Securitisations for Life Insurers

Overview and opportunities

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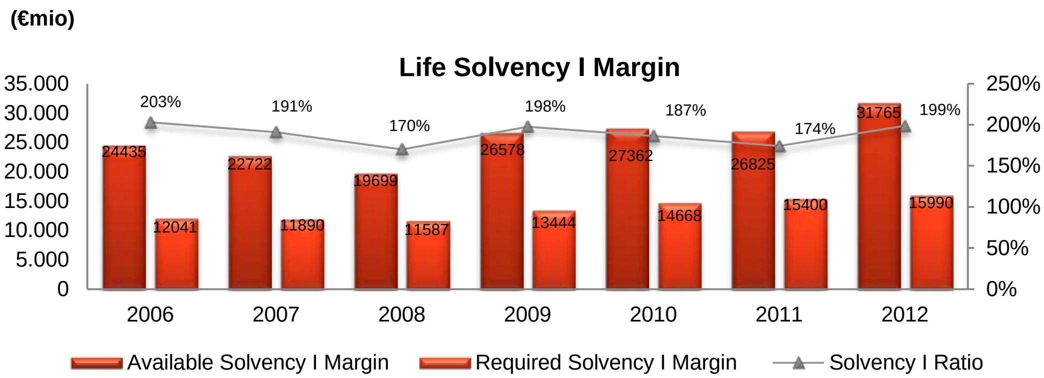
Agenda

Situation in Italy

Italian Market Solvency I Ratio

	2010	2011	2012
P&C	288%	272%	276%
Life	187%	174%	199%
Total	218%	204%	222%



Source: IVASS

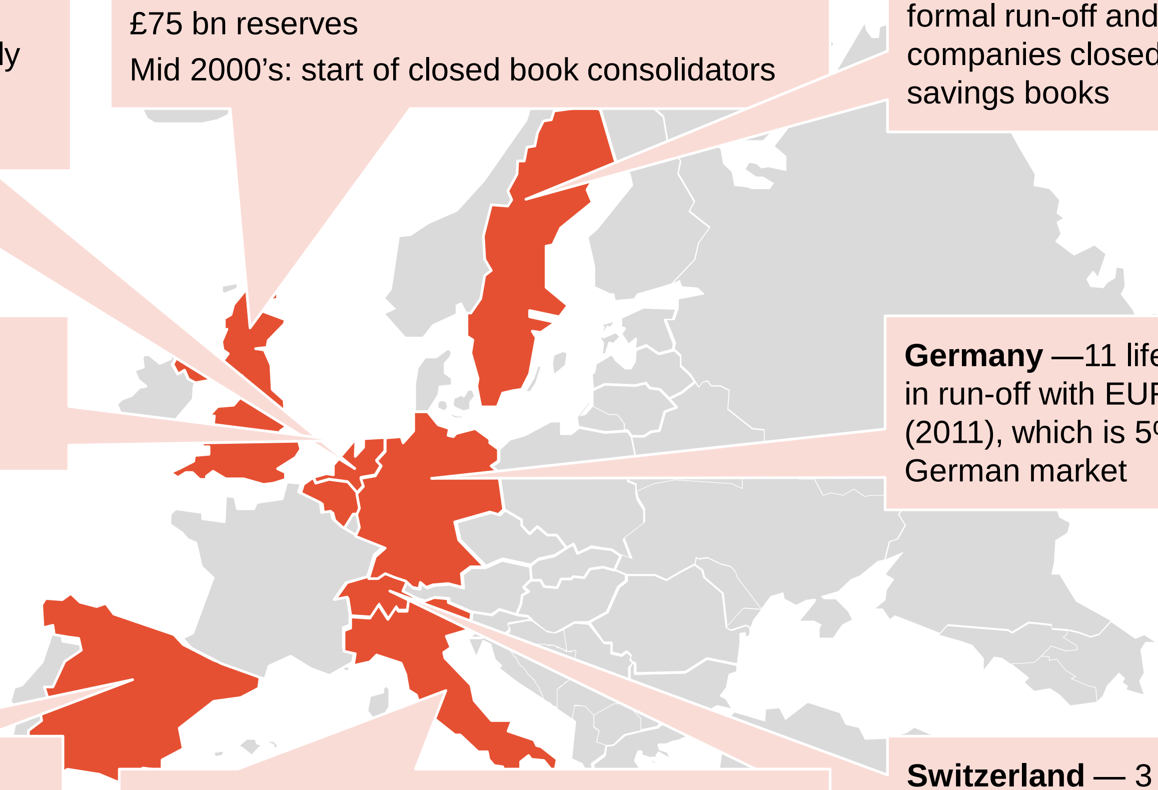
Italian market Solvency II Ratio (LTGA)

