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Reinsurance Market Outlook

June and July 2013 Update

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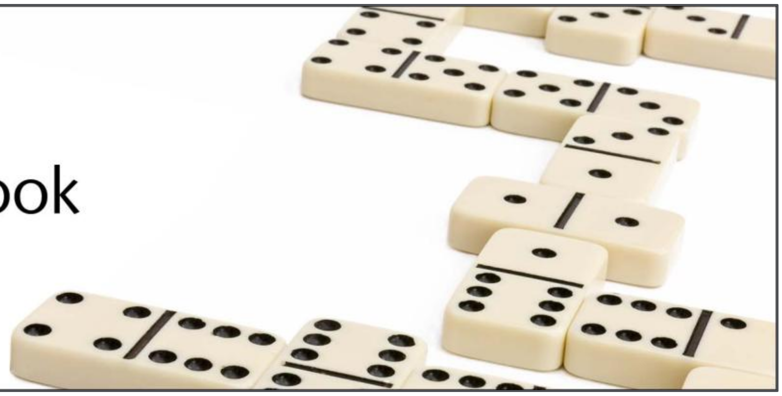


Executive Summary- Increasing Velocity of New Capital Flows Benefits Reinsurance Buyers

Driven by very low single digit expected returns in corporate and government bond markets, pension funds, family trusts, endowments and life insurers continued to allocate more funds to insurance-linked securities (ILS) and collateralized reinsurance ahead of the June 1 and July 1 reinsurance renewals. ILS pricing is down 40 percent since last June and July renewals, and new ILS issuance in the first half of 2013 was USD4.0 billion, the highest since 2007, with 13 bonds closing in the second quarter and several more expected to close in the coming weeks. Despite the decrease in ILS pricing, insurance risk still provides both attractive returns and diversification to these investors. Reinsurers have begun the process of incorporating these new capital flows into their capital structures and we expect the pace of these activities to increase.

June and July 2013 catastrophe reinsurance program renewals include many U.S. hurricane catastrophe exposed insurers, most Australia / New Zealand exposed insurers, many Asia ex-Japan exposed insurers, and a meaningful component of Latin American exposed insurers. Reinsurance demand for these renewals generally remained flat, and the traditional reinsurance capital grew to USD515 billion by the end of the first quarter 2013. Even where alternative market capacity was not deployed, the traditional reinsurance market responded to the competition to drive meaningful value for cedents. Relationships and continuity continue to be highly valued by cedents and leading reinsurers are taking positive actions to lower their costs of managing assumed volatility.

New Opportunities Now Available

Macroeconomic dynamics indicate that the new price points available from the ILS and collateralized will continue. Broader access to ILS and collateralized markets, along with stronger support of traditional reinsurers, may provide options for managing catastrophe risks to be attained at multiple year terms well inside the cedent's cost of equity capital.

With rating agency models and slow demand growth causing insurers and reinsurers to take less risk per unit of capital than ever before, the ILS and collateralized markets have proven to be competitive with traditional reinsurance in peak zones. Insurers will consider their ability to use this capacity to be less restrictive on growth in catastrophe exposed zones. With greater competition for assumption of catastrophe risk, reinsurers will also increase their appetite for non-catastrophe risk, potentially allowing insurers to add new product features using reinsurer capacity.

We continue to anticipate that insurers and reinsurers will find additional innovative ways to use the ILS and collateralized markets, including securitizations of complex commercial property, commercial liability and other new risks. Insurers will closely examine potentially diversifying coverage options and use the increased capacity to compete and grow.

