1999 General
Insurance Convention

# Integration of Insurance & Capital Market Products

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Workshop GIRO Convention 1999

Slides for Discussion

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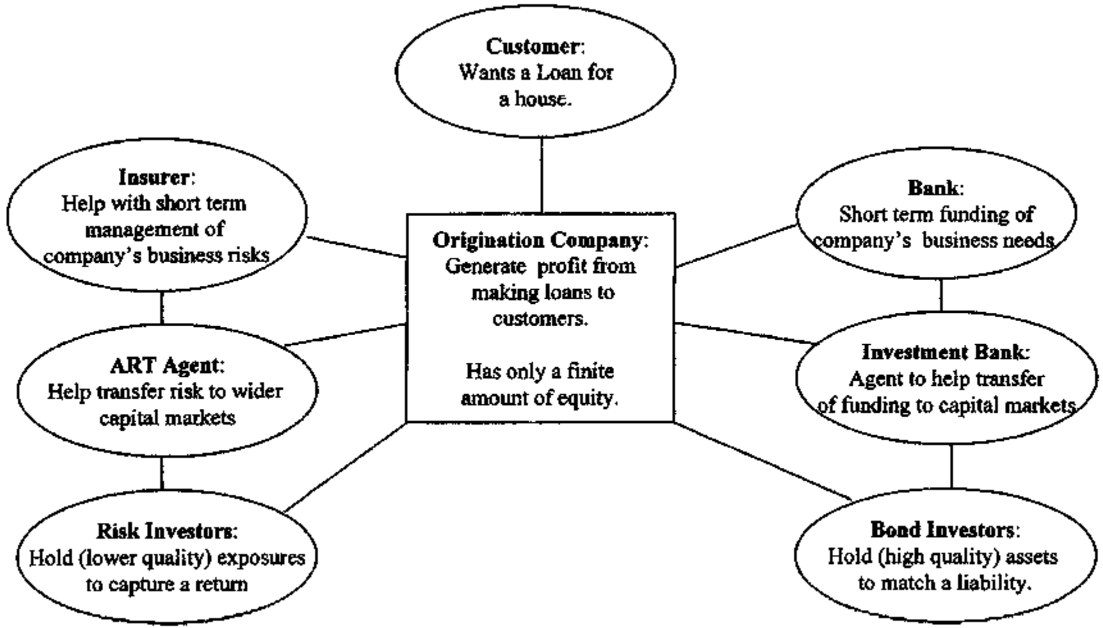
# Background to Discussion Scenario

- A new mortgage company wishes to begin originating residential mortgages in the UK.
- They are seeking the support of their finance partners to help put together a business strategy, namely:
  - <u>A bank</u> to provide the funding for the creation of new mortgages.
  - <u>An investment bank</u> to provide the refinancing of the banks funding exposure.
  - <u>An insurer</u> to provide support in relation to the credit risk during the origination process.
  - <u>A risk transfer mechanism</u> to help refinance the insurers credit exposure.

**The second and fourth steps are a requirement of the bank and the insurer who do not wish to lock in their capital for the 25 year term of the transaction.**

