Reinsurance Market Outlook

June and July 2011 Update

Executive Summary – In testing times, Aon Benfield achieves renewals guidance on behalf of clients

June and July brought meaningful rate changes to regions affected by the significant catastrophe events of the first quarter and a real debate about whether western European and U.S. insurers should pay more for their catastrophe capacity following such loss activity – we believed they should not and we were the sole minority voice advocating this position on behalf of our clients. We have looked at all times to challenge the perceived wisdom of what "should" be available.

June 1 catastrophe renewals consisted mainly of Florida and New Zealand programs and the first noteworthy results were achieved. The pricing of Florida renewals was flat to -5 percent for our clients—which was directly in-line with our guidance published April 1. Florida accounts where clients required co-broking averaged increases of 10 percent and clients we served as sole broker averaged decreases of 7.5 percent. New Zealand renewals pricing at June 1 increased more than 100 percent due to the large and still uncertain losses from the series of events in Christchurch.

July 1 catastrophe renewals consisted of the usual national U.S. insurers, Australian insurers and those Japanese insurers that extended their April 1 programs by three months. The trends of June 1 continued into July with the pricing of U.S. insurers' renewals flat to -5 percent— directly in-line with our guidance published April 1. Japanese programs renewed with price increases ranging from 30 to 50 percent. Australian insurers price increases ranged from 15 to 70 percent.

Substantial work on behalf of our clients was required to overcome the uncertainty surrounding the material reinsured losses, most especially in Japan and New Zealand, as well as the impact of the most recent update of one of the industry's hurricane models. Reinsurers understood that Florida-focused and U.S. national insurers already pay higher multiples of margin per unit of variance than any other reinsured region in the world and responded accordingly. Some market anomalies did occur, for example, reinsurers were not willing to reward insurers that cut exposure in key catastrophe zones with rate decreases that matched the pace of the decreasing exposures. Reinsurers, however, were willing to increase pricing at a rate lower than the pace of growing catastrophe exposures for insurers that wrote more business. These anomalies were more noticeable in programs requiring significant capacity. Reinsurers also understood that the latest catastrophe model update, while bringing some important updates, also introduced many new features that are not fully understood or accepted by insurers or reinsurers themselves.

Our periodic reinsurance market outlook reports are intended for our insurance company clients' (the buyers of reinsurance) consideration as they plan for their upcoming reinsurance renewals. Our market outlook reports make appropriate use of the insight available through our unmatched reinsurance market share in substantially all markets and importantly, including the highest market shares in Florida, Japan, Australia and New Zealand that are considered in this report.

Our outlook considers many factors and relies heavily upon the changes in reinsurance market supply and our clients' demand for reinsurance.

We have substantially more data and market intelligence than any other firm in the reinsurance business. Our outlook is based upon the results we believe are achievable from the entire reinsurance market including all sources of capacity, and it is not intended to predict the level of price rise or decline achieved by any single reinsurer as they make their own specific decision whether to renew or not renew our clients' business. Individual client results can also differ from our overall performance due to their starting point, unique characteristics or circumstances.

We are of course aware of the fact that there were many views published that differed materially from our expectations of the June and July renewals dates. Many of those differing with our analysis are not reinsurance brokers, reinsurers or firms otherwise familiar with the inner workings of these key renewal markets. Some reinsurance intermediaries with substantially lower or no market shares or experience chose to publish expectations that did not reflect critical underlying currents in demand or reinsurance dependence.

The differences in the results we achieved for our clients were dramatic. While our competitors reportedly placed business at increased rates of as high as 15 percent, we drove flat to reduced pricing through to completion for U.S. property catastrophe program renewals. These results were achieved despite a market and other reinsurance intermediaries that tried to establish the case that reinsurance rates in all markets needed to rise as a result of the significant, but not unprecedented, losses in the nine month period leading up to June and July 1. By focusing on the facts, the capital position of the reinsurance industry and not the emotion stirred in the market, we were able to navigate through a turbulent period and achieve differentiating client results.

Our outlook computes price changes on a constant model basis and is computed in the traditional method. The rate of change in price is reduced by the rate of change in expected losses in the layer. For example, if an insurer's price increased by 5 percent and the expected losses increased by 5 percent, then the price change is flat. While others have suggested the model changes and other factors allow for a wide range for the interpretation of results, we have consistently applied this straight-forward, objective fact-based method.