YE11 SCR ratio	Scenario 1 CCP (100%)	Scenario 3 Higher CCP (250%)	Scenario 6 Extended MA Alternative
All Undertakings	132%	138%	182%
Life Undertakings	66%	83%	209%

Source: EIOPA

- Capital is a scare resource, particularly for Life companies
- Trapped capital is an obstacle to an efficient use of capital
- The insurance market is interested in investigating ways to fund organic and inorganic growth

Run-off in life business is likely to increase interest to accelerate release of funds



Netherlands — 3 companies in formal run-off. Several individual insurers practically in run-off due to collapse of individual market

UK — 8 companies in run-off, representing £75 bn reserves

Mid 2000’s: start of closed book consolidators

Sweden — 1 company in formal run-off and 7 companies closed its individual savings books

Belgium — One medium sized insurer recently went into run-off but not formally

Germany —11 life companies in run-off with EUR 40 bn AuM (2011), which is 5% of the German market

Spain — no companies in formal run-off. However some companies left with savings business only, are practically in run-off

Italy — no companies in formal run-off. However segregated with profit funds in run-off are common and some interest exists in securitisation opportunities for with profit funds

Switzerland — 3 companies in formal run-off. Several individual insurers practically in run-off due to collapse of individual market

Agenda

- Introduction
- **VIF Monetisation / Securitisation**
- Structuring of transactions
- Key impacts – metrics, business, process

Securitisations in the insurance industry

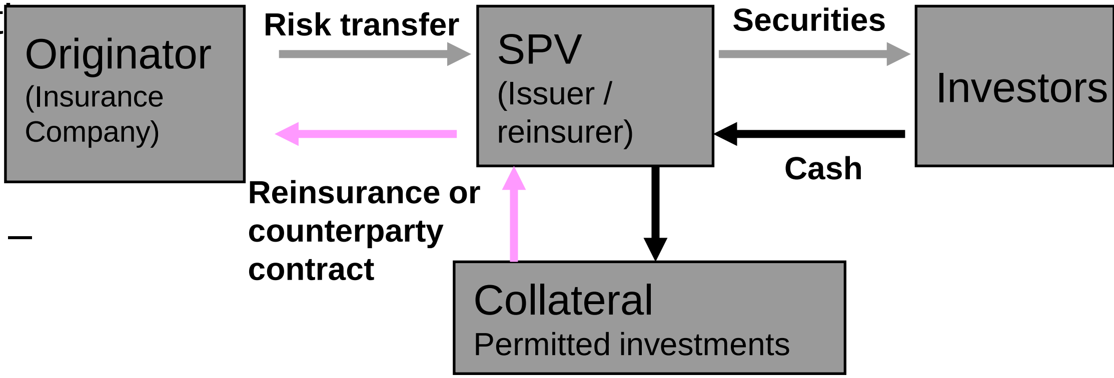
What are securitisations?

- Securitisation is the process of converting illiquid assets into asset-backed instruments which can be sold in the debt capital markets.
- Any type of asset with a reasonably predictable stream of future cash flows can be securitised.
- Securitization in the capital markets started in the banking industry in the 1970s (e.g. Asset Backed Securities, Collateralised Debt Obligations).
- Securitization has since evolved and reached the insurance industry in the late 1990s.
- Today a wide range of insurance assets/risks have been securitized successfully in the capital markets – refer to exhibition on the right.

Matrix of insurance securitisation products

	Non-CAT	CAT (Peak risk transfer)
P&C	**Mass risk protection** • Motor insurance securitisation	**Extreme event protection** • Cat-Bonds (eg Hurricanes) • Sidecars
Life	**Financing tools by monetising future income** • Value of in-force (VIF) securitisations • Reserve funding securitisations (eg to comply with XXX/AXXX regulation in the US)	**Extreme risk transfer** • Mortality and longevity bonds • Structured transactions for longevity / disability / health risk transfer

Illustration of a securitisation



What are VIF monetisations and securitisations?

