Reinsurance Market Outlook

Post Convergence – The Next USD100 Billion

September 2013

Empower Results®

Contents

Executive Summary—Post Convergence: The Next USD100 Billion

Insurers and reinsurers will benefit from the next, and much more transformative, USD100 billion of alternative capital that will enter the reinsurance business over the next five years. The value proposition of reinsurance will improve as the cost of underwriting capital is reduced for reinsurers. The post-convergence market brings unlevered collateralized products that are more accretive to insurers than traditional reinsurance for peak risks.

Reinsurers in the post-convergence market will innovate their capital structures to incorporate the additional USD100 billion of alternative capital flows. Reinsurers will engage in three broad categories of transactions with investors: (a) insurance-linked securities (ILS or catastrophe bonds) to lower the cost of underwriting capital supporting peak tail risks; (b) sidecars to lower the cost of underwriting capital across the portfolio risk spectrum and (c) formation of asset management divisions that will allow reinsurers the opportunity to accept asset management mandates from investors.

Our compilation of reinsurance industry capital which now stands at USD510 billion has included all traditional measures of equity capital deployed in the business by reinsurers as well as important government reinsurance facilities. While we test the predictiveness of reinsurer capital as a univariate in our reinsurance pricing model, we suspect that its predictive value is in decline. The influence of lower yields—ushering substantially more, but harder to measure, capital to reinsurance risk taking is very meaningful.

The benefits of this new capital will begin to extend beyond property catastrophe and mortality risks that are common features of the current ILS market and extend into many other reinsurance lines where loss frequency and severity are more predictable.

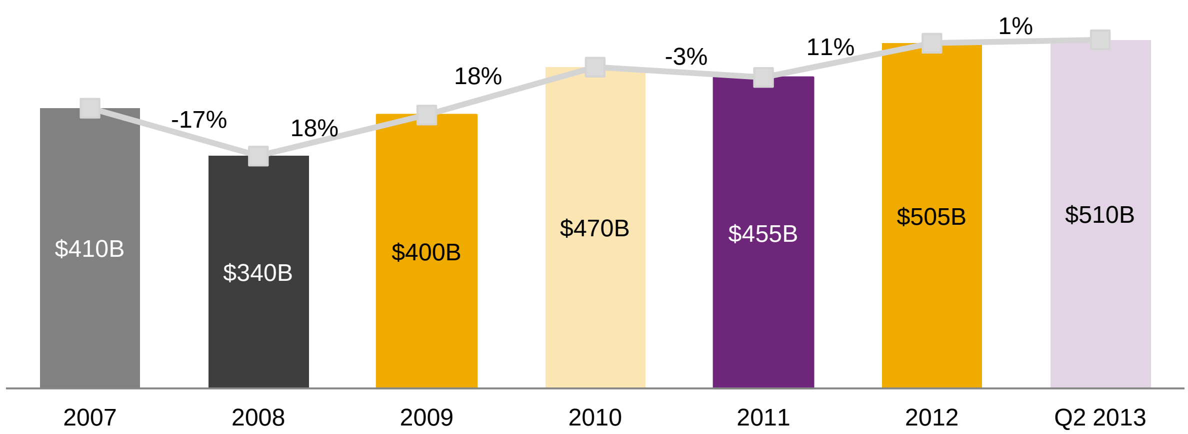
The January 1 renewal market for our clients will benefit materially from an excess of traditional reinsurance capacity and new alternative capital flows over light demand growth for reinsurance capacity. Therefore, our clients should expect to benefit from a competitive market even if a moderate hurricane season should develop.

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.

New Capital Horizon For Reinsurers

Reinsurer capital (including traditional and non-traditional markets) declined slightly from Q1 2013, but remains up 1 percent compared to year end 2012. Higher net income from low catastrophe loss and positive operating performance for reinsurers has been stemmed by the unwinding of unrealized investment gains on bond portfolios when interest rates jumped towards the end of the period. Capacity has been augmented by a steady influx of capital from non-traditional sources providing cedents with additional markets for their reinsurance and traditional reinsurers have moved to embrace these new techniques and sources of funding.

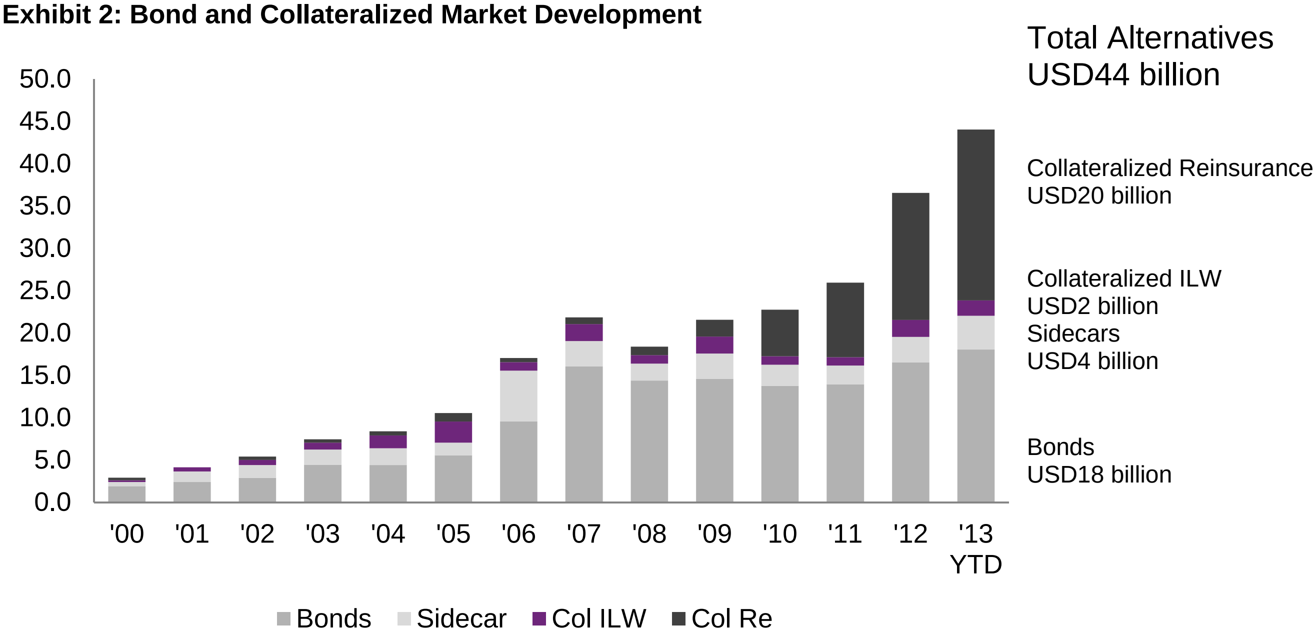
Exhibit 1: Change in Global Reinsurer Capital