Our outlook for the pricing of U.S. property catastrophe renewals for the remainder of the year is flat assuming no additional occurrences of substantial insured and reinsured catastrophe losses. Clearly, however, the reinsurance market for renewals for the remainder of the year is more sensitive to additional losses this year than last given reinsured loss experience to date this year.

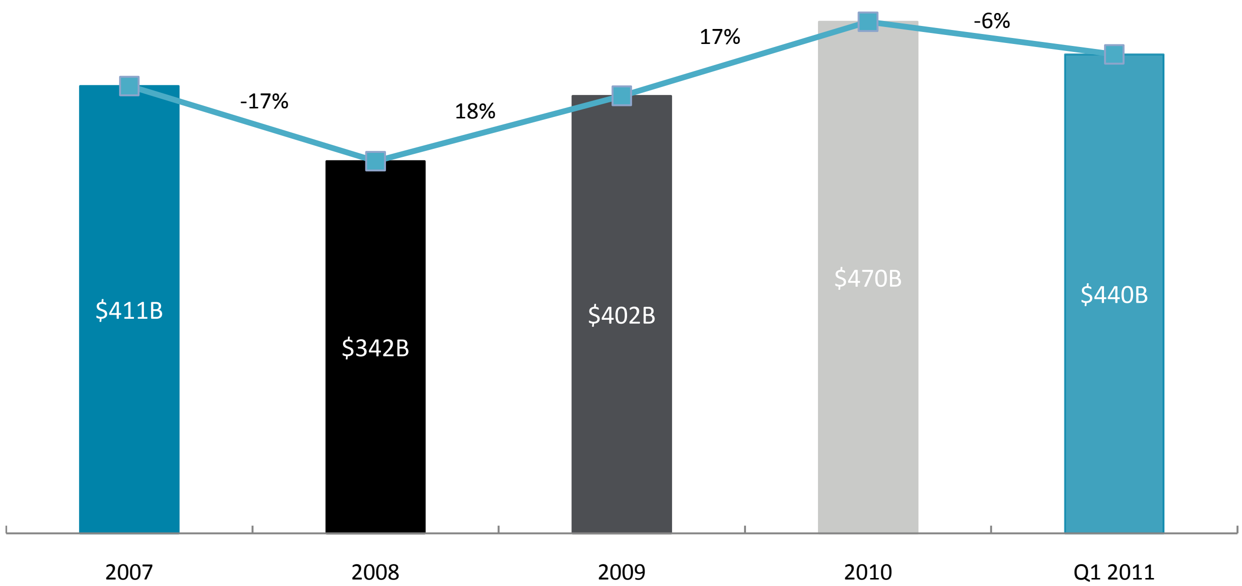
In times of turbulence, fact-based, knowledgeable and experienced leadership matters, thus, we wish to put on record our thanks to insurers and reinsurers for their recognition of partnership, their preparedness to understand the longer term and their overwhelming aim to be responsive. Negotiations, not for the first time or the last, were often challenging, sometimes emotional, and at all times constructive.

If we could be of further assistance in explaining our thoughts or experiences please contact us.

Reinsurer Capital Remains Adequate for Demand

Reinsurer capacity remains abundant despite the Tohoku earthquake, and events in New Zealand and Australia. The impact on many reinsurers is relatively small, resulting in overall capital reduction of approximately six percent since year end 2010 and is well above the earlier peak in 2007. Demand over the same period has changed minimally suggesting reinsurers still have ample capacity to provide the limit desired by clients.

