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"Insuritization" of Investments
Capacity restrictions after 9/11 lead to demand for "insuritization" of alternative investment classes.
See story, page 14

Investment Management
Weather Derivatives: A Growing Tool for Portfolio Managers 1
Mellon and GE Capital Reported in Contention For Royal & Sun Unit 3

Industry News
Catastrophe Losses Estimated at $24 Billion 1
Warren Buffett Comes Clean Describing Insurance Losses 5

Corporate News
John Phelan Quick to Reshape American Re 6
Britannic Asset Management Could be a Good Catch 7

Who's Where
ABB Puts Financial Services Under New CFO 9
Bear Stearns Decides on Co-Chiefs for Fixed Income 9

Deals & Finance
ABN AMRO Gets Big Chunk of Swedish Insurance Assets 11
Phoenix Investment Forms Alliance with Hedge Fund Advisor 11

International
Eight Japanese Life Insurers Downgraded 13

WEATHER DERIVATIVES: A GROWING TOOL FOR PORTFOLIO MANAGERS

Marsh & McLennan Enterprise Risk, a sister company of the New York-based insurance broker, is establishing a weather derivatives desk to be headed by a former weather derivatives manager from Enron, Partho Ghosh.

The move by MMC illustrates the growing interest corporate and institutional investors have in this nascent, not to mention somewhat arcane hedge instrument.

The first of these products appeared in the marketplace in 1997, spawned by the deregulation in the energy markets. The vast majority of these derivatives are traded on the over the counter markets. Recently some exchanges such

Continued on page 2

CATASTROPHE LOSSES ESTIMATED AT $24 BILLION. UNCERTAINTY ABOUT SEPTEMBER 11 CLAIMS COMPLICATES TALLY

US property/casualty insurers paid $24 billion in claims for insured-property damage last year, making 2001 the costliest year ever for catastrophe losses, according to estimates by the Property Claim Services (PCS) unit of Insurance Services Office, Inc. (ISO), Jersey City, NJ.

The 20 events in 2001 were the lowest number of catastrophes for any year since 1969, but the year topped the list for insured-property damage. Year-to-date claims totaled 1.5 million.

Continued on page 4

LATE NEWS….

McCAUGHAN JOINING PRINCIPAL, WILL REPLACE FRANCIS

Jim McCaughan, who quit recently as CEO of the Americas division of Credit Suisse Asset Management, is joining the The Principal Financial Group April 1 as EVP and global head of asset management. He will later assume the role of president and CEO of Principal Capital Management following the retirement of current head, Dennis Francis. Francis has announced he plans to retire later this year after 36 years.

Principal also announced that Julia Lawler has been promoted to SVP and chief investment officer responsible for oversight of asset accumulation investment activities for Principal Life Insurance Company. Both positions are new. ❑

Weather Derivatives *from page 1*

as London's LIFFE have also launched similar products. Typical contracts are Heating Degree Day (HDD) and Cooling Degree Day (CDD).

Today, weather derivatives are a $10 billion industry - still a miniscule portion of the overarching $100 trillion derivatives market. However, industry analysts predict that the size of the weather derivatives markets will grow to $75 billion over the next three years as more investors become familiar with this financial product.

Insurers Use Weather Derivatives to Diversify

"As this market continue to grow we will see more and more asset managers getting involved in this business," said Allan Roopan, vice president in the Financial Products Division of Chubb Financial Solutions (CFSI). Founded in 2000, CFSI develops enterprise risk products aimed at the insurance and capital markets. The group structured and executed one of the first weather derivatives for energy companies and currently manages a $100 million portfolio of weather derivatives.

The primary investors thus far in these products are energy companies. However, Roopan reported that some insurance companies are beginning to invest portfolio funds in these products "if only in a small way."

He added, "I know of at least four European insurance companies that have invested capital from the investment side of their business in weather derivatives. More and more, other European and US insurance asset managers are considering doing the same."

The Case for Weather Derivatives

Part of the reason for the low level of investment is lack of education, Roopan said. "Many insurance companies would find that it would be a good idea to manage some of their risk on the investment side by committing capital to the weather business. But they are not familiar enough with the product."

He gives a basic example: Too much rain in the southeast part of the country could affect the property side of an insurer's books. One way to hedge against this risk would be to invest in a derivative that pays off if there is too little rain in this part of the country. Or consider the case of insurance companies that underwrite coverage for crops. "They are exposed to precipitation and temperature risk," Roopan said. "If there is a hot, dry summer in one part of the country, they stand to lose a lot of money.

"Diversifying away from this risk makes a lot of sense."

Growing Popularity

Martin Malinow, an Executive Vice President at Element Re, believes there will be more participation this year and next among insurers. "We are seeing more insurers coming into the market because weather derivatives provide a stream of premiums that are not correlated to their traditional P&C book or life book. Weather is basically a non-correlated activity."

The entry of new capital in the insurance market is also having an effect, he said.

"We are getting calls from new insurers as well as fund managers that are looking for non-correlated assets. They are asking us to structure products for them based on the weather. There wasn't this demand a year ago."

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Risky Business

A key player in this space was Enron, of course. However, the company's collapse has had no effect on the market for this product, according to industry watchers.

Still, because the market is relatively new and unregulated, experts agree that overvaluation and even price gouging can be a problem. And lack of knowledge of these hedge products can be a problem. Even large, sophisticated companies that have bought these derivatives have admitted they did not understand their finer details.

The key, says Chubb's Roopan, is to make sure you know who you are trading with in terms of credit quality and reputation. "That goes for any product, not just weather derivatives." (*Erika Morphy*) ❑

MELLON AND GE CAPITAL REPORTED IN CONTENTION FOR ROYAL & SUN UNIT

At least two US asset managers are reported to be interested in purchasing the investment management business of British insurance company, Royal & Sun Alliance Insurance Group plc (London: RSA.L), which has launched a program to raise £800 ($1.1 billion) that includes asset disposals. The new capital will be deployed in the general insurance side of RSA's business.

The speculation so far mentions Mellon Financial and GE Capital from the US, and Aberdeen Asset Management and SG Asset Management (a Societe Generale unit) from the U.K.

Royal & SunAlliance Investments could fetch as much as £300 million ($426 million) and put RSA's target well within easy reach. In a statement accompanying RSA's 2001 results, chief executive Bob Mendelsohn said "good progress" was being made with the £800 million program. He confirmed that seven transactions had been initiated. Meanwhile, a 10p dividend cut, from 26p to 16p, has already released £150 million.

Mendelsohn is eager to get his show on the road after the market turmoil and delays that followed the events of September 11. Late last year, he expressed confidence in the company's re-positioning plans when he said: "The general insurance sector will see strong growth over the next few years and Royal & SunAlliance is ideally positioned to make the most of this opportunity. We have initiated a series of actions that will enable us to generate internally the capital necessary to support the significant organic growth we are seeking. We believe that the upturn will continue for a number of years and that our global positioning and firm rating actions should enable us to achieve and maintain our target returns."

None of the rumored contenders has come forward with an official comment. Aberdeen Asset Management has been on a tear recently, having acquired U.K. asset managers OMI Companies, Ivory & Sime Asset Management and RREEF UK Limited all within the past year.

If it turns out that Mellon and SocGen are indeed in competition for the RSA unit, it will elicit smiles from industry insiders who recall that SocGen and Mellon Investor Services, a subsidiary of Mellon Financial, just recently announced a partnership agreement to manage employee stock option and shareholder plans for multinational US and continental European corporate issuers. ❑

PRINCIPAL CAPITAL STARTS OLD UNITED $42 MILLION ACCOUNT

Principal Capital Income Investors, Des Moines, IA, has started to manage a $42 million fixed income mandate for Old United Insurance Companies, a group of privately-held firms operated by Van Enterprises, Inc., Merriam, KS. It will manage a diversified fixed income portfolio customized to meet the risk parameters of the Old United Insurance Companies' general account.

