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Introduction

The first half of 2020 presented challenges to the Insurance-Linked Securities (ILS) market as it faced fallout and volatility from the onset of the coronavirus pandemic. January and February were marked by tightening spreads as the sector was flush with capital. That dynamic quickly changed with the implications to the broader financial markets at the start of COVID-19 global lockdowns. While almost all other asset classes were in freefall, the ILS market did experience a dislocation with spreads widening as certain investors were forced to raise capital. Remarkably similar to the financial crisis over a decade ago, the ILS market remained liquid, which allowed investors that had cash to take advantage of the widening spreads. Certainly the widening of ILS spreads didn’t impact valuations to the same degree as broader credit instruments. However, the financial markets were extremely volatile during this time and the overall uncertainty of the world economic impact from COVID-19 created a pause in debt issuances including the ILS market. We have recently witnessed a new influx of capital to take advantage of these wider spreads, which has resulted in a stabilization in the ILS market.

Swiss Re Capital Markets (SRCM) is pleased to present its market update for 1H 2020. We’ll dive into an overview of the market dynamics and provide an update on the COVID-19 stricken market.
New issuance

Overview

A strong start to 2020 included a record-breaking USD 3.96bn in new issuance during Q1, which outpaced the bumper year of 2018 during the same period. The catastrophe bond (cat bond) market surpassed 2018 by USD 375m in new issuance in the same period before the COVID-19 pandemic caused unease and volatility in global financial markets. As seen below in Figure 1, new issuance paused in early March 2020 as the ILS market felt impact from the uncertainty in the broader markets. After a few weeks of the equity downturn and fixed income sell-offs, the ILS market, like other markets, recovered and continued its new-issuance pipeline.

Figure 1: Cumulative new issuance by month

![Cumulative new issuance by month](image)

Source: Swiss Re Capital Markets, as of June 30, 2020
As time progressed and more sponsoring entities elected to issue ILS instruments, there was a flood of new issuances, with more than USD 6.75bn totaled for the first six months of the year. In comparison to last year, the amount of new issuance during 2020 has far surpassed the total of 2019 (about USD 5.5bn). Nonetheless, even with a healthy amount of issuance, the ILS market (measured by notional outstanding) has shrunk by 1.35% since the end of 2019, which can be seen in Figure 2. A multitude of maturities and payouts for the events of 2017 and 2018 have outweighed the new-issuance calendar for the first six months of 2020.

New issuance during the first half of the year started off with new and then some long-absent sponsors coming to market for the first time in years. During the first quarter of 2020, notable sponsors of cat bonds included Hannover Re issuing 3264 Re 2020-1 Class A that covers North American wind/earthquake and European wind, as well as also Markel issuing Stratosphere Re 2020-1 Class A that covers US-named storm, earthquake, severe thunderstorm and winter storm. For the first time since 2013, Renaissance Re tapped the ILS market by bringing Mona Lisa Re 2020-1 Classes A&B that cover US wind and earthquake.

During Q2 2020, there was the return of the Metropolitan Transportation Authority’s MetroCat Re 2020-1 Class A, which replaced the 2017 catastrophe bond covering New York City storm surge and earthquake they had in place. In June, Achmea Insurance returned to market with the Windmill Re DAC 2020 transaction that covers European wind, and Herbie Re 2020-1 Class A, which was Fidelis Insurance Holdings’ first cat bond transaction that covers US wind and US earthquake. On the innovative front, Swiss Re’s Matterhorn Re 2020-2 Class A transaction was structured as a combination tranche that covers losses from both extreme mortality events and named-storm events; the first time such a structure has been utilized since Mythen Re 2012-2 A.
COVID-19 impact on new issuance

As the COVID-19 pandemic took hold around the globe, uncertainty riddled the global financial markets. New issuance spreads in the ILS market widened by 20–30%, depending on the risk being offered. A secondary market sell-off, largely caused by entities like multi-strategy asset managers seeing opportunities in other markets, sold cat bonds holding stable valuations compared to other asset classes at discounts to par value. Certain ILS-specific fund managers joined those looking to sell bonds, driven by a need to sell assets to meet margin calls on currency swaps with most cat bonds being issued in US dollars.

Investors who did not fall into those buckets turned to the secondary market, where cheaper and higher-yielding assets were ubiquitous, as the new-issue market took a three-week hiatus. This caused spreads on new issuances to follow the trend of the secondary market to stay competitive for investor capital. SRCM observed newly announced catastrophe bonds being offered at much higher interest spreads to expected loss multiples, relative to where deals had priced in January and February for similar cat risks. As a result, the first half of the year demonstrated a much higher average spread to expected loss multiple compared to 2019, with a year over year increase of roughly 18%.