Figure 1: Change in Reinsurer Capital

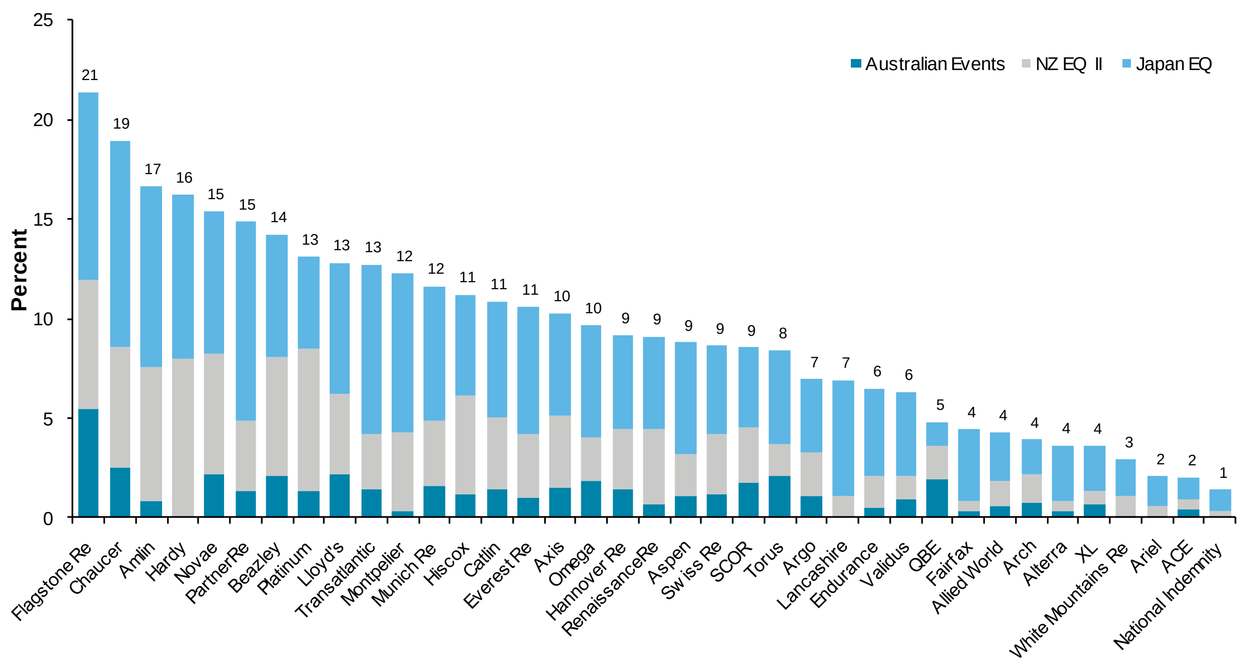


Source: Individual Company Reports, Aon Benfield Analytics

Q1 Catastrophe Loss Impact to Reinsurer Capital

With the majority of reinsurers providing some guidance as to loss impact resulting from the catastrophe events in the first quarter, Figure 2 shows the impact to the Aon Benfield Aggregate group of reinsurers. In total, loss to this group was approximately $21.6 billion.

Figure 2: Q1 2011 Catastrophe Losses as Percent of FY 2010 SHF



Note: Midpoints used where a range of loss was reported
Source: Individual Company Reports, Aon Benfield Analytics