An affiliate of Principal Capital, Income Investors is responsible for managing and sub-advising nearly $40 billion in fixed income assets. Across all asset classes, Principal Capital manages nearly $2 billion in sub-advisory mandates for approximately 15 non-affiliated insurance clients, including over $400 million in core fixed income mandates managed by Income Investors.

Old United was one of two new insurance sub-advisory mandates for Income Investors last year. Principal Capital overall gained four new insurance sub-advisory mandates. The lead portfolio manager for its insurance sub-advisory fixed income clients is Scott Bennett.

All told, the Principal Capital affiliates of Principal Financial Group (NYSE: PFG) manage over $100 billion in combined asset worldwide. ❑

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Catastrophe Losses ***from page 1***

Much uncertainty still surrounds the dollar amount of loss and number of claims from the September 11 terrorist attacks on New York City and the Pentagon. According to PCS estimates, insured-property losses from the attacks stand at $16.6 billion, generating 74,000 personal and commercial property and vehicle claims. Losses from this event will take several months to compile with greater accuracy, and so the PCS estimate is likely to be revised further.

The PCS estimate of September 11 only applies to insured losses for property damage and related coverages, such as business-interruption insurance. The estimate represents only a portion of the total insured losses from the attack and does not include liability insurance; workers' compensation; aviation property/casualty losses; or life and health insurance from the World Trade Center complex, and the immediate surrounding area and locations near the Pentagon in Virginia.

Many policyholders are unsure of their losses and may have filed only partial or incomplete claims, while others may not yet have filed any claims with insurers because their records are missing or destroyed, PCS noted.

More precise insured-loss estimates from the September 11 terrorist attacks will take time to compile because of the complexity of the events which affect both residential and business customers and companies that have insured them, PCS reported.

The difficulty of loss estimation is compounded by potential litigation involving insurers, reinsurers and major property owners. That could significantly affect ultimate loss settlement.

The claims-estimating process by insurers in New York City is taking place building by building and tenant by tenant in those buildings. Claims adjusters' access to the World Trade Center and surrounding areas was inhibited by rescue operations, shutdown of much of downtown Manhattan and health concerns arising from debris in the area.

Final insured-property loss estimates will be significantly influenced by such issues as the cost of relocating businesses, replacing lost employees, rebuilding destroyed office space, adjusting claims for loss resulting from the order of civil authority or business-interruption losses from both within and outside New York City, and the resolution of personal property claims from the collapse of the Twin Towers.

By comparison, catastrophe losses during the three other quarters of 2001 were modest. The worst catastrophe prior to September 11 was Tropical Storm Allison, which caused insured damage of $2.5 billion, primarily in Texas.

Fourth-quarter 2001 insured losses were less than $500 million from four catastrophic events, making this quarter's losses among the lowest in the past 10 years.

Following is a recap of the top 10 catastrophes in the US:

Year	Catastrophic Event	Total Losses
2001	Fire and explosion	$16.6 billion
1992	Hurricane Andrew	$15.5 billion
1994	Northridge earthquake	$12.5 billion
1989	Hurricane Hugo	$ 4.2 billion
1998	Hurricane Georges	$ 3.0 billion
2001	Tropical Storm Allison	$ 2.5 billion
1995	Hurricane Opal	$ 2.1 billion
1999	Hurricane Floyd	$ 2.0 billion
2001	St. Louis hailstorm	$ 1.9 billion
1993	Midwest blizzard	$ 1.8 billion

ISO's PCS unit defines a catastrophe as an event that causes $25 million or more in insured-property losses and affects a significant number of property/casualty policyholders and insurers.

PCS estimates represent anticipated insured loss on an industry-wide basis arising from catastrophes, reflecting the total net insurance payment for personal and commercial property lines of insurance covering fixed property, personal property, vehicles, boats, related property items and business-interruption losses. The estimates exclude loss-adjustment expenses. ❑

NEW DRIVERS IN THE CAPTIVE MARKET

US airlines announced a plan to establish a Risk Retention Group under the auspices of the Air Transport Association in the wake of sky-high terrorism insurance rates.

The move was not entirely unexpected: traditionally in hard markets alternative risk strategies such as captives and risk retention groups become much more popular. The question is, does this represent a permanent shift in strategy, given the long-term uncertainty of the terrorism issue?

"In the aftermath of Sept 11, everything is unique so it is hard to talk about general trends," says John Haley, Counsel in the New York office of Edwards & Angell LLP in their insurance and reinsurance practice group.

In the short term, however, Alexandra Glickman, managing director and practice leader, Arthur J. Gallagher & Co., says the answer is clearly yes.

"The current pricing for terrorism insurance is nothing less than opportunistic. You will see more and more industries pursuing captives and risk retention groups as

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an option." Glickman says Gallagher is exploring the possibility for its commercial real estate clients, especially if "lenders prevail [in current legal maneuvering] and are allowed to require commercial real estate owners to purchase terrorism coverage."

While they may provide more reasonably priced coverage, industry captives are not without their problems, Haley said. "They have governance issues that commercial insurers don't have. Industry captives are more interested in meeting the needs of their constituents than in maintaining a profit.

"It can be difficult for companies that compete with one another to get together and form a unified front in the insurance world. Once they start paying for each others losses, it can become a cause of dissension." ❑

WARREN BUFFETT COMES CLEAN DESCRIBING INSURANCE LOSSES

Insurers need to follow three principles to be profitable, Warren Buffet writes in his annual letter to stockholders in the Berkshire Hathaway (NYSE: BRKa) 2001 annual report.

1. Accept only those risks that can be properly evaluated, and that after evaluation carry the expectancy of profit.

2. Limit the business accepted in a manner that guarantees they will suffer no aggregation of losses from a single event.

3. Avoid business involving moral risk.

Unfortunately, he concluded, the events of 9/11 made clear that implementation of rules 1 and 2 at General Re had been dangerously weak. "In setting prices and also in evaluating aggregation risk, we had either overlooked or dismissed the possibility of large scale terrorism losses. That was a relevant underwriting factor and we ignored it."

This oversight, as well as other factors, led Berkshire Hathaway to report a decline in net worth of $3.7 billion, to $57.9 billion, or $37,920 per share.

Berkshire's insurance operations make up about 60 percent of its business - including GEICO and General RE. Of the $4.3 billion in operating losses from insurance operations, some $2.2 billion came directly from the terrorist attacks.

Gains in building supplies, financial products and other business segments offset the insurance losses.

Buffet promised investors not to repeat the same mistake of underestimating the terrorist attacks. "We will be writing some coverage for terrorist-related losses, including a few non-correlated policies with very large limits," he said. "But we will not knowingly expose Berkshire to losses beyond what we can comfortably handle."

However, he noted that another catastrophic attack could bankrupt the industry.

General Re's Underwriting Losses

Berkshire also stumbled with underwriting losses at General Re, Buffet continued. One cause for failure was that it did not reserve correctly and miscalculated the cost of the product it was selling.

Buffet noted, however, that it's not easy to reserve properly. Problems can lie dormant for decades, he said, citing asbestos liability, before manifesting themselves. Another factor behind the losses at General Re was its overly competitive attitude in going after, and retaining business. "'No' must be an important part of any underwriter's vocabulary," Buffet ruefully concluded. ❑

LIFE INSURANCE EXECUTIVES STRUGGLING WITH SHAREHOLDER VALUE

Executives of stock life insurance companies in North America still have some way to go before achieving greater focus on the management of shareholder value, according to a recent Tillinghast-Towers Perrin study of shareholder value management practices in the life insurance industry. The report is entitled: "Creating Shareholder Value in the Life Insurance Industry,"

"While this study points out some of the challenges to companies trying to manage their business based on shareholder value, it also shows how the industry can realize that goal over the next three years," says Alastair Longley-Cook of Tillinghast - Towers Perrin's Hartford office and coleader of its shareholder value initiative.

