

INSURANCE LINKED SECURITIES

Securitisation - Non Life Risks

What are the different sectors that lend themselves to securitisation in the non life risk space? Please elaborate on each stating why.

There are a number of risks which lend themselves to capital market risk transfer, or securitisation. They include catastrophe peril such as earthquakes, windstorms (including hurricanes and typhoons) and floods, and other non life risks associated with motor coverage, industrial liabilities and aviation.

Investor appetite for insurance linked securities (ILS) continues to grow since they bear little to no correlation with the defaults of most other securities, and therefore offer greater diversification in an investment portfolio. In 2006 alone, Swiss Re Capital Markets placed nearly USD3.1 bn of total non life issuance of approximately USD4.9 bn.

All the perils mentioned above, have the potential for additional securitisation in geographical areas where similar securitisations have proven to be a mutually beneficial transfer of risk - for the reinsurer and for the investor. Outside of those geographical areas, the potential for securitisation must be evaluated on a peril-by-peril basis. New peril is introduced each year and this is subject again to available models. Investors have demonstrated a significant appetite for new, diversifying perils.

How many of these prospects have actually been securitised to date?

Since its inception in 1996, the market for insurance linked securities has witnessed worldwide issuance in excess of USD9.5 bn. In recent years, insurance linked securities have shown strong growth both in volume and deal numbers, indicating a growing risk bearing capacity in the coming years.

What are the main barriers to realising securitisation of the above?

One of the principal barriers to securitisation is lack of reliable models. What is more, the decision to transfer risk to the capital markets may be partially driven by a reinsurer's tolerance for a given risk. There are multiple actuarial and financial considerations that go into this decision.

How can they be overcome and ... under what time frame can one expect to realise them?

Catastrophe models are continually being refined - as long as this happens and new models become available, more perils should emerge over time in the securitisation space.

From known examples, such as motor insurance, how lucrative is it/can it be?

An ILS solution is in development for Motor securitisation. This is important in that it creates a benchmark. I am confident that it can be adapted to provide capital markets a solution that delivers risk management and solvency capital benefits to primary insurers (under the new regulatory environment being developed in Europe in preparation for Solvency II). We believe that capital markets have the potential to grow capacity available to Motor insurers significantly.

Who would typically buy/invest in these securities - and what sort of risk/reward profile would they deliver when compared with cat bonds? (would investors demand higher spreads ... or would spread be relatively tight?)

Generally speaking, there are different types of investors for different securitisations. For example, investors in Motor are seeking occurrences that are high frequency with low severity and low volatility. Notes on Motor securitisations to date have been investment grade. On the other hand, cat bond investors are looking for low frequency, high severity events - trades which are non-investment grade.

Plans/prospects for securitisation as applied to the agriculture sector?

We are looking at this space with interest, but cannot comment on specific plans or actions.

What role has and do hedge funds, private investors play/ed in this respect (securitisation of non life risks)?

Hedge funds and dedicated cat bond funds are the largest players in the securitisation market.

Hedge funds purchase ILS, but some also provide protection through industry loss warranties - ILWs and collateralised reinsurance. In addition, hedge funds have many other connections to the insurance industry. For example, they purchase the stocks and hybrid capital issued by (re)insurance companies, set up reinsurance vehicles and companies and fund side-car capital arrangements, and take other non-cat risks (life, life settlement, aviation, terrorism, etc.) whether or not in rated bond form.



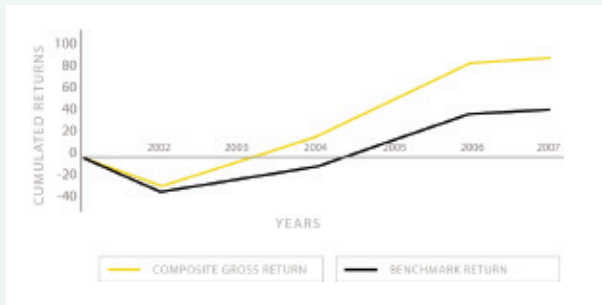
Luca Albertini, Managing Director,
Swiss Re Capital Management and Advisory

