



IFEX Event Linked Futures

***IFEX Event Linked Futures for Protection Sellers
“The Basics of IFEX”***

IFEX Event Linked Futures (ELFs); A new solution for Protection Sellers....

- *IFEX* is the *Insurance Futures Exchange*, based in London and Chicago.
- *IFEX* is a market first – offers the reinsurance market convenient and flexible derivative trading - based on existing well understood reinsurance contracts.
- *IFEX* ELFs are exchange and screen traded on the Chicago Climate Futures Exchange – enhancing the transparency and liquidity of insurance linked derivatives.
- An *IFEX* ELF is an investment contract that, to a large degree, replicates the economics of an Industry Loss Warranty (ILW) reinsurance contract but with a number of advantages:
 1. Minimal counterparty risk;
 2. Permits access to the re/insurance market without establishing a reinsurance company or investing in an SPV.
 3. Capital efficiency for Protection Sellers;
 4. Hedging against reinsurance price volatility;
 5. Allows US wind risk to be traded continuously, i.e. 'dynamic hedging';
 6. Hedging against losses caused by natural catastrophes other than US wind
 7. No Ultimate Net Loss clause.



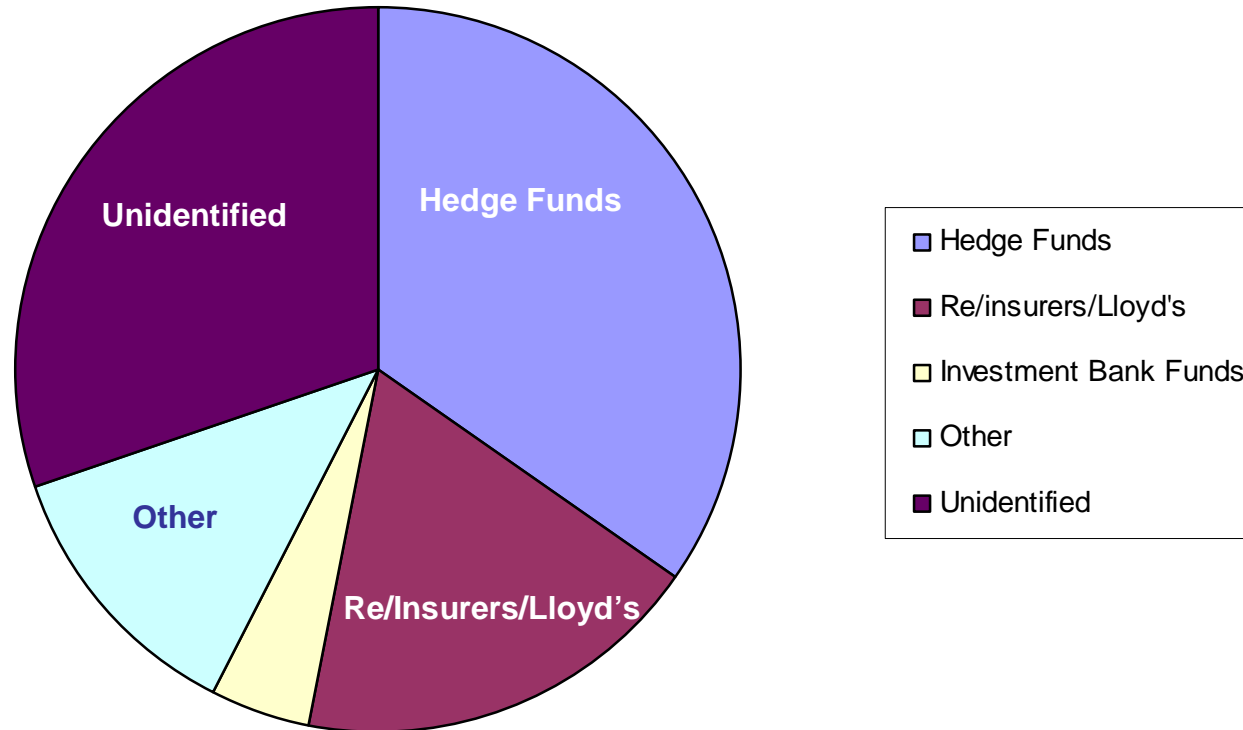
Derivative Initiative
of the Year



Nine other benefits of ELF^s for Protection Sellers...

- The 2010 and 2011 ELF contracts enable Protection Sellers to offer cover for US Wind events during the calendar years 2010 and 2011 respectively.
- ELF^s can lower the cost of reinsurance transactions.
- Protection Sellers can lock in prices for future years ahead of normal renewal dates.
- Protection Sellers can adjust their positions continuously.
- Trading is possible when a hurricane is developing - trade 'live' CAT.
- Trading is possible after a hurricane has made landfall – trade 'dead' CAT.
- Protection Sellers can use ELF contracts to increase or decrease their US Wind exposures in different geographical territories and specific loss trigger levels.
- Protection Sellers can trade insurance price without insurance risk by buying and selling ELF contracts outside the hurricane season.
- ELF^s can be used to 'close out' traditional reinsurance positions.