Mike Lombardi, a principal in the firm's Toronto office and co-leader of the study, said: "The industry is struggling with lower revenue and fewer opportunities for profitable acquisitions. This study demonstrates that life insurers need tools, such as economic value analysis, to assess and communicate their strategies better to their own people and the market."

The study included a survey of senior executives in North American stock life insurance companies and subsequent interviews with a sample of the executives and investment analysts in the United States and Canada who follow the life insurance industry. The study probed current practice on four dimensions of shareholder value management: strategy, metrics, communication with the market and organizational alignment. The findings were as follows:

Strategy

The strategy of choice for insurers to increase shareholder value has been and will continue to be mergers and acquisitions. Sixty-two percent of respondents predict M&As to be one of their company's top four priorities over the next three years, even though analysts are skeptical about their future effectiveness.

One leading analyst noted that "it was easier to achieve P/E arbitrage in the mid-90s and succeed with an M&A strategy. Today it is much harder."

Other strategies to increase shareholder value, focused on inherent growth, can be expected to decline. For example, "growing existing distribution channels" will drop from 62 percent to 52 percent as a top priority. "Innovating products" will drop from 48 percent to 38 percent. Execu-

Continued on page 6

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Shareholder Value *from page 5*

tives say they will pursue these strategies even though many report that they have not been effective in the past.

Metrics

Insurers use a number of different measures as their key internal financial metrics. For example, 91 percent use return on equity as a key financial metric, and 40 percent rate it as their most important metric. The percentages are the same for earnings growth. But 86 percent of respondents say their current most important metric has weaknesses that "hamper our ability to manage toward long-term value creation."

Relatively few life insurance companies today (33 percent) use economic value to measure the internal value of organizations. However, the study found that the number of companies using economic value is likely to rise to 50 percent over the next three years.

Communication with the Market

Seventy-two percent of executives believe their company is undervalued, and 76 percent attribute this in part to the market's reliance on GAAP measures. Other reasons cited by executives include the complexity of industry accounting and financial practices, cited by 86 percent; the short-term focus of investors, cited by 52 percent; and the complexity of insurance products, cited by 43 percent.

According to the study, the use of economic value measures in communicating externally with the market will triple over the next three years, with 33 percent (up from 10 percent) using them as one of the top two techniques. At the same time, other measures will decline, such as focus on "earnings growth"' (to 38 percent from 62 percent).

Organizational Alignment

One executive stated that "our employees are strongly motivated to improve the company and increase shareholder value, but the tools are not in place to empower employees and create a `clear line of sight' between that goal and what they actually do in their jobs." Survey findings support this view: 100 percent of respondents say their company culture supports changes necessary to shareholder value creation, and 95 percent say people at all levels are motivated to increase shareholder value; however, only 67 percent believe people at all levels think like owners or understand how their actions influence shareholder value.

Mike Lombardi concludes, "This study points to the very real challenges of managing shareholder value in the life insurance industry in North America. But the good news is that the study, as well as our own consulting experience, shows some executives and companies finding a way out of these difficulties and developing a 'clear line of sight' between shareholder value, strategy and organizational alignment, grounded in 'economic value' as the key financial metric." ❑

CORPORATE NEWS

JOHN PHELAN QUICK TO RESHAPE AMERICA RE

Moving swiftly after his March 9 appointment, the new chairman and CEO of American Re Corp., John P. Phelan, named Albert J. Beer as president, Strategic Business Units, and Wolfgang Engshuber as president, Corporate Centers, to take effect immediately. American Re, Princeton, NJ, is a member of the Munich Re Group.

Phelan's announcement also said that, subject to appropriate legal and regulatory approvals, American Re's international reinsurance operations will transfer their business to the appropriate offices of Munich Reinsurance Company, Munich, Germany. "Clients of American Re's international reinsurance operations will benefit from more direct access to the capital, capacity and extensive global network of the entire Munich Re Group.," Phelan said. Certain global specialty lines of business, including Surety and Home/Foreign, will continue to be underwritten and managed directly by American Re.

The changes, Phelan added, are intended to provide America Re and its clients "with better focused, more disciplined marketing and underwriting and the greater efficiencies available through shared resources." They will enable the company to "focus its efforts on developing its core businesses in the United States."

Separately, American Re said Mahmoud Abdallah has resigned to pursue a new venture. He was EVP and president of the international operations of the firm's principal subsidiary, American Re-Insurance Co. He was also chairman of Munich-American Global Services, Inc. and oversaw the Information Technology Division. He will remain as a senior advisor to parent company Munich Re Group.

Also, Robert Burgess resigned from American Re as executive vice-president, general counsel and secretary, effective March 8. He will continue as a consultant to the firm. ❑

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BRITANNIC ASSET MANAGEMENT COULD BE GOOD CATCH

The outperforming asset management business of Britain's Britannic plc is drawing the attention of financial services companies sizing up Britannic, or its component parts, as a possible acquisition. The company's search for a merger partner was disclosed earlier this year, following the departure of Danny O'Neil as group chief executive. He has not been replaced.

Britannic has been repositioning itself away from its unprofitable home business segment into alternative product areas and distribution channels, including the closing down of its 2,000-strong Britannic Assurance direct sales force. However, the company believes it needs greater scale in order to exploit opportunities to the full, and executive chairman Harold Cottam said this month: "We are alert to appropriate opportunities to achieve the necessary scale for the Group."

Despite the tough market conditions, the asset management business, Britannic Asset Management (BAM), turned in a strong performance in 2001 with the Britannic Assurance life fund UK equity portfolio outperforming the FTSE All Share by 3.1 percent. Retail gross premiums were up 26 percent, net sales were strong, and new fund management inflows held up well in the circumstances, at £448.6 million versus £551.2 million.

Another positive development was the December 2001 acquisition of Glasgow-based Blairlogie Capital Management. With an established US and Australian client base, Blairlogie provides an excellent platform for international growth, as well as adding approximately $800 million to Britannic's funds under management. The firm was acquired from ABN AMRO Asset Management for an undisclosed sum. Gavin Dobson, the chief executive of Blairlogie now heads up Britannic's international institutional business and James Smith, Blairlogie's chief investment officer, is investment director.

As the candidates line up to study the pros and cons of acquiring Britannic, the asset management business should loom large in the negotiations that follow. Group funds under management at Dec. 31 totaled £17.6 billion ($25 billion). Press reports have named insurance companies Royal London and AMP and the banks Alliance & Leicester and Abbey National as possible contenders. Aegon NV of the Netherlands has also been mentioned. It will be interesting to find out whether BAM can be plucked from Britannic and purchased separately. Merrill Lynch & Co. has been hired by Britannic to process potential suitors. ❑

CREDIT SUISSE TAKES IT ON THE CHIN

Credit Suisse Group, Zurich, reported a net operating profit of CHF 4.0 billion in 2001, down 45 percent versus 2000, excluding exceptional items at Credit Suisse First Boston of CHF1.1 billion ($646 million) and the amortization of acquired intangible assets and goodwill. Net profit was CHF 1.6 billion, compared with CHF 5.8 billion (down 73 percent) in 2000.

In the fourth quarter 2001, the net operating profit was CHF 616 million, excluding the exceptional items at Credit Suisse First Boston and the amortization of acquired intangible assets and goodwill. This compares with a net operating profit of CHF 21 million in the previous quarter and CHF 1.9 billion in the fourth quarter 2000.

As previously announced, the Group reported a net loss of CHF 830 million for the fourth quarter after taking into account the exceptional items and the amortization of acquired intangible assets and goodwill. This compared with a net loss of CHF 299 million in the third quarter and a net profit of CHF 590 million in the corresponding period of 2000.

