss Re</td>
<td>Swiss Re</td>
<td>Scottish Re</td>
<td>AXA</td>
<td>Swiss Re</td>
</tr>
<tr>
<td><strong>Year</strong></td>
<td>2003</td>
<td>2005</td>
<td>2006</td>
<td>2006</td>
<td>2006</td>
</tr>
<tr>
<td><strong>Mortality Index</strong></td>
<td>70% United States</td>
<td>62.5% United States</td>
<td>100% United States</td>
<td>60% France</td>
<td>62.5% United States</td>
</tr>
<tr>
<td></td>
<td>15% United Kingdom</td>
<td>17.5% United Kingdom</td>
<td></td>
<td>5% Canada</td>
<td>15% United States</td>
</tr>
<tr>
<td></td>
<td>7.5% France</td>
<td>7.5% Germany</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5% Italy</td>
<td>2.5% Switzerland</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Risk Period</strong></td>
<td>4 years</td>
<td>5 years</td>
<td>3 years</td>
<td>4 years</td>
<td>4 and 5 years</td>
</tr>
<tr>
<td><strong>Index Calculation</strong></td>
<td>1 year</td>
<td>2-year average</td>
<td>2-year average</td>
<td>2-year average</td>
<td>2-year average</td>
</tr>
<tr>
<td><strong>Trigger / Exhaustion Levels</strong></td>
<td>130% / 150%</td>
<td>A: 125% / 145%</td>
<td>A: 115% / 120%</td>
<td>A: 119% / 124%</td>
<td>A: 125% / 145%</td>
</tr>
<tr>
<td>(% of Base Index)</td>
<td>B: 120% / 125%</td>
<td>B: 110% / 115%</td>
<td>B: 114% / 119%</td>
<td>B: 120% / 125%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>C: 115% / 120%</td>
<td>D: 110% / 115%</td>
<td>C: 110% / 114%</td>
<td>D: 106% / 110%</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Page 7</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Spread movements tend to follow perceived risk of avian flu epidemic:

- Significant media coverage in Q1 and Q2 of 2006 associated with spread widening
- Absence of alarming headlines and success of most recent transactions associated with spread tightening in Q3 and Q4 of 2006

**Graph: Extreme Mortality Spreads**

- **Vita II B**
  - Initial Pricing: 90bps
  - Expected Loss: 0.7bps
  - Rating: A/Aa3

- **Vita II C**
  - Initial Pricing: 140bps
  - Expected Loss: 4bps
  - Rating: A-/A2

- **Vita II D**
  - Initial Pricing: 190bps
  - Expected Loss: 14bps
  - Rating: BBB/Baa2

- **OSIRIS B2**
  - Initial Pricing: 120bps
  - Expected Loss: 7.3bps
  - Rating: A-/A3

- **OSIRIS C**
  - Initial Pricing: 285bps
  - Expected Loss: 17.8bps
  - Rating: BBB/Baa2

*As of March 23, 2007
Source: Swiss Re Capital Markets*
While primarily used as a risk management tool, SRCM believes transaction sponsors should receive capital credit from the rating agencies

- Fully collateralized source of capital tied to out-of-the-money mortality risk
- S&P plans to allow credit for CAT reinsurance up to 20% of total base C-2 charges
- Mortality securitization structure is a stronger form of capital than CAT reinsurance due to absence of counterparty credit risk

Capital benefit is derived from replacing hard capital and its associated negative carry with soft or contingent capital in the form of a collateralized mortality derivative structure

- Cost of soft/contingent capital is determined by cost of the securities issued by the structure in excess of the investment earnings on the collateral assets
Mortality Index Illustration

Mortality levels required to trigger a payout on the notes have been experienced in recent years.

Mortality has improved 1.67% on average over the last 35 years for the US component of the Osiris index.

Based on historical data for the Osiris US index, mortality would have to revert to levels in the following years in order to trigger a payout to the sponsor:

<table>
<thead>
<tr>
<th>Class</th>
<th>Trigger</th>
<th>Exhaustion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Class A</td>
<td>1995</td>
<td>1991</td>
</tr>
<tr>
<td>Class B</td>
<td>1996</td>
<td>1995</td>
</tr>
<tr>
<td>Class C</td>
<td>1999</td>
<td>1996</td>
</tr>
<tr>
<td>Class D</td>
<td>2001</td>
<td>1999</td>
</tr>
</tbody>
</table>
Trends Impacting Market Growth

- Financial guarantors becoming more comfortable with the sector, reducing “emotional” pricing volatility

- Strong interest in latest transactions indicate increased investor appetite for mortality risk

- Recent upgrades by S&P indicate increased acceptance from the rating agencies

- Rating agencies view on capital credit will be a strong driver on issuer side

- Indemnity and morbidity transactions may be next
Vita II Case Study
Vita Capital II: Summary of Notes

Vita Capital II transaction structure is similar to Vita Capital I.

