SEARS HOLDINGS

Sears Reinsurance and Securitization Transactions

Updated March 2014

Summary

- Sears Holdings Corporation manages insurance risks through a wholly owned subsidiary, Sears Reinsurance Company Ltd. ("Sears Re")

- Sears Re owns securities that are backed by segregated assets held by a bankruptcy remote subsidiary of Sears Holdings Corporation

- Sears Re has the right to sell the securities to third parties if the need arises and, in the event of a default in payment on the securities by the issuers, Sears Re would have rights to the underlying collateral

Sears Re Rationale

- **Like other large companies, Sears Holdings has numerous insurance risks, including:**
  - Risks associated with merchandise service/protection agreements sold to customers
  - Workers' compensation
  - Casualty
  - Property

- **Sears Re was formed in 2001 for the purpose of:**
  - Providing centralized management of these insurance risks through a single entity to facilitate efficient management of them; and
  - Providing dedicated assets to meet the related insurance obligations

- **Sears Re is a wholly owned captive insurance company**
  - Domiciled in Bermuda and regulated by the Bermuda Monetary Authority as a Class 3 insurer
  - As an insurance company, it is required to maintain liquid investments to support its insurance obligations

Securitization Overview

- **Subsidiaries of Sears Holdings Corporation engaged in securitization transactions to generate suitable investments for Sears Re**

- **Securitization refers to the process by which specific assets are segregated into a structure, which then issues securities backed by those specific assets**
  - In other words, the assets are segregated from other corporate assets to provide a segregated stream of cash flow from those assets to make payments on the securities and to provide additional comfort that in the event of default on the payment obligations on the asset-backed securities, segregated collateral would be available to meet these obligations

- **The securitization structures that support Sears Re use *bankruptcy-remote, special purpose* entities**
  - ***Special purpose*** means that the entity is limited in what it can do
    - Its activities are generally limited to only those related to issuing and servicing the debt securities and holding the assets supporting the debt securities
  - ***Bankruptcy-remote*** means that it is unlikely that a bankruptcy filing by or against the entity that holds the assets that support the debt securities would occur, and generally result only from the operation and performance of those assets
    - Very similar to a secured borrowing, as the debt holders essentially have first lien on the assets, but with the expectation that there should not be other creditors making claims based upon activities unrelated to those assets

Securitization Transactions

- **Two securitization structures were used to develop asset-backed securities for Sears Re**
  - Real Estate Mortgage Investment Conduit ("REMIC") Transaction – November 2003
    - 125 Sears Full-line Stores were contributed to a bankruptcy-remote structure
    - Sears Re purchased $1.25 billion of mortgage-backed securities issued by the REMIC
    - In the fourth quarter of fiscal 2013, Sears Re reduced its excess statutory capital through the distribution of all mortgage-backed securities held by it to its parent
  - IP Transaction – May 2006
    - U.S. rights to the *Kenmore*, *Craftsman* and *DieHard* trademarks were contributed to a bankruptcy-remote entity – KCD IP, LLC
    - Sears Re purchased $1.8 billion (par value) of asset-backed securities issued by KCD IP, LLC

- **Securitization structures**
  - The REMIC and IP securitizations were established with corporate formalities
  - The securitizations were designed to give Sears Re investments that satisfy tax and regulatory requirements that Sears Re own assets that can be easily sold
  - In essence, through the securitization structure, the underlying assets indirectly serve as collateral for the obligations to our customers and employees that are insured by Sears Re

- **Since Sears Re, the issuers of the mortgage-backed and asset-backed securities, and the owners of the underlying securitized assets are wholly owned subsidiaries of Sears Holdings Corporation, all of their balances are consolidated and reported on SHC financial statements**
  - Nothing is off-book

Securitization Transactions

- **In November 2003, Sears, Roebuck and Co. formed a Real Estate Mortgage Investment Conduit (REMIC)***
  - Through a "true contribution," the real estate associated with 125 Full-line Stores was transferred to bankruptcy-remote, special purpose entities, and then leased back to Sears, Roebuck and Co.
  - The contributed stores were mortgaged
  - Mortgage Pass-Through Certificates with a par value of $1.25 billion were issued and subsequently purchased by Sears Re
  - The Mortgage Pass-Through Certificates are secured by the mortgages and collateral assignments of the store leases
  - Payments on the Mortgage Pass-Through Certificates are funded by the lease payments

- **In May 2006, Sears, Roebuck and Co. securitized certain intellectual property assets**
  - Through a "true contribution," the rights to use the *Kenmore, Craftsman* and *DieHard* trademarks in the U.S. and its possessions and territories were transferred to KCD IP, LLC, a bankruptcy-remote, special purpose entity
  - KCD IP, LLC has licensed the use of the trademarks to subsidiaries of Sears Holdings Corporation, including Sears, Roebuck and Co. and Kmart Corporation
  - Asset-Backed Notes with a par value of $1.8 billion were issued by KCD IP, LLC and subsequently purchased by Sears Re, the collateral for which includes the trademark rights and royalty income
  - Payments on the Asset-Backed Notes are funded by the royalty payments