Lukas Mühlemann, Chairman and CEO, said, "Clearly, the global economic climate made 2001 a challenging year for the Group, as well as for the entire financial services industry. However, our company's fundamentals remain strong and our asset gathering and asset management businesses achieved solid profitability and growth."

On the outlook, the Group said it remains cautious for 2002 and expects revenue levels at Credit Suisse First Boston to be lower than in 2001 and earnings at Credit Suisse Financial Services not to exceed 2001 levels. Credit Suisse First Boston reported a net loss of CHF 1.6 billion ($961 million) for 2001 versus a net profit of CHF 2.4 billion (USD 1.4 billion) in 2000. An extensive restructuring and cost reduction program is underway.

Net new assets totaled CHF 66.4 billion in 2001, representing growth of 4.8 percent of assets under management. Credit Suisse Financial Services contributed CHF 7.9 billion of total net new assets, Credit Suisse Private Banking CHF 33.0 billion, Credit Suisse Asset Management CHF 9.2 billion and Credit Suisse First Boston CHF 16.3 billion. The Group's total assets under management stood at CHF 1,425.5 billion as of December 31, 2001, up 2.4 percent on the year-end 2000 figure.

Credit Suisse Asset Management recorded a five percent decline in net operating profit to CHF 322 million in 2001. The unit achieved a net operating profit of CHF 139 million in the fourth quarter, following a weaker third quarter. Net new assets totaled CHF 9.2 billion for the full year and CHF 1.9 billion for the fourth quarter. As of December 31, 2001, discretionary assets under management stood at CHF 364.2 billion and total assets under management increased by 4.4 percent to CHF 508.8 billion. ❑

A SECOND BILLION FOR NEW YORK LIFE

New York Life Insurance Co. reported that net income in 2001 was $1.086 billion, compared with $1.205 billion in 2000. The 2001 results include realized capital losses of $56 million, compared with $387 million in realized capital gains in 2000. Operating revenue - comprised of premiums and fees - increased 11 percent in 2001 to $13.0 billion, compared with $11.7 billion in the prior year. The company's surplus and investment reserves - the funds that finance growth and protect policyholders - grew to $8.741 billion, representing one of the strongest capital positions in the industry.

New York Life said its investment management business continued to grow, with assets under management reaching $152.9 billion in 2001, an increase of 32 percent over 2000. The

Continued on page 8

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New York Life *from page 7*

increase was aided by the acquisition of McMorgan & Co., a company specializing in the multi-employer benefit plan marketplace. New York Life Investment Management LLC (NYLIM), which is among the 25 largest asset management firms in the US, recorded operating revenue of $632 million in 2001. This result was comparable to the prior year's results despite the volatile stock market. Sales climbed to $16.4 billion, up 20 percent over 2000. ❑

ING CONTINUES TO EXPAND IN MEXICO

ING (NYSE: ING) said it plans to take a 17.5 percent interest in Grupo Financiero Bital by investing $200 million in the Mexican financial services company. Amsterdam-based ING has signed a memorandum of understanding, prior to negotiating a final agreement.

The planned investment is part of a capital-raising program by Bital. It is expected that institutional investors and Bital's current owners will participate, and ING expects the transaction to be completed in the second quarter of this year.

ING has owned a 49 percent interest since 1998 in a bancassurance joint venture with Bital, which enables ING to distribute insurance products through Bital's branches. Cooperation between ING and Bital dates to 1997, when both companies established Afore Bital, one of the largest pension funds in Mexico. In October 2000, ING acquired Bital's interests in Afore Bital.

In 2001, ING acquired Seguros Comercial America, now known as ING Comercial America, the largest insurance company in Mexico with a 21 percent market share in the Mexican life and health insurance market and a 33 percent share in the property and casualty insurance sector. ❑

MUTUAL RISK GENERATES $100 MILLION FROM SALE

Mutual Risk Management Ltd., Hamilton, Bermuda (NYSE: MM) reached a definitive agreement with The BISYS Group Inc. to sell its fund administration business, Hemisphere Management Ltd., and gain approximately $100 million after-tax on the sale.

Despite the sale, the firm's stock price continued to erode and was trading recently around 50 cents a share. The company announced a fourth quarter loss of $99.7 million, and this was followed by a lowering of its agency ratings.

Completion of the transaction is subject to regulatory approval and other usual terms and conditions. The proceeds of the sale will be used to repay indebtedness and the company's banks and debenture holders have approved the transaction.

Mutual Risk has also retained Greenhill & Co., LLC, to assist in developing a restructuring of its balance sheet. ❑

GAINSCO VERGING ON NYSE DELISTING

On March 5, Gainsco, Inc., Fort Worth, TX, (NYSE: GNA) said it had received formal notice from the New York Stock Exchange that it is "below criteria" for continued listing which requires a total market cap of not less than $50 million over a 30 trading day period and stockholders' equity of not less than $50 million.

Gainsco said it is involved in active discussions with the NYSE regarding its business plan, but if its shares cease to be listed, it believes that an alternative trading venue will be available. ❑

BRIEFLY

Aegon NV, The Hague, Netherlands (AEG), reported that net profit in 2001 totaled EUR2.40 billion or EUR1.76 per share compared with EUR2.07 billion or EUR1.57 per share the previous year. Euro earnings were up 16 percent, while per share earnings rose 12 percent. The company refrained from giving a definitive 2002 forecast, but said the outlook for its core business was "positive" and earnings would be "at least equal" to 2001.

Willis Group Holdings, London (NYSE: WSH) reached an agreement to sell the property and casualty division of Willis Administration Services Corp. (WASC-PC) to Alternative Service Concepts, L.L.C. Terms of the transaction, which is expected to close within 60 days, are not disclosed.

WASC-PC was established to serve the emerging alternative market for risk coverage in the mid-1970s and has built strong market share since that time with state, county and municipality program managers, as well as specialty association groups. The Division employs 170 staff working from a network of 22 offices throughout the United States.

Commenting on the sale, Joe Plumeri, chairman and CEO, said as Willis puts increasing focus on providing risk management services to the corporate sector, "it is right that we reduce our presence in non-core businesses, such as WASC-PC."

PartnerRe Ltd., Pembroke, Bermuda, (NYSE: PRE) said it underwrote reinsurance policies during the key January renewal season that should generate $1.37 billion in premium -- an increase of 37 percent. The company entered the renewal season with expiring premium of approximately $1 billion. Prices on the renewal book increased approximately 20 percent on average. The January renewal period typically accounts for over 60 percent of total business. Patrick Thiele, PartnerRe President and CEO said: "We believe the strong market we are seeing can continue into 2003."

A record $791 million in consolidated statutory net income for the **Massachusetts Mutual Life Insurance Company (MassMutual)** and its domestic insurance subsidiaries was reported by the MassMutual Financial Group, Springfield, MA. This was an increase of $51million or seven percent over the prior year. Total revenue reached $16.0 billion, up eight percent. Worldwide insurance sales rose 14 percent to nearly $3.3 billion. Total assets under management advanced to $233.6 billion, compared to $213.1 billion the prior year. This strong overall growth in assets was achieved despite significant volatility in world equity and fixed-income markets.❑

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ABB PUTS FINANCIAL SERVICES UNDER NEW CFO

ABB, the Zurich-based global power and automation technology group, said it is placing its Financial Services division under incoming chief financial officer (CFO) and executive vice president **Peter Voser**, who joined ABB this month. He takes responsibility for the division's four business areas - Structured Finance, Equity Ventures, Treasury and Insurance, with immediate effect.

The other group financial functions, Controlling, Corporate Finance & Taxes, Real Estate, Risk Management & Insurance and Value Services, already report to the CFO. The group function Strategy and Ventures, which includes the mergers and acquisitions unit, will also report to the CFO.

"Given the increasing need for close coordination of our financial functions and businesses, we have decided to move them under the leadership and guidance of the CFO," said president and chief executive officer Jörgen Centerman. "This organizational change will also strengthen the overall control framework."

