OLIVER WYMAN

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Executive Summary of the proposed approach to restructure the insurance liabilities of CLICO International Life Insurance Ltd. (CIL)

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MARSH & McLENNAN COMPANIES

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Overview

We have been asked to provide a high level overview of a plan for restructuring of the policyholder liabilities of CLICO International Life Insurance Ltd (“CIL” or the ”Company”) assuming no additional funding is to be immediately provided to fill the shortfall and rehabilitate the policyholder benefits to their original level.

The high level objectives of the restructuring include

- **The financial rehabilitation** of the business lines:
  - A. The goal is to remove the current deficit, mitigate the risk of potential liquidity shortfalls in the short to medium term and be compliant with local regulatory requirements. This will be achieved by:
    - i. Aggregate write down - Designing revised products with an actuarial value equivalent to the value of the available Company assets, and
    - ii. Redesigning the products into two components: a guaranteed benefit component adequately supported by liquid qualifying assets AND a non-guaranteed benefit component supported with the remaining assets (recovery fund) [1]
  - B. This will help to ensure the business can be transferred to a replacement insurer, who would be willing to fund the solvency capital requirement. The willingness and/or ability of a replacement insurer to accept the portfolios and fund the solvency capital requirements will depend on the extent to which:
    - i. The value of the policyholder benefits can be written down to remove the deficit
    - ii. The product features are designed to result in an acceptable risk profile (considering the available assets transferred) and an acceptable expected return on solvency required capital funded by the buyer

- **Minimise further loss to policyholders:**
  - A. Fairness: The goal is to minimize the loss to the policyholders but on a fair basis. That is, the restructuring of the benefits, division of the remaining assets and design of the new benefit features should be done on an equitable basis. Specifically,

[1] In the Canadian case of the failed Confederation Life in 1994, there was also a “Recoverablity fund” of illiquid assets which was managed by the Liquidator. The initial recovery ratio was 80% and after 7 years and it was eventually trued up to 100%. This recovery ratio applied to all policyholders equitably

i. The policyholder reserves are a fair proxy to the level of claims each policyholder has on the remaining assets of the Company, as such the aggregate recovery ratio and the recovery ratio at the policyholder level should be the same.

ii. Replacement products will be designed to reflect the intended purpose of the original benefit but the revised terms of repayment will need to be based on the level of liquidity available from the asset cashflows. That is, the EFPAs will be replaced with a revised savings/accumulation product and the traditional life products will be replaced with a revised traditional life product

B. Provide possibility for future gain: To compensate for the immediate loss in guaranteed benefit, the design should allow policyholders (or their beneficiaries) the ability to gain from future long term potential realised gains on the currently illiquid/ non-performing asset portfolio

i. This will be achieved by offering a secondary benefit component for which the timing and amount of the payout is not guaranteed as the value of this component will be supported by the value of the non-liquid assets. The benefit will be realised to the policyholders/beneficiaries when the supporting assets become income-producing and/or are liquidated

- **Easy augmentation of guaranteed insurance benefits by future potential Government contributions**:

A. It is still not clear at this point whether there will be any immediate source of financing or promise of future financing from the Governments for the recapitalization of the business lines to guarantee the original contractual benefits.

B. However, there may be some potential for future Government funding as such a practical method should be developed whereby the policyholder benefits can be easily augmented in the future from a potential capital injection. We propose that a method with principles similar to most Policyholder protection compensation schemes or Insurance Guaranty funds in other jurisdictions can be applied

i. That is, the method for using additional government funding to increase insurance benefits can be similar to the methods used by Insurance Guaranty Funds in other jurisdictions which utilises compensation limits, such as caps, which favours smaller policies with lower sum assureds.

The remainder of this document outlines at a high level an approach and the worksteps for the restructuring.

Proposed worksteps to restructure liabilities

Worksteps to restructure benefits and rehabilitate the portfolio for transfer to a replacement insurer