Figure 3: Weighted average issuance spreads 2011–2020

Source: Swiss Re Capital Markets, as of June 30, 2020

1 Excludes Cal Phoenix 2018-1 A, Sanders Re 2018-1 A, 2019-1 B and 2020-1 B
Redemptions and maturities

As potential COVID-19-related ambiguity rumbled through the ILS market, the capital position of the market was often in question. Throughout March, some investors were worried about the possibility of an overwhelming amount of fund redemptions initiated from end investors, as the asset class suffered from mark-to-market losses toward the end of Q1.

In late Q2, the market dynamic changed. That was due to two main factors: an abundance of maturities that returned capital to investors, and some anticipated fund redemptions that did not materialize. In early June, nearly USD 2bn was returned to the market via maturing cat bonds. That followed more than USD 1.4bn of maturities in May, and before nearly USD 900m of expected maturities at the beginning of July. While there was record-breaking new issuance at the beginning of the year, the pause and slowdown due to COVID-19 turmoil allowed the flow of capital to rebalance, and the maturities to catch up to the issuance levels.

Secondly, some ILS fund managers were fearful of fund redemptions, as well as the drawn-out losses from events in 2017 and 2018. However, instead of being faced with those redemptions, investors were able to raise funds. The relative stability of the ILS market throughout this period and rate increases seen across the (re)insurance industry proved to be attractive.

Figure 4: Simple net cash flow to investors

As seen in Figure 4, the cumulative net cash flow since October 2019 is slightly positive at plus USD 291m. With the increase in overall capital, the demand for catastrophe bonds became eminent. This capital plus moderate inflows to fund managers created a trend of tightening secondary spreads. The primary market was able to reap the benefits of investors holding large sums of cash, and the fiduciary responsibility to put that cash to work.
Secondary markets & relative value

Overview

At the beginning of 2020, secondary spreads tightened as an abundance of maturities from existing cat-bond structures returned ready cash to investors, who then turned to the secondary markets that held plenty of opportunities.

COVID-19 impact on ILS trading activity

Due to their low correlation to equity and credit markets globally, cat bonds held their mark-to-market valuations well up until early March. Through the month, average cat-bond prices then decreased marginally due to a high volume of forced selling activity, mainly in the Bid Wanted in Competition (BWIC) format.

Figure 5:
Cat-bond trading 1H 2020

<table>
<thead>
<tr>
<th>Number of Bonds Traded</th>
<th>Trade Price (USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>104</td>
<td>102</td>
</tr>
<tr>
<td>100</td>
<td>100</td>
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<tr>
<td>98</td>
<td>98</td>
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<td>96</td>
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<td>94</td>
<td>94</td>
</tr>
<tr>
<td>92</td>
<td>92</td>
</tr>
<tr>
<td>90</td>
<td>90</td>
</tr>
</tbody>
</table>

Source: Swiss Re Capital Markets and Trade Reporting and Compliance Engine (TRACE), as of June 30, 2020

3 Average trade prices exclude potentially impaired and zero-coupon bonds
Figure 6 illustrates an enhanced view of select actively traded cat bonds, as well as their price movement over the first six months of the year.

**Figure 6:**
Actively traded cat-bond price curve

![Actively traded cat-bond price curve](image)

Source: Trade Reporting and Compliance Engine (TRACE), as of June 30, 2020
After the selling in March subsided, many investors with capacity saw the secondary market as an opportunity, and throughout Q2 saw significant mark-to-market gains. During May and early June, significant maturities returned capital to the hands of investors needing to put that capacity to use. This surge in demand, alongside a lack of a new-issue pipeline in late June, led to tightening secondary spreads. Although there has been signs of tightening, Figure 7 shows US wind spreads at the end of Q2 2020; these spreads haven’t been this wide since 2013. This increase in spreads during the first half of the year presents an attractive investment opportunity in cat bonds for investors globally.