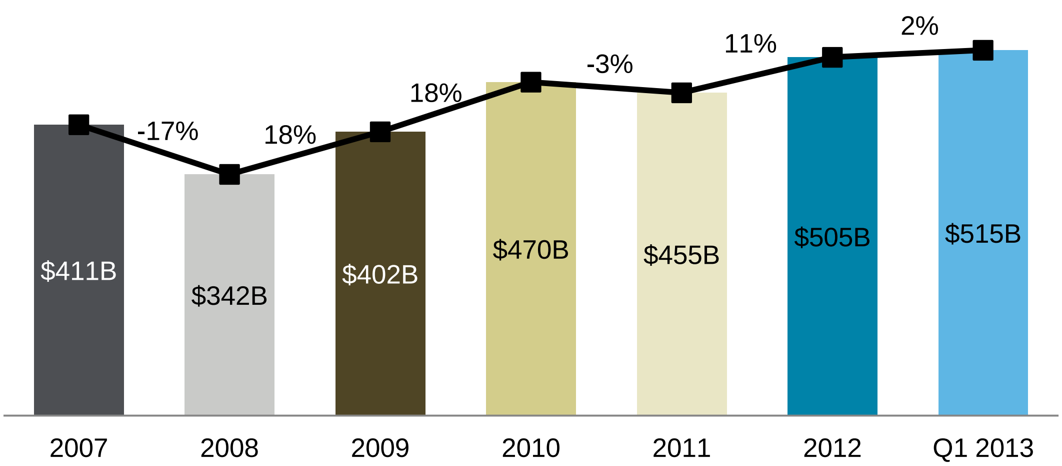
Note: This reinsurance market outlook report should be read in conjunction with our firm's views on rate on line, capacity and retention changes for each cedent's market. Our professionals are prepared to discuss variations from our market sector outlook that apply to individual programs due to established trading relationships, capacity needs, loss experience, exposure management, data quality, model fitness, expiring margins and other factors that may cause variations from our reinsurance market outlook.

Supply and Demand

Reinsurer capital reached a new peak level at the end of Q1 2013, up 2 percent since year end 2012 to USD515 billion. While demand remained stable, there is increased pressure from alternative market capacity that continues to evolve to meet insurer demands at attractive rates. The shift in the market further towards ILS transactions in recent months will leave those reinsurers that have not started to manage third party capital struggling to react.

Supply remains abundant in all global regions.

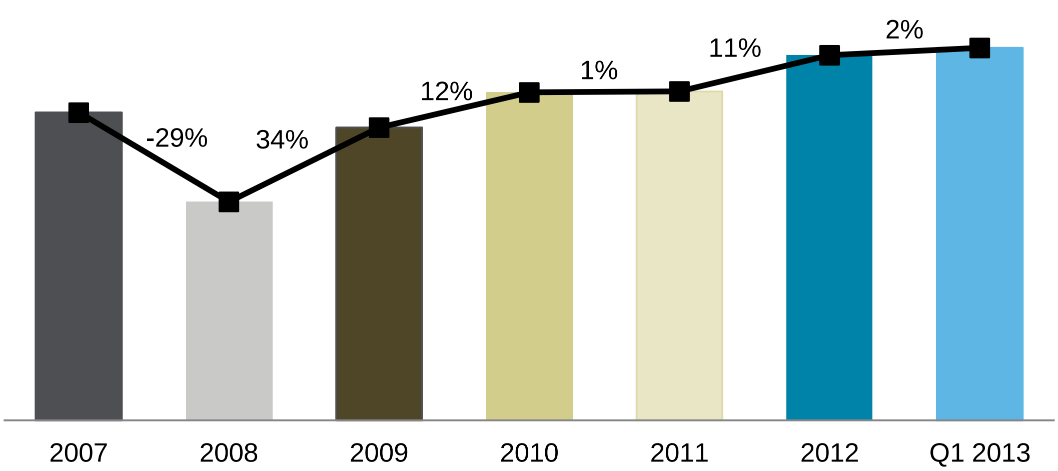
Exhibit 1: Change in Reinsurer Capital



Source: Individual company reports, Aon Benfield Analytics

Continued lower catastrophe losses and higher primary premiums have resulted in growth in insurer capital in Q1 2013, increasing 2 percent from year end 2012.