Vita Capital II is a multi-tranche shelf program intended to target different risk appetites across the investor base.

<table>
<thead>
<tr>
<th>Vita Capital II Ltd. Notes</th>
<th>Class A</th>
<th>Class B</th>
<th>Class C</th>
<th>Class D</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Trigger Level:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>% of 2003 Index Value</td>
<td>125%</td>
<td>120%</td>
<td>115%</td>
<td>110%</td>
</tr>
<tr>
<td><strong>Exhaustion Level:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>% of 2003 Index Value</td>
<td>145%</td>
<td>125%</td>
<td>120%</td>
<td>115%</td>
</tr>
<tr>
<td><strong>Overall Annualized Expected Loss</strong></td>
<td>0.0003%</td>
<td>0.0073%</td>
<td>0.0411%</td>
<td>0.1458%</td>
</tr>
<tr>
<td><strong>Overall Annualized Attachment Probability</strong></td>
<td>0.0015%</td>
<td>0.0165%</td>
<td>0.0755%</td>
<td>0.2344%</td>
</tr>
<tr>
<td><strong>Overall Annualized Exhaustion Probability</strong></td>
<td>&lt;0.001%</td>
<td>0.0015%</td>
<td>0.0165%</td>
<td>0.0755%</td>
</tr>
<tr>
<td><strong>Rating</strong></td>
<td>A+/Aa2</td>
<td>A-/Aa3</td>
<td>BBB+/A2</td>
<td>BBB-/Baa2</td>
</tr>
</tbody>
</table>

(a) Equals the 5-year cumulative values as estimated by Milliman divided by 5
(b) Standard and Poor’s, Moody’s
Vita Capital II Index Weights

Vita Capital II’s Mortality Index is customized using different weights to match Swiss Re’s mortality exposure by:
- Geographical weights
- Gender weights
- Age

Note: Age groups 65-79 make up for under 1% of total
Note: Age groups 80-84 make up for under 1% of total

Note: UK includes England & Wales only

Gender Weights

- Female 35.0%
- Male 65.0%

Geographical Weights

- USA 62.5%
- Japan 7.5%
- Canada 5.0%
- UK* 17.5%
- Germany 7.5%

Age Weights: UK

- 20-24 10%
- 25-29 23%
- 30-34 21%
- 35-39 23%
- 40-44 19%
- 45-49 12%
- 50-54 8%
- 55-59 4%

Age Weights: US, Canada, Germany & Japan

- 20-24 5%
- 25-29 5%
- 30-34 13%
- 35-39 12%
- 40-44 20%
- 45-49 16%
- 50-54 12%
- 55-59 7%
- 60-64 3%
- 65-69 2%
- 70-74 1%
- 75-79 1%
- 80-84 1%
Vita Capital II Trigger Definition

- The **Combined Mortality Index Value** for a given 2-year period is defined as the average of consecutive annual index values over the corresponding period:
  - Index value is computed using age and gender weighted death rates for five countries and obtained from publicly available sources
  - Weights are set at inception to mirror Swiss Re’s mortality exposure

- Both the **Trigger Level** and **Exhaustion Level** for observed mortality in the risk period are measured against 2002/2003 Index Value.

- For any Class, a **Trigger Event** is deemed to have occurred when the Combined Mortality Index Value exceeds the respective Trigger Level.

- If a Trigger Event has occurred, the percentage of principal lost increases linearly between the Trigger Level and Exhaustion Level, calculated as:

  \[
  100\% \times \frac{\text{Combined Mortality Index Value} - \text{Trigger Level}}{\text{Exhaustion Level} - \text{Trigger Level}} \text{ subject to a maximum of 100%}
  \]
### Historical Occurrence

<table>
<thead>
<tr>
<th>Event</th>
<th>Class D</th>
<th>Class C</th>
<th>Class B</th>
<th>Class A</th>
</tr>
</thead>
<tbody>
<tr>
<td>Influenza Epidemic(^2) (1918)</td>
<td>0.67x</td>
<td>1.01x</td>
<td>1.35x</td>
<td>1.69x</td>
</tr>
<tr>
<td>World War II(^3) (1939-45)</td>
<td>0.56x</td>
<td>0.84x</td>
<td>1.13x</td>
<td>1.41x</td>
</tr>
<tr>
<td>Korean War(^4) (1950-53)</td>
<td>22x</td>
<td>33x</td>
<td>45x</td>
<td>56x</td>
</tr>
<tr>
<td>Vietnam War(^5) (1967-74)</td>
<td>17x</td>
<td>25x</td>
<td>33x</td>
<td>41x</td>
</tr>
<tr>
<td>AIDS (1995)</td>
<td>5.0x</td>
<td>7.5x</td>
<td>10.0x</td>
<td>12.4x</td>
</tr>
<tr>
<td>September 11 (2001)</td>
<td>103x</td>
<td>155x</td>
<td>206x</td>
<td>258x</td>
</tr>
<tr>
<td>European Heatwave (2002)</td>
<td>29x</td>
<td>43x</td>
<td>57x</td>
<td>71x</td>
</tr>
</tbody>
</table>

(1) Assumes geographic & demographic distribution of deaths is proportionate to underlying populations. Actual magnitude will vary depending on actual concentrations by age groupings.

