ALTERNATIVE ALTERNATIVES

Opalesque Research

Issue 38, 24.10.2007

INSURANCE LINKED SECURITIES

Nephila Capital

1. The rationale behind conceiving a catastrophe CDO-Gamut Re?

As an investment manager, we at Nephila Capital Ltd., specialise in catastrophe reinsurance and weather risk.
Active in the space for over a decade, we recognised that there was a gap between the two capital markets: institutional investors seeking non-correlated returns and insurance markets seeking additional risk capacity.

In keeping with our "follow the logic" philosophy - the catastrophe CDO-Gamut Re evolved as a risk financing vehicle that supported catastrophe risk exposure. The notes have 5 tranches - and each has been structured to offer a different risk/reward profile.

RATINGS

Desc.	Notional	Coupon	Subord.	Maturity	Ratings
Class A	$60,000,000	3M + 1.40%	80.6%	Jan 31st, 2010	Aa3
Class B	$120,000,000	3M + 3.00%	41.9%	Jan 31st, 2010	Baa3
Class C	$60,000,000	3M + 7.00%	22.6%	Jan 31st, 2010	Ba3
Class D	$25,000,000	3M + 15.00%	14 5%	Jan 31st, 2010	NR
Class E	$45,000,000	Residual		Jan 31st, 2010	NR

Gamut Reinsurance Ltd : Moody's ratings - notes linked to a managed portfolio of natural catastrophe risks
Source: Nephila Capital Ltd.

There are four classes of secured notes and a subordinated tranche. Both, Moody's and S&P have assigned ratings to the three senior-most tranches in the capital structure. The notes were tranched sequentially so that higher rated tranches have a more senior claim to cash flows, separated as interest and principal proceeds. Additionally, a subordinated tranche would suffer losses first should losses in the underlying portfolio occur.

This long term vehicle has a fixed life of just under 3 years, and is actively managed by us, with the objective of providing investors with a selection of risk / return profiles that are uncorrelated with the traditional financial markets.

: Credit and catastrophe risk co-existing in a CDO structure

There have been instances where catastrophe risk bonds have been included in credit CDOs.
Most investors are however looking to isolate and capture "uncorrelated" market returns - i.e. there is a marked preference for specialised risk products rather than inclusion within a portfolio that is primarily credit risk. Investors typically prefer not to mingle the credit and catastrophe risks within a single vehicle as it detracts from the purity of the non-correlation and the corresponding investment benefit within a portfolio offered by insurance risk.

: Presence of a secondary market

Gamut Re securities can be traded - Swiss Re and Goldman Sachs, as broker dealers, provide a secondary market for the CDO - but it is better suited to investor with a "buy and hold" outlook.

: Threat posed by competition

Similar products, but with static portfolios of risk, have been offered by ABNAmro.

We believe our product distinguishes itself owing to its active management - our expertise in being able to identify and manage a portfolio of attractively priced risks to optimise uncorrelated returns. The underlying instruments are either bonds or have a duration of between 6 months to 1 year.

: CDO's underlying range of assets

Catastrophe bonds, industry loss warranties, and direct reinsurance. The vehicle does not invest in retrocessional reinsurance and weather risk.

2. Innovation with regards - creating products that are specifically tailored to meet the need of the agriculture community (in the wake of increasingly erratic weather phenomena).

We view weather risk as distinct from catastrophe risk, and we manage a dedicated weather fund and are working to grow our presence in this area. In theory the two risks could be combined within a vehicle to offer more diversification within the non-correlated returns, but the sectors have very different underlying risk profiles which at the moment are better suited to distinct investment vehicles.
Currently the size of the weather risk market is 1-2% of the catastrophe risk market - which is estimated to be approximately USD200bn in risk protection purchased per year. We believe investing in weather related risk holds potential for a market of equal size at some point in the future.

: "encourage the growth of weather risk markets" - how? user profile… Currently weather risk emanates largely from specific sectors: energy and utilities, aviation, tourism, agriculture…

There is real opportunity based on the huge economic sensitivity to weather risk in the global industry and the investor interest in another non-correlated statistical risk (much like in catastrophe risk, but without a large existing underlying market). Hence we are working with insurance brokers, primary market players such as SwissRe and Galileo, and new market entrants such as WeatherBill in developing this market - we are really excited about the growth prospects in this sector, as well as in catastrophe risk (including future CDO structures in both sectors).

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