Exhibit 2: Change in Insurer Capital

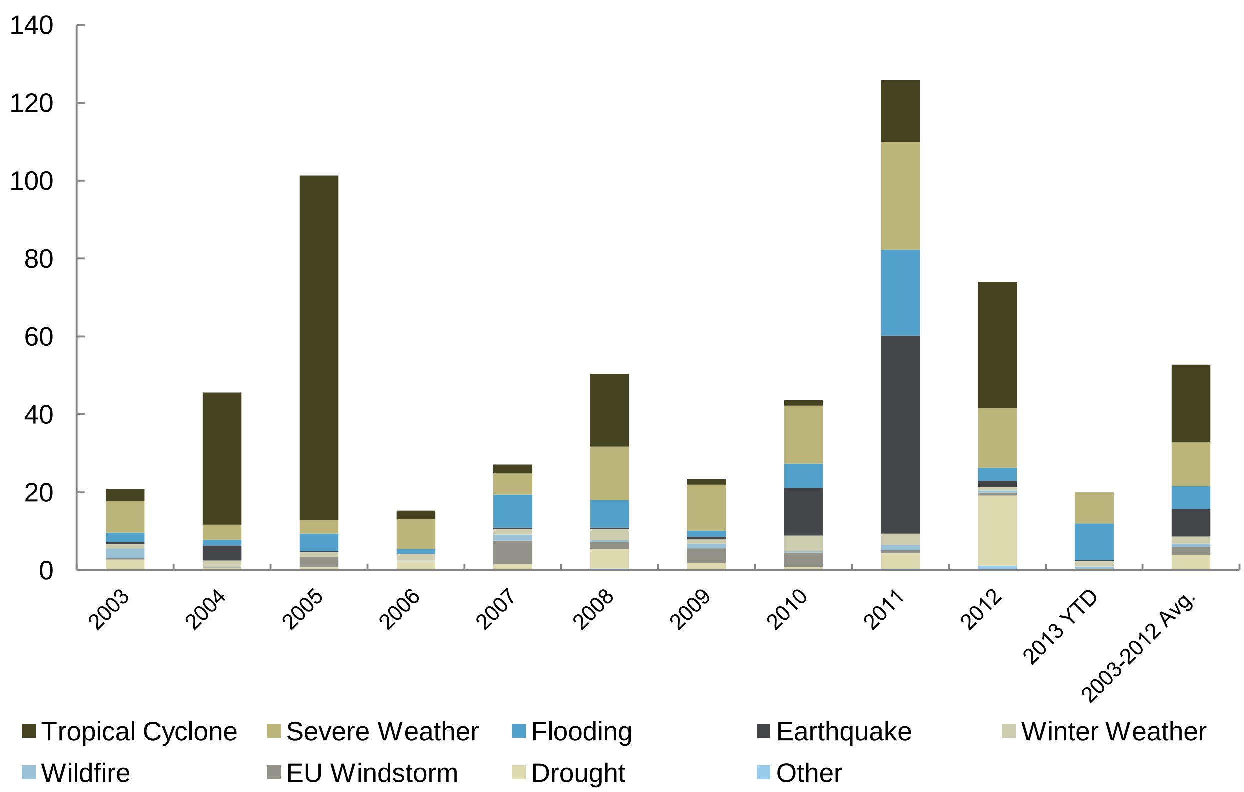


Source: Individual company reports, Aon Benfield Analytics

Insured Catastrophe Losses Lower than Average Through Q2

Following two years of above average catastrophe loss activity, 2013 insured losses to date on a global scale are slightly below the longer term 2003 to 2012 norm. Catastrophe events have resulted in approximately USD20 billion insured losses for 2013 compared to a half year average of approximately USD22.8 billion over the prior ten years. By comparison, global loss activity through Q2 in 2011 had produced more than four times the losses experienced this year. While flood losses in 2013 of almost USD9.5 billion already surpass the annual average largely as a result of the losses experienced in Central Europe in May/June and Canada's Alberta province in June, insured loss emanating from severe weather for 2013 of USD8.0 billion remain close to the prior ten year average of approximately USD8.7 billion.