Source: Individual company reports, Aon Benfield Analytics

To incorporate the additional alternative capital investments, reinsurers will almost certainly engage with investors in three categories of transactions. While insurance-linked securities or catastrophe bonds have played a role in the industry historically, especially for large peak zone writers, insurers are becoming increasingly aware of the competitive rates offered by these products and more familiar with their terms. The market has expanded rapidly with new entrants and new coverages and these trends are expected to continue. Sidecars are also likely to remain an important source of alternative capacity which can serve to reduce reinsurers' cost of capital. Exhibit 2 shows the most significant movement for reinsurers will likely come in the form of asset management. Aon Benfield estimates that approximately USD44 billion of the capital in the market today is coming in these three components and significant additional capital inflows are expected.

Exhibit 2: Bond and Collateralized Market Development

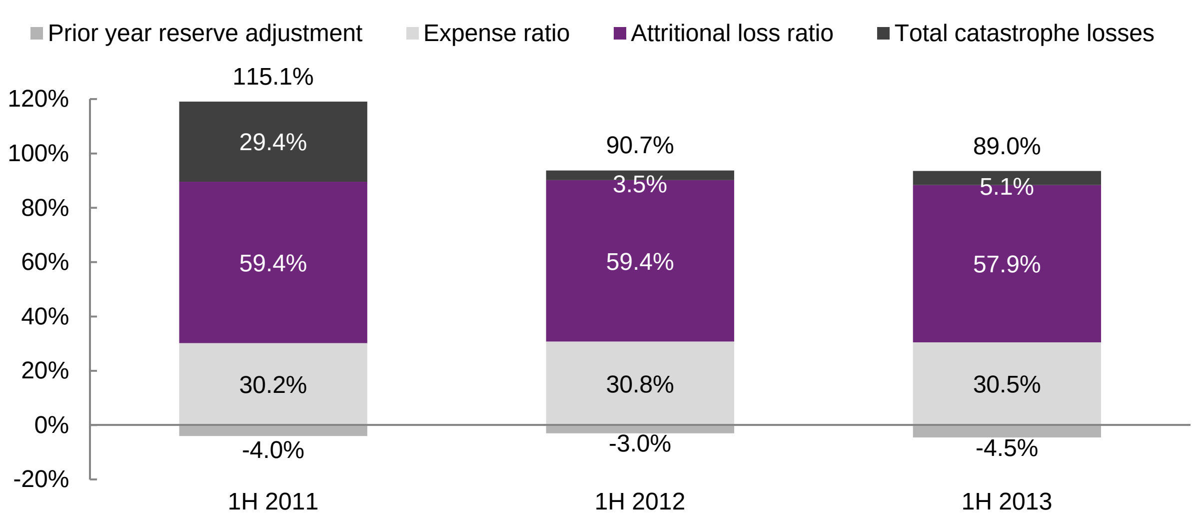


Source: Aon Benfield Analytics

Reinsurer Financial Results

Despite lower catastrophe loss activity for the industry, the combined ratio impact to reinsurers of these events increased from 3.5 to 5.1 percent for the first half of 2013. For the Aon Benfield Aggregate group of reinsurers, the net cost of catastrophe losses increased by 55 percent reflecting higher cessions to the reinsurance market. Nevertheless, the overall combined ratio was down 1.7 percentage points as a result of a lower attritional loss ratio, higher premium leverage and increased prior year reserve releases.

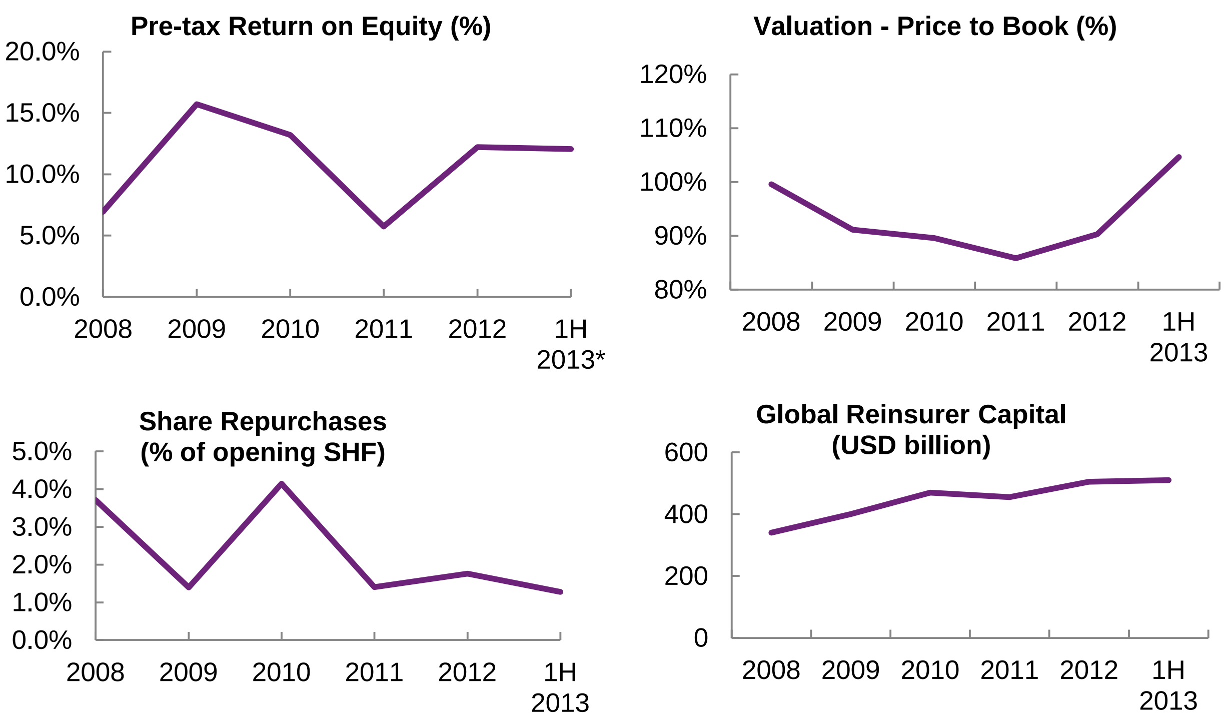
Exhibit 3: Aon Benfield Aggregate Combined Ratios