Who is trading ELF's?...



- **Total number of accounts opened exceeds 60 – split by sector as above** (as at 29th January 2010).
- **The second largest sector is 'unidentified' - as it is possible to trade IFEX ELF's anonymously.**
- **'Other' includes Pensions Funds, Small Funds and Wealthy Private Individuals amongst others.**

The ELF contract basics...(1)

1. **ELFs are binary futures contracts listed on the Chicago Climate Futures Exchange (CCFE).**
2. **ELF contracts provide for a payment if industry wide losses from a specified natural catastrophe event reach a pre-specified Loss Trigger Level (LTL).**
3. **Event LTLs are based upon independent estimates by Property Claims Services (PCS).**
4. **An ELF is an investment contract that replicates the economics of an Industry Loss Warranty. It is not a reinsurance contract.**
5. **An ELF is a Contract for Difference and counterparty risk is minimised because all transactions are cleared and margined.**

The ELF contract basics...(2)

1. The Contract Risk Period;

The Contract Risk Period covers the calendar year of the contract year.

2. The Territories Covered;

- US Wind Territories and Possessions (US T & P).
- Florida Wind.
- US Gulf Coast Wind (Alabama, Mississippi, Louisiana and Texas).
- US Eastern Seaboard Wind (Georgia to Maine).
- US North East (Virginia to Maine).

3. Loss Trigger Levels (LTL):

\$10bn, \$15bn, \$20bn, \$25bn, \$30bn, \$40bn, \$50bn, \$60bn, \$75bn and \$100bn.

First Event, Second Event, Third Event and Fourth Event contracts are available.

4. Contract Limit/Notional Value;

This is expressed in 'lots', each of \$10,000.

So to purchase (or sell) \$1M of Contract Limit/Notional Value one would buy (or sell) 100 lots.

An ELF is a Contract for Difference...(1)...

An 'Initial Price' (equivalent to a 'premium') is agreed with a Protection Buyer.

This dictates the Initial Value of the Contract.

The Initial Price is expressed as a percentage of the Contract Limit/Notional Value, i.e. a Rate on Line.

The 'Daily Price' will subsequently increase or decrease dependent upon the threat of a hurricane (also by supply and demand).

This movement dictates the flow of Variation Margin between the Protection Seller and Protection Buyer.



An ELF is a Contract for Difference...(2)... 'Claims'.

Payment of 'Claims';

- The ELF Contract will 'settle' at 100 should an insured loss triggering event occur.
- Will 'settle' at 0 at the end of the Contract Risk Period if no insured loss triggering events occur.

ELF prices trade strictly between 0% and 100% of Contract Limit/Notional Value. Hence;

- a) The maximum potential liability of the Protection Seller to pay Variation Margin to the Protection Buyer is the Contract Limit/Notional Value less the Initial Value of the Contract (*i.e. similar to a claim being paid 'net of premium'*).
- b) The maximum potential liability of the Protection Buyer to pay Variation Margin to the Protection Seller is limited to the Initial Value of the Contract (*i.e. similar to a 'premium'*).

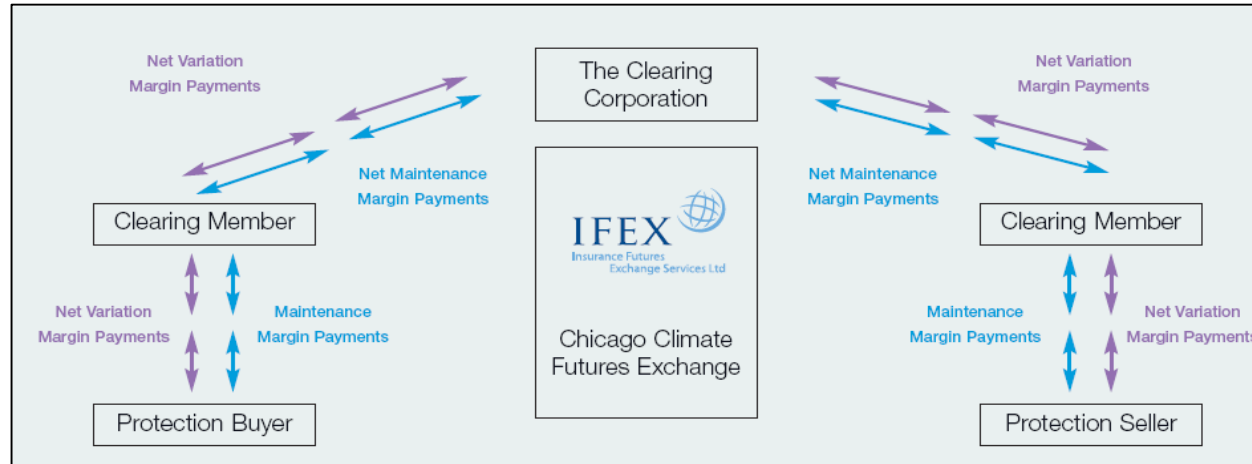
An ELF is a Contract for Difference...(3)...'Trading'.