Jan Roxendal, who has successfully headed ABB's financial services activities since 1991 and been a member of the ABB executive committee since 1998, has decided to leave the company but has made himself available for a transition period of three months, ABB said. ❑

BEAR, STEARNS DECIDES ON CO-CHIEFS FOR FIXED INCOME

Jeffrey Mayer and **Craig Overlander** have been named co-heads of the Fixed Income Division at Bear, Stearns & Co. Inc., New York. They will continue to report to Warren Spector, who along with Alan Schwartz, was named president and co-chief operating officer of the firm in June 2001. The Division grew 47 percent in fiscal 2001 and reported more than $1.6 billion in total revenue, representing approximately 33 percent of total 2001 revenue. ❑

PATRICK BAIRD NAMED PRESIDENT AND CEO AT AEGON USA

Patrick S. Baird, 48, has been named president and CEO of AEGON USA, Inc. and a member of the AEGON USA board of directors, effective April 19. He is currently EVP and chief operating officer. Baird succeeds Donald J. Shepard who will become chairman of the executive board of AEGON N.V. Shepard will remain on the AEGON USA board. ❑

AMMC PROMOTES JOHN BERDING, LINTZ RETIRES

John B. Berding has been promoted to Executive Vice President of American Money Management Corporation (AMMC), the portfolio management company of American Financial Group, Inc. (AFG). Cincinnati, OH. At the same time, the retirement was announced of Robert C. Lintz, AMMC senior executive vice president, effective March 1. Lintz, who started in 1965, saw AFG assets grow from $150 million to $17.5 billion. ❑

ENDURANCE BUILDS EXECUTIVE RANKS

Endurance Specialty Insurance Ltd., Hamilton, Bermuda, announced three appointments:

- **Louis A. Adanio**, 47, as executive vice president, chief property underwriting officer. He was previously at Cambridge Risk Technical Underwriters and, before that, spent 16 years at SCOR Reinsurance.
- **Mark Boucher**, 42, as executive vice president, international operations. Boucher was previously at Royal and Sun Alliance (RSA) where he oversaw the company's London-based commercial operations.
- **David Cash**, 36, as chief actuary and chief risk officer. Cash was previously Vice President at Centre in Bermuda, where he focused on structured finance and investment programs and was responsible for the creation of Centre's senior settlement financing company, Centre Life Financial.

Endurance started operating three months ago as a global provider of property and casualty insurance and reinsurance. ❑

MCCARTNEY NEW CFO AT ZURICH NORTH AMERICA

Zurich North America, Schaumburg, IL, named John McCartney to the position of chief financial officer. He had been CEO of Empire Fire and Marine, a business unit of Zurich North America that provides tailored insurance and financial solutions to small and mid-sized commercial markets. McCartney takes over from Thomas Buess, who was named CFO of Zurich Financial Services Group, the parent organization of Zurich North America, in December 2001. Steve Rand is McCartney's successor at Empire. ❑

Continued on page 10

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Who's Where *from page 9*

JONATHAN MOSS JOINS REYNOLD PORTER CHAMBERLAIN

London law firm Reynolds Porter Chamberlain (RPC) appointed Jonathan Moss to its reinsurance practice. He was previously at Vizards Wyeth, where he worked in both the UK and French insurance and reinsurance markets.

Moss' background includes high profile international reinsurance litigation involving the liquidations of North Atlantic Insurance Company and HIH Casualty & General Insurance Limited and The Piper Alpha Platform disaster. ❑

CHRIS CHAMBERS CEO AT MAN INVESTMENT PRODUCTS

Man Group plc. London, announced the following appointments at Man Investment Products, its asset management business:

- Chris Chambers as chief executive officer, with effect from March 1. He joined from Credit Suisse First Boston where he was European head of equity capital markets.
- **David Huyton** as chief investment officer. His prime responsibility since 1995 has been the firm's flagship fund, AHL.
- **Christoph Möller** as chief executive officer, Man Investment Products Switzerland. ❑

THOM BENTLEY JOINS SCOTTISH WIDOWS CONSULTING TEAM

Scottish Widows Investment Partnership (SWIP), Edinburgh, Scotland, appointed Thom Bentley (35) as a director on its consulting team. His responsibilities include managing relationships with global equity and bond consultants, together with pan-European researchers. SWIP manages over £18 billion of institutional funds. According to Chris Walker, head of the Institutional Division: "Last year saw nearly £500m of new mandate wins and 2002 has started strongly. Consultants are ever more sophisticated in their analysis and we are happy to meet their needs with this appointment." Bentley joined SWIP from Aegon Asset Management. ❑

NEW APPOINTMENTS AT ING'S AELTUS

Aeltus Investment Management, Inc., Hartford, CT, announced that **Peggy Caldwell** and **Joe Pickert** are joining the firm as senior vice presidents of sponsor sales. Caldwell will be located in Chicago, while Pickert will be located in Los Angeles. Aeltus is an independently managed subsidiary of ING Group.

Caldwell was previously with Barclays Global Investors and has also worked at Cigna, Fidelity and Salomon Brothers. Pickert spent four years at Neuberger Berman as salesperson in institutional separate accounts. Prior to that, he was with Dreyfus Retirement Services, MassMutual Pension and the Dallas Cowboys. ❑

BRIEFLY

Credit Suisse First Boston (CSFB) announced that **Amy Butte**, formerly a senior managing director at Bear Stearns, will join as chief strategist and CFO for the firm's Financial Services Division, which includes Credit Suisse Asset Management (CSAM), Pershing and Private Client Services (PCS).

St. Paul Cos Inc., St. Paul, MN, (NYSE: SPC) named **Jerome Fadden**, 44, as head of its reinsurance operation, replacing James Duffy, who is retiring. He was EVP and director of strategic development at UBS PaineWebber.

Amvescap plc, London, said **Denis Kessler**, 49, has been elected a non-executive member of its board of directors. A noted economist, Kessler is executive chairman of the French Federation of Insurance Companies (FFSA).

Susan Rivera has been named president of ACE INA Holdings Inc., Philadelphia, PA She was previously president of American Home Assurance Company. ACE INA's ultimate parent is ACE Limited (NYSE:ACE).

Aon Corp., Chicago, (NYSE: AOC) named **Steven J. Bensinger** as CFO, Combined Specialty Corporation. He will be based in Atlanta. Aon has announced plans to spin off its underwriting operations to stockholders through a new company to be named Combined Specialty Corporation. The spin-off is scheduled for spring, 2002.

State Street Corporation, Boston, (NYSE: STT) said Ronald L. O'Kelley, executive vice president and chief financial officer, has decided to leave the company for personal reasons. **Stefan Gavell**, 48, executive vice president, will assume the role of CFO on an interim basis.

PartnerRe Ltd., Pembroke, Bermuda (NYSE: PRE) appointed **Jean-Paul Montupet** to its board of directors. He is EVP and advisory board member of Emerson (NYSE: EMR), a manufacturer and marketer of electrical and electronic products and systems based in St. Louis, MO.

Bessemer Trust, New York, announced that **John A. Hilton, Jr.** has been appointed chief operating officer. He previously headed Bessemer Trust's New York office and was responsible for oversight of Bessemer's Northeast, Central and Western regions business. He will continue to report to Frank E. Helsom, Bessemer president and CEO.

Michael Martin has joined UBS Warburg as a managing director and global head of the financial institutions investment banking group, based in New York. He reports to Kenneth Moelis, managing director and head of investment banking in the Americas, as well as Robert Gillespie and Rory Tapner, joint global heads of investment banking.

Phil Heaney joined the fixed income group at the UK's Britannic Asset Management from Westdeutsche Landesbank and will focus on credit analysis. ❑

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ABN AMRO GETS BIG CHUNK OF SWEDISH INSURANCE ASSETS

ABN AMRO Asset Management will provide day-to-day management, effective June 2002, for a majority of the investment assets of Sweden's Lansforsakringar, or LF Insurance Group under an agreement announced March 11.

