

Fund Management: Traded Insurance Risk

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The Insurance Linked Investments Market

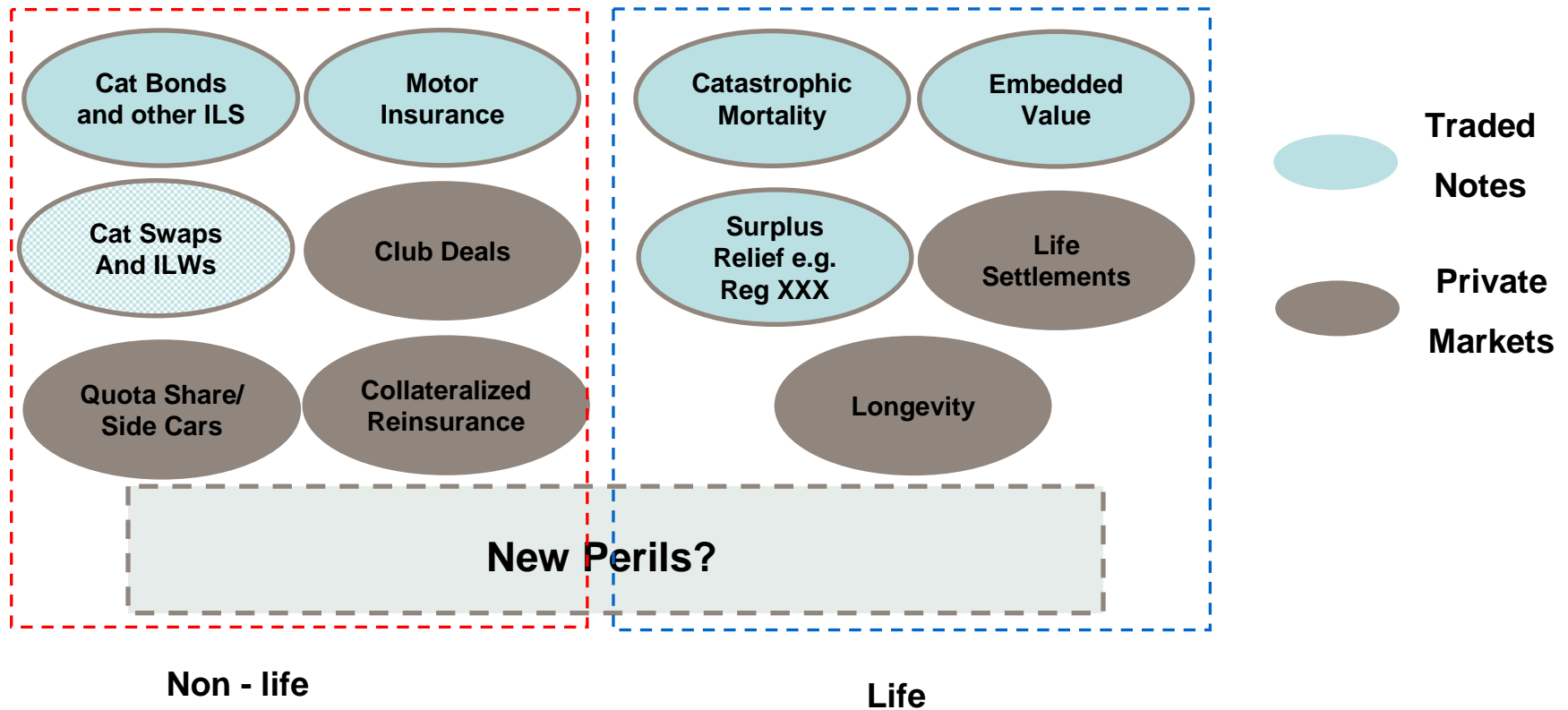
- The sustained growth of the insurance linked investment market led to a number of developments:
 - Different types of **protection buyers** with different needs approach insurance capital markets
 - Different types of **instruments** have been developed to address specific needs of protection buyers
 - A **dedicated investor base** with specialised knowledge has been developed, also preventing contamination from the turbulent status of the securitised markets
 - **Modelling and analysis** of insurance capital markets instruments have expanded, and **rating agencies** have further developed its methodology for insurance capital markets instruments
 - **Portfolio management tools** for insurance risk have been developed (albeit with a focus on non life in current status) to facilitate the monitoring of insurance linked investments