Figure 7:
US wind-exposed cat bonds

- **Secondary Spread**

<table>
<thead>
<tr>
<th>Year</th>
<th>0%</th>
<th>2%</th>
<th>4%</th>
<th>6%</th>
<th>8%</th>
<th>10%</th>
<th>12%</th>
<th>14%</th>
<th>16%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan 12</td>
<td>15 – 180 bps</td>
<td>181 – 375 bps</td>
<td>376 – 600 bps</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jul 12</td>
<td>15 – 180 bps</td>
<td>181 – 375 bps</td>
<td>376 – 600 bps</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jan 13</td>
<td>15 – 180 bps</td>
<td>181 – 375 bps</td>
<td>376 – 600 bps</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Jul 13</td>
<td>15 – 180 bps</td>
<td>181 – 375 bps</td>
<td>376 – 600 bps</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jan 14</td>
<td>15 – 180 bps</td>
<td>181 – 375 bps</td>
<td>376 – 600 bps</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jul 14</td>
<td>15 – 180 bps</td>
<td>181 – 375 bps</td>
<td>376 – 600 bps</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jan 15</td>
<td>15 – 180 bps</td>
<td>181 – 375 bps</td>
<td>376 – 600 bps</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jul 15</td>
<td>15 – 180 bps</td>
<td>181 – 375 bps</td>
<td>376 – 600 bps</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jan 16</td>
<td>15 – 180 bps</td>
<td>181 – 375 bps</td>
<td>376 – 600 bps</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jul 16</td>
<td>15 – 180 bps</td>
<td>181 – 375 bps</td>
<td>376 – 600 bps</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jan 17</td>
<td>15 – 180 bps</td>
<td>181 – 375 bps</td>
<td>376 – 600 bps</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jul 17</td>
<td>15 – 180 bps</td>
<td>181 – 375 bps</td>
<td>376 – 600 bps</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Jan 18</td>
<td>15 – 180 bps</td>
<td>181 – 375 bps</td>
<td>376 – 600 bps</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jul 18</td>
<td>15 – 180 bps</td>
<td>181 – 375 bps</td>
<td>376 – 600 bps</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jan 19</td>
<td>15 – 180 bps</td>
<td>181 – 375 bps</td>
<td>376 – 600 bps</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jul 19</td>
<td>15 – 180 bps</td>
<td>181 – 375 bps</td>
<td>376 – 600 bps</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jan 20</td>
<td>15 – 180 bps</td>
<td>181 – 375 bps</td>
<td>376 – 600 bps</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jul 20</td>
<td>15 – 180 bps</td>
<td>181 – 375 bps</td>
<td>376 – 600 bps</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Swiss Re Capital Markets, as of June 30, 2020

4 Swiss Re Capital Markets pricing indications only; average seasonally-adjusted spread of all ILS bonds with exposure to US WS and at least one year to maturity.
5 Bonds with a spread movement since issuance of more than 75% are excluded.
6 Sanders Re 2018-1 A, 2019-1 B, and 2020-1 B are excluded.
Relative value

Throughout 1H 2020, SRCM saw high volatility in other financial markets. This is evident when analyzing Barclays US High Yield Index and the S&P 500 Total Return Index against the Swiss Re Global Total Return index (SRGLTRR), as seen in Figure 8. A benefit of cat bonds has always been the low correlation to global equity and credit markets. Although there was volatility presented by COVID-19, equity and credit markets almost fully rebounded towards the end of June 2020, whereas the SRGLTRR index did not experience volatility to the same degree, and once again demonstrated the relative strength of the asset class.

**Figure 8:**
Swiss Re Global Cat Bond Total Return Index (SRGLTTTR) vs other relative benchmarks

Source: Swiss Re Capital Markets and Bloomberg LP, as of June 30, 2020

7 The Swiss Re Global Cat Bond Index Total Return is a market value-weighted basket of natural catastrophe bonds tracked by Swiss Re Capital Markets, calculated on a weekly basis; past performance is no guarantee of future results. Underlying data for Barclays Capital High Yield Index provided by Barclays Capital. Underlying data for the S&P 500 Total Return Index is captured from Bloomberg LP. Underlying data for Swiss Re Global Cat Bond Index Total Return is based on indicative prices only.
Another example of the relative value in the ILS market can be seen when it's compared to the Bank of America High Yield BB and B rated corporate bond indices. Figure 9 highlights secondary-spread stability in peak risks like US wind compared to HY indices during market-stressed events.