(2) Based on Index standardized mortality of US population applied proportionately to all five countries under Covered Area.

(3) Includes military and civilian deaths based on assumed worst years of 1944 and 1945. Japanese impact also includes deaths attributable to Atomic Bombs dropped on Hiroshima and Nagasaki.

(4) Includes US military deaths only, averaged over 4 years.

(5) Includes US military deaths only, based on worst years of 1968 and 1969.

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_Magnitudes of less than 1.0x indicate that the event would have caused a loss of principal on the relevant class of notes._
Excess Reserves Securitization
Regulation XXX/AXXX requires term writers to hold reserves well in excess of reasonable best estimate of policy liabilities.

Since the introduction of Regulation XXX/AXXX companies have developed a combination of financing alternatives to fund their peak reserve requirements:
- Internal funding
- Coinsurance
- Offshore reinsurance with letter of credit
- Securitization

Securitization provides the largest economic benefits:
- Preservation of tax reserve deductions
- Favorable rating agency treatment
- Term funding at locked-in cost
XXX/AXXX Reserve Securitization

- US statutory reserve requirement results in significant redundancy over best estimate liabilities (economic reserves)
- Idea is to fund economic reserves portion via a coinsurance treaty and fund excess reserves with securitization proceeds
- Rate of return demanded by investors for assuming underlying risk is significantly lower than company’s cost of capital, therefore resulting in more efficient use of capital
Subject business is ceded to a newly-formed captive reinsurance company

Investors purchase capital markets securities from Issuer

Issuer uses the proceeds to purchase surplus notes from Captive

Captive funds Reinsurance Trust Account with initial premium transfer from sponsor and proceeds from surplus note issuance

Principal is paid on the surplus and capital markets notes with funds released from the Reinsurance Trust Account as statutory reserve requirement goes down
Financial Guarantors

- Have played a critical role in the development of life insurance securitizations
- Premiums have gone down significantly since the early life insurance transactions
- All XXX/AXXX transactions to date have included a financial guarantee
  - Monolines have essentially taken the complexity and regulatory risk that investors have sought to avoid
  - Results in significant price arbitrage at current premium levels
- Guarantors impose triggers and remedies to limit their exposure from adverse events
- Although their participation may lengthen the process, arbitrage role of the wrap is significant at today’s spread levels
Embedded Value Monetization
Embedded Value Monetization

- Allows life insurance companies to monetize future profits embedded in a block of business
- Generates cash from an otherwise intangible asset, improving capital efficiency, transferring risk and potentially improving return on equity
- Has been used in the US and Europe to unlock value in acquired blocks of business (e.g. ALPS Capital) and closed blocks created in demutualizations (e.g. Prudential, MONY)
- Transactions to date have received favorable tax, accounting and rating agencies treatment in the sponsors’ jurisdictions
- Proceeds can be used for other corporate purposes
  - Funding acquisitions
  - Funding new business growth
  - Special dividends or share buyback
An insurance carrier (insurer) establishes a wholly owned subsidiary (ReinsurCo) and enters into a reinsurance treaty.

At closing the insurer receives a ceding commission from ReinsurCo in connection with the reinsurance of the block of business.

ReinsurCo issues capital securities to a third-party special purpose vehicle (SPV) to fund the ceding commission payment, transaction costs and a reserve fund. The reserve fund may be available to cover losses under the reinsurance treaty.

The SPV funds the purchase of the capital securities by issuing notes to investors. These notes usually have multiple tranches and are secured by the ReinsurCo’s securities and cash releases from the reserve fund. Features of the notes generally mirror those of the capital securities.

Monoline guarantor may be included for credit enhancement under a wrapped structure (not included in Queensgate transaction).
Subject Business

- A transaction should not include risks investors cannot quantify
- Product type
  - A mix of insurance products including traditional and interest sensitive life is well received by investors
- Regional and demographic diversification
  - A certain degree of regional diversification is important to investors
  - Age diversification tends to increase stability. Gender is not a primary concern.
- Persistency is a material risk investors take when buying embedded value securities
  - Unless business is lapse-supported high lapses will hurt investors
  - Seasoned books with no active sales force managing clients tend to have lower lapse rates and actuaries can draw on historical experience
  - New business is benefited by contractual protection (surrender charge, agent claw back) and mitigates some of the lapse risks