Capital Markets Remain A Key Source of Capacity

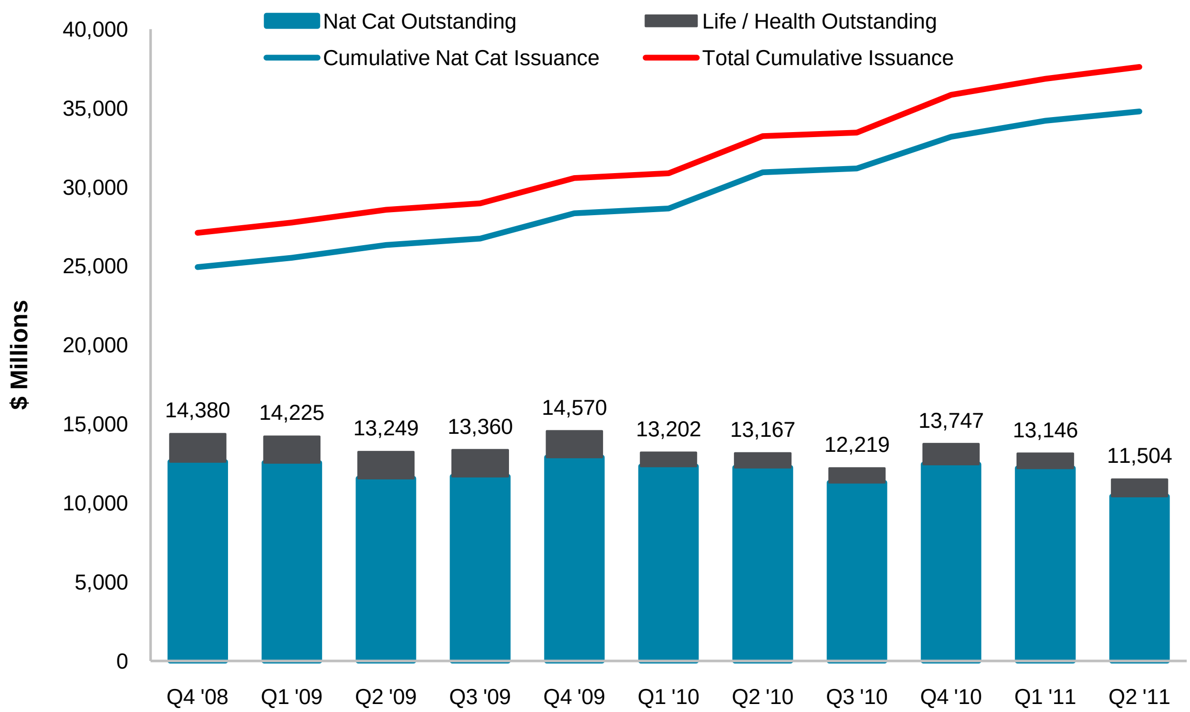
The Insurance-Linked Securities market continues to provide a capital markets alternative to the traditional reinsurance market. Five catastrophe bond issuances closed in the second quarter of 2011, compared to nine issuances in the same period in 2010. Four of these five issuances were from repeat-issuers, including one from the life/health sector. In total, $742 million was issued in the second quarter of 2011, versus $2.3 billion in the same period in 2010.

Foremost among these five transactions, USAA returned to the market with Residential Reinsurance 2011 in three tranches: Series 2011-1 Class 1, Class 2, and Class 5 for $57 million, $33 million, and $160 million, respectively. Like earlier issuances, the transaction covered five US perils: hurricane, earthquake, winter storm, severe thunderstorm, and wildfire. Spreads were in line with 2010 pricing, demonstrating consistency in year over year pricing.

As of June 30, 2011 there are $11.5 billion in catastrophe bonds outstanding, including the life/health sector. The total is less than the June 30, 2010 total of $13.2 billion for several reasons. First, some issues that matured during the recent 12 months were not reissued or replaced which reduced the total outstanding. Sponsors and investors both continued to evaluate the substantial model change from RMS. Finally, the catastrophe events in Japan and New Zealand continued to concern the market.

Aon Benfield Securities forecasts substantial issuance of catastrophe bonds in the second half of 2011, based on sponsors' current desire to discuss potential transactions for the fourth quarter.

