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 **Society of Actuaries** - Insurance Securitization Panel

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Insurer Motivations for Insurance Securitization

- Risk Transfer
- Liquidity
- Regulatory (Rating Agency) Capital
- Business Segmentation
- Cedant Collateralization
- Paid for with pre-tax revenues.

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Issues:

- Transaction Costs
- Cost relative to Reinsurance
- Rating Agency views of these transaction types.
- Often not the cheapest cost of comparable capital

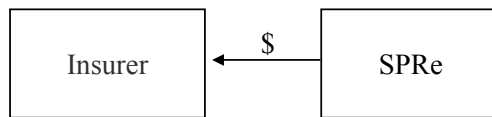
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Motivation 1:



Post Reinsured event:



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Motivation 1 - Risk Transfer

- Is this the most efficient structure for an investor?

An example:

Assume ROL for 2.5% expected loss risks = 5%

A large liquid cat bond market

\$100 million to invest in this asset class

LIBOR =2%

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Motivation 1 - Risk Transfer

- Alternatives 1:

Borrow \$900 million and buy \$1 billion in Cat Bonds

Earn: LIBOR + 5% on \$1 billion (= \$70 million)

Pay: LIBOR + 0.75% on \$900 million (= \$24.75 million)

Net = \$45.25 million less loss costs.

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Motivation 1 - Risk Transfer

- Alternatives 2:

Put \$100 million into a new Reinsurer

Write \$1 billion in business identical to the Cat bond portfolio

Reinsurer has a .5 premium/surplus ratio

Earn \$50 million less loss costs

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Motivation 1 - Risk Transfer

- Are the transaction costs of these two approaches significantly different?
- Do cedants pay more for cash collateralized reinsurance?
- How did investors vote with their dollars?

Costs and benefits are very company specific

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Motivation 2 - Liquidity

Selling future profits provides extra cash.

- MONY used a closed block securitization for this purpose
- Would raising debt have accomplished the same objective?

Structurally subordinated existing Holding Company Lenders

- Did this transaction utilize Debt Capacity?
 - Moody's: Yes
 - S&P: No
 - Fixed Income Markets: No

Costs and benefits are very company specific

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Motivation 3 - Regulatory Capital

Selling future profit streams can produce surplus.

Issuing Holding Company Debt or Surplus notes can do the same thing?

- Is the rating agency treatment of those transactions different?
 - Moody's: No
 - S&P: Maybe
- Useful for entities for whom market capacity is important (eg Ford)
 - Weak link to cedant requires use of a monoline wrap.

Costs and benefits are very company specific

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Motivation 4 - Business Segmentation

Utility of a well regarded investor in a subordinated position

Example: Prudential has Pacific Life and AIG's as closed block equity investors

Analysts have:

- Accepted that the closed block is fully funded
- Not Focused on the closed block from a return perspective

S&P has not treated the debt as financial leverage

Costs and benefits are very company specific

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Motivation 5 - Cedant Collateralization (XXX)

- Both Reinsurer and Primary Insurer Issue
- Both types of companies need to collateralize non-admitted reinsurance
- Current L/C market is robust
- Projected L/C demand likely to create issues

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Motivation 5 - Cedant Collateralization (XXX)

Many trade-offs:

- Duration of Collateralization (longer is more expensive)
- Unknown future collateral need
- Roll risk on Auction Rate Structure
- Relative desire to utilize your firm's market capacity

Costs and benefits are very company specific

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Conclusion:

- Multiple transaction forms
- Many designed to meet very specific needs
- Make sure you understand what your firm needs
- Pick the best fit
- Consider diversifying the mechanisms used.