Source: Individual company reports, Aon Benfield Analytics

For the Aon Benfield Aggregate set of reinsurers, annualized pre-tax ROE was in line with 2012 at 12 percent. Share repurchases increased slightly at year end 2012 (1.3 percent compared to 0.9 percent at 1H 2012). While 1H 2013 seems in line with the prior mid-year figure, continued low catastrophe loss activity may result in oversupply causing further repurchases at the end of 2013. Valuations of the group have increased dramatically since a low in 2011.

Exhibit 4: Aon Benfield Aggregate Reinsurer Capital, ROE, Share Repurchase, and Valuation



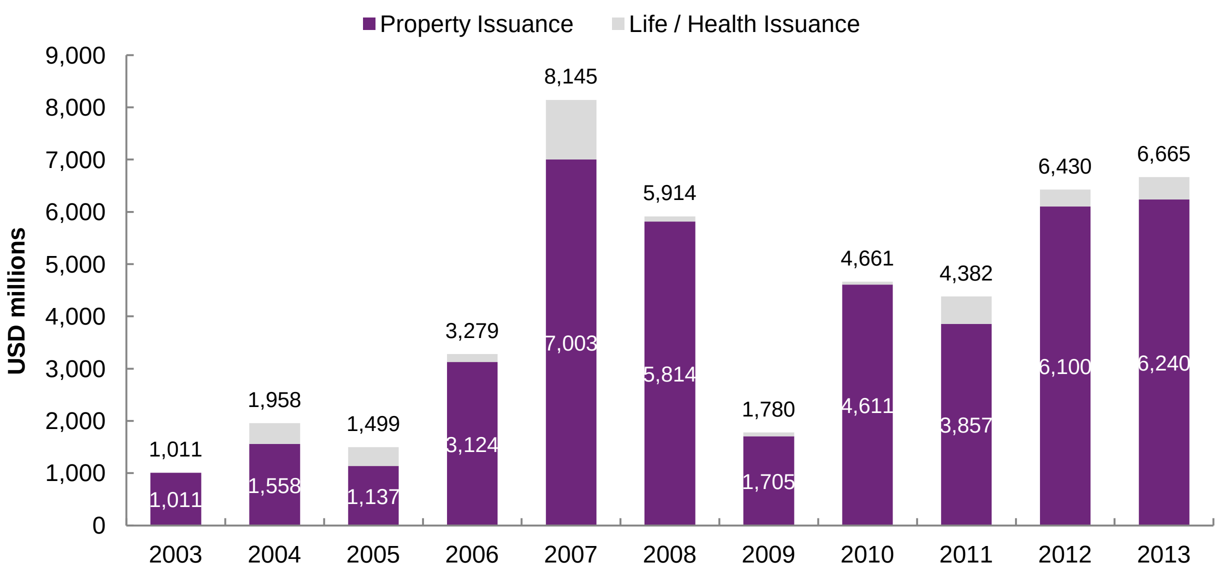
Note: ROE, share repurchases and price/book charts relate to the Aon Benfield Aggregate group of companies
Source: Individual company reports, Aon Benfield Analytics

Aon Benfield Securities' Annual Review of the Catastrophe Bond Market

The 12 months ending June 30, 2013 was a dynamic period for the ILS market. Large investor inflows, from both new and existing participants, drove declining spreads which in turn sparked increasing sponsor interest.