Figure 3: Outstanding Catastrophe Bond Volume By Quarter



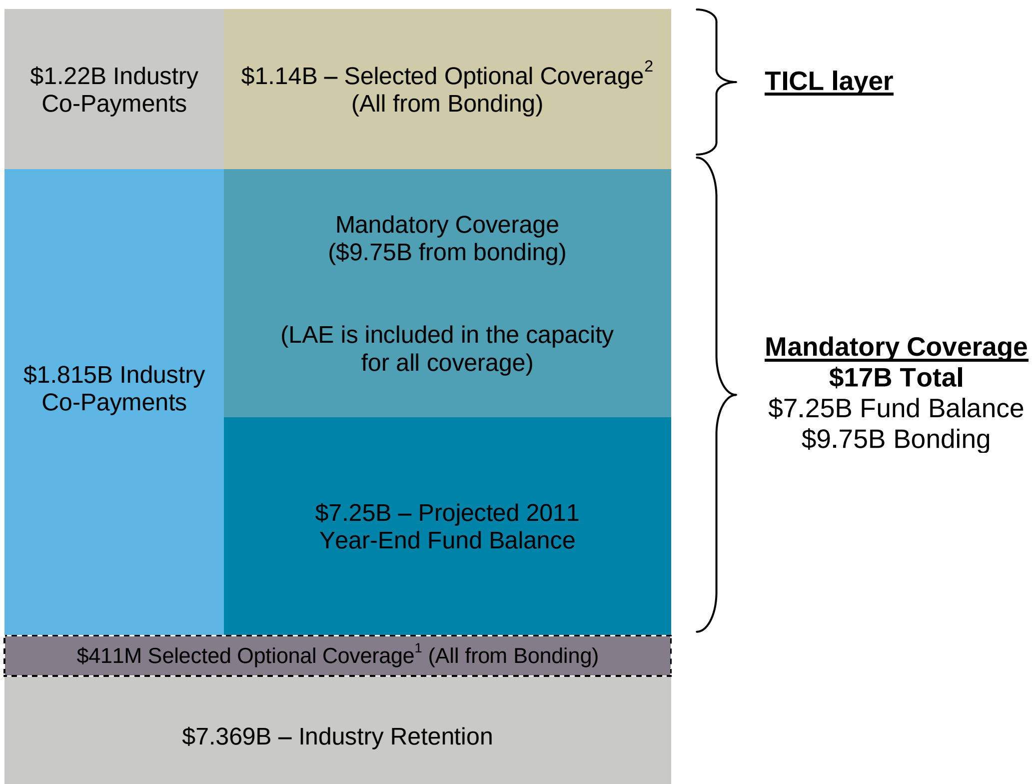
Source: Aon Benfield Securities

Sidecars—a subject which did not receive much press prior to the second quarter—have had a resurgence of popularity in the wake of natural catastrophes this year. Most sidecars are focused on capitalizing on higher rates, particularly in the retro market, either now or anticipated in the future.

FHCF Capacity and Bonding Estimates

As part of the May Advisory Council meeting, the FHCF provided an update of current elections for TICL capacity as well as available bonding capacity for the 2011 hurricane season. The following charts depict the FHCF structure as well as potential claims paying capacity required from both cash and bonding. Based on selections made earlier this year, the FHCF would need to bond $11.3 billion to fully fund all outstanding limits provided. Estimates from senior managers ranged widely with Goldman Sachs at $4 billion and JP Morgan at $17 to $23 billion. While the average including Citi and Barclays is $12 billion, should $4 billion be the maximum bonding available post-event there is a potential for almost $7 billion (or approximately 40% of the limit) to be unfunded capacity.

Figure 4: FHCF Claims Paying Capacity



1 Optional Coverage selected by certain statutorily designated companies (LAC and companies approved to participate in the Insurance Capital Build-Up Incentive Program); total maximum available is $1B

2 Total maximum available optional TICL coverage is $6B

Forecasters Predict Above Normal U.S. Hurricane Activity

2011 forecasts continue with above normal hurricane activity predictions for the 2011 hurricane season. TSR, CSU and NOAA all expect a higher level of named storms, hurricanes and major hurricanes than average.

Figure 5: U.S. Hurricane Season Forecasts—TSR, CSU and NOAA

	Named Storms	Hurricanes	Major Hurricanes
TSR (June 2011)			
Average	10.5	6.2	2.7
2011	14.1	7.6	3.5
Difference	+3.6	+1.4	+0.8
CSU (June 2011)			
Average	9.6	5.9	2.3
2011	16	9	5
Difference	+6.4	+3.1	+2.7
NOAA (May 2011)			
Average	11	6	2
2011	12-18	6-10	3-6
Difference	+4.0	+2.0	+2.5

Source: TSR, CSU and NOAA websites.

Regional Market Dynamics for June and July Renewals

June and July renewals bring a global diversity similar to January renewals. This renewal also saw significant placements in Japan resulting from the extensions on many programs that previously renewed in April. Regions with catastrophe loss experience in the last 12 months saw price increases, while most other regions saw flat to modest reductions at renewal.

Japan

July 1 saw the renewal of earthquake excess of loss programs that were extended by three months from the traditional inception date of April 1. The three month extensions were given to allow these insurers time to get more clarity on the likely loss from the Tohoku earthquake on March 11. Speedy original claims settlements on dwelling policies means that a substantial portion of the overall claim has now been finalized and has given a greater transparency to the ultimate loss figures on these accounts.

These placements renewed with an overall program price increase in the range of 30 to 50 percent.