Value-of-in-force business (VIF)

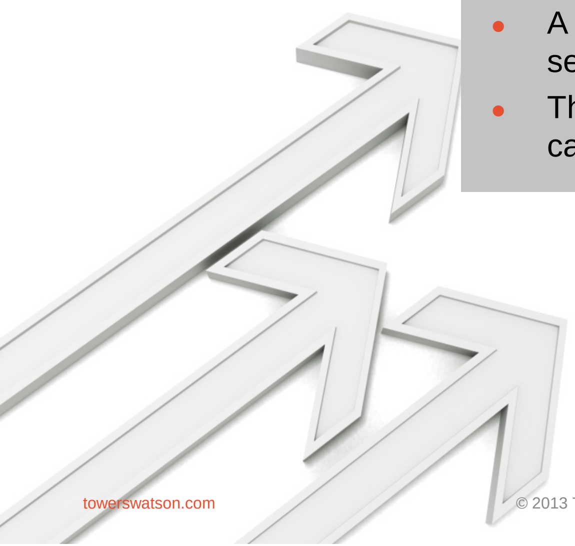
- VIF refers to the future profits expected to emerge from a specific life insurance portfolio
- Estimations and calculations of VIF can be made by performing actuarial projections of the life insurance portfolio's cash flows

VIF monetisations

- A VIF-monetisation is a transaction that allows an insurer to exchange expected future cashflows for an upfront amount of capital.
- Transactions often negotiated with reinsurers and / or investment banks

VIF securitisations

- A VIF-securitisations is a specific type of VIF monetisation where securities are created
- The purchasers of the security exchanges the purchase price for future cash flows expected from the underlying insurance portfolio



Purpose of VIF transactions

- Monetise future profits embedded in a block of life business
- Proceeds can be used for other corporate purposes (eg funding acquisitions, new business growth, special dividends or share buyback)
- Potentially improving capital efficiency, transferring risk and improving RoE

VIF monetisations and securitisations are important capital management tools

Capital management toolbox

Areas of Capital Management

Financial/ actuarial	Business management	Investment	Reinsurance	Capital solutions	Business reorganisation
Review models for prudence	Product redesign/ repricing	Asset portfolio redesign/ restructure	Reinsurance optimisation	Equity raising	Discontinue/ run-off certain lines of business
Review actuarial reserves/DAC for prudence	In-force management	Cashflow/ duration matching	Internal reinsurance	Debt structuring	Reorganisation of corporate legal structures
Accounting and tax optimisation	Ongoing business volume/ mix management	Derivatives/static/ dynamic hedging	Risk transfer/ external reinsurance	Contingent capital	Redomiciling/ branch structures
Regulatory arbitrage	Underwriting and claims management	Credit	Financial reinsurance	Sidecars or equivalent	Internal captives/ resources
Inter-group arrangements	Expense management and outsourcing	Alternative investments	Securitisation	Other (non-reinsurance) internal transactions	Purchase/sale of business/blocks of business

Possible Capital Management Actions

…and a useful tool to enhance or protect group liquidity and dividend-paying capacity

More recent VIF monetisation and securitisation deals

- In the life market, VIF-monetisation and securitisation have been structured in different ways
- Significant further interest in Spain/Portugal and from insurers across various markets – more deals expected…

An overview of selected prior transactions:

Insurer / bancassurer	Investor	Date	Acquired business	Notable features	Payment
AEGON (Portofinos)	-	January 2007	Non-profit, unit-linked and unitised with-profits	• Securitisation, no monoline guarantee • Unrated private placement	**£92m**
Bank of Ireland (Avondale)	-	October 2007	Unit-linked life and pensions	• Securitisation with monoline guarantee • Synthetic structure based on modeled rather than actual surplus	**€400m**
Santander	Abbey Life (Deutsche Bank)	July 2012	Individual life risk business, including annually renewable term business & single premium term business	• Private placement (reinsurance) • Quota share reinsurance 100%	**€490m**
CaixaBank	Berkshire Hathaway	November 2012	Individual life risk business, including annually renewable term business	• Private placement (reinsurance) • Quota share reinsurance 100%	**€524m**
BBVA	SCOR	March 2013	Individual life risk business, including annually renewable term business & single premium term business	• Private placement (reinsurance) • Quota share reinsurance 90%	**€630m**
BES Vida	Munich Re	June 2013	individual life business	• Private placement (reinsurance)	**~€150m**

Source: Company press announcements.