	Workstep 1	Workstep 2	Workstep 3a	Workstep 3b
Steps in the process	**Segment assets**	**Determine the write-down and recovery ratio**	**Restructure policyholder benefits**	**Allocate potential future Government funding**
Description	• Segment asset portfolio into two types: – Type 1: Admissible assets with appropriate characteristics to support guaranteed policyholder benefits – Type 2: Illiquid or currently non-performing assets more suitable for supporting variable non-guaranteed benefits	• We propose that the current reserve levels are a fair proxy to the level of claim that each policyholder has on the assets of the failed company • As such, both the aggregate write-down required and allocation of the remaining assets will be pro-rata to the value of current reserves • This will result in the same recovery ratio assigned to all business segments and policyholders • Define the guaranteed recovery ratio based on Type 1 assets determined in Workstep 1	• As per Principle in Workstep 2- The existing assets and the value of the restructured benefits allocated to each policyholder should be proportional to the level of the original reserves held for each policyholder • Restructured features to be designed such that: • Policyholders needs or objectives are considered – given the different policies purchased • Cashflow profile considers liquidity available from assets • Value of restructured guaranteed insurance components are equal to value of the Type 1 assets	• We propose that any additional Government funding can be allocated differently. • It can be used to augment the guaranteed benefits up to a certain limit • This will benefit smaller policies with lower sum assureds • This will be in line with the most common models adopted by policyholder protection funds which set both percentage and dollar caps on the level of compensation – e.g. guarantee 100% for the first $10,000 of any claim, plus 10% of the balance thereafter up to a maximum of $20,000 • Specific terms need to be worked through based on level of funding

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Highlights and key implications

A separate more detailed report is available each workstep above. The following is a summary of takeaways and implications of the proposed approach:

- It is our view that the level of policyholder reserves is a fair proxy to the level of claims each policyholder has on the remaining assets of the Company. As such, we recommend the use of policyholder reserves on the original contracts to be used as a fair basis to write down the liabilities and allocate the remaining assets to the various business lines, product segments and individual policyholders. This will result with the same recovery ratio[2] or write-down being applied to each business line, product segment and policyholder.

- The resulting policyholder liability value, including an appropriate risk margin, is not to exceed the value of the available assets as determined in Workstep 2. One purpose of the risk margin included in the policyholder liability is to provide for an adequate expected return on the required capital to be funded by the replacement insurer. It is also a required measure of prudency as per guidance under most international actuarial standards.
- We recommend there be a guaranteed component and a non-guaranteed variable component to the benefits offered to each policyholder. The guaranteed component will be designed to reflect the customer's needs and the cashflow profile of the available appropriate assets. The non-guaranteed variable component will offer the customer the potential for future gains
- Only the Type 1 assets identified in the existing asset portfolio will be suitable to support the guaranteed benefit component. This may initially result in a very low <u>guaranteed</u> benefit recovery ratio (where guaranteed recovery ratio = Type 1 assets/current reserve value). Based on a high level review of the assets, an initial guaranteed recovery ratio of 20c to 30c on the every dollar of the current reserves is possible
- A guarantee today from Governments of a future capital injection can also be factored in now to improve the initial recovery ratio (sensitivity testing can be performed on this). The Government is able to augment the guaranteed restructured benefits offered by either:

  A. An immediate capital injection or a guarantee of a future capital injection to directly increase the guaranteed benefit components of any or all liability segments

  B. The purchase of some of the illiquid and/or non-income producing assets in exchange for cash or Government bonds. This option will serve to increase the defined guaranteed insurance benefit component offered to the policyholder, but also reduce the variable non-guaranteed benefit component
- Type 2 assets will be placed in a "Recovery fund" and managed according to a defined liquidation strategy. The potential future gains from the fund will be used to augment the guaranteed benefit component or pay cash dividends to the policyholder or their beneficiaries
- Workstep 3 is where the bulk of the detailed analysis will take place, balancing product design, liquidity constraints, fairness and affordability.

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[2] This relationship is sometimes expressed as a liquidation ratio, or the number of "cents on the dollar" available for distribution to policy-level claimants.

- The design of policy features and allocation of benefits to individual policies should offer the same recovery ratio to each individual policyholder as well, as each policyholder's claim on the remaining assets is in direct proportion to the individual's policyholder reserves. The process would be to allocate assets to each policyholder in proportion to their original reserve levels and then solve for the benefit amounts which can be offered.
- However, just as important is the design of the features which need to be able to mitigate the financial risks to the portfolio as such design limits are likely to include
    - ii) Low to zero initial cash surrender value over the first 5 or 7 years
    - iii) No immediate maturity payments, that is matured or past due benefits will probably be staggered over the short term in an annuity form to be specified by the cashflow profile of the available Type 1 assets
- We propose that any potential future government funding can be allocated differently to augment and further compensate policyholders. Approaches which are similar to those of Insurance Guaranty Funds can be designed where the guaranteed benefits offered are relative simple to administer and are subject to coverage limits or caps. A guaranty association's coverage limit or "cap" does set a "floor" for policyholder recoveries, no matter what else happens in the receivership/liquidation case. The much more important factor—at least for policyholder claims significantly in excess of caps—is the liquidation ratio achieved in the insolvency. See Appendix A for a comparison of various compensation schemes

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