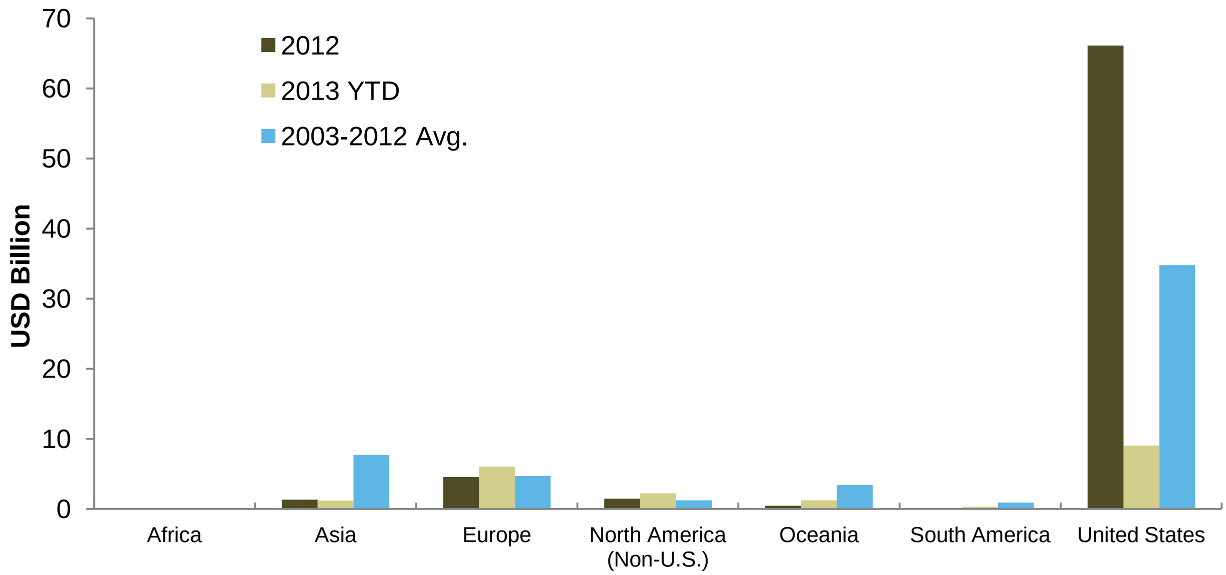
Exhibit 3: Annual Insured Losses By Event Type (USD Billions)



Source: Aon Benfield Analytics

Following two years with significant severe weather and drought in the U.S., mid-year losses for 2013 of USD9.0 billion are roughly 30 percent of the total losses sustained in the same period in 2011, 40 percent of the losses in 2012 and comparable to the prior ten year average of USD9.0 billion. By contrast, losses in Europe to date of USD6.0 billion are nearly double the insured losses for the same period in 2012 and have already surpassed the annual 2012 (USD4.6 billion) and ten year average (USD4.7 billion).

Exhibit 4: Annual Insured Losses By Region (USD Billions)



Source: Aon Benfield Analytics

Central Europe Floods Update

The costliest insured event thus far in 2013 was the massive flood event that swept across much of Central Europe. The floods, which were the worst European flood event since 2002, left at least 23 people dead. The floods were caused by extensive rainfall across Central Europe in late May and early June due to a series of low pressure systems that slowly tracked across the region. Many locations recorded multiple months' worth of rainfall in just 48 hours, which fell on already saturated soils. Some areas recorded 1-in-100 year rain amounts. This caused excessive run-off and a quick rise of most major rivers in the region.

The most significant damage was experienced in Germany after the Elbe and Danube rivers (along with their tributaries) overflowed their banks. One of the hardest-hit towns in Germany was Passau, where floodwaters were the highest since 1501. Other cities to sustain damage included Deggendorf, Halle, Eilenburg, Magdeburg, Chemnitz, Wittenberg and Rosenheim.