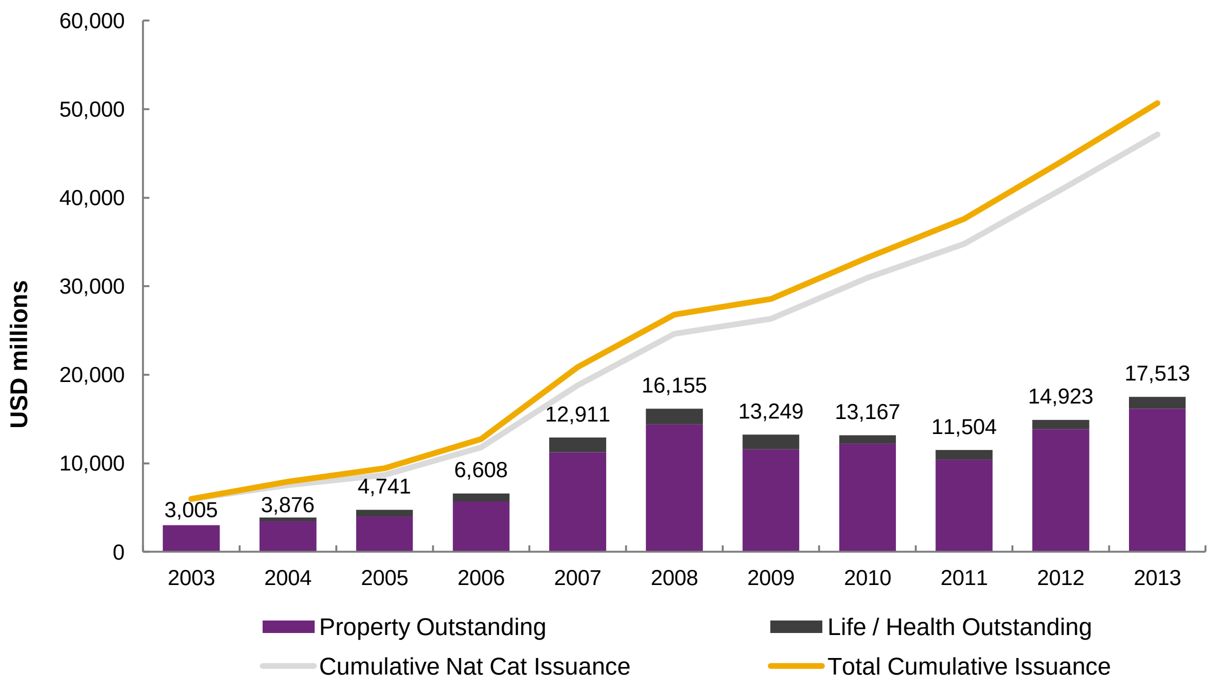
As of June 30, annual issuance volume reached USD6.7 billion (Exhibit 5), and total bonds on risk were at an all-time high of USD17.5 billion (Exhibit 6), an increase of USD2.6 billion from the previous year and surpassing the previous record of USD16.2 billion at June 30, 2008.

Exhibit 5: Catastrophe Bond Issuance by Year (Years ending June 30)



Source: Aon Benfield Securities, Inc.

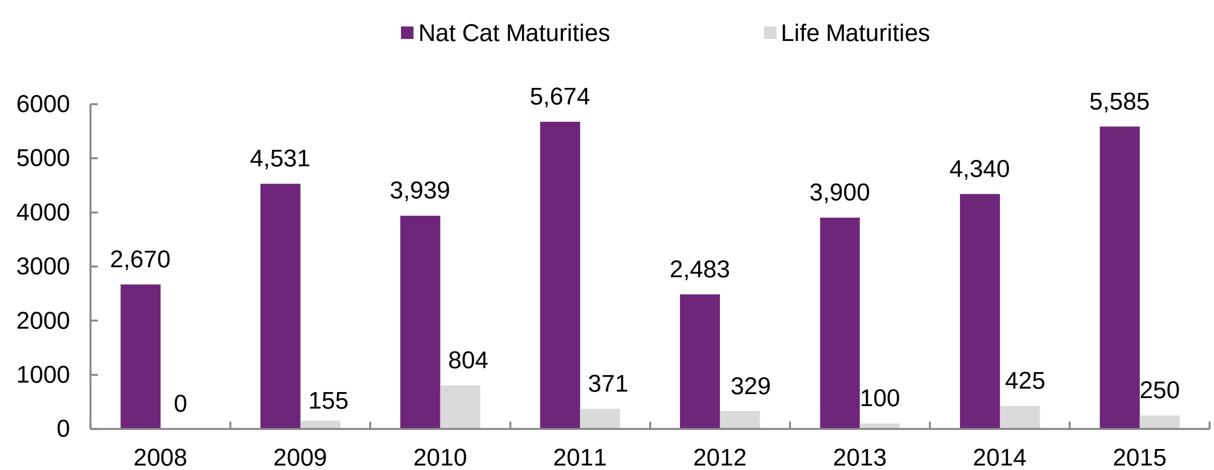
Exhibit 6: Outstanding and Cumulative Catastrophe Bond Volume, 2003 – 2013 (Years ending June 30)



Source: Aon Benfield Securities, Inc.

The new record level of catastrophe bonds on risk highlights the recent expansion of the ILS market. An increasing number of bonds will mature over the next two years due to the increase in issuance following the global financial crisis. Aon Benfield Securities forecasts that the market expansion will continue, as new issuance volumes are expected to outweigh maturities in the coming years.

Exhibit 7: Catastrophe Bonds Maturing by Year (Years ending June 30)



Source: Aon Benfield Securities, Inc.

Key Market Drivers

Supply and Demand

In the 18 months ending June 30, 2013, there were large capital inflows across the ILS sector from both existing and new investors. Since January 2012, an estimated USD5 to USD6 billion in new capital has entered the market, with around USD3 billion flowing into the market in the last six months. This additional capital has created strong demand from investors for new issuance. In 2013, sponsors began benefiting from this demand, with transactions often closing at spreads below the rates expected in the traditional reinsurance markets. Spreads were down between 30 and 45 percent in the first half of 2013, compared to the fourth quarter of 2012. This spurred a very active period of issuance for the first half of 2013, which continued well into the third quarter. Investors kept pace with the primary activity, even during periods where many transactions were on offer simultaneously.

Enhanced Coverage

Indemnity issuances continued to be an important component of the catastrophe bond market, comprising 13 of the 27 issuances that closed in the year ending June 30, 2013. A number of sponsors securing U.S. hurricane coverage also locked in capacity for longer than the typical three years. These included Nationwide Mutual Insurance Company (Nationwide Mutual), Allstate Insurance Company (Allstate), Louisiana Citizens Property Insurance Company (Louisiana Citizens) and Amlin AG, which all secured coverage for four years.

American International Group (AIG) successfully moved to an indemnity trigger, following several industry index transactions. The ground-breaking indemnity transaction, which includes commercial property and energy risks, provides AIG with coverage for five years.

