



# IFEX Event Linked Futures

***IFEX ELF's for Protection Buyers  
"Trading Strategies"***

# IFEX offers two commodities...

## Buying & Selling Protection

Buying or selling protection in derivative form can be done either on screen or through an interdealer broker. In the latter case, the price is negotiated off exchange as a Block Trade.

Block Trades are then put through the exchange to benefit from the clearing system and its security.

- The Block Trade minimum is 25 lots equivalent to a contract limit/notional value of \$250,000.

This kind of trade offers excellent security through the clearing process.

## Price Trades (and Hedges)

Such trades permit trading of price with little or no insurance risk if conducted outside of the relevant hurricane season.

The 2010 ELF contracts will only be *more significantly* exposed to risk from June 1 2010 until November 30 2010, and will be subject *largely* only to price risk outside the hurricane season. Outside the hurricane season such trades have very low margin – 2% of contract limit/notional value for the Protection Buyer and 8% for the Protection Seller.

# Transformer/fronting arrangements...

Protection Buyers who prefer to buy protection in reinsurance form rather than as a derivative can use a Transformer/Fronter.

Transformer/Fronting Arrangements convert protection bought in derivative form into traditional ILW reinsurance by selling an ILW reinsurance policy to a Protection Buyer offsetting it with an equivalent IFEX ELF.

This would allow Protection Buyers to get full capital relief.

There are a number of reinsurers which will offer Transformer/Fronting Arrangements for IFEX.

# Filling Gaps in Reinsurance programmes...

## **Filling Gaps in Reinsurance Programmes.**

**IFEX ELF contracts make it possible for Protection Buyers to fill gaps in outwards reinsurance programmes, or mitigate the cost of reinstatement premiums or reduce retentions.**

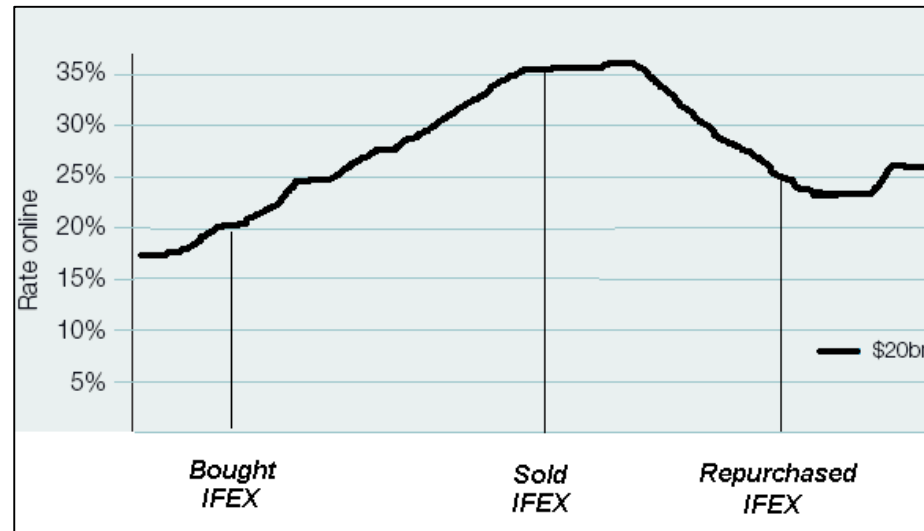
## **IFEX ELFs used to Crystallise Profit.**

**IFEX ELFs can be used to close out cash market positions by buying equivalent IFEX ELF contracts to reduce or negate existing risk exposure.**

**A Protection Buyer might purchase an IFEX ELF contract late in the hurricane season for a modest cost to help protect annual earnings.**

# Using ELF's for 'Dynamic Hedging' ...

Dynamic hedging allows the protection buyer to increase or reduce his exposure to US wind in accordance with changing prices and his risk appetite.



A Protection Buyer had bought an ELF contract for 2010 at a loss trigger level (LTL) of \$20b @ 20% Rate on Line (RoL). There are then a number of catastrophes and the price of the equivalent 2010 ELF moves to 35% RoL. The Protection Buyer decides to sell the equivalent ELF. The Protection Buyer then carries the associated risk without the ELF. Should the price then fall the Protection Buyer would have the ability to purchase a new ELF reinstating the coverage in order to protect the earnings.

# Hedging'/LONG Strategies...

'Long' means the buying of a security such as a stock, commodity or currency, with the expectation that the asset will rise in value.

A Protection Buyer fears that future prices may rise so buys an ELF contract today locking in the current price.

**This might be used to:**

- Hedge against a rise in the price of a future renewal.
- Exploit mispricing compared to the technical rate;
- Exploit an anticipated price rise in the cost of ILWs;
- Hedge against any natural catastrophe in 2010 or 2011.



A "long renewal" hedge will allow Protection Buyers to manage their portfolio through the up phase of a price cycle.

# Trading ELF Prices...

**ELF prices will respond to news concerning;**

- **Catastrophes affecting the international reinsurance market.**
- **Major entries and exits from the international reinsurance market.**
- **Developments in capital markets.**

# Exploiting Price Discrepancies and Spreads...

## Exploiting price discrepancies.

Protection Buyers and/or Sellers will be able to exploit occasional price anomalies. An example is the pricing of traditional reinsurance after the 2005 Hurricane Katrina.