Trading ELFs;

- If the Daily Price decreases, Variation Margin is immediately payable by the Protection Buyer to the Protection Seller.
- If the Daily Price increases, Variation Margin is immediately payable by the Protection Seller to the Protection Buyer.
- This process will continue until the ELF contract is 'settled' at either 0 or 100.
- ELF Price movements are twice daily 'marked to market'.

However, a Protection Seller can exit its position earlier by buying the ELF contract, unlike a traditional reinsurance policy, an ELF does NOT have to be held until ultimate 'expiry'.

Clearing and Security - Minimal Counterparty Risk



The Protection Seller and Protection Buyer each establish an IFEX account with a Clearing Member of their choice. The Clearing Member carries out its own checks on the financial standing of its clients.

If the client defaults, then the Clearing Member must meet its client's obligations under the ELF.

The Chicago Climate Futures Exchange (CCFE) provides the trading platform.

The Clearing Corporation is the central counterparty and clears all 'margin' transactions.

The Clearing Corporation guarantees all transactions.

Combined with the role of the Clearing Member and the adoption of 'Maintenance Margin' - this virtually eliminates counterparty risk.

Maintenance Margin – enhancing the clearing process

The clearing system ensures that the parties always have sufficient funds in their margin account to meet their potential financial obligations.

This is the function of Maintenance Margin which is, in effect, a security deposit.

Maintenance Margin can be made by deposits of cash, or high grade interest bearing securities, letters of credit or accumulation of Variation Margin.

Posted	For Protection Buyers	For Protection Sellers
Before/After Season (Dec 1 to May 31)	\$ 200 in total per contract * (2% of notional value/limit)	\$ 800 in total per contract * (8% of notional value/limit)
During Hurricane Season (June 1 to Nov 30)	\$ 600 in total per contract *	\$2,400 in total per contract *
If 'moderate' threat declared	\$3,000 in total per contract *	\$3,000 in total per contract *
If 'severe' threat declared	\$8,000 in total per contract *	\$2,000 in total per contract *

** or that sum determined by the daily price if that is different.*

The Protection Buyer never has to commit more than that implied by the initial contract price.

The Protection Seller never has to commit more than the amount implied by the difference between the contract limit/notional value and the initial contract price.

An ELF is a contract for difference...(4)... 'Price Discovery'.

Via the IFEX screen;

- a) Protection Sellers can post anonymously the (offer) price at which they wish to sell cover.
- b) Protection Buyers can post anonymously the (bid) price at which they wish to buy cover.
- c) When bid and offer prices converge, the transaction is automatically completed.

This is can be done via the IFEX trading screen - or agreed Over The Counter (OTC) through an Inter Dealer Broker, and later concluded on screen to benefit from IFEX clearing and security.

Getting Started with IFEX...

1. Obtain Screen Access.

Contact Billy Welch (Chicago +1 312 229 5137) or Robert Miller (London +44 (0)20 7382 7808).

Access is free for 120 days, then a small charge may be made unless an account is opened.

2. Select a Clearing Member and open an Account.

You will need to set up an account with a CCFE Clearing Member of your choice into which Maintenance Margin will be posted - and into which Variation Margin will be paid or received.

3. Establish Trading Strategy

CCFE Clearing Members willing to undertake trades for clients on the CCFE include;

ADM Investor Services Inc.
Barclay's Capital Inc.
Credit Suisse Securities (USA) LLC
Deutsche Bank Securities Inc.
Fimat USA, LLC
Fortis Clearing Americas LLC
Goldman Sachs & Co.
JP Morgan Futures Inc.
Man Financial Inc.
Merrill Lynch, Pierce, Fenner & Smith, Inc.
Newedge Group Prudential Bache Commodities LLC
UBS Securities LLC

Summary...

ELFs offer;

- 1. The reinsurance market convenient and flexible derivative trading;**
- 2. The convenience and lower costs of cleared and margined exchange traded contracts;**
- 3. The enhanced transparency and liquidity of insurance linked derivatives;**
- 4. Minimal counterparty risk;**
- 5. Access to additional sources of capital;**
- 6. Attractive cash flow benefits for Protection Buyers;**
- 7. Capital efficiency for Protection Sellers**
- 8. Hedging against reinsurance price volatility;**
- 9. Allows US wind risk to be traded continuously, i.e. 'dynamic hedging';**
- 10. Hedging against losses caused by natural catastrophes other than US wind, and**
- 11. No Ultimate Net Loss clause.**