# Parties to the Origination Project



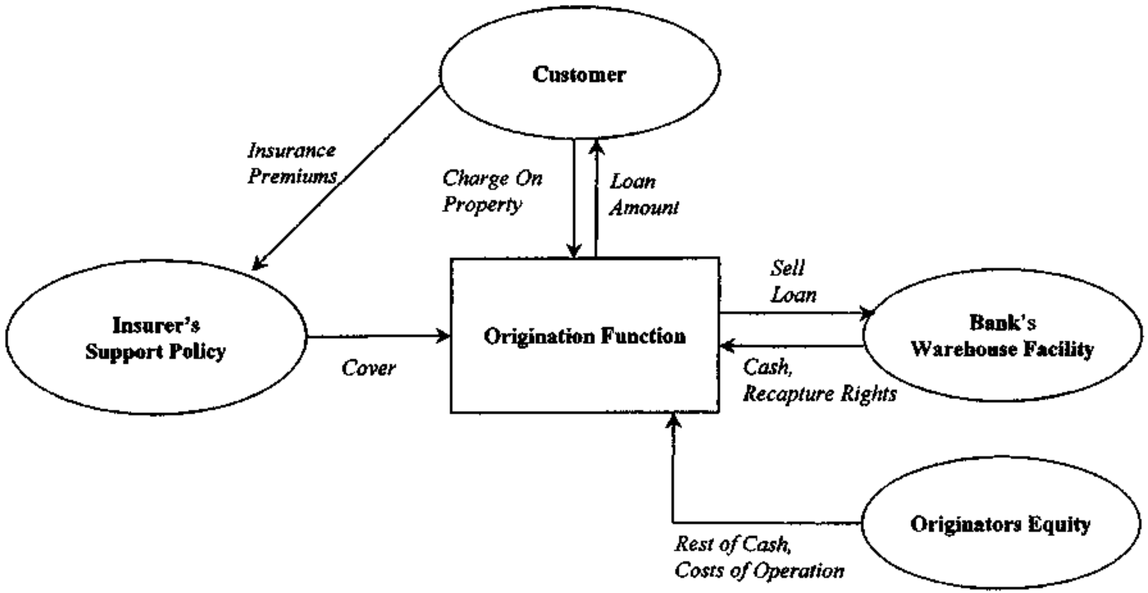
# Assets and Risks Created by Origination

- Mortgage Loan Asset which may have the following Funding Risks:
  - A Right to re-draw principal amounts up-to a schedule.
  - B Early repayment rights and terms (especially if fixed interest mortgage).
  - C Payment holidays.
- Credit Risk associated with the inability of a borrower to meet the mortgage repayments in the following time frames:
  - D Short term arrears
  - E Long term to permanent loss of ability
- Credit Risks associated with inability to recover the loan value from:
  - F The charged property
  - G Other personal wealth of the borrower

**Questions:**

- How are these risks to be handled in the short and long term?
- What is the major concern(s) of the following:
  - Customer
  - Originator
  - Insurer
  - Risk Investor
  - Bank
  - Bond Investor

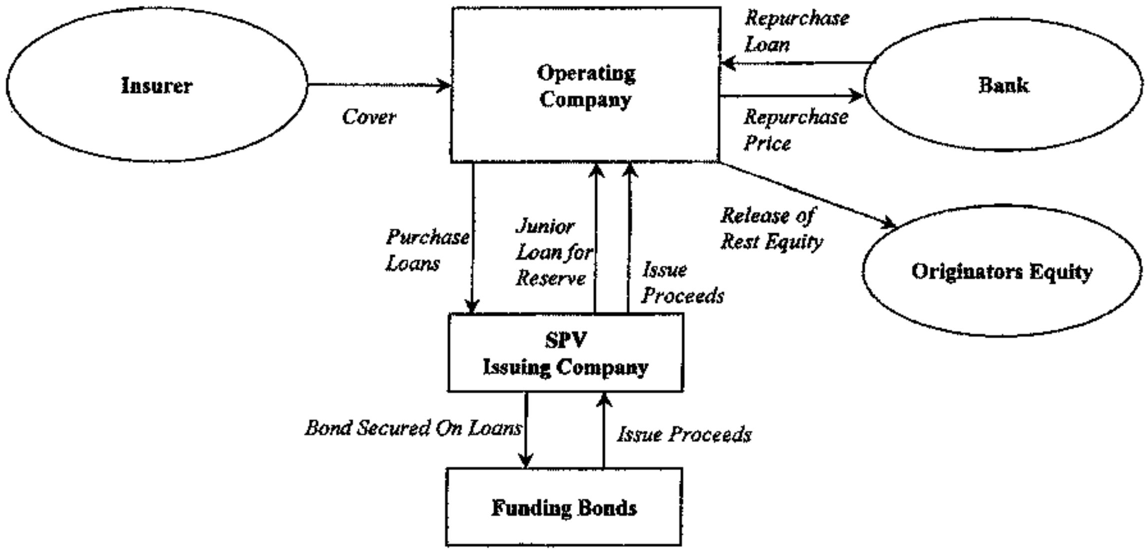
# Step 1: Origination




**Questions:**

- How are risks to be handled in the short and long term?