Key parties involved in a VIF securitisation

Sponsor

- Optimize capital structure
- Manage / transfer risk
- Access more efficient capital

Investors

- Ultimate risk holder
- Investor demand is driven by spread and diversification
- Investor types include reinsurers, bank conduits, money managers, specialist ILS & hedge funds

Rating Agencies

- Analyse and rate transaction
- Recourse considerations
- Treatment of capital and leverage post-transaction

Life Securitisation

Service Providers

- Liquidity providers, monoline insurers, swap counterparties
- Legal Counsel
- Trustees
- SPV Administrators

Modelling Agency

- Provide independent view of risk and cashflows
- May also provide services as verification and calculation agent

Regulators

- Approval process for reinsurance contract
- Evaluation / Rating of transaction contract and capital relief

Structure and details of transaction have to be tailored to individual purposes

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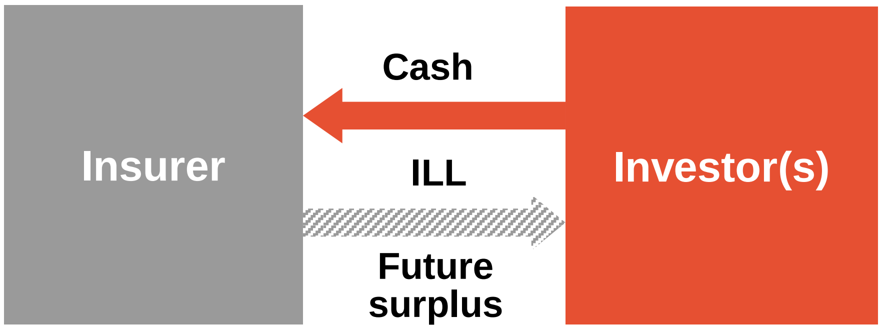
VIF Monetisation / Securitisation

Structuring of transactions

Key impacts – metrics, business, process

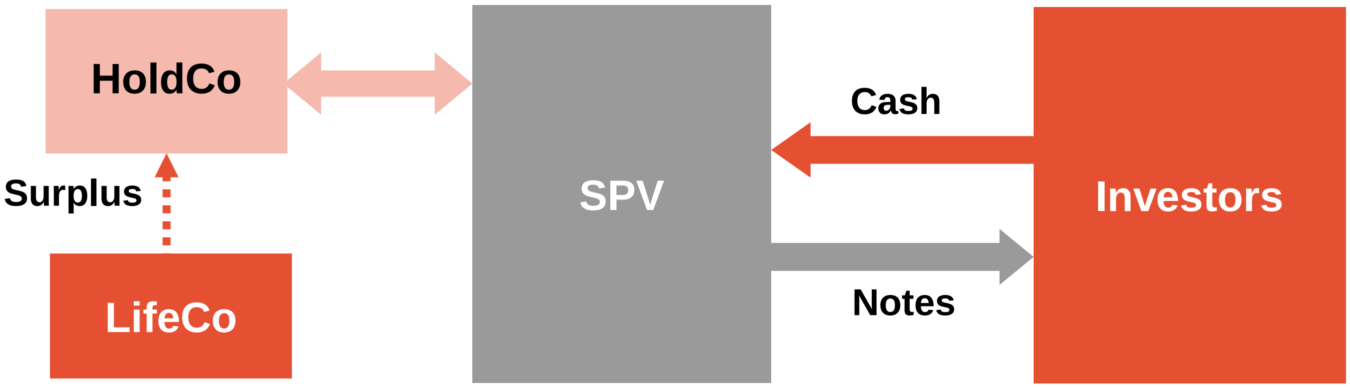
Capital markets structure – Private placement



- Implemented using an Insurance-Linked Loan (ILL) or reinsurance
- Investors directly exposed to underlying insurance risks