Australia

Following significant catastrophe loss activity over the past 12 to 18 months, Australian property renewals faced a hardening market at July 1. Significant pressure was applied to retention levels, pricing on loss-affected layers and minimum rates on line charged on upper layers. Pressure was also applied to reinstatement conditions, although the bulk of the market continues to buy with prepaid reinstatements as a result of regulatory requirements. Notwithstanding these pressures, ample capacity remains available for Australian programs.

Pricing impacts varied by cedent, with risk adjusted increases generally in the range of 15 to 70 percent.

Catastrophe risk was largely removed from proportional treaties with event limits decreasing, or in some cases being removed entirely. Casualty rates were largely flat and the class benefited from an increased supply of reinsurance capacity, driven by reinsurers with strong property relationships targeting casualty portfolios in order to mitigate their volatility.

New Zealand

As expected, renewals were dominated by the recent earthquakes in Christchurch. In addition to the insured damage caused by the September 4, 2010 and February 22, 2011 events, the ongoing seismic activity was also a source of concern for reinsurers. The effects of the ceded losses and heightened seismic activity resulted in a significant reappraisal of the risk with pricing, attachment, reinstatements and capacity all being scrutinized and subject to change. Price increases were in excess of 100% and while some program retentions remained unchanged, there was certainly significant pricing and capacity pressure on lower layers of catastrophe programs. Pre-paid reinstatements were more readily available at higher return periods.

Event limits on proportional and excess of loss were greatly reduced or catastrophic perils were excluded altogether. The removal or reduction of event limits positively influenced commission levels on proportional treaties balanced, of course, with treaty performance.

Where risk and general accident (mainly short tail in New Zealand due to the lack of bodily injury cover) treaties were unaffected by the earthquakes, there was still considerable negotiation around pricing and the number of reinstatements although price increases generally reflected exposure movements plus a small consideration for capital charges.

Despite some predictions of capacity shortages, especially with respect to earthquake cover around Christchurch, this did not eventuate and cedents were able to secure acceptable reinsurance capacity.

Malaysia

Loss free catastrophe excess of loss programs enjoyed an average risk adjusted price reduction of 5 to 10 percent. Programs affected by recent Flood events in Northern Malaysia (November 2010) and Southern Malaysia (January 2011) saw price increases of up to 10 percent.

Proportional treaties with continued profitable records saw ceding commissions increasing by up to 2.5 percentage points. A number of cedents were also able to secure significant increases in Property and Engineering Surplus Treaty limits - this was partially resulting from indigenous insurers trying to catch up with larger local rivals and multi-national insurers in an increasingly competitive landscape.

The trend of overseas reinsurers based in Asia Pacific looking to diversify into relatively more benign catastrophic territories (recent floods notwithstanding) like Malaysia continues to put pressure on pricing and margins.

Colombia / Peru

Facultative renewals are now seeing flat to slight increases on renewal compared to prior reductions.

Treaty reinsurers continue to push for increases on catastrophe exposed accounts. That said, capacity remains abundant limiting the upward pricing pressure to no more than a 5 percent increase on renewals.

Non-catastrophe renewals were completed at flat pricing year over year.

Chile

Despite expectations for price reductions following the significant market hardening in 2010, the impact of international catastrophes throughout Q1 of 2011 carried over to Chilean property catastrophe renewals resulting in flat pricing on a risk adjusted basis for 2011.

Property risk programs renewed flat to down 5 percent. Facultative renewals varied with small risks renewing flat, medium risks achieving 5 percent reductions and large risks achieving 10 percent reductions. Property excess of loss capacity remained stable between 2010 and 2011.

For proportional property treaties, minimum rates, event limits and ceding commissions have been maintained. Reinsurance capacity is slightly increased versus 2010 with 3 or 4 new entrants to the market and no exits from existing markets.

Non-property treaty business capacity is stable and pricing/terms are flat to softening.

Argentina

Facultative capacity remains stable year over year with flat to slight increases in pricing.   Treaty business in Argentina is stable with both pricing and terms similar to last years' renewals.