Flooding in Germany (Source: Euroluftbild)

Elsewhere, flood damage was prevalent in the Czech Republic, Slovakia, Austria, Switzerland, Poland and Hungary.

Based on current estimates, the overall economic loss is tentatively listed at up to EUR17 billion (USD22 billion). The insurance impact will be much less, with losses expected to reach as much as EUR4.0 billion (USD5.3 billion). Most of the losses were sustained in Germany, with economic and insured totals estimated to be at least EUR12 billion (USD16 billion) and EUR3.0 billion (USD4.0 billion) respectively.

U.S. Convective Storm Loss Update

Severe thunderstorm activity in the United States during the first half of 2013 was notable for its exceptionally quiet start and very busy finish. Specifically in terms of tornado activity, the majority of the focus was centered on severe weather outbreaks in late May that spawned the first EF-5 tornado touchdowns in the U.S. since May 2011.

Convective storm losses – defined as losses sustained from tornadoes, hail or straight-line winds – on an economic and insured basis were on par to their recent 10-year (2003 to 2012) Q1/Q2 non-inflated averages. According to data from Aon Benfield's Impact Forecasting division, preliminary economic losses are USD12.6 billion and insured losses are USD7.3 billion. This compares to the non-inflated 10-year averages of USD13.1 billion (economic) and USD8.1 billion (insured). However, it should be noted that the 2013 insured loss totals are well below the Q1/Q2 losses sustained in 2011 (USD24 billion) and 2012 (USD13 billion).

The most significant losses occurred during a multi-day stretch (May 18 to 22) that was highlighted by an EF-5 tornado that caused catastrophic damage in Moore, Oklahoma along its 17.0 mile (27.0 kilometer) path. The May 20 tornado, which had up to 210 mph (340 kph) winds, damaged or destroyed as many as 13,000 homes and other structures and was directly responsible for 23 fatalities. The Oklahoma Insurance Department estimated that claims payouts attributable to the tornado could approach USD2.0 billion. This would put the Moore tornado at the same level as the USD2.0 billion insured loss sustained during the May 2011 Joplin, Missouri EF-5 event, which remains the costliest single tornado in U.S. history.

Moore, Oklahoma (Source: Impact Forecasting)

El Reno, Oklahoma (Source: Impact Forecasting)

Only days later, another multi-day severe weather outbreak swept across central and eastern sections of the U.S. (May 26-June 2). The stretch was again highlighted by an EF-5 tornado that touched down in El Reno, Oklahoma on May 31, and only several miles (kilometers) west of where the EF-5 tornado occurred in Moore 11 days prior. The National Weather Service determined that the El Reno tornado had maximum winds of 295 mph (475 kph) – the second highest wind speed ever recorded – and a U.S. record 2.6-mile (4.2-kilometer) width. Eight people were killed, including several professional storm chasers. Damage, while major, was not extensive due to the tornado's 16.2-mile (26.1-kilometer) track through a mostly rural area. Other notable U.S. non-tornadic storms during the first half of 2013 that caused large insured losses included a billion-dollar hail event in the Southeast (March 18-20), a major hailstorm in Amarillo, Texas (May 28), and a derecho that tracked from the Great Lakes to the Eastern Seaboard (June 12-13).

Despite recent activity, data from the Storm Prediction Center indicates that the overall number of U.S. tornadoes in 2013 remains well below average and under the 25th percentile of years dating to 1954.

Forecasters Predict Above Normal Atlantic Hurricane Activity

The three main hurricane season prognosticators (National Oceanic and Atmospheric Administration (NOAA), Colorado State University (CSU) and Tropical Storm Risk (TSR)) have all forecast above normal hurricane activity for the 2013 Atlantic Hurricane Season. Each agency cites several factors as to why an active season is anticipated, most notably due to above average sea surface temperatures in the main development region of the Atlantic Ocean and weaker than normal wind shear in the upper levels of the atmosphere. The development of an El Niño phase of ENSO also seems unlikely, which typically correlates to less tropical cyclone activity in the Atlantic. ENSO-neutral conditions are expected to last through the peak development months of August and September.