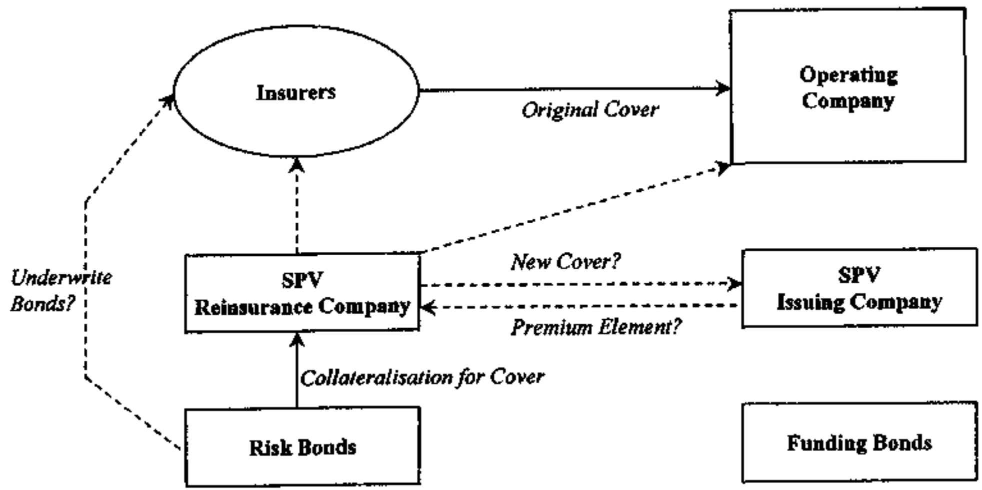
# Step 2a: Refinance the Funding Element




**Questions:**

- What are the issues to be considered when creating this transaction?
- Are there any implications for the design of the products for Step 1?
- How can the insurers participate in this refinance process?

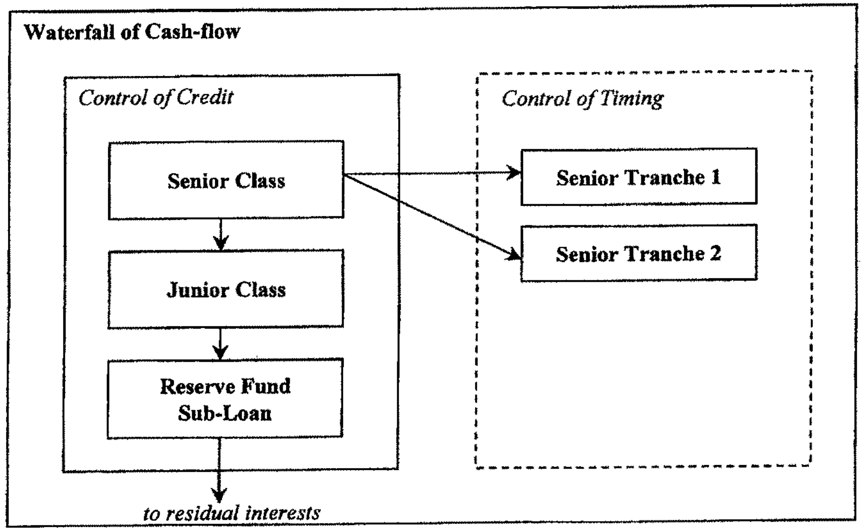
# Step 2b: Refinance the Risk Element




**Questions: (Consider both the Risk D (MPP) and Risk F (MIG) elements)**

- Between which parties should the new cover be placed?
- Should there be a premium?
- What should happen with the old policies and associated reserves?
- Are there any issues in the wording of the new contracts?
- At what price should the insurers purchase the risk bonds?
- What does the operating company get out of all of this?