Benign Loss Activity

There was no loss activity that resulted in catastrophe bond payouts for the 12 months ending June 30, 2013. Superstorm Sandy, which made landfall in the United States on October 29, 2012, gained significant attention due to the amount of Northeast exposure in the ILS market. As losses were reported over the following months, and as Property Claim Services' (PCS) estimate of the total industry insured property losses stabilized, it became clear that Sandy was unlikely to trigger any catastrophe bond payouts.

Transaction Review

Twenty seven transactions (including three deals covering life and health risks) closed during the 12-month period ending June 30, 2013. The average transaction size increased to USD247 million for this period, compared to USD211 million for the 12-month period ending June 30, 2012.

U.S. hurricane risk continued to be the main peril ceded to the ILS market, and comprised around two-thirds of notional limit issued over the 12 months. The contribution to expected modeled loss from U.S. hurricane risk for new property catastrophe issuances increased from 51 percent for the year ending June 30, 2012 to 56 percent for the same period in 2013. By comparison, the contribution from European windstorms decreased from 17 percent to 6 percent in the same timeframe. The contribution to expected modeled loss from U.S. earthquakes increased slightly from 20 percent to 23 percent. Meanwhile, life and health issuance activity contributed USD545 million of issuance across three transactions. This includes one class of notes from Mythen Re Ltd. Series 2012-2 (Mythen Re 2012-2), which provides Swiss Reinsurance Company Ltd. (Swiss Re) with coverage for both UK extreme mortality and U.S. hurricanes.

Third Quarter 2012

Four transactions totaling USD804 million closed during the third quarter of 2012. The issuances offered investors a diverse selection of perils including European windstorm, California earthquake, Japan typhoon and extreme mortality.

Transactions issued in the third quarter of 2012 include:

- Embarcadero Reinsurance Ltd., sponsored by the California Earthquake Authority (CEA), provides indemnity coverage on an annual aggregate basis. The transaction was upsized to USD300 million, providing the CEA with USD600 million of total capacity from cat bonds; and

- Eurus III Ltd, sponsored by Hannover Rückversicherung AG (Hannover Re) provides euro100 million (USD129 million) coverage against Europe windstorms for four seasons on an industry index basis. The transaction utilized European Bank for Reconstruction and Development (EBRD) notes as collateral, which provide an investment yield of 3M Euribor less 38 basis points.

Exhibit 8: Third Quarter 2012 Catastrophe Bond Issuance

Beneficiary	Issuer	Series	Class	Size (millions)	Covered Perils	Trigger	Collateral
Munich Re	Queen Street VI Re Limited			$100.0	US HU, EU Wind	Industry Index	MMF
Swiss Reinsurance Company	Vita Capital V Ltd.	Series 2012-I	Class D-1	$125.0	AUS, CAN Mortality	Industry Index	IBRD Notes
			Class E-1	$150.0	AUS, CAN, US Mortality		
California Earthquake Authority	Embarcadero Reinsurance Ltd.	Series 2012-II	Class A	$300.0	CAL EQ	Indemnity	MMF
Hannover Rückversicherung AG	Eurus III Ltd.	Series 2012-1	Class A	€100.0*[1]	EU Wind	Industry Index	EBRD Notes
Total Closed During Q3 2012				**$804.1**			

Source: Aon Benfield Securities, Inc.

Legend

AUS – Australia
CAL – California
CAN – Canada
EU – Europe
US – United States
EQ – Earthquake
HU – Hurricane

Historically, the third quarter has been characterized by light issuance volumes. In the past couple of years, however, issuance volumes for the third quarter have increased; and this trend has continued in 2013.

[1] Converted at $1.29 = €1.00 as of September 23, 2012

Fourth Quarter 2012

Seven transactions closed in the fourth quarter of 2012, totaling USD1.9 billion. New issuances were sourced solely from repeat sponsors and included the following transactions:

- MultiCat Mexico Limited Series 2012-I, the second issuance from the existing program, provides USD315 million in protection for The Fund for Natural Disasters on a parametric basis. The three classes of notes provide coverage against Mexico earthquakes as well as hurricanes from the Pacific and Atlantic.

- Compass Re Ltd. Series 2012-1 provides National Union Fire Insurance Company of Pittsburgh (AIG) with USD400 million in coverage against hurricanes and earthquakes on an industry index basis. The transaction was not initially broadly marketed, but is tradable in the secondary market.

Exhibit 9: Fourth Quarter 2012 Catastrophe Bond Issuance

Beneficiary	Issuer	Series	Class	Size (millions)	Covered Perils	Trigger	Collateral
The Fund for Natural Disasters	MultiCat Mexico Limited	Series 2012-I	Class A	$140.0	MX EQ	Parametric	MMF
			Class B	$75.0	MX HU		
			Class C	$100.0	MX HU		
Munich Re	Queen Street VII Re Limited			$75.0	US HU, EU Wind	Industry Index	MMF
SCOR	Atlas Reinsurance VII Limited		Class A	$60.0	US HU, EQ	Industry Index	EBRD Notes
			Class B	€130.0[2]	EU Wind		
Swiss Reinsurance Company	Mythen Re Ltd.	Series 2012-2	Class A	$120.0	US HU, UK Mortality	Industry Index	IBRD Notes
			Class C	$80.0	US HU		
United Services Automobile Association	Residential Reinsurance 2012 Limited	Series 2012-II	Class 1	$155.0	US HU, EQ, ST, WS, CAL WF	Indemnity	MMF
			Class 2	$70.0			
			Class 3	$95.0			
			Class 4	$80.0			
National Union Fire Insurance Company of Pittsburgh	Compass Re Ltd.	Series 2012-1	Class 1	$400.0	US HU, EQ	Industry Index	MMF
Zurich Insurance	Lakeside Re III Ltd.			$270.0	US, CAN EQ	Indemnity	MMF
Total Closed During Q4 2012				**$1,888.2**			

Source: Aon Benfield Securities, Inc.

