Swiss Re

Seminar on Reinsurance: Case Studies for Runoff

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Legal notice

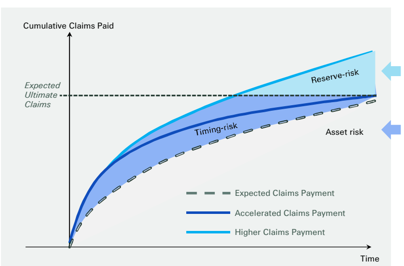
Agenda

- Intro: Runoff Transactions
- Case Studies
- Questions

Intro: Runoff Transactions

Loss Portfolio Transfers & Adverse Development Covers

Illustration of the Structure



Components

Adverse Development Cover (ADC) is a retrospective Stop Loss and covers the risk of insufficient reserves

Loss Portfolio Transfer (LPT) is a retrospective Quota Share and covers the timing risk as well as the investment risk (asset liability matching)

Claims handling assumed by Reinsurer/TPA or maintained by client with alignment of interest

How Retroactive Differs from Prospective

The losses have already occurred!

- There is much less variability around the claims frequency estimate for retroactive than for prospective
- Ability to perform detailed Due Diligence, which includes the ability to review individual claims files
- Ability to re-price the portfolio
- Other Differences:
  - Accounting
  - Rating agency credit for reinsurance
  - Retroactive typically many years vs. prospective usually one year.

Business needs addressed by a runoff transaction

- Provides economic protection against unfavorable reserves development
- Transfers risk and capital requirements to the assuming reinsurer
- Is particularly effective under Solvency II or for rating agencies (S&P, AMBest), as results in immediate capital relief at contract inception
- Can be attractive even with abundant capital as that capital may be utilized more effectively
- Is effective in an M&A context to "ring-fence" specific, potentially undesirable and/or troublesome, portfolios

Case Study 1

Case Study 1

Client situation
- Client has a WC portfolio, which is in runoff and is non-core to the client's current business plan
- The WC business was written between 1998 and 2005
- Case and IBNR reserves total $125M
- 625 open claims
- This legacy portfolio is a distraction to the client, due to the administrative burden

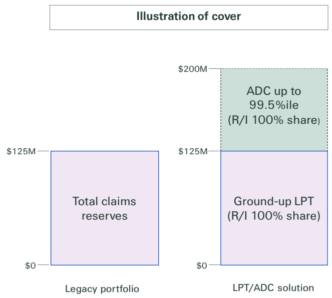
Client objectives
- Economic Finality against unfavorable reserve developments
- Capital Relief due to required capital reduction for reserve risk and investment risk

Economic Finality
Protect against the reserve and operational challenges of legacy portfolios

Reinsurance solution
- Ground-up Loss Portfolio Transfer (LPT)
- Exit point of the Adverse Development Cover (ADC) at 99.5%ile
- Limited structuring, however structural features can include:
  - Per claimant sublimits
  - aggregate limits by year
  - R/I deemed in place
- Claims handling is transferred to reinsurer. (If reinsurer does not assume claims control, reinsurer will require a co-participations to ensure alignment of interest)

Benefits
- Allow to focus on the current business plan without the financial and administrative distractions associated with legacy liabilities
- Economic Finality against unfavorable reserve developments
- Capital Relief due to required capital reduction

Price
- In today's interest rate environment, the price to transact will likely be greater than $125M.



Case Study 2

Case Study 2

Client situation
- Entering into an acquisition in order to grow business
- The interest in purchasing the target company was driven by on-going and new business, and not the target's reserve portfolio
- Seller indemnity from the target company was not available

Client objectives
- Seeking a "sleep-easy cover" to prevent any surprise from the acquired reserves
- Budgeting the cost of a solution in the economics of the M&A deal
- Signal to their stakeholders that they care about the quality and predictability of our quarterly earnings
- Reduce the amount of capital needed to support the acquired reserves

ADC to support a M&A Transaction

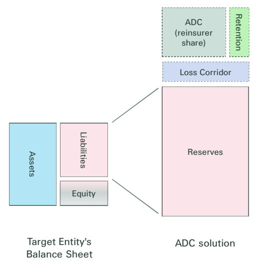
Protect against adverse development of acquired reserves