ABN AMRO will pay EUR140 million for the right to manage assets with a total value of EUR13 billion for ten years. This will increase the global assets of ABN AMRO Asset Management to EUR185 billion. In return, ABN AMRO will receive a fixed management fee and a variable, performance-based fee. The transaction is subject to regulatory approval.

Customers of LF Insurance Group will gain access to several international funds operating under the ABN AMRO, Banco and Alfred Berg brand names, both for direct fund saving and saving in unit-linked insurance. LF Insurance has approximately 600,000 life insurance customers and 200,000 fund customers in Sweden.

Tom Cross Brown, Head of ABN AMRO Asset Management commented: "With our Swedish operation Alfred Berg Asset Management, we can offer an excellent strategic combination, which gives us the possibility to meet LF Insurance Groups' high demands on international capacity. I look forward to a cooperation that will be profitable for both our new clients and the partnership."

ABN AMRO Asset Management is part of ABN AMRO Bank N.V., based in the Netherlands. Lansforsakringar is Sweden's only customer-owned locally established banking and insurance group. Altogether, it manages assets totaling EUR19 billion. ❑

PHOENIX INVESTMENT FORMS ALLIANCE WITH HEDGE FUND ADVISORY FIRM

Phoenix Investment Partners, Ltd., the investment management subsidiary of The Phoenix Companies, Inc., Hartford, CT (NYSE: PNX) announced an agreement in principle to form a strategic alliance with LJH Global Investments, LLC, a hedge fund advisory firm with offices in Naples, FL and London.

According to the announcement, the Phoenix-LJH relationship will initially focus on creating a registered fund of hedge funds product. The idea is to provide individual investors with access to a portfolio of hedge funds that require smaller investment minimums than other types of hedge funds. LJH will develop and manage the fund, and Phoenix will spearhead sales and marketing to high-net-worth individuals through its investment and annuity distribution systems.

This is the second strategic partnership Phoenix Investment Partners has struck with a fund of hedge funds manager. In June 2001, Phoenix teamed with Arden Asset Management, a New York manager with $2 billion+ in assets, to develop and distribute a fund of hedge funds for institutional investors that Arden manages and Phoenix distributes.

Donnell A. Segalas, executive vice president of Phoenix's alternative financial products division, said: "We believe that, when properly utilized, hedge funds can reduce risk and enhance returns in a diversified portfolio. The fund of hedge funds product is an ideal approach for individuals seeking exposure to this type of investment," Segalas said.

As of December 31, 2001, Phoenix Investment Partners, through its affiliates, managed approximately $60 billion on a pro forma basis including $7.5 billion in assets from the acquisition of Kayne Anderson Rudnick Investment Management, LLC, which was completed in January 2002. ❑

BANK OF NEW YORK ACQUIRES BOSTON'S GW&K

The Bank of New York (NYSE: BK) agreed to acquire Gannett Welsh & Kotler, Inc. (GW&K), a privately held asset management firm based in Boston, Massachusetts. Terms were not disclosed.

GW&K offers both fixed income and equity portfolio services and manages approximately $5 billion for high-net-worth individuals and small to mid-sized institutions located in the Boston area and nationwide. The firm is particularly well-known for its fixed income service, which focuses on capital preservation and tax-advantaged returns and has made it one of the largest independent fixed income managers in the United States. Following the acquisition, BNY Asset Management's assets under management will increase to $72 billion. ❑

AON PLACES INNOVATIVE CREDIT ENHANCEMENT STRUCTURE FOR AMBEV

Aon Corporation, Chicago, (NYSE: AOC) said a $500 million debt issue arranged for American Beverage Corporation (Ambev), and enhanced by commercial political risk insurance, was completed successfully. UBS Warburg led the transaction. Aon's Risk Capital Products Group worked with Signet Participations Ltd. to structure and place the political risk insurance for Ambev.

The issue received investment-grade ratings and was the first political risk insured bond issue to be rated by all three major ratings agencies.

"We are seeing political risk insurance being used more frequently these days because it allows transactions to pierce the respective country ceiling of the jurisdiction where the

Continued on page 12

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Aon Corporation *from page 11*

issuer is located," said Tiziana DiTullio, an analyst in Moody's Latin American Structured Finance group. "For a transaction to accomplish this, there must be some type of external support sized to cover debt service payments for 18 months; this can take the form of political risk insurance, among other types of coverage. For the AmBev transaction, this support was provided by a political risk insurance policy as well as an offshore reserve account."

AmBev, headquartered near Pittsburgh, is a member of the Dutch food group, Koninklijke Wessanen NV. It's the world's fourth largest brewer and sixth largest beverage company. (For a Q&A on political risk insurance with Peter Ruhlin of Linklaters, *see IFI* Feb. 15, page 9). ❑

DEUTSCHE BANK ACQUIRING RREEF ASSETS FOR $490 MILLION

Deutsche Bank, Germany, (NYSE: DB) agreed to purchase real estate investment management firm RREEF for a total consideration of $490 million, consisting of $440 million for RREEF's operating business and $50 million for co-investment assets. The transaction is expected to close in the first half of 2002.

RREEF´s investment focus is on industrial properties, office buildings, residential apartments, and shopping centers in the 50 largest metropolitan areas across the US. Richard M. Gunthel, managing director and global head of DB Real Estate, said the acquisition will complete Deutsche Bank's expansion of US real estate investment management activities.

RREEF, which has three corporate offices located in Chicago, San Francisco and New York and employs approximately 1,000 people, will operate as a business unit within DB Real Estate, the real estate investment management group of Deutsche Asset Management. The "RREEF" brand name will be preserved and the senior management team will remain in place.

RREEF had $16.2 billion in assets under management as of December 31, 2001, and the acquisition adds considerably to Deutsche Bank's combined global real estate property and real estate equity securities assets under management, raising the total to more than $36.0 billion and, based on calculations by Pensions & Investments, putting it in first position worldwide. ❑

AMERUS BUYS SHARES WITH OCEANS OFFERING

AmerUs Group Co., Des Moines, IA (NYSE: AMH) completed an offering of Optionally Convertible Equity-linked Accreting Notes (OCEANs) due 2032 in a 144a private placement. Gross proceeds from the offering were $185 million, which included the exercise of an option granted to the initial purchaser to purchase up to an additional $35 million original principal amount of OCEANs to cover over-allotments.

Of the proceeds, $45 million has already been used to repurchase approximately 1.3 million shares. Another $120 million will repay existing indebtedness under the company's revolving credit facility. ❑

A.M. BEST AFFIRMS RATING FOR XL CAPITAL GROUP

A.M. Best Co. affirmed the financial strength rating of A+ (Superior) for the core operating subsidiaries of XL Capital Ltd (NYSE: XL), Bermuda, and the "a" rating on the $100 million 7.15 percent senior notes, due 2005, issued by NAC Re Corporation, Stamford, Connecticut. An "a+" debt rating was also assigned to the existing senior debt obligations issued and guaranteed by XL Capital Ltd, and indicative debt ratings given to a recently filed universal shelf offering.

Best said XL Capital maintains significant financial flexibility as demonstrated by successful acceptance of recent offerings. Market cap at December 31, 2001, was approximately $12.5 billion. The group's financial leverage--while significantly elevated over the prior year's levels--remains commensurate with its current rating level at 25 percent debt and preferred to capital.