Legend

CAL – Californie
CAN – Canada
EU – Europe
MX – Mexico
UK – United Kingdom
US – United States

EQ – Earthquake
HU – Hurricane
ST – Severe Thunderstorm
WF – Wildfire
WS – Winter Storm

[2] Converted at $1.29 = €1.00 as of November 1, 2012

First Quarter 2013

Catastrophe bond issuance for 2013 began with a relatively light first quarter. Three transactions closed totaling USD670 million, including one health bond. The other transactions comprised:

- Caelus Re 2013 Limited Series 2013-1 (Caelus Re 2013-1), sponsored by Nationwide Mutual, provides coverage against U.S. hurricanes and earthquakes. The transaction closed well below marketed price guidance and was upsized to USD270 million. Caelus Re 2013-1 was the first property catastrophe bond to close in 2013 and demonstrated the dramatic spread decreases from the fourth quarter 2012, as discussed earlier. Nationwide Mutual returned in the second quarter of 2013 with a subsequent issuance, bringing their total on-risk coverage from catastrophe bonds to USD590 million.

- Everglades Re Ltd. Series 2013-1 (Everglades Re 2013), sponsored by Citizens Property Insurance Corporation (Florida Citizens), closed its second catastrophe bond transaction in two years. Everglades Re 2013 provides USD250 million in indemnity coverage for Florida Citizens, bringing its total on-risk coverage to USD1.0 billion from catastrophe bonds. Florida Citizens also benefited from the large spread decreases since the prior issuance. Everglades Re 2013 closed at almost half the multiple of expected loss of the 2012 issuance.

Exhibit 10: First Quarter 2013 Catastrophe Bond Issuance

Beneficiary	Issuer	Series	Class	Size (millions)	Covered Perils	Trigger	Collateral
Aetna Life Insurance	Vitality Re IV Limited	Series 2013-1	Class A	$105.0	Health	Indemnity (MBR)	MMF
			Class B	$45.0	Health	Indemnity (MBR)	
Nationwide Mutual	Caelus Re 2013 Limited	Series 2013-1	Class A	$270.0	US HU, EQ	Indemnity	MMF
Citizens Property Insurance Corporation	Everglades Re Ltd.	Series 2013-1	Class A	$250.0	FL HU	Indemnity	MMF
Total Closed During Q1 2013				**$670.0**			

Source: Aon Benfield Securities, Inc.

Legend

FL - Florida
US – United States
EQ – Earthquake
HU – Hurricane

Second Quarter 2013

The second quarter of 2013 was a very active period, during which 13 transactions closed bringing a total of USD3.3 billion of new issuance. Transactions included:

- Merna Re IV Ltd., State Farm Fire and Casualty Company's (State Farm) fifth catastrophe bond issuance, provides coverage against earthquakes in the New Madrid region on an indemnity basis. The USD300 million transaction closed at the low end of marketed price guidance and achieved the lowest absolute spread in five years.

- Sanders Re Ltd., Allstate's first issuance since 2008, provides coverage against hurricanes and earthquake across two classes of notes. The industry index transaction was upsized to USD350 million, with each class closing below initial marketed price guidance. Additionally, the transaction secured the lowest absolute spreads for hurricane capacity since 2008.

- Armor Re Ltd. is the first issuance from American Coastal Insurance Company (American Coastal), which writes commercial residential property insurance in Florida. The transaction provides American Coastal with USD183 million in coverage against Florida hurricanes for one season.

Exhibit 11: Second Quarter Catastrophe Bond Issuance

Beneficiary	Issuer	Series	Class	Size (millions)	Covered Perils	Trigger	Collateral
State Farm	Merna Re IV Ltd.			$300.0	New Madrid EQ	Indemnity	MMF
Nationwide Mutual	Caelus Re 2013 Limited	Series 2013-2	Class A	$320.0	US HU, EQ	Indemnity	MMF
North Carolina JUA/IUA	Tar Heel Re Ltd.	Series 2013-1	Class A	$500.0	NC HU	Indemnity	MMF
Turkish Catastrophe Insurance Pool	Bosphorus 1 Re Ltd.	Series 2013-1	Class A	$400.0	Turkey EQ	Parametric Index	MMF
Allstate	Sanders Re Ltd.	Series 2013-1	Class A	$200.0	US HU, EQ	Industry Index	MMF
			Class B	$150.0			
Louisiana Citizens	Pelican Re Ltd.	Series 2013-1	Class A	$140.0	LA HU	Indemnity	MMF
American Coastal	Armor Re Ltd.	Series 2013-1	Class A	$183.0	FL HU	Indemnity	MMF
The Travelers Indemnity Company	Long Point Re III Ltd.	Series 2013-1	Class A	$300.0	Northeast HU	Indemnity	MMF
Allianz Argos 14 GmbH	Blue Danube II Ltd.	Series 2013-1	Class A	$175.0	US, CB, MX HU & US, CAN EQ	Industry Index	IBRD Notes
USAA	Residential Reinsurance 2013 Limited	Series 2013-I	Class 3	$95.0	US HU, EQ, ST, WS, CAL WF	Indemnity	MMF
			Class 11	$205.0			
Assurant, Inc.	Ibis Re II Ltd.	Series 2013-1	Class A	$110.0	US HU	Industry Index	MMF
			Class B	$35.0			
			Class C	$40.0			
Munich Re	Queen Street VIII Re Limited			$75.0	US HU, AUS CY	Industry Index	MMF
Amlin AG	Tramline Re II Ltd.	Series 2013-1	Class A	$75.0	US, CAN EQ	Industry Index	MMF
Total Closed During Q2 2013				**$3,303.0**			

Legend

CAL – Californie	CY – Cyclone
CAN – Canada	EQ – Earthquake
AUS – Australia	HU – Hurricane
CB – Caribbean	ST – Severe Thunderstorm
FL – Florida	WF – Wildfire
LA – Louisiana	WS – Winter Storm
MX – Mexico	

Source: Aon Benfield Securities, Inc.