**Figure 9:**
Relative value indices: Swiss Re composite

<table>
<thead>
<tr>
<th>Secondary Spread</th>
</tr>
</thead>
<tbody>
<tr>
<td>14%</td>
</tr>
<tr>
<td>12%</td>
</tr>
<tr>
<td>10%</td>
</tr>
<tr>
<td>8%</td>
</tr>
<tr>
<td>6%</td>
</tr>
<tr>
<td>4%</td>
</tr>
<tr>
<td>2%</td>
</tr>
<tr>
<td>0%</td>
</tr>
</tbody>
</table>

Source: Swiss Re Capital Markets, as of June 30, 2020; Bank of America Merrill Lynch US High Yield B and BB Indices

9 US WS BB Rated Comp contains bonds with at least 1 year to maturity that have exposure to US WS, and an EL between 16-180 bps (or with an actual BB rating, regardless of EL)

10 US WS B Rated Comp contains bonds with at least 1 year to maturity that have exposure to US WS, and an EL between 18-375 bps (or with an actual B rating, regardless of EL)

11 BofA Merrill Lynch High Yield Option Adjusted Spread via the Federal Reserve Bank of St. Louis website

12 Swiss Re Capital Markets pricing indications only. Average seasonally adjusted spread of all ILS bonds with at least 1 year left to maturity
With a global market downturn taking place in March, the SRGLTRR index produced a slightly negative return figure for Q1. Since then, the SRGLTRR has rebounded with the largest Q2 return since 2012. This was an increase of roughly three percentage points compared to Q2 2019.

**Figure 10:**
Swiss Re Global Cat Bond Total Return Index (SRGLTTR) returns

Source: Swiss Re Capital Markets, as of June 30, 2020
Structural spotlights

Deal spotlight #1

<table>
<thead>
<tr>
<th>Issuer:</th>
<th>International Bank for Reconstruction and Development (IBRD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Offering:</td>
<td>IBRD CAR 125 A, IBRD CAR 126 B, IBRD CAR 127 C, IBRD CAR 128 D</td>
</tr>
<tr>
<td>Format:</td>
<td>144A</td>
</tr>
<tr>
<td>Tenor:</td>
<td>4 years</td>
</tr>
<tr>
<td>Covered Events:</td>
<td>Earthquake, Atlantic Named Storm, Pacific Named Storm</td>
</tr>
<tr>
<td>Covered Area:</td>
<td>The United Mexican States</td>
</tr>
<tr>
<td>Trigger:</td>
<td>Parametric, per occurrence</td>
</tr>
<tr>
<td>Modeling Firm:</td>
<td>AIR Worldwide Corporation (AIR)</td>
</tr>
<tr>
<td>Total Size:</td>
<td>USD 175m, USD 60m, USD 125m, USD 125m</td>
</tr>
<tr>
<td>Interest Spread:</td>
<td>350 bps, 900 bps, 1,000 bps, 650 bps</td>
</tr>
</tbody>
</table>

The World Bank returned to the ILS market seeking coverage against earthquake and tropical cyclone risks to the Mexican Fund for Natural Disaster (Fondo de Desastres Naturales, FONDEN), via the issuance of four classes of notes for a four-year term.

These issuances followed recent maturities of notes issued by the World Bank on behalf of FONDEN. The IBRD CAR 118 Class A and IBRD CAR 119 Class B Notes matured in February 2020. These notes were issued as part of the Pacific Alliance transaction and provided FONDEN with protection against earthquakes. The IBRD CAR 114 B and CAR 115 C Notes matured in December 2019 and provided FONDEN with protection against tropical cyclones.

The new coverage is on a per-occurrence basis, utilizing a parametric trigger based on the location, depth and magnitude of an Earthquake Event for the Class A Notes and Class B Notes, and on the central pressure and the storm track of a Named Storm Event for the Class C Notes and the Class D Notes. The principal can be reduced by 25%, 50%, 75% or 100%, in accordance with the aforementioned parameters.

The trigger structure has been notably enhanced versus the prior takedowns, incorporating more granular, tailored coverage for earthquake and meaningful adjustments to the payout gates for tropical cyclones.

In addition, the net proceeds from the sales of the notes will be used by the IBRD to finance sustainable development projects and programs in IBRD’s member countries, making this the first cat bond issued under the IBRD’s Sustainable Development bond program. This concept has attracted a wide range of investors and contributed to the great success of the FONDEN 2020 cat bond transaction.

To date, this issuance represents the largest cat bond transaction sponsored by FONDEN and the longest tenor of any sovereign cat bond issued, demonstrating the Mexican government’s confidence in the ILS market to help build its resilience for the future.
Deal spotlight #2

<table>
<thead>
<tr>
<th>Issuer: Sutter Re Ltd.</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Offering: Series 2020-1 A</td>
<td>Series 2020-1 F</td>
</tr>
<tr>
<td>Format: 144A</td>
<td></td>
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<tr>
<td>Tenor: 3 years</td>
<td>2 years</td>
</tr>
<tr>
<td>Covered Events: US Earthquake</td>
<td></td>
</tr>
<tr>
<td>Covered Area: State of California</td>
<td></td>
</tr>
<tr>
<td>Trigger: Indemnity, annual aggregate</td>
<td></td>
</tr>
<tr>
<td>Total Size: USD 200m</td>
<td>USD 135m</td>
</tr>
<tr>
<td>Interest Spread: 500 bps</td>
<td>850 bps</td>
</tr>
</tbody>
</table>

The California Earthquake Authority (CEA), the not-for-profit residential earthquake insurance provider for the state of California and longtime sponsor of cat bonds, returned to the ILS market, initially seeking upwards of USD 400m in capital markets-backed capacity. This was the first issuance under the new special purpose insurer, Sutter Re Ltd., though the structure is largely similar to that of Ursa Re Ltd.