- **Sears Re has never been required to sell any assets to make payments on its policies**

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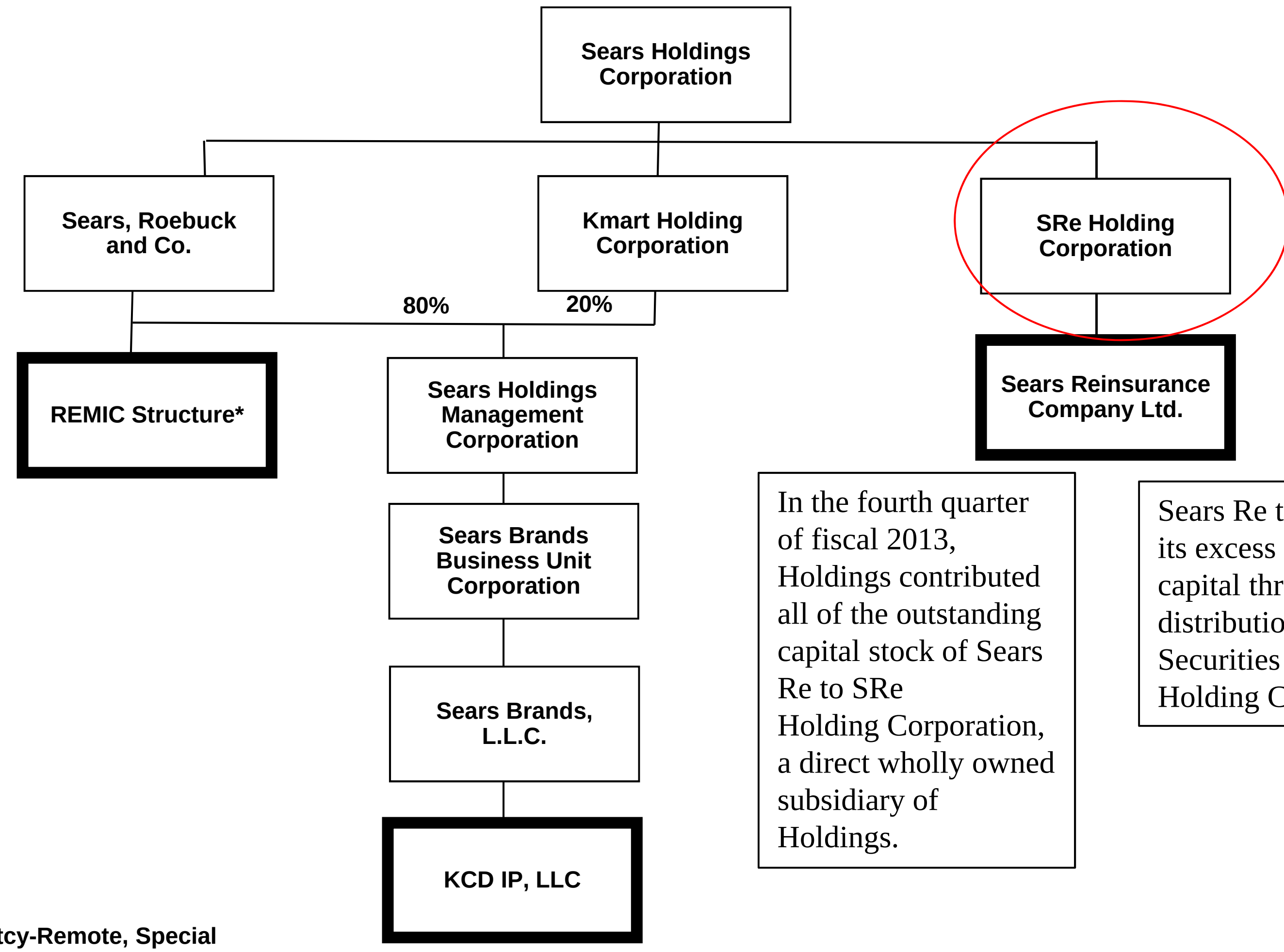
* From 1988 to 2003, Sears, Roebuck and Co. financed its credit card business in part through the securitization of credit card receivables. Sears Re owned securities issued through this process until the Sears credit card business was sold in November 2003. The REMIC was formed because of the need to provide Sears Re with an acceptable replacement investment for the securities backed by credit card receivables.

Sears Re and Securitization Related Entities



In the fourth quarter of fiscal 2013, Holdings contributed all of the outstanding capital stock of Sears Re to SRe Holding Corporation, a direct wholly owned subsidiary of Holdings.

Sears Re thereafter reduced its excess statutory capital through the distribution of all REMIC Securities held by it to SRe Holding Corporation.

* Five Bankruptcy-Remote, Special Purpose Entities

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