The figure below shows the latest TSR, CSU and NOAA forecasts. The table shows a comparison of each group's climatological average to their forecast for 2013.

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

	Named Storms	Hurricanes	Major Hurricanes
TSR (June 2013)			
Average	10.8	6.3	2.7
2013	15.6	7.7	3.5
Difference	+4.8	+1.4	+0.8
CSU (June 2013)			
Median	12	6.5	2
2013	18	9	4
Difference	+6.0	+2.5	+2.0
NOAA (May 2013)			
Average	12	6	3
2013	13 – 20	7 – 11	3 – 6
Difference	+4.5	+3.0	+1.5

Source: TSR, CSU and NOAA

Rating Agency Update

The rating agencies continue to be active in fine-tuning their criteria and approach, which impacts how insurers manage capital and reinsurance decisions. A.M. Best updated their capital adequacy model (BCAR) which included lowering the imbedded discount rate on reserves from 5 percent to 4 percent and adding a new risk charge related to post-retirement and pension fund obligations. We estimated these changes lowered the U.S. industry BCAR by nine points or USD22.9 billion of industry capital. More recently, A.M. Best eliminated its haircut on Florida Hurricane Catastrophe Fund (FHCF) reinsurance when determining a company's 100 year net PML risk charge. Previously, A.M. Best applied a 5 percent haircut to FHCF recoveries.

For Florida Homeowners specialists, Demotech is the rating agency which drives reinsurance buying decisions for most. In addition to standard annual and quarterly financial reviews, Demotech conducts a specific review related to a company's reinsurance program through analysis of their "Exhibit A" filing, which was due June 14, 2013 and requires companies to disclose gross and net catastrophe losses at various return periods and under three different modeling assumptions. Demotech requires companies to purchase reinsurance protection up to at least the 100 year long-term basis including demand surge / loss amplification and expects the reinsurance program to support a 1 in 60 year second event.

Standard & Poor's (S&P) recently released their new insurance rating criteria in which some of the key components are highly influenced by reinsurance and capital management decisions. Some of the key areas of the criteria focus on an insurer's capital and earnings, risk position, and ERM. Capital and earnings are the base for determining an insurer's financial risk profile (FRP), with an analysis of an insurer's risk position influencing the FRP assessment. In the new criteria, an insurer's ERM assessment can move the rating up one notch or lower the rating by one or more notches.

Second Quarter 2013 Catastrophe Bond Transaction Review

New issuance for the first half of 2013 was just under USD4.0 billion, the highest level since 2007. USD17.5 billion of total limit was outstanding as of June 30, 2013. Thirteen cat bonds closed during the second quarter, with several additional transactions expected to close in the coming weeks. Strong demand has continued since the first quarter such that transactions continue to be marketed into the start of hurricane season.

Market pricing conditions continued the downward shift from earlier in the year, stabilizing by the end of the quarter. ILS pricing is down 30 percent since the fourth quarter of 2012. The catastrophe bond market consistently continued to offer more aggressive pricing than the traditional reinsurance market. Although new issuance in the second quarter included predominantly repeat sponsors, including United Services Automobile Association (USAA), The Travelers Indemnity Company (Travelers) and Assurant, we expect new sponsors will continue to enter the ILS sector. A broad array of coverage was offered during the quarter including regional earthquake and hurricane, Turkey earthquake and Australia cyclone, as well as U.S. nationwide multi-peril.

American Coastal Insurance Company (American Coastal) entered the market for the first time and secured USD183 million in Florida hurricane capacity via Armor Re Ltd.

In April, Allstate Insurance Company (Allstate) returned to the market for the first time since 2008 with Sanders Re Ltd. Allstate successfully secured USD350 million in industry index coverage against hurricanes and earthquakes across two classes. The Class A notes closed with a spread of 3.50 percent, the lowest spread seen in five years for U.S. hurricane risk.