The first half of 2013 produced a total of USD4.0 billion in new issuance (Exhibit 12), an increase of USD400 million over the first half of 2012, and the highest first half issuance level since 2007.

Exhibit 12: Catastrophe Bond Issuance by Half-Year

Source: Aon Benfield Securities

Outlook

As of August 23, new catastrophe bond issuance for the third quarter of 2013 had already reached USD1.1 billion. This represents, and may ultimately exceed, the highest level of issuance during a third quarter since 2007, which included State Farm's USD1.2 billion Merna Reinsurance Ltd., the largest ever single catastrophe bond issuance.

Repeat and, increasingly, new sponsors are accessing the ILS market to leverage the favorable market conditions. There is strong demand for catastrophe bonds for the remainder of the 2013 calendar year, with investors seeking to deploy capital. Conditions remain positive for the catastrophe bond market, with 2013 issuance on track to reach USD7.0 to USD8.0 billion in total.

Softening Market Stabilizes Demand

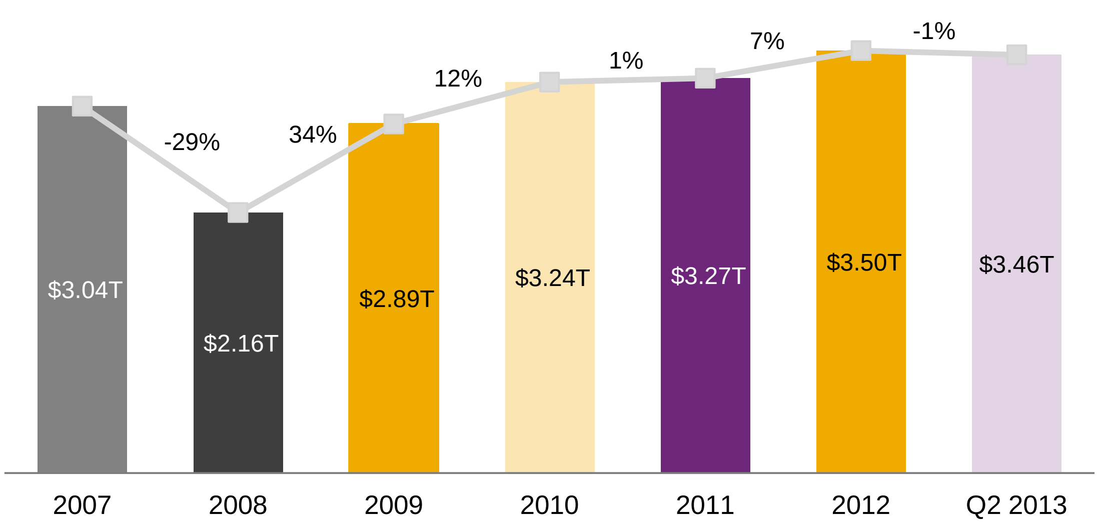
Insurer demand for reinsurance continues at stable levels for 2013 with low catastrophe loss activity in most regions throughout the first half of the year. With continued growth in capacity through investment from the capital markets, insurers renewing at January 1 will likely see softer market terms and conditions and more customized solutions for their specific portfolios should no major catastrophe events impact the current supply/demand balance.

Discussed in more detail later in this report, insurer capital adequacy is now substantially higher than rating agency demands, putting pressure on demand for reinsurance. However, despite record capital, upgrades are slow to come and ratings pressure is predominately related to earnings adequacy, resulting in increased demand for reinsurance providing protection from earnings volatility. Ultimately, increasing capital and earnings positions of insurers will force reinsurers to provide even more accretive pricing with attractive terms and conditions. As an alternative, insurers with stable ratings and high capital positions will elect to take on additional net exposures.

In addition to capital and earnings impacts, model change has historically driven changes in demand by insurers. Despite model changes reducing PMLs for some U.S. companies earlier this year, multi-model approaches adopted more recently will also serve to stabilize demand.

Aon Benfield's study of global insurer capital reveals a total of USD3.5 trillion of capital dedicated to insurance, with USD1.2 trillion supporting property casualty, USD1.8 trillion supporting life & health and USD0.5 trillion supporting reinsurance, including catastrophe bonds and government pools. While global capital increased 7 percent from 2011 to 2012, a slight decline has been seen in capital since year end 2012.

Exhibit 13: Change in Global Insurer Capital



Source: Aon Benfield Analytics

Global Trends Affecting Insurance and Reinsurance Demand

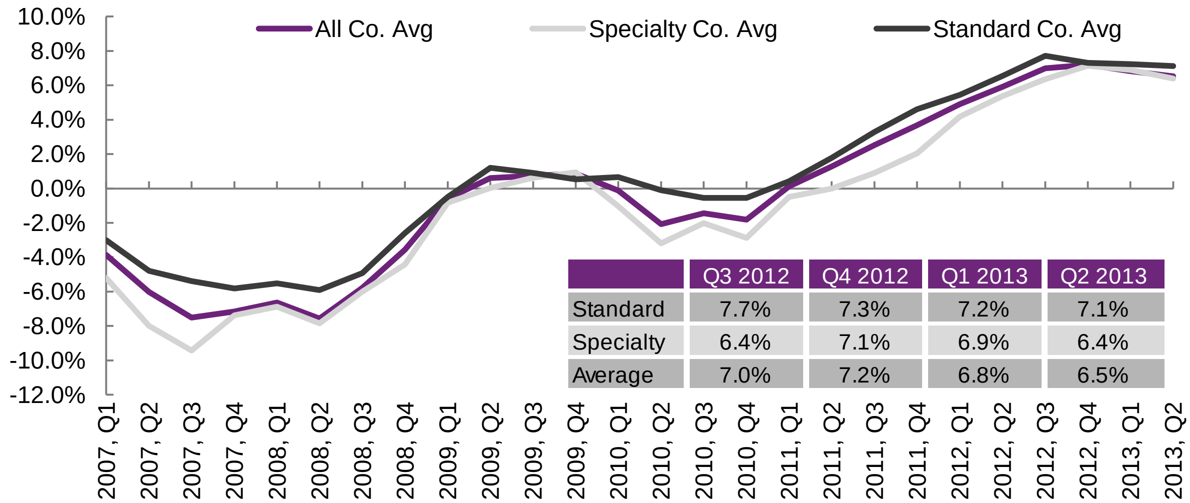
A number of significant trends are developing that have the potential to shift the demand for insurance and reinsurance risk. While newly insureds are often reliant on reinsurance capital to support growth, there are also trends that support a reduction in risk premiums for various segments of business. A few of these trends and their impact on the market are summarized here:

