

**Presentation on:**



**Alternative Risk Financing in  
the Capital Markets**

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# Options for Capital Markets Risk Transfer

Transaction	Approx Cost	Highlight of Result	Market Considerations
RBC Relief	(L+) 75-100	<ul style="list-style-type: none"> <li>◆ Frees encumbered surplus capital in operating company.</li> <li>◆ Excess of loss protection - reinsurer assumes catastrophic-like risk.</li> </ul>	<b>Reinsurance Markets:</b> Requires only a stand-by capital provider.
XXX Capital Relief	(L+) 75-125	<ul style="list-style-type: none"> <li>◆ Frees excess reserves against term insurance products.</li> <li>◆ Avoids reliance on LOC's.</li> </ul>	<b>Capital Markets:</b> Requires long term financing and stable rates.
Surplus Relief	(L+) 150-300	<ul style="list-style-type: none"> <li>◆ Frees encumbered surplus capital AND releases some reserves in <i>operating</i> company.</li> <li>◆ Reinsurer assumes catastrophic-like risk in conjunction with non-recourse "balance sheet" lending against future profits.</li> </ul>	<b>Reinsurance Markets or Capital Markets:</b> Requires short-term financing against a portion of embedded value.
Targeted Block Securitization	(L+) 75-300	<ul style="list-style-type: none"> <li>◆ Raises new capital at <i>holding</i> company.</li> <li>◆ Investor provides limited recourse term financing.</li> </ul>	<b>Capital Markets:</b> Requires long-term financing using cash against a portion of embedded value.
"Preferred Tracking Stock"	7-10%	<ul style="list-style-type: none"> <li>◆ Raises equity capital at <i>holding</i> company and shares targeted performance.</li> <li>◆ Dividend payout can be an attractive feature.</li> </ul>	<b>Capital Markets:</b> Institutional or Retail.
Risk Transfer	10-15%	<ul style="list-style-type: none"> <li>◆ Frees encumbered surplus capital AND releases all reserves in <i>operating</i> company.</li> <li>◆ Reinsurer/Buyer assumes risk and capital requirements of the business.</li> </ul>	<b>Combination of Capital Markets and Reinsurance Markets:</b> Requires long-term financing against entire embedded value.
True Sale	12-18%	<ul style="list-style-type: none"> <li>◆ Sale of legal entity or underlying insurance contracts.</li> <li>◆ Buyers assume all, including new business production.</li> </ul>	<b>M&amp;A Market:</b> Administrative burdens of reinsurance.

# Areas of Focus for Convergence of Insurance and Capital Markets

## Completed

- Term Life Insurance
- Contingent Capital
- Property Catastrophe
- Embedded Value
- Credit Insurance
- Weather

## Potential

- Universal Life Insurance
- Political Risk
- Reinsurance Recoverables
- GMDB Reinsurance
- Life Settlements
- Mortgage Insurance

## Significant Challenges

- Terrorism
- Asbestos
- General Liability
- D&O
- Medical Malpractice

# Life Insurance Securitization

- ◆ Focus is on books with significant embedded value.
- ◆ Additional source of capital for regulatory reserve and surplus requirements.
- ◆ Monetizing revenue streams not recognized as an asset on the balance sheet.

## Structured Finance Approach to Raising Capital from a Block of Insurance Business

Liability Value	Financing
<b>Catastrophic</b> deviation from liability' expected value	"Debt" Capital
<b>Moderate</b> deviation from liability' expected value	Mezzanine Financing/Preferred Equity
Expected economic value of the liability	"Equity" Capital

## Areas with Maximum Potential for Capital

- ◆ Closed Blocks of Participating Life Insurance.
- ◆ Non-Participating Traditional Permanent Life.
  - Industrial or Debit Insurance.
  - Pre-Need/Final Expense Insurance.
  - Direct Insurance.
- ◆ Extended Term Insurance.
- ◆ Level Term Insurance.
- ◆ Deficiency Reserves.

# Life Insurance Securitization

Focus	Evaluation
<b>Investors</b>	<ul style="list-style-type: none"><li>◆ Investor demand will be driven by:<ul style="list-style-type: none"><li>– Robustness, predictability and modelability of cash flows.</li><li>– Expected duration of securitization.</li><li>– Existence of debt service coverage account.</li><li>– Financial guarantee (wrapper from a bond insurer).</li><li>– Legal form of transaction (accounting and tax implications).</li></ul></li></ul>
<b>Rating Agencies</b>	<ul style="list-style-type: none"><li>◆ The use of securitization has recently been encouraged, but special focus is placed on whether the debt will count as operating leverage or financial leverage.</li><li>◆ Securitizing embedded value is viewed favorably, but only when the unlocked value is reinvested in assets bearing a higher return.</li></ul>
<b>Prior Deals</b>	<ul style="list-style-type: none"><li>◆ Regulation XXX Securitization for GE Financial Assurance</li><li>◆ Prudential, MONY Closed Block Securitizations</li><li>◆ Skandia M&amp;E Fee Securitizations</li><li>◆ Barclays Life (UK) Embedded Value Securitization</li><li>◆ National Provident Institution (UK)</li></ul>

# Non-Recourse Regulation XXX Solution

In July 2003, Lehman Brothers executed a first ever capital markets solution to Regulation XXX excess reserving.