Pros	Cons	Considerations
✓ Precedents for securitising UK unit-linked, non-profit and with-profits business ✓ Quicker and cheaper to implement than a public placement ✓ Small number of investors may enable achievement of greater price efficiency and increases potential flexibility of structure ✓ Scope for more complex products to be included in defined block	✗ Monetary amount that can be raised in a private transaction likely to be less than a public capital markets issue, reflecting credit exposure and illiquidity of a private placement – however with lower overheads it may be more efficient to use a series of private transactions than a single public capital markets issue ✗ May still require full rating	• A (securitised) value of in force asset may be a reasonable asset for a pension plan • Advance rate determined through a series of stress tests on underlying portfolio cash flows • Potential benefit from higher effective return on capital employed – financing the VIF with securitised debt rather than shareholder equity

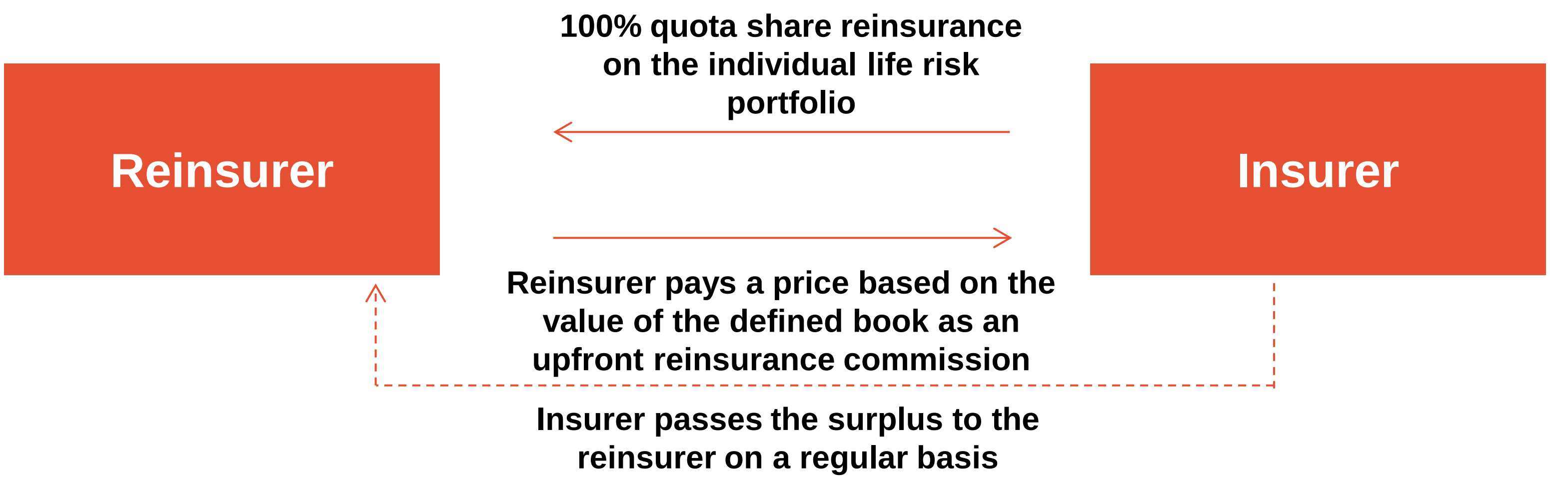
Traditional capital markets structure – Public placement



- Cash raised at SPV protects HoldCo as to the emergence of surplus at the insurance subsidiary
- Protection through counterparty contract similar to reinsurance

Pros	Cons	Considerations
✓ Precedents for securitising UK unit-linked, non-profit (incl annuities) and with-profits business ✓ Can be on a synthetic basis to speed up implementation and reduce administration ✓ Can combine VIFs from different legal entities in one transaction ✓ Asset diversification for investors	✗ Complexity and potential inflexibility of structures ✗ Capital raised needs to be down-streamed to be used in Group ✗ Public placements may need extra due diligence, level of disclosure, independent credit ratings, etc	• Counterparty could be either HoldCo or LifeCo • Various structures exist e.g. ISPV or ICC / PCC structures could be considered • Domicile of SPV may lead to tax advantages • Could use pre-agreed surplus formula or published surplus