# Step 2c: Structure of the Funding SPV



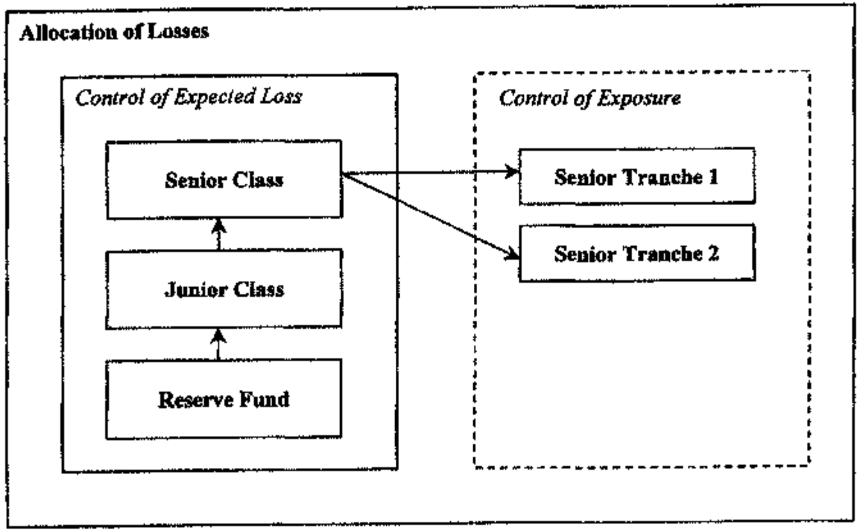

*<u>Note:</u>*
*Only consider two classes for simplicity.*

*Would often be 3-6 in practice*

**Questions: (Consider the position of Investors and Originators Interest)**

- How many classes of note should there be? Is it worth tranching a class of notes?
- How should the classes be repaid?
- What trigger events should affect the payment profile?
- What options (if any) should the SPV have to call the debt?
- What other terms should their be on the notes?
- What should be the size and terms on the reserve fund? What level of initial funding?

# Step 2d: Structure of the Risk Bonds



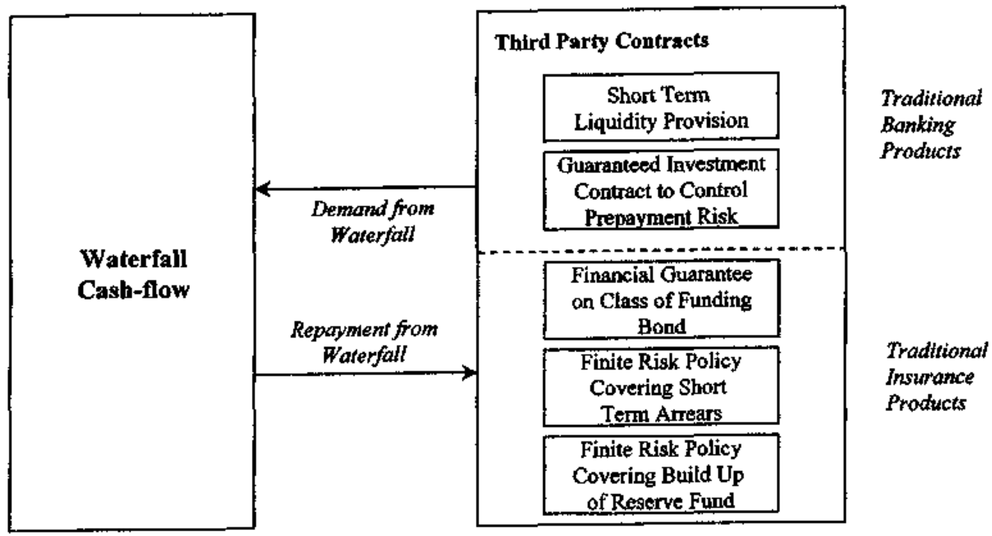

*Note:*
*In practice very little structuring has historically been done in this area to date.*

*Such structuring considerations should also be applied to large multi-year reinsurance programs.*

**Questions: (Consider the position of Investors and Originators Interest)**

- What advantages are there in structuring the Risk bonds in to Classes and tranches?
- How should the classes be repaid (e.g. sequential / pro-rata/ acceleration)?
- What trigger events should effect the class redemption profile?
- What options and terms should be on the notes?
- How should the risk structure behave if the funding structure if refinanced?
- What should be the size and terms on the reserve fund? What level of initial funding?

# Step 2e: Other Support for the Structures




**Questions:**

**(Consider the position of Investors, Third-Party-Support Providers and Originators Interest)**

- How can the following products be used to make the transaction more attractive?
- What non-standard contract terms (if any) will be required?