*July 2003*

**\$300,000,000**

**Dutch Auction Securities**



**GE Financial Assurance<sup>SM</sup>**

**River Lake Insurance Co.**

A Special Purpose Captive  
Reinsurance Company

of

**First Colony**

*Insured by*

**MBA**

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*Structuring Advisor and  
Sole Lead and Bookrunning Manager*

## Business Needs

- ◆ Locked-in financing of redundant reserves created by Regulation XXX
- ◆ Flexibility to increase/decrease funding as reserve needs change
- ◆ No use of financial leverage
- ◆ No use of Ceding Company's credit capacity in the capital markets
- ◆ Non-Recourse to First Colony and GEFA

## Solution

- ◆ Established and capitalized a Captive insurance company (River Lake), which reinsured the Term Life business of First Colony.
- ◆ River Lake raised additional capital equal to the redundant reserves by issuing Surplus Notes to a Capital Markets Trust
- ◆ The Capital Markets Trust issued Money Market Securities, which were wrapped by a Financial Guarantor (transferring Mortality, Lapse and Asset risks).

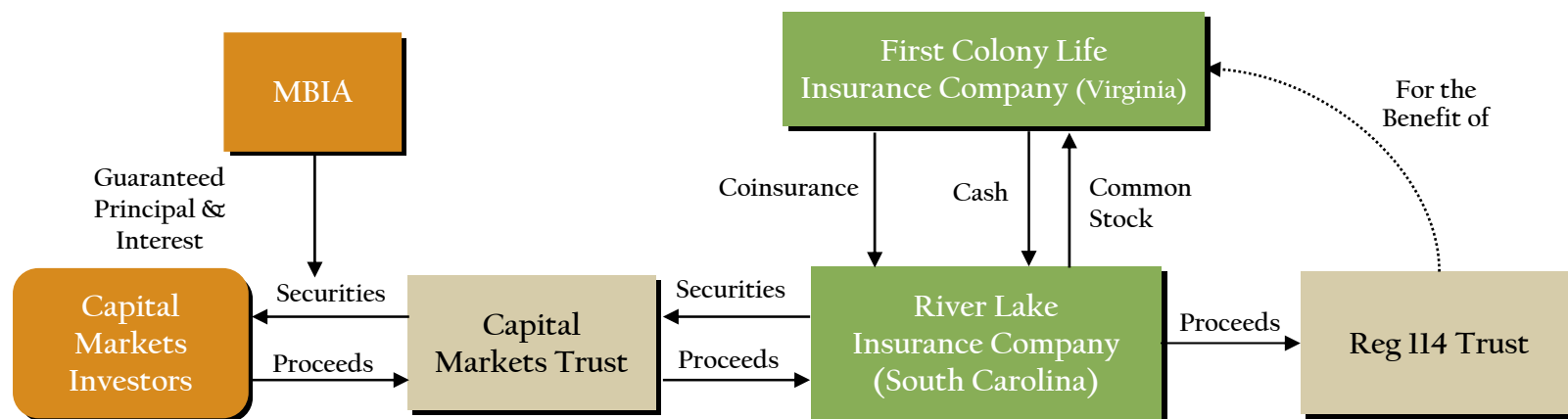
## Result

- ◆ Locked-in access to a \$1.15 billion financing shelf that River Lake can access over time as its reserve needs grow
- ◆ Structure was non-recourse and added no financial leverage
- ◆ Landmark deal with strong support and interest from issuers, investors and rating agencies

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# Non-Recourse Regulation XXX Solution

The book of business is segmented from ongoing operations by reinsuring to a newly formed Captive (River Lake) and related risks are transferred to the financial guarantor(s).



# Prudential Financial Closed Block Securitization

Simultaneous with its December 2001 IPO, Prudential Financial raised \$1.75 billion in the first ever Closed Block debt offering.