Following the "significant losses" incurred during 2001--as a result of the World Trade Center attacks and exposures associated with Enron's bankruptcy -- A.M. Best expects XL Capital's earnings to rebound in 2002, providing fixed charge coverage in the low double-digit range. Ongoing competitive market challenges associated with the group's large account and reinsurance segments, along with integration and financial risks associated with its large acquisitions in recent years, remain negative factors. ❑

INSURANCE IPOS

The upcoming IPO of Citigroup's Travelers Property Casualty Corp. is expected to be priced on March 21. Lead underwriter Salomon Smith Barney is expected to price the 210 million share offering at between $16 and $19 per share, raising approximately $3.7 billion. The NYSE stock symbol will be TAP.A.

Crum & Forster Holdings, Morristown, NJ, a wholly-owned insurance subsidiary of Fairfax Financial Holdings Limited, Toronto, filed for an IPO of up to $100 million common stock. The proceeds will be used for general corporate purposes. Fairfax will sell shares of Crum & Forster as part of the offering but will make sure it maintains control of Crum & Forster. Lead underwriter is Banc of America Securities LLC.

Global Preferred Holdings, Inc., Duluth, GA, filed for an initial public offering totaling approximately $121 million. The underwriting group includes William Blair & Company, Raymond James & Associates, Inc., and Cochran, Caronia Securities LLC. The company, which plans to use the symbol GPHO, changed its name last year from WMA Life Insurance Co. ❑

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MOODY'S DOWNGRADES EIGHT JAPANESE LIFE INSURERS

Moody's Investors Service downgraded the insurance financial strength ratings (IFSRs) of eight Japanese life insurance companies. The rating agency said the downgrades reflect worse-than-expected weakening of the life insurers' financial conditions, a grim outlook for a quick recovery in the industry operating environment, the limited benefit of capital contributions planned, and uncertain prospects for additional external support.

The companies affected are: Daido Life, Dai-ichi Life, Fukoku Life, Meiji Life, Mitsui Life, Nippon Life, Sumitomo Life, and Yasuda Life. The ratings outlook for these companies remains negative. The downgrades conclude reviews that began February 5, 2002 (October 12, 2001 in the case of Yasuda Life). At the same time, Moody's revised the rating outlook of Taiyo Life to negative from stable.

In its analysis, Moody's said the Japanese life insurance sector has been facing a long-term decline, stemming from a saturated market that coincided with the deterioration in the economic conditions of the country. Policy-in-force has been declining, precipitated by increases in lapses and surrenders. This, combined with negative earnings spread and diminishing investment portfolio values, is severely pressuring the industry players.

The number of insurance company failures, Moody's added, has been on the rise and surviving industry players have not benefited from a flight-to-quality as policyholders sought investments outside the troubled life insurance sector. Meanwhile, the prospects for external support, particularly from affiliated banks, are hampered by these institutions' own financial constraints. "Hence, the source of future capital for the weaker industry players remains unclear," Moody's commented.

Although the life insurers are actively engaged in strategic and cost cutting initiatives, in Moody's view, their actions are unlikely to materially stem the business decline and overcome the structural deficiencies of the industry. The measures, which include demutualizations, alliances, new product development, and risk asset reductions. often take much time to implement and actual benefits are likely to be modest, Moody's said.

The rating agency's conclusion was that, in the absence of a significant economic recovery and/or a drastic alteration of the industry structure, the profitability and the financial health of the participants will continue to deteriorate. Moody's noted, however, that the largest and best-capitalized insurers remain in a superior position to withstand the difficulties given their stronger franchises and greater financial resources.

The following ratings were affected:

- Daido Life Insurance Company (Daido Life): IFSR downgraded to Baa2 from A3 with negative outlook.
- Dai-ichi Mutual Life Insurance Company (Dai-ichi Life) : IFSR downgraded to Baa2 from A3 with negative outlook.
- Fukoku Mutual Life Insurance Company (Fukoku Life) : IFSR downgraded to Baa3 from A3 with negative outlook.
- Meiji Life Insurance Company (Meiji Life) : IFSR downgraded to Baa2 from A2 with negative outlook.
- Mitsui Mutual Life Insurance Company (Mitsui Life) : IFSR downgraded to Ba3 from Ba1 with negative outlook.
- Nippon Life Insurance Company (Nippon Life) : IFSR downgraded to A3 from Aa3 with negative outlook.
- Sumitomo Life Insurance Company (Sumitomo Life) : IFSR downgraded to Ba1 from Baa1 with negative outlook.
- Yasuda Mutual Life Insurance Company (Yasuda Life) : IFSR downgraded to Baa2 from A2 with negative outlook.
- Taiyo Mutual Life Insurance Company (Taiyo Life): Outlook changed to neg;ative from stable. Baa2 IFSR remains unchanged. ❑

APCIMS/EASD MERGER WINS UNANIMOUS APPROVAL

A new trade association for the European securities industry was created as members of the Association of Private Client Investment Managers and Stockbrokers (APCIMS) unanimously approved a merger with the European Association of Securities Dealers (EASD).

With the merger, one of Europe's largest and most influential trade bodies for the securities industry has been formed. It has been given the temporary title of APCIMS-EASD.

APCIMS-EASD members include the overwhelming majority of private client stockbrokers and investment managers in the UK, the major securities firms throughout Europe, their advisers and contractors of outsourced services, and a network of affiliated trade associations.

Mark Powell, APCIMS-EASD Chairman, said: "These next few years are vital to all of our members. Bringing about a single market in financial services and removing barriers to business are commitments of the EU. A strong, active, professional association is an essential requirement to influence this process. Our role is to ensure that the result is to the benefit of all investors, regardless of their size or where they are situated." ❑

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"INSURITIZATION" - THE APPLICATION OF INSURANCE TECHNIQUES IN THE CAPITAL MARKET

BY GABRIELLE ZEINDLER
(SWISS RE FINANCIAL SERVICES BUSINESS GROUP)

The financial and insurance industries are in the process of convergence. While for the retail segment this has happened by combining the distribution channels of banking and insurance products (especially life insurance), the convergence in the industrial area has taken the route of transferring insurance risks into the capital markets by using financial market techniques ("securitization").

Securitization has caused a product-based linkup between the world of insurance and the capital market, which has gained recognition largely in the form of "cat bonds." These instruments are used to transfer insurance risks-such as California earthquakes or US windstorms, or even weather risks-to the capital market, in exchange for a comparatively high return for the investor and a low correlation to its existing investment portfolio.

It is also possible to make use of insurance techniques in the capital market ("insuritization").

Insuritization

The prerequisites for this are "alternative assets," which possess special characteristics. These might include illiquidity, a significant degree of diversification, potential limited systematic risk and a high level of individual volatility.

Alternative assets typically have significant financial inefficiencies and additionally, have a number of characteristics that render financial market risk management techniques unreliable. The introduction of insurance strategies in the form of insuritization provides a competitive alternative.

> ***Alternative assets have a number of characteristics that render financial market risk management techniques unreliable.***

In the private equity area, **Swiss Re Financial Services Business Group** has demonstrated its leading position in the insuritization field through its insurance protections of the bonds issued by **Princess Private Equity Holding Ltd.**, **Pearl Private Equity Holding** and other transactions (private placements, credit enhancements of over-commitment strategies, and regulatory capital arbitrage transactions).

Demand for Structured Products

Concurrent with industry convergence, demand for protected investments and interest in alternative assets are increasing rapidly. This is because of a broad market, which is driven by pension funds, life insurance companies and corporations, as well as by private investors, whether high net worth individuals or retail investor. The potential to structure and deliver solutions in these market segments is significant.

The regulatory environment plays an important role in determining portfolio allocation of alternative assets within each country.

In some instances, principal protection allows investors to shift asset allocation towards high performance asset classes within the given investment criteria, or alternatively allows creation of higher leverage on an investment portfolio than would otherwise be possible.

In other situations, structured transactions can lead to alternative accounting and thus alternative treatment of existing portfolios, with the respective capital arbitrage or tax optimization opportunities.

In the area of asset management, the addition of alternative assets to the product portfolio, in the form of structured products, allows a broadening of the client base. This occurs by including investors that would be otherwise regulated in their investments in alternative assets.

