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CURRENT ISSUES IN LIFE ASSURANCE SEMINAR

ROYAL COLLEGE OF PHYSICIANS, LONDON
30 MAY 2008

Alternative sources of capital

Overview of presentation:

- Introduction
- Case studies:
  - 1. Bank of Ireland (Index-linked “securitisation”)
  - 2. Legal & General (Creation of Insurance SPV)

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Introduction

- Improving regulatory capital position
- Balance sheet acceleration
- Re-configuring capital structure

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Introduction

- Rating agencies & markets
- Risk transfer
- Historic difficulties
  - Regulatory hurdles
  - Up-front costs
  - Market appetite

Case study – Bank of Ireland

- Background and reasons for project
- Structure of transaction
- Dynamic structure
- Surplus measurement
- Launching the Notes

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Background – company details

- Bank of Ireland (BOI) – mkt. cap. €9.2 bn
- BOI operates in retail sector in Ireland/UK and in capital markets
- Life assurance subsidiary – Bank of Ireland Life (BIL) trading as "New Ireland"
- Second-largest life assurer in Ireland
- Sells full range of products

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Background – reasons for project

- Restrictions within Irish regulations on allowable Tier 1 capital from insurance subsidiaries
- Deduction of BIL's Value of In-Force (VIF) from BOI's Tier 1
- BOI keen to take credit for this
- Stable medium-term source of funding

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Background - BIL Value of In-Force

- VIF at June 2007 split as follows:*

Unit-linked Insurance (IFRS4)	€425 m
Unit-linked Investment (IAS39)	€375 m
Non-linked Insurance (IFRS4)	€100 m
Total:	**€900 m**

- Seeking to take credit for IFRS4 VIF
- Limit based on VIF in the accounts

- Source: BOI presentation to Society of Actuaries in Ireland

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Structure - Balancing parties' goals

- Parent bank
- Life assurer
- Regulator
- Noteholders

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Structure

- Discussions: BOI, BIL, Watson Wyatt, Goldman Sachs, Lehman Bros
- Discussions with Regulator
- IFRS4 VIF - Unit-linked only - €400 million
- Dynamic block of business
- Index-linked repayment profile
- No direct payment from life company
- Surplus calculation within the life company
- Coverage from IAS39 ("Investment") policies

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Structure – Additional coverage

- Commitment to use surplus from "Investment" policies
- Only if necessary
- Dividend stopper

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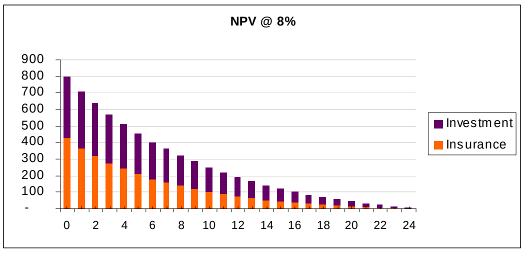
Dynamic structure: In-force unit-linked VIF run-off



- Source: BOI presentation to Society of Actuaries in Ireland

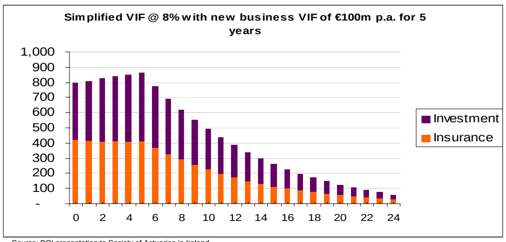
Dynamic structure

- If dynamic structure not used
  - Note repayments begin immediately
  - Very short-term if just based on existing block
  - High project cost for short term

Dynamic structure – new business

- If dynamic structure used
  - Top up with new business annually for 5 years
  - Only if necessary
  - Avoids over-collateralisation
  - No discretion – based on results of calculations
  - Freedom for life company

Dynamic structure – unit linked VIF profile with new business



- Source: BOI presentation to Society of Actuaries in Ireland

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Surplus measurement – previous deals

- Closed books
- Surplus measurement based on accounting information
- Time-consuming process

Surplus measurement – aims of Bank of Ireland's project

- Compatible with ongoing insurance business
- Need to allow for future new business
- Simple
- Transparent
- Consistency with cashflows on which Notes were launched
- Regulatory approval

Surplus measurement – approach adopted

- Based on actuarial systems
- VIF calculations analyse components of expected future profits
- Adjust each component of expected on an annual basis to derive "actual" profits
- Adjustments based on accounting information
- Goal of simplicity
- No expense risk

Surplus measurement – example

- "Actual" profit item =

Expected profit item x [actual proxy measurement] / [expected proxy measurement]

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Surplus measurement - example

- Example (only indicative figures)
  - expected 2008 FMC = €50 m
  - opening 2008 FUM = €5.0 bn
  - expected closing 2008 FUM = €5.3 bn
  - actual closing 2008 FUM = €4.9 bn
  - reported "actual" FMC = €48 m
  - €50m * [1/2 * (€5.0bn + €4.9bn)] / [1/2 * (€5.0bn + €5.3bn)] = €48m

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Surplus measurement

- Similar process for other components
- Independent review
- Dispute resolution process

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Case study – Bank of Ireland

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- Surplus measurement
- **Launching the Notes**

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Launching the Notes – Rating agencies

- Reviewed by Moody's and Standard & Poor's
- Watson Wyatt review of 22 sets of stress & scenario tests
- Risk of increased lapses would have largest effect
- Followed by investment market falls
- Ongoing stress test each year as part of the dynamic block structure

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Launching the Notes – Monoline insurer

- Time line
- Involvement of Ambac to wrap the Notes
- Detailed due diligence of VIF and legal documentation
- Wrapper covered €380 million at 'AAA' *
- (Balance rated at 'A-')

- * Source: BOI presentation to Society of Actuaries in Ireland

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Launching the Notes – cost of issue

- €400 m raised placed on deposit at EURIBOR
- Funding costs:
- €380m at EURIBOR +0.75% p.a.
- €20m at EURIBOR +3.09% p.a.
- Average cost EURIBOR +0.87% p.a.
- Ambac fees

- Source: BOI presentation to Society of Actuaries in Ireland

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