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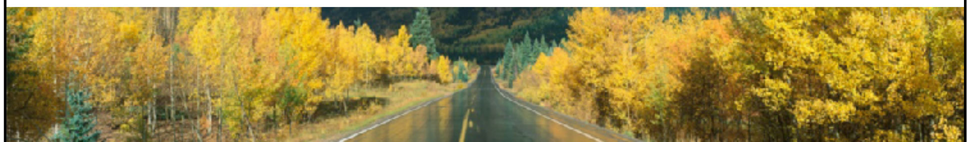

Risk Transfer Solutions Through Reinsurance and the Capital Markets

Actuaries' Club of the Southwest
Spring Meeting

Galveston, TX

June 10, 2010

Michael Greer

PROVIDING RISK AND CAPITAL MANAGEMENT SOLUTIONS FOR THE LIFE INSURANCE INDUSTRY.

1999 Forecast – Presented to Swiss Re's Executive Board

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- Convergence of capital markets and reinsurance is imminent

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2006 SOA Presentation

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- XXX Technology has been tested
- First embedded value securitization announced (Forethought)
  - First unwrapped EV securitization quickly follows (transfers true risk to capital markets)
    - Overall volumes light
    - Cost/complexity high
    - Significant regulatory review
- Converge of capital markets and reinsurance is imminent

2007 Insurance Securitization Conference

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- While the press coverage has been broad and the seminar circuit heated, capital deployed has been limited
  - Four XXX Redundant Reserve Financings
  - One AXXX Redundant Reserve Financings
  - Two EV Securitizations – No Real Risk Transfer
  - Two EV Securitizations – Risk Transfer
- While recent growth impressive in percentage terms, the promise of life-related securitizations remains to be realized...
- Lehman invests in Wilton Re as proof convergence works
- Recent AXXX deal took three years to complete (first AXXX deal to market)
- It takes a village to raise one of these deals (and each village is expensive)
- Convergence of capital markets and reinsurance is imminent
  - Even with principle based reserving
  - Really

2010 Marketplace

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- Leverage expensive (if it exists)
- Capital markets can fail
- Securitization market governed by “no” and “never”
  - No asset risk
  - Never fund long term (“use our 5 year LOC to defease your 30 year obligation”)
  - No risk taking (recourse only)
- That Lehman investment …
- Convergence of capital markets and reinsurance is imminent

The Presentation

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- State of the Union
- Why convergence still make senses (but it’s different now)
- Case study on EV Securitization
- Summary

State of the Union – Certain Recent Transactions

Date	Sponsor	Bank	Size	Tenor
Apr-10	Mutual of Omaha	Calyon	$150mm	7 years
Apr-10	Protective Life	UBS	$610mm	8 years
Dec-09	LNC	CS	$550mm	10 years
Sep-09	Banner	Calyon	$300mm	not disclosed

State of the Union – Current Deals

- Shorter term deals (1-3 years) being executed as an interim solution by some
- Funded solutions are unavailable. LOCs are the only viable solution
- Prices have widened, in line with overall credit market widening
- Tenors longer than 10 years remain challenging
- Rating agencies continue to analyze transactions to determine the operating vs. financial leverage treatment
- Both recourse and non-recourse LOC solutions have been executed
- XXX preferred to AXXX, even for recourse
- Banks hedging risk to non-traditional investors

Convergence of Capital Markets and Reinsurance

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- Securitization market will rebound – the benefits still exist
  - Cost of reinsurance/pure equity financing
  - Bifurcates mortality support and capital support
  - Reinsurance counterparty risk
  - Retention of tax attributes by ceding company
- Marketplace will be different
  - More unwrapped securitizations
  - Investors won't rely on monolines or rating agencies as much
- Need for knowledgeable players
  - Lead investors
  - First loss position
  - Risk aggregators

Convergence of Capital Markets and Reinsurance

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- Lead Investors
  - Structures and risks are complex for investors
  - Reinsurers understand the product risks
  - Reinsurers are knowledgeable about securitization structures
  - Reinsurers with "skin in the game" provide other investors comfort (alignment of interest)
- First Loss, Equity Position
  - Embedded value securitizations may have more tranches
  - Reinsurers may look to fill the first loss position
  - Reinsurers can help structure the securitization
  - Again provides other investors comfort