For this issuance, the CEA targeted protection at both the top and bottom of their reinsurance tower. Class A Notes for both the 2020-1 and 2020-2 Series cover a USD 500m layer, attaching at just under USD 6.5bn, while the Class F Notes for both the 2020-1 and 2020-2 Series cover a USD 500m layer attaching at USD 2.1bn.

Sutter Re Ltd. was issued in May 2020 following volatile market conditions earlier in the spring (driven by the negative impacts of COVID-19). Despite challenging market conditions, the CEA locked in USD 700m of capacity, representing a 75% upsize from the initial marketing of the deal and making it the largest issuance for the first half of 2020.

One of the primary structural enhancements of this transaction was the implementation of two settlement dates to accommodate upcoming maturities from the Ursa Re Ltd. 2017-1 transaction, thus maximizing capacity for the CEA. The CEA also opted for classes with two- and three-year risk periods, allowing for the USD 700m of notes to mature across two years instead of one.

The risk modeling and reset of Sutter Re Ltd. was aligned with that of the Ursa Re Ltd. program, streamlining the risk modeling for CEA’s outstanding cat bonds. Consequently, the Sutter Re Ltd. 2020-1 and 2020-2 resets will leverage the December resets for Ursa Re Ltd., with an adjusted set of risk metrics based on portfolio growth.

The Sutter Re Ltd. transaction was a great success despite less-than-ideal market dynamics, demonstrated by CEA’s ability to lock in considerable capital-markets capacity at a lower rate increase compared to other transactions issued during the same time period.
Specialists throughout Swiss Re Capital Markets are available for consultation on bespoke ILS solutions, and they invite a dialogue on the subject with sponsors and investors alike. For more information, please contact any of the individuals listed below in your jurisdiction.

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Risk factors

An investment in Insurance-Linked Securities involves potentially significant risks for an investor. In summary, these risks include (but aren’t limited to):

- Investors may lose all or a portion of their investment in Insurance-Linked Securities if a natural catastrophe or other event triggers a payment by the issuer of the Insurance-Linked Securities under the underlying risk-transfer agreement to which the Insurance-Linked Securities relate.

- The maturity of the Insurance-Linked Securities may be extended without the prior consent of the investor.

- The Insurance-Linked Securities may be redeemed before their maturity date (including before any extension of such maturity date by the issuer).

- If the Insurance-Linked Securities are redeemed before maturity, the interest rate payable to you under the Insurance-Linked Securities will be reduced.

- Investors have limited recourse to assets of the issuer of the Insurance-Linked Securities and no recourse to assets of the counterparties to the underlying risk-transfer agreements to which the Insurance-Linked Securities relate.

- If the issuer of the Insurance-Linked Securities becomes insolvent, investors may lose some or all of their investment.

- Investors may be required to consolidate the issuer for accounting purposes under certain circumstances.

- An investment in the Insurance-Linked Securities may have adverse tax consequences for investors.

- Any claim you have against the issuer in the event of the issuer’s insolvency will rank below any claim a counterparty to the underlying risk-transfer agreements, to which the Insurance-Linked Securities relate, has against the issuer.

- Enforcement of security interest granted to a Trustee for the benefit of the investors may be limited.

- The Insurance-Linked Securities may not have a secondary market or the secondary market for the Insurance-Linked Securities may have limited liquidity and the market and market price of the Insurance-Linked Securities in the secondary market may be highly volatile.

- The Rating Agenc(y)(ies) (if any) may change any rating assigned to the Insurance-Linked Securities. Any credit rating given in respect of the Insurance-Linked Securities may not reflect the potential impact of all risks related to the Insurance-Linked Securities. A credit rating is not a recommendation to buy, sell or hold the Insurance-Linked Securities and may be revised or withdrawn by the rating agency at any time.

The risk factors relating to an investment in Insurance-Linked Securities are set out in detail in the offering circular for the relevant Insurance-Linked Securities. You should consult this information when considering any investment activity.
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