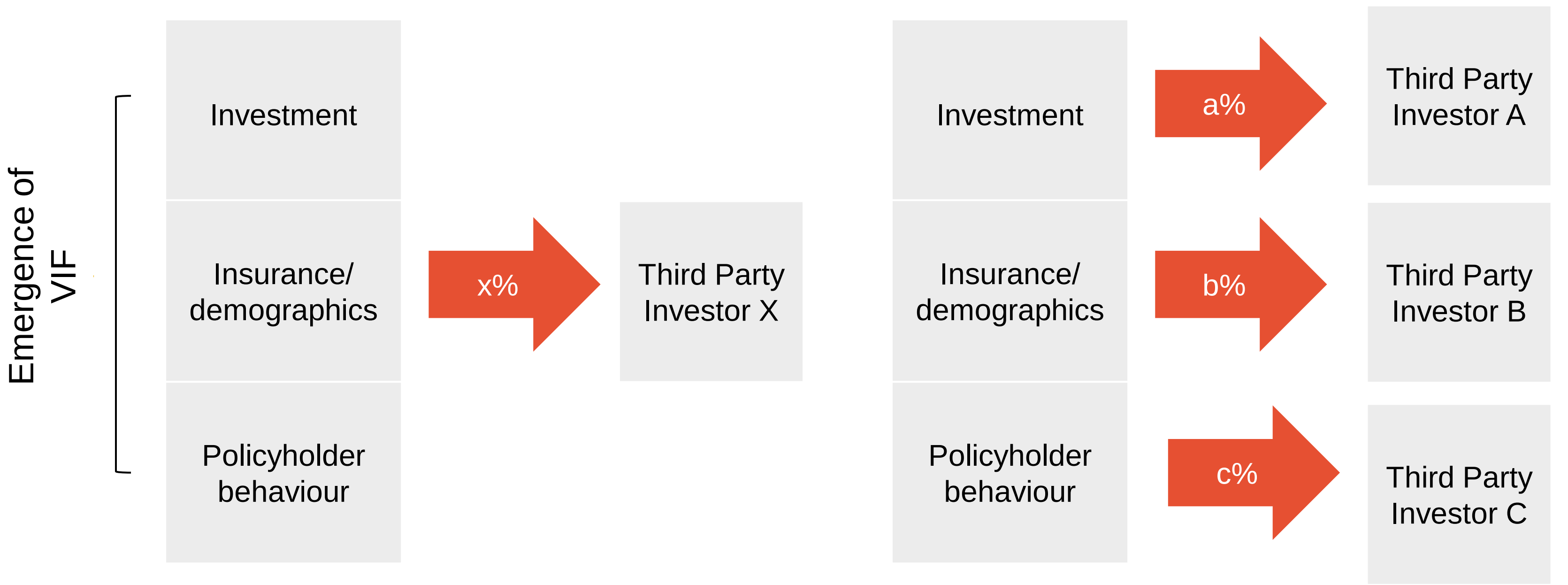
Recent pure reinsurance structures seen in Spain and Portugal



Pros	Cons	Considerations
✓ Single investor ✓ Relatively simple structure ✓ Profit sharing arrangements can be used to improve LTV and ensure cedant retains ‘skin in the game’	✗ Reinsurer likely to require protection against lapse risk e.g. via contractual terms such as early termination arrangements ✗ Significant haircuts to EV seen in recent European transactions ✗ Reinsurer appetite / capacity unclear in UK market	• Expenses typically prescribed in the surplus formula • Collateral arrangements required to mitigate counterparty risks and protect policyholders • Reinsurer may retrocede some of the risks • Considerable negotiation required to agree terms and special clauses

Even one step further: a segmented risk transfer?