Convergence of Capital Markets and Reinsurance

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- Reinsurers can serve as risk aggregators or warehousers for smaller companies
- Reinsurers will sponsor privately negotiated transactions
- Reinsurers can play key role in standardizing risks – securitizations must be homogenous to succeed
- Reinsurers can provide deal management/oversight (reduce set up or learning costs of transactions)
- Reinsurers will continue to be a key holder of “non-capital market” risks
  - Certain underwriting risks
  - Higher risk tranches
  - Other novel risks requiring significant due diligence
  - Basis risk

Limits of Reinsurance as a Capital and Risk Management Tool

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- Operating leverage
- Capacity
- Perceived (actual) cost
- Reinsurers’
  - Attitudes
  - Skill sets
  - Risk tolerances

Case Study

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- Spectrum of risk/capital sharing on EV securitization

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Embedded Value Securitization

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- 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

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Benefits of Embedded Value Securitization

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- Converts an intangible asset into cash
- Improves capital adequacy
- Risk transfer to investors

Traditional EV Securitization

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- Advantages:
  - Monetization of 50% of embedded value frees capital for redeployment
  - Low cost of capital, as tail risk is retained by ceding company
- Disadvantages:
  - The demise of the monoline wrap required additional structuring that can significantly affect pricing and proceeds, including:
    - Restriction on the risks transferred and a potential for significant overcollateralization requirements. Downside risk stays with client.
    - High level of internal resources commitment and third party structuring costs
    - Difficulty in transferring certain risks, particularly investments, can make equity tranches more difficult to sell at a price
    - Possible recourse requirements, resulting in holding company credit risk adding an additional risk profile to the deal and potential uncertainty of its risk transfer
- Reinsurer Enhancements:
  - YRT reinsurance to transfer certain mortality risk

Traditional EV Securitization Alternative – with Risk Transfer to Investor

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- Advantages:
  - Monetization of up to 80% of embedded value frees more capital for redeployment
- Disadvantages:
  - Higher cost of capital vs. a Traditional program (assuming the equity tranches can be sold in the traditional program)
  - High level of internal resource commitment and third party structuring costs
- Reinsurers Enhancements:
  - YRT reinsurance to transfer certain mortality risk
  - As an investor in a subordinated tranche, reinsurers can provide confidence to investors as a natural and “smart” buyer of the risks that investors may not be interested in investing in or do not understand
  - Potential arbitrage between reinsurers views on certain risks such as mortality that could make reinsurer participation extremely cost effective
  - Certain reinsurers can provide administration, further solidifying cash flow

Inforce EV Reinsurance

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- Advantages:
  - True risk transfer nature of reinsurance provides monetization of 100% of embedded value, which frees more capital for redeployment
  - Full risk transfer including complete downside risk protection
  - No underwriting or structuring costs or requirements
  - Transfer of administration can provide significant operational benefits and/or savings
  - Permanent, equity comparable proceeds, not a debt based solution
- Disadvantages:
  - The option has a higher cost of capital vs. other options, although, as mentioned above, this option is effectively an equity substitute
  - Reinsurer credit exposure

Reinsurance as Component of Capital Structure

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Benefits

- Compatibility with GAAP and Statutory reporting requirements
- Well understood capital management instrument in the insurance industry
- Privately negotiated transaction
- Ease of execution
- Limited public market disclosure
- Effective duration of long-term surplus relief / collateral protection may exceed products available in the bank market and capital markets
- Potential to incorporate non-standard financing/ insurance risk exposures in a reinsurance product

Considerations

- Limited capacity in the life reinsurance markets for “balance-sheet” oriented products
- Introduces reliance on “partnerships” specific to an individual transaction
- Limited availability for non-standard insurance product exposures
- Potential frictional costs for reinsurers to absorb liquidity / rollover risks related to surplus relief
- Concentration limits that are monitored by the rating agencies and regulators
- Significant insurance regulatory involvement
- Limitations on ability to facilitate surplus relief transactions within the traditional reinsurance sector

Reinsurance is a “secured” risk management and surplus relief instrument

In Summary

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- Long term, both the reinsurance and capital markets will provide outlets for risk
- Solutions will likely involve both
  - Each has different benefits within the risk/cost spectrum
- Combining the solutions will result in better risk coverage and/or more attractive pricing

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