Swiss Re

New Swiss Re *sigma* study reveals how the use of indices in insurance-linked securities benefits both (re)insurers and investors

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Zurich, 7 September 2009 – According to Swiss Re's new *sigma* study, "The role of indices in transferring insurance risks to the capital markets", both (re)insurers and investors benefit when clearly defined and regularly updated indices are used in insurance-linked securities (ILS) and other risk-transfer instruments. These instruments provide (re)insurers with an additional capital management tool, while investors gain access to an attractive, diversifying asset class.

Insurance-linked securities (ILS) and related instruments can be used to transfer insurance risks to the capital markets. These include securitisations, industry loss warranties (ILWs) and a variety of derivative contracts. These products are mainly used to transfer peak natural catastrophe risks and weather-related risks. Catastrophe or "cat" bonds and weather derivatives are quite commonplace and can be traded on public exchanges or privately. The markets for other products – such as mortality and longevity swaps – are still in an earlier stage of development.

Use of indices may help create more liquid markets
Many of the above-mentioned instruments involve the use of indices. A typical index-linked contract in (re)insurance links payments to an index that tracks, or approximates, the development of insurance losses (eg the intensity of an earthquake in a certain region). For investors, indices are often more transparent and easier to understand than individual insurance risks. In addition, index-based instruments may be standardised more easily, which lowers costs and could help create greater liquidity in insurance risk markets.

New loss index initiative to boost ILS in Europe
A good index needs to be transparent, accurate, reliable and supplied by an independent party. In the United States, for example, Property Claims Services (PCS) provides information on insured property losses. The breakdown of losses by state and different insurance business lines allows protection buyers to customise an index and thus minimise the basis risk, which is the risk that actual losses will deviate from payoffs received under the contract. In Europe – until recently – such reliable and independent information on insured losses had been lacking.

The recently created company PERILS (Pan-European RiskInsurance Linked Services) will fill this gap by collecting and aggregating industry-wide claims data for Europe. The initiative is a joint effort of the major European players in the insurance and reinsurance industries. According to Thomas Hess, Swiss Re's Chief Economist, the new PERILS industry loss index should help stimulate the development of new products and create more liquid insurance risk markets in Europe.

Cat bonds have weathered the financial crisis well

After rapidly growing between 2005 and 2007, the issuance of cat bonds slowed in 2008 due to the financial markets crisis. However, interest in cat bonds has recovered recently. In the first half of 2009, Swiss Re Capital Markets underwrote 4 cat bonds with a total notional amount of USD 585 million.

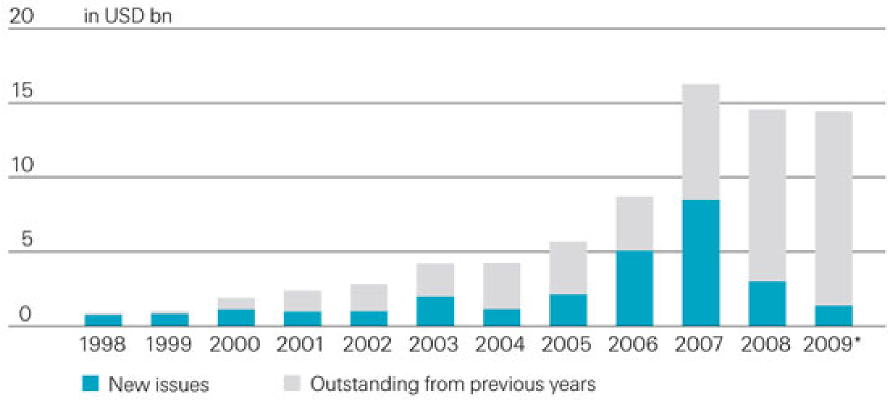
Martin Bisping, head of Non-life Risk Transformation at Swiss Re, said: "During the first seven months of this year, 11 cat bonds with a total notional amount of USD 1.8 billion were issued. Trading volumes of cat bonds have held up even during a time when liquidity in other market segments dried up."

ILS and related instruments hold strong growth prospects

Despite the potential of ILS, the share of insurance risks transferred to the capital markets represents just a small share of overall (re)insurance capacity. To date, the volume of outstanding cat bonds is USD 14 billion. Together with an estimated market volume of roughly USD 10 billion for ILWs and cat derivatives, this amounts to USD 24 billion or 12% of the aggregate global cat reinsurance capacity. Martin Bisping noted: "This share may well expand in the future, boosted by recent efforts to reach a higher degree of product standardisation, as well as by the creation of new indices, such as the European market loss index by PERILS."

According to the *sigma* study, significant untapped opportunities also exist for mortality and longevity index-linked risk transfer, supported by increasing pandemic concerns and the savings and retirement needs of an ageing global population.

Figure 1: Non-life cat bonds – new issues and outstanding amounts



* January–22 July 2009

Source: Swiss Re Capital Markets

Notes to editors

Swiss Reinsurance Company Ltd
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How to order this *sigma* study:
The English, German, French and Spanish versions of the *sigma* study No 4/2009, "The role of indices in transferring risks to the capital markets" are available electronically on Swiss Re's website: www.swissre.com/sigma. The versions in Chinese and Japanese will appear in the near future.

Printed editions of *sigma* No 4/2009 in English, French, German and Spanish are also now available. The printed versions in Chinese and Japanese will be available shortly. Please send your orders, complete with your full postal address, to:

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