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Insurance Linked Securities: Investor, Legal and Rating Agency Perspectives

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SIZE OF THE UK NON-LIFE RUN-OFF MARKET

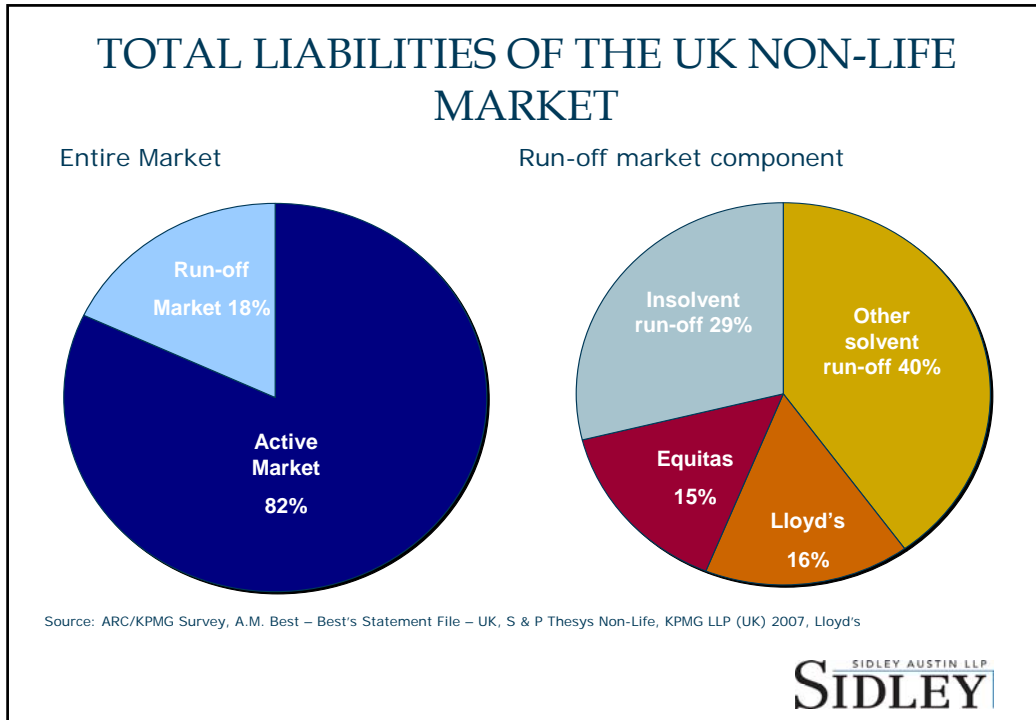
As at end of 2006	Total liabilities (£ billion)	Percentage share of market (%)	Technical provisions (£ billion)	Percentage share of market (%)
Active market	153.0	82%	126.7	82%
Run-off market	32.7	18%	27.4	18%
Total UK non-life market	185.7	100%	154.1	100%

Source: ARC/KPMG Survey, A.M. Best – Best’s Statement File – UK, S & P Thesys Non-Life, KPMG LLP (UK) 2007, Lloyd’s

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GERMAN MARKET RUN-OFF

The size of the German-speaking non-life run-off market measured by technical reserves is estimated at EUR €66.5 billion (£45 billion) which is approximately 19 percent of the total non-life market*

*If companies entirely in run-off are included, the estimated size of the German-speaking non-life run-off market increases EU €75 billion.

Source: ARC/KPMG Survey

HOW LONG DOES A RUN-OFF LAST?

- Probably the best indicator is the likely length of asbestos claims, arguably the longest tailed of all latent claims.
- One epidemiological study assumes **a final year of 2049 for mesothelioma deaths in the US**, by using a hybrid model based on both direct and indirect estimates of exposure¹
- A paper produced by the Health & Safety Executive in the UK includes a model of asbestos claims run-off which 'implies an exposure of 2% of the peak 1967 level in 2010 **reducing to below 1% by 2050**'²
- Whilst the later deaths may not generate insurance claims (as they may not have arisen from insured periods), there remains the possibility of second generation claims

¹ 'Forecasting Product Liability Claims: Epidemiology and Modeling in the Manville Asbestos Case', by Eric Stallard, Kenneth G. Manton, and Joel E. Cohen
² 'Mesothelioma Mortality in Great Britain: Estimating the Future Burden' (found here <http://www.hse.gov.uk/statistics/pdf/proj6901.pdf>)



THE WORLD OF ASBESTOS IN 2003

- Worldwide production of asbestos 2,148,584 metric tons
- Worldwide apparent consumption of asbestos 2,108,943 metric tons

Region and country	Production	Imports	Exports	Apparent consumption ¹
Asia and the Middle East	369,000	702,640	6,307	1,065,333
Central and North America	194,350	38,596	178,342	58,152
Europe	1,232,500	258,609	634,182	856,927
Oceania	-	21	1	20
South America	199,516	41,086	144,343	96,260

Source: USGS, U.S. Department of the Interior, U.S. Geological Survey, Worldwide Asbestos Supply and Consumption Trends from 1900 through 2003

[Data in metric tons. Terms used: -, zero. Data are unrounded but are believed to be accurate to no more than three significant digits. Production, import, and export data from United Nations Statistics Division, 2005; Virta, 2005a]

¹ Apparent consumption calculated as production plus imports minus exports, not adjusted to account for changes in government and industry stocks.



SOLVENCY II

- Increased capital required for business that is subject to volatility
- Greater focus on capital intensive books of business
- Likely to promote greater consideration of "run-off" business and the capital it ties up

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OPTIONS - ASIDE FROM MAINTAINING THE STATUS QUO

- Consolidate run-off in one team and location
- Sell all or part to specialised purchasers
- Buy Adverse Development Cover or similar reinsurance and pass over claims handling
- Scheme of Arrangement
- Securitisation

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SECURITISATION

- Reserves generally provided by equity capital
- Securitisation would aim to shift elements of the risk of adverse development to the capital markets
- Consequences: -
 - release of capital for more underwriting
 - improved return on equity
 - potential gains in rating evaluation and investor confidence

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HOW WOULD IT WORK?

- Initial and annual review by credible independent actuary
- Claims audit, probably annually
- Controls on claims handling and rights of intervention at defined levels
- Sharing the pain: ensuring the insurance company retains an element of any book securitised
- Indemnity based

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WHAT BUSINESS IS SUITABLE?

- Conceptually, most books of business are susceptible
- However.....
 - not recent underwriting
 - from investor perspective, possibly not certain recent and volatile types of business?

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WHY WOULD INVESTORS BUY?

- Uncorrelated risk
- Relatively short risk exposure
- Progressive, rather than single hit with adverse development

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