South Africa

Despite the recent major losses around the world, the July 1 renewals saw flat to a slight reductions. It appears that as the rest of the world experiences large losses, foreign reinsurers are providing more capacity to South Africa as a way of diversification. Capacity remains plentiful for programs with positive results. 2010 was a very profitable year for both direct insurers and reinsurers, contributing to increased competition.

Proportional programs, which are still common, renewed at expiring or slightly increased commissions and capacity, again driven by the lack of large losses and the available capacity.

United Kingdom

Despite poor property catastrophe results in international regions, UK property catastrophe programs renewing at July 1 were flat on a risk adjusted basis. European wind capacity remains plentiful.

The market continues to anticipate the upcoming European windstorm model release from RMS Euro and future impacts as a result of the model change remain inconclusive.

For motor and casualty programs with lower retention levels, rates decreased as a result of the continuing reduction in market loss frequency. Rates for upper layers have hardened in line with pricing from January 1 as injury award levels continue to rise.

Achieved reinsurance rate reductions have not been sufficient to balance the effect of significant original rate increases. As a result, insurers are facing increased premium spend.

Liability insurance rates are still flat as are reinsurance rates with an absence of major claims.

United States

Property catastrophe placement pricing remained in line with our April projections at flat to down 5 percent on a risk adjusted basis. Reinsurer capital remains stable and at adequate levels for insurers seeking additional capacity.

Demand remained stable for July renewals with the majority of companies electing to maintain similar programs to prior renewals.

Through April 1, overall per risk excess of loss pricing was down 5 to10 percent adjusted for exposure. Rates for June and July renewals were flat to down 5 percent, influenced to some extent by the large losses produced by the recent US tornado activity. Catastrophe peril coverage and loss experience continue to be the key elements driving price change for per risk programs. Retentions and capacity remained stable.

Specialty Lines Market Dynamics for June and July Renewals

General Casualty

Casualty excess of loss reinsurance program renewals saw flat to 2 percent reductions for rate change on treaties with good loss experience. Proportional renewals achieved flat to an increase of 1 percentage point in ceding commissions on treaties with good loss experience. There has also been some bundling of coverages previously reinsured separately. Also Aon Benfield has seen clients conflicted over whether to keep larger net retentions in order to retain more income versus buying more coverage as their direct business continues to be underpriced leading to increased loss ratio picks. Many portfolios, both new and existing, continue to operate at profitable levels and reinsurers are attempting to analyze business plans and support those clients that can demonstrate profit through actual loss experience and/or from a rating strategy that enables profit even in a challenging insurance market. Companies with actual experience continue to have an advantage in terms and conditions and new operations have faced greater difficulty in securing capacity from the highest quality reinsurers.

Workers' Compensation

The reinsurance marketplace for workers' compensation is still competitive with ample capacity. Reinsurers have started to look for rate increases on renewals as severity trends have pushed up technical pricing on some portfolios. June and July renewals for workers' compensation were flat to up 3 to 5 percent depending on the market and the loss experience of the client.

From the primary side we note pricing within the primary workers' compensation marketplace in recent months has been either leveling or increasing in most states and jurisdictions. Most notable are positive pricing changes within the state of California. Employers' payrolls are modestly improving after several years of significant declines. This change in exposures has resulted in a slight improvement in carriers' overall premium charges. The trend of overall indemnity loss frequency increases from 2010 has many carriers concerned over the future uncertainty of these changes and the potential impact on loss cost rate adequacy.

Accident, Health and Life

While the recent catastrophic events in Australia, New Zealand, Japan and the US tornados resulted in significant insured losses, generally Accident and Life catastrophe programs were unscathed due to large net retentions and other mitigating factors. Accordingly, most June 1 and July 1 renewals saw some rate reductions, though not to the same magnitude of prior years with the maximum relief in the low to mid-single digits. Additional capacity continues to flow into the market as reinsurers, most of whom are still over capitalized, seek to deploy their capital to maintain premium levels. Specifically, new markets are interested in growing their shares in Latin America to diversify exposures, particularly in Brazil, Mexico, and Columbia. Recent changes to catastrophe models have had little to no effect on the PMLs for

Accident and Life portfolios. Once again, absent any major catastrophic events, these pricing trends should remain intact in the near term.