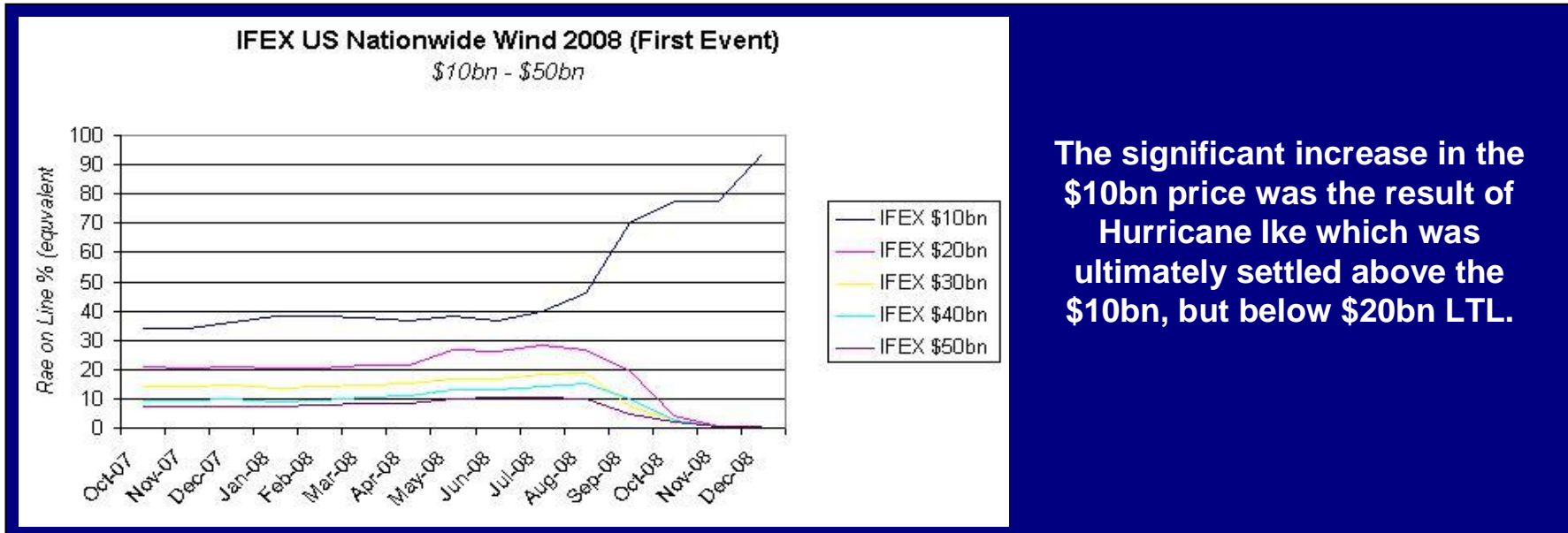
Because trading IFEX ELF contracts have lower transaction costs compared to the alternatives they are the ideal means of exploiting such perceived price discrepancies.

For example, if the 2010 \$10bn IFEX ELF US Tropical Wind is at a price materially lower than that indicated by exceedance probabilities, and/or which historical losses won't support, that suggests it becomes attractive to buy such contracts.

## Trading ELF Spreads

Currently, IFEX lists US Tropical Wind ELFs for two loss periods and First, Second, Third and Fourth Events. This array of Events, Loss Trigger Levels and loss periods may throw up pricing discrepancies and hence opportunities for trading.

# Trading 'live' and 'dead' CAT...



The significant increase in the \$10bn price was the result of Hurricane Ike which was ultimately settled above the \$10bn, but below \$20bn LTL.

- IFEX ELF contracts will allow active trading in 'live' and 'dead' CAT.
- It is possible to trade the contracts as hurricanes develop and approach the covered territories – 'live CAT'.
- It is also possible to trade 'dead CAT' - once hurricanes have made landfall and it is unclear what the loss estimate will be and whether the chosen loss trigger level has been exceeded.
- Protection Buyers and Sellers will be able to use IFEX ELFs to manage their financial aggregates to relevant tropical wind exposures.

# Overlaying US CAT Exposures...

- IFEX ELF contracts for US Tropical Wind ELF provide an effective and efficient and means of adjusting exposures to CAT risk.
- Adjustments to exposures can rapidly be made to reflect changing risk preferences without the need to commute or buy protections in the conventional reinsurance market.
- IFEX ELF positions can be used to hedge:
  - Holdings of shares in reinsurance companies;
  - CAT bonds;
  - Industry Loss Warranties;
  - Lloyd's commitment.

# Hedging Non-Wind Catastrophes...

**IFEX Tropical Wind Event Linked Futures contracts can be used to hedge against any catastrophe that causes any major losses to the international reinsurance industry.**

**A Protection Buyer could in 2010 buy an ELF for 2011 US Tropical Wind.**

**If a major catastrophe, e.g. an earthquake in the United States, occurred in 2010, the price of the 2011 ELF would increase substantially.**

**The result is that the Protection Buyer receives significant Variation Margin towards offsetting increased renewal rates in 2011.**

**In the absence of such a major catastrophe, the cost of the hedge is limited to the bid-offer spread, plus the relevant fees and commissions for trading.**