Reinsurance solution
- Out-of-the-money ADC attaching above the reserves of the acquired entity
- Claims handling remained with the buyer
- Structuring:
  - Sub-limits considered for certain exposure categories
  - Client retains a share of the ADC, to ensure alignment of interest
  - Loss corridor

Lines of Business
- Generally employ a whole account approach, with all lines of business subject to the cover

Benefits
- Containment of acquired legacy risks for a single one-off price, included in the overall price of the M&A
- Reduced the required capital of the acquired entity

Illustration of cover



Case Study 3

Case Study 3

Client situation
- Insurance company facing pressure on its economic capital position
- Decreasing capital returns in the home market
- High leverage ratio
- Comfortable level of reserves

Client objectives
- Upstream economic capital tied up supporting reserves to support expansion plans
- Reduce cost of risk capital in a mature market

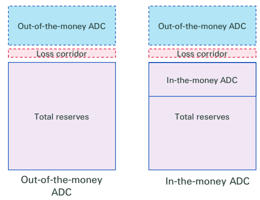
Manage Economic Capital
Release economic capital and improve capital fungibility

Reinsurance solution
- Out-of-the-money ADC, protecting the full non-life reserve portfolio of the entity
- Attachment point is slightly above current reserve level and the exit point is at the 99.5%ile
- Reinsurer does not assume control of the claims
- Structuring:
  - Yearly cancel/re-write option
  - Commutation incentives
- If including an in-the-money ADC, then structuring can include:
  - Funds withheld
  - Profit commission

Lines of Business
- Generally employ a whole account approach, with all lines of business subject to the cover

Benefits
- Substantial capital relief recognized by AM Best and S&P, but not recognized by Risk Based Capital
- Reduced liquidity impact
- Improved capital fungibility

Illustration of cover



Out-of-the-money ADC
- Exit point corresponds to 99.5%ile
- Entry point then calibrated to provide the client with the required amount of capital relief, which can be redeployed for use in other markets

Case Study 4

Case Study 4

Client situation
- Reinsurer B is in runoff
- Reinsurer B has tried to commute with the Primary Company, however the Primary Co. is not a willing counterparty
- Reinsurer B had a 15% share of a multiline XOL treaty for the layer $750k xs $250k for TY's 2006, 2007, & 2008 covering WC, AL, and GL with the Primary Company.
- Reinsurer B also had a 15% share of a WC XOL treaty for the layer $4M xs $1M for TY's 2006, 2007, & 2008 with the Primary Company.

Client objectives
- Pay another reinsurer to assume their exposure of the reinsurance treaty through a Reinsurance Novation, thereby divesting of the liabilities
- Upstream the economic capital tied up in supporting the reserves from this reinsurance treaty

Reinsurance Novation

Removing the risk from the balance sheet

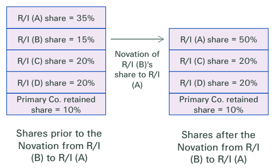
Reinsurance solution
- Reinsurer B will Novate its shares of the reinsurance treaty to another reinsurer, Reinsurer A, thereby discharging Reinsurer B.
- The Novation is subject to agreement of all 3 parties (Primary Company, Reinsurer B, and the Reinsurer taking Reinsurer B's shares, Reinsurer A)

Benefits
- Reinsurer B can remove the risk from their balance sheet
- The Primary Co. could replace Reinsurer B, which is in run-off and may not be as motivated to make timely payments as the other reinsurers
- Reinsurer A can take on shares of a treaty which they are already familiar with, and they can re-price the exposure to achieve a return that meets their pricing standards

Price
- Often, a primary company would like to replace a reinsurer on a treaty due to a downgrade in the rating of the reinsurer or timeliness of payments, however it is the Reinsurer looking to Novate that will pay another reinsurer to assume their share of the treaty, therefore Reinsurer B must be motivated to transact.

Illustration of cover

$4M xs $1M WC layer for TY 2006



Q&A