- The total market (between public and private transaction in life and non life sectors) backed by capital markets investors has grown to the size of a large reinsurance company and has become an integral part of the reinsurance industry landscape

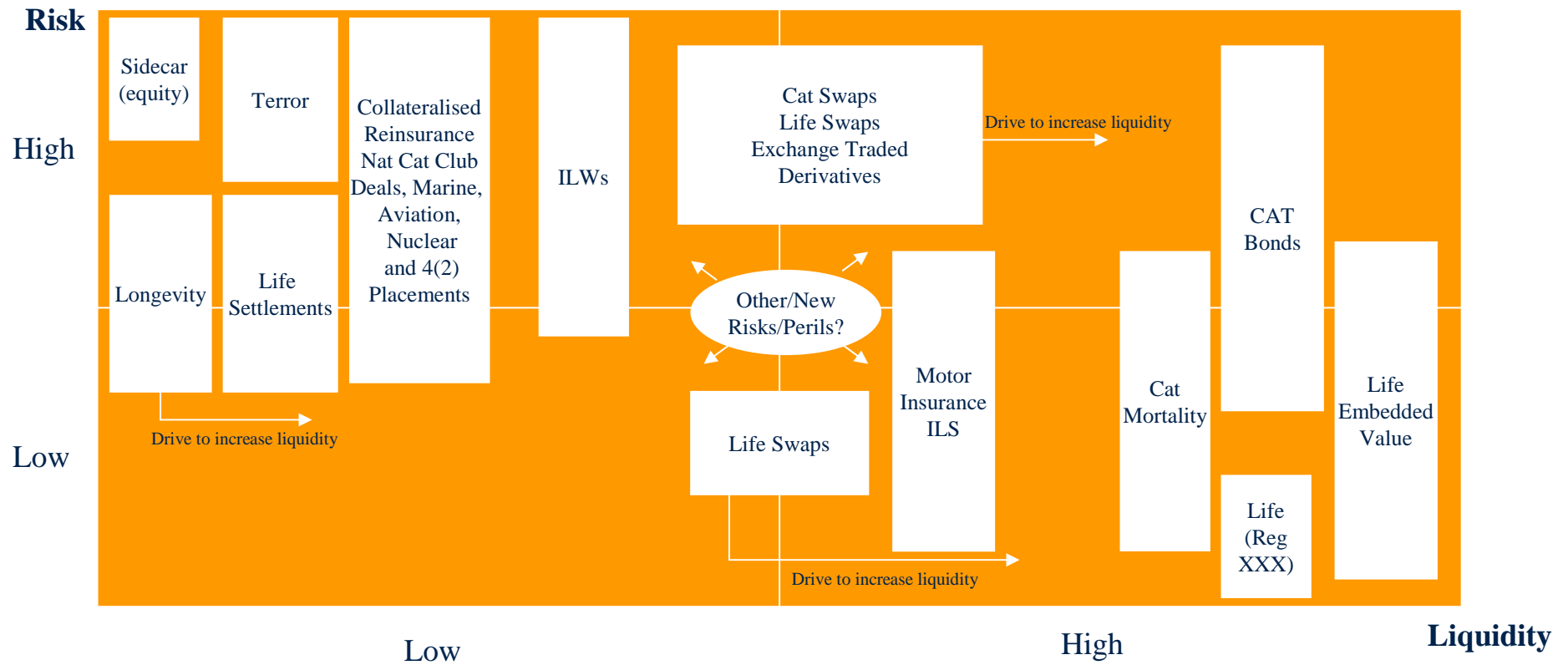
- The new insurance linked investments landscape poses investors new challenges and opportunities

The Insurance Linked Investments Market

- Many instruments are being used to transfer insurance linked risk to the capital markets
- We believe all instruments have a role in a portfolio strategy to ensure liquidity, profitability and growth



Risk and Liquidity Profile of Investments



Key Trends in the Insurance Linked Investments Market

Market Conditions

- Non investment grade ILS issuance not materially affected by recent market turmoil
 - Secondary liquidity maintained and increased trading from investors exiting the sector has been well absorbed by existing investors, with fresh capital also being raised

- EV insurance securitisations and investment grade P&C transactions (to include multiple events or high frequency transactions) have been partially affected
 - Such transactions targeted general securitisation investors as their un-leveraged return is too tight for specialised investors
 - EV securitisations have a greater component of market and credit risk embedded in their risk profile