*December 2001*

**\$1,750,000,000**

**Prudential  Financial**

**Prudential Holdings, LLC  
IHC Closed Block Debt Issuance**

\$332.85 million Series A Notes due 2017  
\$776.65 million Series B Notes due 2023  
\$640.50 million Series C Notes due 2023

*Joint Bookrunner*

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## Business Needs

- ◆ Separation of Prudential's traditional participating business from its future Financial Services business
- ◆ Enhanced capital efficiency and equity market valuation

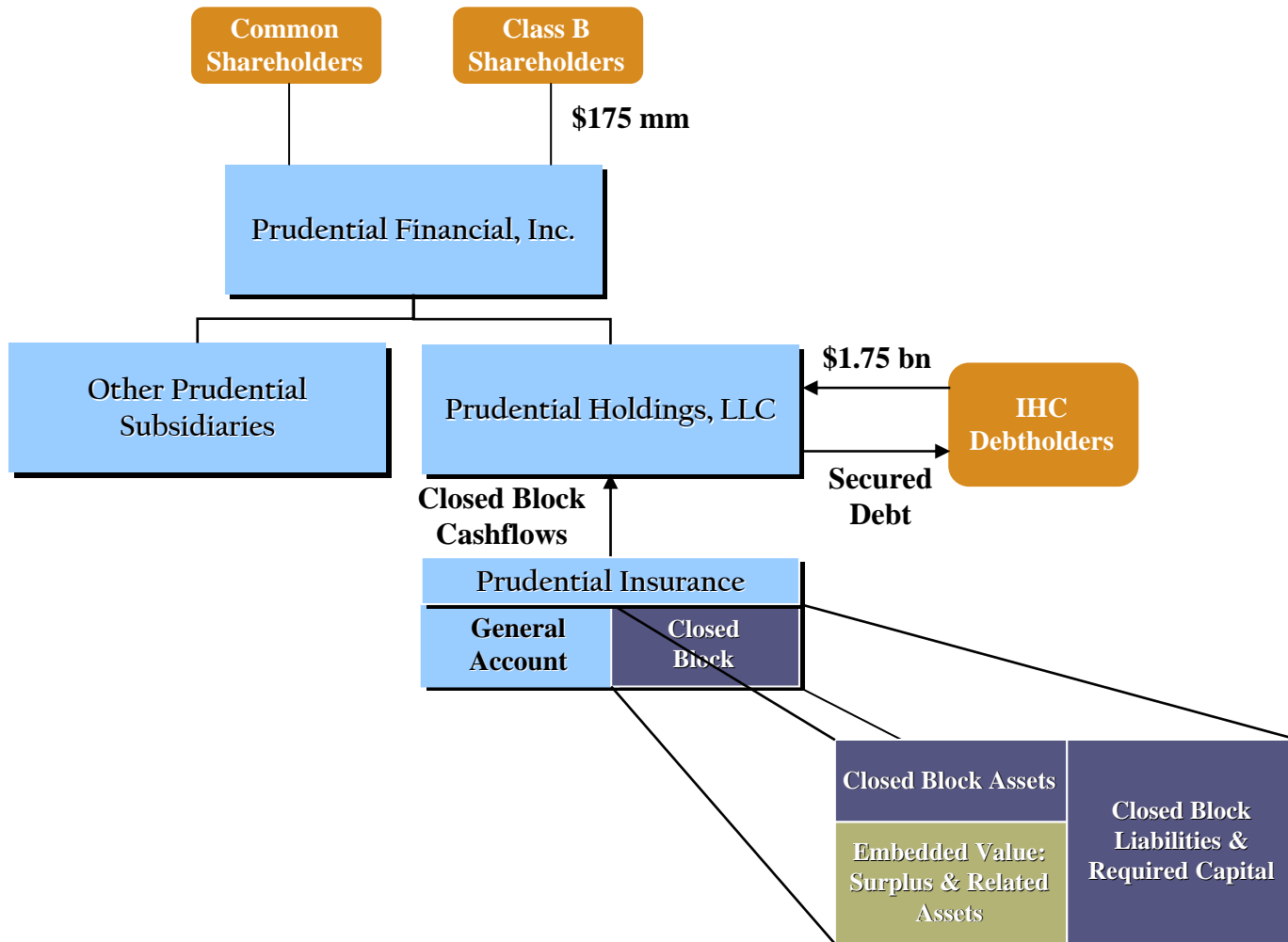
## Solution

- ◆ Established an Intermediate Holding Company (Prudential, LLC) which issued debt depending solely upon the financial experience within the Closed Block (mortality rates, lapse and investment performance).
- ◆ Simultaneously sold equity in the Closed Block Business via a private placement of Class B common stock, which with the IHC debt, effectively deconsolidated Prudential's traditional participating business from its ongoing Financial Services Businesses.

## Result

- ◆ Prudential monetized the closed block's embedded value and then redeployed this capital elsewhere at higher ROEs.
- ◆ The offering was the first of its kind and represents a landmark financial innovation for the insurance industry.

# Prudential Financial Closed Block Securitization





Any  
Questions?