Motor insurance provides a huge pool of risk to be potentially securitised. Motor insurance has been discussed for a while as a risk with good potential for securitisation - the first deal was finalised in 2005. The potential for motor bonds is large, due to the huge volume of insured motor risk. In 2006, motor insurance incurred estimated losses of USD350 bn. This is expected to grow to USD 660 bn by 2016. Securitisation of 3% of the claims - which is equivalent to the penetration of property catastrophe risk five years ago - would require a volume of USD20 bn of motor bonds, while a penetration comparable to property catastrophe today would result in motor bonds of USD42 bn. This would presuppose overcoming the regulatory impediments to growth raised above.

Complementary solutions could develop along with ILS securitisations, as in the banking industry. For example, banks use the credit default swap market in tandem with the securitisation market to manage their credit exposures, and something similar could evolve along with the development of the motor insurance securitisation market or other ILS techniques.

Source: Swiss Re, sigma No 7/2006

BEHAVIOURAL FINANCE



Fund's gross performance vs its benchmark, since inception
source: Bank Degroef

OSIRIS EQUITIES EMU BEHAVIOURAL VALUE

Focus: Long only, large- mid-cap EMU equities - fund's investment philosophy is based on behavioural finance, asset allocations are manager supervised but essentially the process is model (quant)-driven.

Strengths: Robustness of model - screens, management team's expertise, ability to sustain performance despite growth – ie. increase in assets under management

Weaknesses: Eventually capacity constraints

Opportunities: Strategy can be conditioned by further developments in behavioural finance and research in the field of complex adaptive systems.

Threats: Exhibits high correlation to market cycles

Risk Management

□ = low □ = low/moderate □ = moderate □ = moderate to high ■ = high

Fund's major risk: behavioural finance anomalies will be arbitrated over time. The strategy shows sensitivity to the value/growth cycle in the market

• Quant expertise	□□□□■	• Model-bias risk	□□□□□
• Ability to successfully implement behaviour finance finding to Mitigate risks	□□□□□	• Discipline achieved in entering and exiting non performing stocks	□□□□■
• Enhance relative perform	□□□□□	• Currency risk	none
• Robustness of model and screening process	□□□□□	• Leverage related risk	none
		• Key Man risk	□□□□□

Performance Parameters

■ =insufficient ■ =adequate ■ = satisfactory ■ = good ■ = outstanding

• Positions in the portfolio currently	78	• Models avg. accuracy rate in entering and existing trades	70%
• Diversification Geographic	■ ■	• Manager's ability to „weed“ out non performers (fund adopts a contrarian approach)	■ ■ ■ ■
• Sector	■ ■ ■	• Efficiency in putting investor capital to work: (fully invested)	■ ■ ■ ■ ■
(even; with occasional concentration in particular sectors - currently 33% is allocated to finance)		• Fund's annual expense ratio - (including transaction costs): 1.3%	
• Capitalisation	mid-cap bias		

Outlook

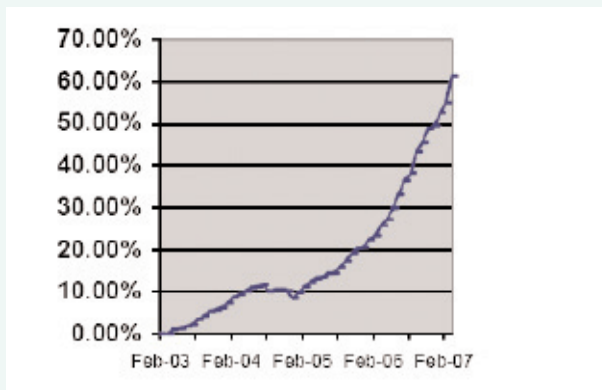
↑ upside potential ↻ upside to range bound ➡ range bound ↺ range bound to down ↓ downside potential