Principal Protections on Private Equity Offerings

In an insuritized private equity product, the investor is able to benefit in a number of ways.

In the case of private equity, the investor receives an insured product, in the form of a bond for which yield is not highly correlated with the return of his remaining investment portfolio. In addition, the investor gains access to the wide diversification of the underlying private equity portfolio.

Nevertheless, he may expect to earn the customary returns on private equity investments, since the risk is transferred through a genuine risk transfer. This is different from "zero bond" structures, in which a large part of the principal is used to buy and build up the "cover," thereby not creating expected alternative asset class returns but rather, for a big part of the principal, government yield returns.

In addition to an expected relatively low correlation with the other part of its investment portfolio, the investor reaps further advantages from the insured private equity bonds.

Generally, high minimum investments are required from private equity investors before they can participate as limited

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partners in a private equity partnership. In the case of a bond, however, small denominations are also quite common-for example, the Princess issue, with its $1,000 participation certificate. This also provides small investors with access to (insured) private equity investments.

Another characteristic of private equity is its lack of liquidity. Once commitments are made, the investor might have difficulty selling its participations prior to the natural exit. Depending on the particular stage of financing, the natural exit, which in particular covers initial public offerings (IPOs), management buyouts and trade sales, could actually occur several years down the road.

This problem can be best addressed by private equity bonds being listed on a stock exchange and by the corresponding market making. Reality shows, however, that some of the exchange listed fund-of-fund vehicles trade at a discount because liquidity is not really given.

Another advantage is the tax exemption for capital gains for some forms of investments in various countries that may apply.

All these advantages are naturally counterbalanced by the price of the insurance protection, as well as the cost of the professional private equity management in fund-of-funds structures.

Most investors carefully consider the advantages and disadvantages of direct fund investments against fund-of-funds vehicles.

For example, direct fund investments incur a series of expenses. These include costs for careful selection of the best partnerships, with background checks of all involved parties; investments and their interim valuations must be dealt with administratively. In the case of private equity, this generally involves considerable expense.

In addition, the investor usually needs to consider further portfolio issues, including not only the various forms of diversification (geographic, market segment, etc.) but also the various financing stages, business segments, and effective cash flow management (draw-downs versus distributions). Moreover, a possible credit line will have to be made available if an over-commitment strategy is pursued.

Even if an individual investor can fulfill these requirements in specific areas and with his specific expertise, this may become difficult in other geographic areas or business segments.

Insuritization and Securitization

Other structures focus on achieving more favorable regulatory treatment, as opposed to placing additional assets under management.

In particular, the capital underpinning rules for private equity investments for US investment banks make such investments costly in terms of the risk capital they require.

Using collateralized debt obligations (CDOs) structures, an existing private equity portfolio-for example, from a US investment bank-can be sold into a special purpose vehicle that refinances itself with investors with a different risk appetite (i.e., pre-defined interest rates on bonds over the life of the asset, instead of uncertain future private equity returns). As the portfolio is sold to the special purpose vehicle, it is off-balance sheet of the seller.

By using option structures, it may even be possible to redirect some of the excess returns on such portfolios back to the original holder of the assets. Together with the respective capital relief, this leads to an enhanced return on equity.

Most investors carefully consider the advantages and disadvantages of direct fund investments against fund-of-fund vehicles.

Additional leverage can be created through use of a highly rated insurance coverage provider. Insurance cover is provided to the special purpose vehicle in the form of a protection, which leads to an enhanced credit quality of the issue, and thereby to lower refinancing costs. This enhances the return on equity of the original seller. The overall result is an extremely efficient product for the seller of the assets.

Underwriting Capacity

Since it is a new class of business for the insurance world, insurance capacity is restricted, mainly due to the relatively small capital base of the insurance world, but also because of the limitation arising from the overall diversification (risk accumulation control), and the time the build-up phase of a portfolio of similar risks takes.

Another factor is the new experience and know-how that has to be collected and built up over a certain period.

In addition, recent developments on the financial markets and their impact on insured private equity portfolios can now be compared with collected underwriting information from the past, and corresponding expected results and developments.

The insurers will not only consider their exposure assumed from insuring alternative asset classes, but will use a consolidated view of insurance risk and investment risk in the same underlying alternative asset class, which may lead to further restrictions.

Since September 11th, a huge amount of insurance capacity has been destroyed and the price for any capacity left has increased dramatically in addition to the previous capacity restrictions. This has an impact on the attractiveness of insuritized solutions. With higher insurance premiums the economic benefit to the investor is reduced, resulting in a natural upper limit independently of the price for insurance capacity in general.

Continued on page 16

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"Insuritization" *from page 15*

The challenge for the architect of a deal is to optimize the use of the insurance capacity available (be it in-house capacity or from other markets through co-insurance or retrocession) and to use substitutes in the construction of such structures wherever possible.

Such substitutes contain different combinations of insurance techniques (layering, retrocession, finite reinsurance, combination of risks and of asset classes, decomposition of the risk into systematic and non-systematic risks and the respective hedging of the systematic part of it).

The first insuritizations consisted of risk transfer from capital to insurance markets; further developments address special needs within the private equity world.

This situation changed dramatically last year, when one of the major rating agencies came up with the necessary techniques and models to provide a rating on a private equity backed securitization. The ability to have such products rated broadens the variety of additional capacity providers. This includes, but is not limited to, companies whose restrictions require product ratings (such as the credit monoline market) or the opening up of the financial markets with capacity and capital creation techniques such as securitizations.

Insuritization and Securitization of Alternative Investments: A Market for the Future

The first transactions in which illiquid assets were insured (Princess Private Equity Holding, Pearl Private Equity Holding and others) showed that this is a window of opportunity to the (re)insurer, and one that can be further developed.

This is true not only for private equity and hedge funds, but also for other alternative asset classes. Candidates for deals in this category include intellectual property, natural resources (including farmland, timberland and oil & gas investment programs), real estate (including hotel and shopping center real estate investment programs), high yield ("junk") bonds and distressed ("vulture") investment programs.

While the first insuritizations consisted of a pure risk transfer from capital markets to insurance markets, further developments tend to address special needs within the private equity world. Structures that help with capital underpinning, or create stable returns, instead of low returns at the beginning and high returns at the end (the so-called "J-curve" effect in private equity), or the insurance of over-commitment strategies which help to get access to more favorable line-of-credits, or structures that avoid the feared discount on publicly traded private equity fund-of-funds, insurance covers for single partnerships are only some of the examples.

Following the well-known cat bond securitizations, the future will show how quickly the market will adapt the new techniques to securitize insuritized transactions and to create additional insurance capacity for the insurer on one hand and new investment opportunities for investors on the other.

To date, only few other insurance type products in the area of private equity, such as the *Prime Edge* (structured by **Deutsche Bank**, **Allianz Risk Transfer** and **Capital Dynamics**) or *Private Equity Partnership Structures I, LLC*, a securitization of limited partnership interest structured by **AON Corporation** were seen. However, it is expected that further transactions will appear in the near future. On the hedge fund side, there are many more secured transactions, most of them issued by banks.

Together with its clients, Swiss Re is structuring highly innovative and effective transactions. Because of the complexity and lengthy development process of such transactions, the broad know-how base needed from the underwriters/structurers on both insurance, corporate finance and investment banking, the dedicated team effort to move things forward, together with a clear understanding of the investors to be addressed by such a product are key factors to success.

For the future, streamlined and standardized processes on several structural and legal issues are expected. In addition, the growing sophistication of the investors that directly invest in such products or that indirectly provide (re)insurance capacity through securitizations will lead to a more efficient market from the competitor's and co-insurer's side. This is the edge of some very exciting developments of new products. ❑

Gabrielle Zeindler is a member of Credit and Asset Re, a unit of the Swiss Re Financial Services Business Group, Zürich.

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