The table below summarizes the terms of the deals that closed during the second quarter:

Beneficiary	Issuer	Series	Class	Size (millions)	Covered Perils	Trigger	Rating	Expected Loss[1]	Interest Spread
State Farm Fire and Casualty Company	Merna Re IV Ltd.			$300	New Madrid EQ	Indemnity	Not Rated	0.40%	2.50%
Nationwide Mutual Insurance Company	Caelus Re 2013 Limited	Series 2013-2	Class A	$320	US HU, EQ	Indemnity	Not Rated	1.98%	6.85%
North Carolina JUA/IUA	Tar Heel Re Ltd.	Series 2013-1	Class A	$500	NC HU	Indemnity	B+	2.77%	8.50%
Turkish Catastrophe Insurance Pool	Bosphorus 1 Re Ltd.	Series 2013-1	Class A	$400	Turkey EQ	Parametric Index	BB+	1.01%	2.50%
Allstate	Sanders Re Ltd.	Series 2013-1	Class A	$200	US HU, EQ	Industry Index	BB+	0.95%	3.50%
			Class B	$150			BB	1.22%	4.00%
Louisiana Citizens Property Insurance Company	Pelican Re Ltd.	Series 2013-1	Class A	$140	LA HU	Indemnity	Not Rated	2.05%	6.00%
American Coastal	Armor Re Ltd.	Series 2013-1	Class A	$183	FL HU	Indemnity	BB+	0.40%	4.25%
Travelers	Long Point Re III Ltd.	Series 2013-1	Class A	$300	Northeast HU	Indemnity	BB	1.24%	4.00%
Allianz Argos 14 GmbH	Blue Danube II Ltd.	Series 2013-1	Class A	$175	US, CB, MX HU & US, CAN EQ	Industry Index	BB+	0.96%	4.25%
USAA	Residential Reinsurance 2013 Limited	Series 2013-1	Class 3	$95	US HU, EQ, ST, WS, CAL WF	Indemnity	B-	3.68%	9.25%
			Class 11	$205		Indemnity	Not Rated	2.60%	8.00%
Munich Re	Queen Street VIII Re Limited			$75	US HU, AUS CY	Industry Index, Modeled Loss	Not Rated	2.90%	6.50%
Assurant Inc.	Ibis Re II Ltd.	Series 2013-1	Class A	$110	US HU	Industry Index	BB+	0.85%	4.00%
			Class B	$35			BB-	1.53%	4.50%
			Class C	$40			B	3.36%	8.00%
Amlin AG	Tramline Re II Ltd.	Series 2013-1	Class A	$75	US & CAN EQ	Industry Index	Not Rated	1.21%	3.25%
Total Closed During Q2				**$3,303**					

Source: Aon Benfield Securities, Inc.

[1] Modeled expected losses for the first annual risk period, with warm sea surface temperature results for hurricane risks

Strong issuance volumes are expected to continue for the second half of the year, with an estimated total USD7 - 8 billion in new issuance expected for 2013.

The aggressiveness of the catastrophe bond market was further highlighted by Everglades Re Ltd., sponsored by Citizens Property Insurance Corporation (Florida Citizens). Following their initial issuance in 2012, Florida Citizens returned to the market seeking indemnity coverage and secured interest spreads far below those offered in the traditional markets for Florida hurricane exposure.

In March, State Farm Fire and Casualty Company (State Farm) returned to the catastrophe bond market seeking coverage to replace the maturing Merna Reinsurance II Ltd., which provided indemnity coverage against earthquake occurring in the New Madrid region. State Farm secured USD300 million in capacity via Merna Re IV Ltd., which was several times oversubscribed. The transaction closed with an interest spread of 2.50 percent, which is the lowest threshold for minimum spreads in five years.

Strong issuance volumes are expected to continue leading up to hurricane season, with an estimated USD4 billion expected to close.

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