D&O / E&O

During the first half of 2011 and into the July 1 renewal season, pricing for D&O and Professional Liability treaty reinsurance remained flat for portfolios that continue to perform profitably on an overall basis. Reinsurer margins on pro rata treaties were under pressure due to the underlying rate environment as reinsurers continue to evaluate ground up loss ratios. Underwriting terms and conditions have improved (i.e. expansion of classes of business covered, relaxation of certain treaty restrictions, etc) for those clients who were able to demonstrate a proven track record and outline opportunities for profitable expansion within a business plan.

Due to changes in certain reinsurance program structures and retentions during 2011, there is still opportunity for reinsurers to replace lost/declined business with new programs. We are beginning to see stronger interest from markets sitting on the sidelines of D&O reinsurance who may be attempting to enter now at what they view as a time when the market is nearing the end of prolonged softening. Treaties that are more structured in nature are receiving more favorable attention from reinsurers than those that are unlimited in nature and or more prone to systemic losses.

Into the later part of 2011 and beginning of 2012, we anticipate that reinsurers will continue to put pressure on carriers to scrutinize underlying rates unless there is an event that would trigger an overall change in the market. Unless carriers' results deteriorate from continued rate erosion and loss activity we expect reinsurers to continue their support at current economic terms.

Surety

The surety industry continued to produce better than expected results throughout the first half of 2011. However, the challenging construction economy has created significant anxiety as respects the future performance of surety. Contractor failures continue to rise modestly but many contractors are winding down their businesses in an orderly fashion due to limited project opportunity and have not caused serious issues for sureties. Primary writers of surety remain cautiously optimistic that they will be able to manage through this extended economic downturn without a material impact to their loss ratio.

Primary pricing, terms and conditions for Contract Surety remain consistent compared to last year. Commercial Surety however, is beginning to experience an erosion of terms and conditions due mainly to increased competition that has been attracted to that sector due to its favorable long-term results. Top line revenue for most primary companies has fallen over the last two years as limited spending for infrastructure improvements requires less surety bonds. Nonetheless, reinsurers remain attracted to this line of business. Treaty retention increases over the past few years have placed reinsurers in the position of avoiding the small frequency losses that have impacted the primary companies.

Reinsurers are acknowledging that exposure reductions have occurred due to shrinking backlogs and are reflecting this through modest rate reductions. While reinsurers recognize that notional exposure has generally decreased, they expect volatility to rise in the second half of 2011 and 2012 and therefore are reluctant to give full credit to the exposure reductions and historically favorable treaty results.

With regard to surety reinsurance, several of our late spring renewals continued the trend that was established at January 1; that being rate reductions of 5 to 10 percent for those programs that had performed favorably. Since fewer surety programs renew at July 1, drawing a definitive conclusion on pricing movement is more challenging but generally, it appeared that the rate of pricing reductions stabilized. This however, could be resulting from other factors including the specific experience, classes of business targeted or the sector of the marketplace where those sureties participated. Reinsurance capacity remains adequate and there are an increasing number of markets ready to enter the space if reinsurance pricing hardens.

Lawyers Professional Liability

The Lawyers Professional Liability insurance market is showing pockets (certain states and areas of practice) of increasing loss frequency and especially loss severity, driven in part by increasing loss adjustment expense. However, the insurance market is competitive and primary rate levels are generally flat.

Reinsurance pricing for June and July renewals was stable on an exposure and experience neutral basis. Reinsurance capacity continues to be plentiful in the U.S., London, Europe, and Bermuda.

Medical Professional Liability

The Medical Professional Liability insurance market is stable with continuing favorable results, soft pricing and significant competition. Medical Professional Liability insurers continue to release prior year loss reserves given better than expected loss frequency and moderate loss severity.

Reinsurance pricing for June and July renewals was flat to slightly decreasing (less than 5 percent). Reinsurance support remains strong from U.S., London, Europe, and Bermuda reinsurers, with increasing demand for catastrophe/contingency type reinsurance coverage and stable to decreasing demand for working layer cover.

U.S. Predicted Catastrophe Pricing: Second Half 2011

As desribed above, catastrophe price movements seen at the July 1 renewal were consistent with our predictions made in April. Few significant programs renew during the balance of the year and we expected the pricing of these programs to be flat to down 5 percent absent market changing catastrophe event.

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