More flexible structures could appeal to more investors



Current securitisation arrangements lack the ability to tailor exposure – investors take exposure to all the risks for a given return

Splitting the emergence of VIF by drivers could allow different investors to get tailored risk exposure and get paid accordingly

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High-level consideration of impact on key metrics

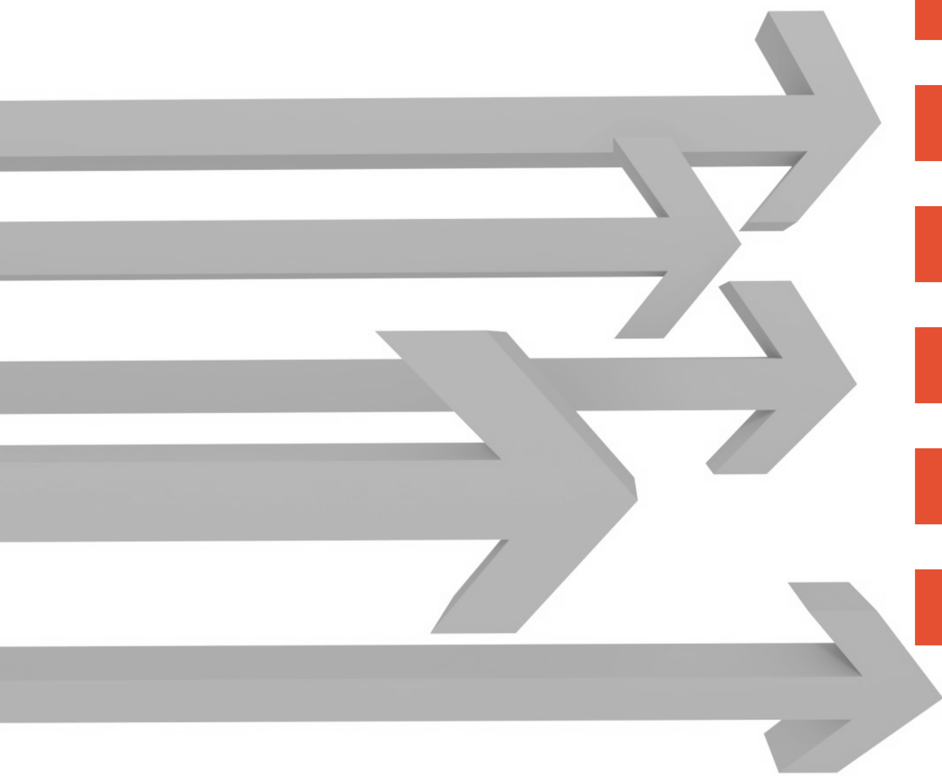
- How can a VIF securitisation impact key risk metrics of an insurance company?

Solvency I	Economic view	Solvency 2	Liquidity
Improves Pillar 1 position by cash amount raised / initial reinsurance commission No need to set up reserves as future payments to investors contingent on surplus arising	VIF already recognised under Pillar 2 Could be used to turn VIF partly into cash	VIF already recognised under SII – although could be employed to address non-economic aspects e.g. contract boundaries, risk margin Impact on SCR will depend on extent of risk transfer and financing under chosen structure	Cash raised at life companies might be up-streamed to improve capital and liquidity position of the group

IFRS → **Under existing IFRS, we expect a direct improvement in the life company's IFRS equity… although we understand that such a benefit may not arise once IFRS 4 Phase II becomes effective**

EV → **The impact on the insurer's reported EV will depend primarily on the price paid for the portfolio relative to the EV**

Key business considerations



- How much you want to raise?
- Debt vs equity
- Speed (public vs private)
- Duration of funding
- Flexibility
- Complexity and costs
- Market conditions
- Future proofing (Solvency II?)

A possible timeframe for a VIF securitisation (capital market placement)*

Months

1-2

- Choice in-force portfolio to be securitised
- Consider securitisation objectives
- Determination of securitisation structure
- Creation of information memorandum document
- Detailed cash flow analysis (estimates / forecasts)
- Preparation for rating process

3-4

- Results from cash flow analysis and verification of securitisation eligibility
- Final structure of securitisation (possibly including liquidity provider, monoline insurer, swap counterparty and reinsurance)
- Pricing of issue
- Founding of SPV
- Approach of rating agencies
- Initiation of stock exchange approval process and draft of offering circular (in case of market issuance)

5-6

- Completion of documentation and legal documents
- Approach of investors (marketing, publication of circular etc.) / arrange distribution by investment banks
- Transfer of rights / assets to the SPV
- Close transaction

*) Excludes time for rating process and is indicative only as timeframe may vary from transaction to transaction

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