- Monolines have ceased to be available for insurance securitisation and are currently unlikely to be a key component of this sector in the near future

Key Trends in the Insurance Linked Investments Market

Reduced primary issuance

- Lack of issuance in investment-grade insurance linked investments reduced the headline notional issuance level (particularly in the life sector), *but*
 - Specialised insurance linked investors tend to be active in the non investment grade or borderline investment grade sectors, thus marginally being affected by such declines

- Expected lower issuance also in non investment grade “cat bond” and diversifying perils, and much reduced sidecar issuance due to softening traditional reinsurance markets *but*
 - A number of alternative instruments with the appropriate risk/reward have been offered to the capital markets
 - New issuers have approached the markets and novel structures have been introduced, thus preparing the grounds for a renewed growth of the sector
 - The ability of some specialised investors to invest in high risk/reward structures have allowed the issuance of instruments with solid returns

Key Trends in the Insurance Linked Investments Market

Trigger Types

- The percentage of ILS with indemnity trigger has sharply increased as protection buyers are less inclined to take basis risk via ILS in a softer market
- Some transactions have not been modelled by an independent modelling agency or have been subject to an internal model review
- Indemnity triggers require a high level of underwriting sophistication by investors, who need to get comfortable with additional elements over a non indemnity transaction such as:
 - Data quality forming the portfolio information
 - Underwriting rigour and policy of protection buyers
 - Protection buyer’s standing in the market and any anti-selection risk
 - Claim handling procedures
 - “Skin in the game”
 - Information availability during the life of the transaction (such as change in portfolio exposure)
 - Commutation mechanism and extension period
- Access to specialised insurance expertise is therefore now critical for investors interested in transactions with indemnity triggers, and....less and less product is available with non indemnity triggers in the market

Key Trends in the Insurance Linked Investments Market

Multi-peril vs. Single Peril

- An important percentage of ILS issued in 2008 was multi-peril
- Multi-peril transactions could deliver interesting returns for investors *but* reduce the portfolio manager's ability to achieve the desired level of portfolio diversification
- In an environment in which there is less availability of diversifying or single-peril transactions in the 144a ILS market, portfolio managers need to equip themselves to be able to reach out to the other instruments available to capital markets investors in the private or exchange traded markets
- Alternative markets are also for an important component indemnity based instruments, or swaps structured as reinsurance instruments (such as ILWs), thus posing for some investors the need of transforming structures

Managing the Complexity of the Investments Portfolio

- Portfolio management and monitoring systems for an insurance linked investors need to increase their sophistication to manage the increased complexity of instruments and risks available
- Key modelling firms offer softwares to monitor the risk profile of the portfolio and the correlation of the various investments, *but*
 - Need to build proprietary systems for transaction non sustained by such models (such as private trades, or some diversifying non life risks and most life risks)
 - Need to be aware of the key differences in risk assessment of same perils by different modelling firms
- Need internal risk modelling team or access to underwriting resources to form own view of risk to compare with the (differing) views of other modelling firms and to be able to price un-modelled perils and private transaction
- Different instruments with different degrees of liquidity would require a liquidity monitoring of the portfolio to face redemptions, and portfolio rebalancing needs

Further Enhancements to the Sector Could be....

- Sound information on indemnity transactions to allow investors to monitor its portfolio exposure per risk type and per territory
- Information to be updated and distributed to investors over the life of the transactions to ensure not only an unchanged overall expected loss or attachment probability but also to monitor changes in the portfolio exposure
- Greater transparency on the current pricing of some transactions (such as ILWs or cat swaps) during the renewal season
- Greater and transparent access to indicative secondary pricing of notes from key market participants

Future Trends

- Once the investment-grade insurance securitisation market eventually reopens it will bring a wealth of new instruments to market (multi-event transactions, high frequency risks such as motor or home contents, life securitisations)
- The lack of monoline capacity will require more specialised investors to back large issuance of life securitisations
- The constant entrance in the sector of new protection buyers and the repeat issuance from existing participants increases the sustainable issuance level
- Large insurance and reinsurance players have set up dedicated teams of capital markets specialists for their own risk management needs thus indicating that their firms will be a constant presence in the insurance capital markets landscape
- Specialised capital markets investors will be able to take risks in different forms thus moving another step closer to the needs of the protection buyers

QUESTIONS?