• Currently assets under management	EUR 1.2bn	• Suited for inclusion in	
• Targeted AuM	EUR 3bn	A conservative portfolio:	high
• Consistency in delivering targeted returns since inception:		A balanced portfolio	high
	fairly high	A thematic portfolio	high
• Model related fatigue factor	low /moderate	• Fund tends to outperform when there is a convergence on valuation spreads between value and growth shares	
• Ability to deliver targeted returns over		• Fund tends to underperform when: mega caps show relative outperformance	
Next 12 months	➡	• Funds avg. annual correlation to benchmark:	0.95
Next 1-3 years	↻		

Investment Insights

• Fund's target audience	broad based	• Fund's investment advisor is registered with	Belgian Financial Authorities
• Fund's base and only currency it is available in	EURs	• Transparency provided to investors	fairly high
• Available to institutional investors	globally	• Awards/ratings	S&P rating: AA
• Fund's complexity for an investor	moderate		2006 European Lipper Award for Pan Euroland Equities

WINE



Fund's performance since inception
source: OWC Asset Management Limited

THE VINTAGE WINE FUND

Focus: The fund buys top wines (91% top red Bordeaux) stores them to profit from price increases, but also trades actively the bid/ask spreads on such wines. This trading activity is implemented using a unique web-based screen that posts bid and ask prices for the wines traded, which is updated live. The fund acts as a market maker, like a principal trading firm, as opposed to most others who limit their intervention to agency or brokerage intermediation. This trading activity, has recently covered 20-25% of the fund's stock, achieves 5-6% pa additional return over and above the passive price appreciation of the stock.

Strengths: Fine wine expertise; wine picking
4 year track record

Weaknesses: Concentration of underlying positions
Size of underlying wine market.

Opportunities: Constrained supply, explosive demand for premium quality wine
Creation of such wealth has not been witnessed before

Threats: Can't sustain current pace of growth endlessly, at some point markets will find their equilibrium and revert to calmer returns of 8-12% pa.

Risk Management

□ = low □ = low/moderate □ = moderate □ = moderate to high □ = high

• Ability to identify wines that will appreciate	□□□□■	• Concentration of underlying risk	□□□□■
• Ability to secure those wines	□□□□■	• Average yearly turnover of wine stock	about 25% last year
• Established network	□□□□■	• Wine hedge fund competition	unique
• Risk that wine in cellar falls out of favour	□□□□□	• Storage related risk (fully insured)	□□□□□
• Existence of a secondary market for fund's wines	□□□□□	• Develop an element of cork taste (applicable to 5% of the wines)	□□□□□
• Ability to recover risk premium paid	□□□□□	• Currency related risk	□□□□□
• Lock in profit for wines in stock	□□□□□	• Key man risk	□□□□□

Performance Parameters

■ =insufficient ■ =adequate ■ ■ = satisfactory ■ ■ ■ = good ■ ■ ■ ■ = outstanding

• Avg. no. positions held in the portfolio	roughly 200	• Ability to cope with redemptions	■ ■ ■
• Diversification achieved by wines		• Ability to put investor cash to work	■ ■
Geographic	■	• Ability to deliver uncorrelated (to the major asset classes) returns	
By vintage	■ ■ ■ ■	Equity	■ ■ ■ ■ ■
By brand/mark	30+	Bonds	■ ■ ■ ■ ■
• Ability to identify opportunities	■ ■ ■ ■ ■	• Suitability to	
• Ability to deliver targeted returns in		inclusion in a conservative portfolio	■ ■ ■ ■ ■
A rising	■ ■ ■ ■ ■	inclusion in a balanced portfolio	■ ■ ■ ■ ■
Falling (through trading)	■ ■ ■	inclusion in a thematic portfolio	■ ■ ■ ■ ■
Sideway trending markets	■ ■ ■ ■ ■	• Total expense ratio to be expected including management fee: 2.68%	

Outlook

↑ upside potential ↗ upside to range bound ↔ range bound ↘ range bound to down ↓ downside potential

• Fund's outlook on investing in the space		• Barriers to entry	ability to raise money and talent
This year is shaping up to be the best year ever		• Conditions needed for the fund to outperform	sideway trending markets
• Peer group outlook	↑	• Conditions needed for the fund to under perform	recession
• Fund's ability to deliver targeted annualised returns over 5+ year period	↑	• Max AuM:	EUR150 mn

Investment Insights

• Target audience	high net worth individuals	• Available to investors	globally
• Level of fund's complexity	low	• Base currency of the fund	EUR
• Fund offers	long term capital growth	• Transparency of portfolio provided	fairly high
• To optimise returns, recommended avg. holding period	3 years	• Registered with	FSA

ENTERTAINMENT

Investing in entertainment backed assets



C. Mead Welles, CEO and Senior Portfolio Manager, Octave Entertainment Fund

What made you want to invest in the entertainment space?

The opportunity to invest in the entertainment space was driven by our experience structuring complex financial transactions around commodities and international trade. We were approached by a number of entertainment companies who had similar financing needs, and we recognised that we could apply our model to the entertainment and media space as we had historically applied to commodities and agriculture. Specifically, we try to use some combination of receivables and inventory to secure our transactions. In the case of media, the receivables are the distribution contracts that exist between any given seller of content and the companies that distribute that content to the end viewer. The inventory is the media library in question; it could be a film library, or a television series, or even a music catalogue.

Who should invest, and what would be the benefits?

The benefits of investing in an entertainment fund are high yields with low volatility and low correlation to other asset classes. The strategy is best suited for sophisticated institutional investors, who are seeking investments with this risk return profile.

Would you say entertainment-based investing is unique, when compared with other assets?

Investment in the entertainment space in and of itself is not new. With weightless assets, there are a number of risks that are quite different from other, more conventional industries that may not be as easily mitigated, like technology changes. One example is the change in home video standards from VHS to DVD to VOD. These landscape shifts can render the initial due diligence and models for any given transaction obsolete in a short period of time. The approach we take is designed to mitigate the risks as best as we can.

Why are such investments synonymous with higher risk, uncertainty, longer gestation periods ... from your experience would you say that is indeed the case? If yes, are the rewards commensurate? Elaborate.

The entertainment sector is perceived to have higher risk because of the many “unknowns” on how profits are generated. The industry has always looked at profit from a pre and post tax standpoint which by its nature makes the financing risks more unclear for an outsider. Furthermore, some of the perceived risk stems from the fact that cash flows in the entertainment sector are not as linear as they are in other industries. For instance, when a seller of content (eg. an owner of a film library or a studio) signs a contract with a cable channel for distribution, the cable company is typically not required to air the movie on a set schedule. Since most contracts call for payment after the film has been aired, the seller has no control or visibility on when the payment will come in. Although the gross contract value is visible upfront, the realisation of those cash flows is unpredictable, which makes it difficult not only for the seller to plan its cash flows, but for traditional lenders to as well.

Of course, the rewards for accepting this higher perceived risk is a higher expected return. In the case of our fund, we try to mitigate this perceived risk, as the science of our structuring process is to secure our position while at the same time allowing the obligor access to sufficient cash flow to manage its business.

How do you break down the scope of investing in this space ... how do you identify investment prospects, what sort and why?

The scope of investing in the entertainment and media space is quite broad. There are opportunities globally in the financing of film libraries, television series, music catalogues, and live concerts, among other areas. Our method of identifying prospects is driven by referrals and by proactive sourcing; we have developed an extensive network of relationships within the entertainment space, so that we can maintain a diverse pipeline of transactions.

What skills would you say an investor must possess if one were looking at investing in this space?

Knowledge of the risks inherent in the entertainment sector and familiarity with structured finance are important.

Is now a particularly opportune time to invest ... when is?

We do not advocate a “market timing” approach to investing in the entertainment space. In the case of our fund, we structure transactions so that the security underlying each transaction and the relative ability of any obligor to repay tend to be independent of economic cycles. We do watch trends and we do not like to be trend setters in this arena. In that regard, we are always happy to wait around to “pick up the pieces.”

What are the different investment vehicles available to an investor looking to invest in the entertainment space?

There are a variety of investment vehicles that we know of available to investors. Vehicles include debt funds that lend against libraries or cash flows, equity funds that invest in entertainment companies and individual productions, and hybrids that are more opportunistic.

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