Category	Factors	Trend
Auto Safety	- Continuous safety improvements - Driver, lane and distance sensors - Bot driven / Driverless cars + Manufacturer product liability	Declining Frequency
Urbanization	+ Increased catastrophe severity + More apartment living + Longer independent living + Multi-generational housing + Elder care facilities	Increasing Aggregations – Severity
Lower Interest Rates	+ Disappearing DB retirement plans + Disappearing DB health plans + Obamacare impact on young + Healthcare exchange (state, co-op, employer)	Challenging Retirement
Lower Interest Rates	- Demand for diversifying yields will continue to increase - Catastrophe risk has gained significant traction - Sharpe ratios will continue to drop to credit related levels - Preference for homogenous risks	Lower Cost Catastrophe Reinsurance
Pace of Technology	N Velocity is increasing and adoption rates are improving + Big data benefits and issues + Privacy - Branded bricks in decline + Online shopping = Product, reputation, and data risk	Lifestyle Changing Technology / Expectations
Segmentation	- Segmented rates / Behavior based rates - Highly personalized rates based on big data + Retrospectively rated rates from big data + Lifestyle policies + Exclusive / captive agents + Independent agents + Direct marketing / Big data targeting	Less Privacy / But Individualization
Expanding Government Safety Net	+ Hurricane, earthquake and flood insurance + Mortgage financing – more targeted + Private funding of government works	Increasing Needs / Increasing Problems
Longevity	+ Life expectancy continues to improve / Quality may not + Outliving funds risk + Catastrophic health risk	Every day is the new 30
Chronic Illness	+ Wellness programs + Medical tourism + Targeted accountable care programs	Living Longer May Not be Comfortable

U.S. Primary Casualty Rates Continue Positive Trend

Aon Benfield's summary of casualty rate changes shows increases in all segments albeit at a slower pace than the in the previous two quarters. Standard commercial rate increases continue to outpace specialty rate increases at 7.1 percent and 6.4 percent respectively.

Exhibit 14: Primary Casualty Pricing Trend

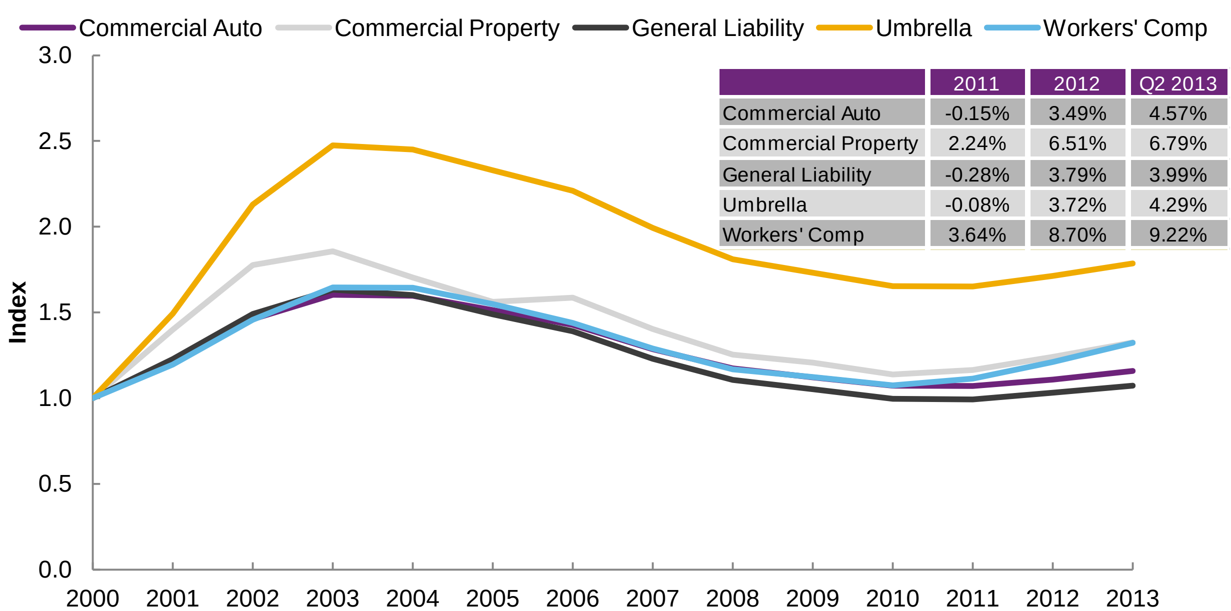


	Q3 2012	Q4 2012	Q1 2013	Q2 2013
Standard	7.7%	7.3%	7.2%	7.1%
Specialty	6.4%	7.1%	6.9%	6.4%
Average	7.0%	7.2%	6.8%	6.5%

Source: Aon Benfield Quarterly Rate Monitor Report

All major lines of business for the Council of Insurance Agents & Brokers (CIAB) continue to increase with workers' compensation increasing at a faster pace than all other lines. Despite a smaller increase in umbrella premium, it remains the highest rated relatively to 2000 and 2001.

Exhibit 15: U.S. Primary Pricing Trend



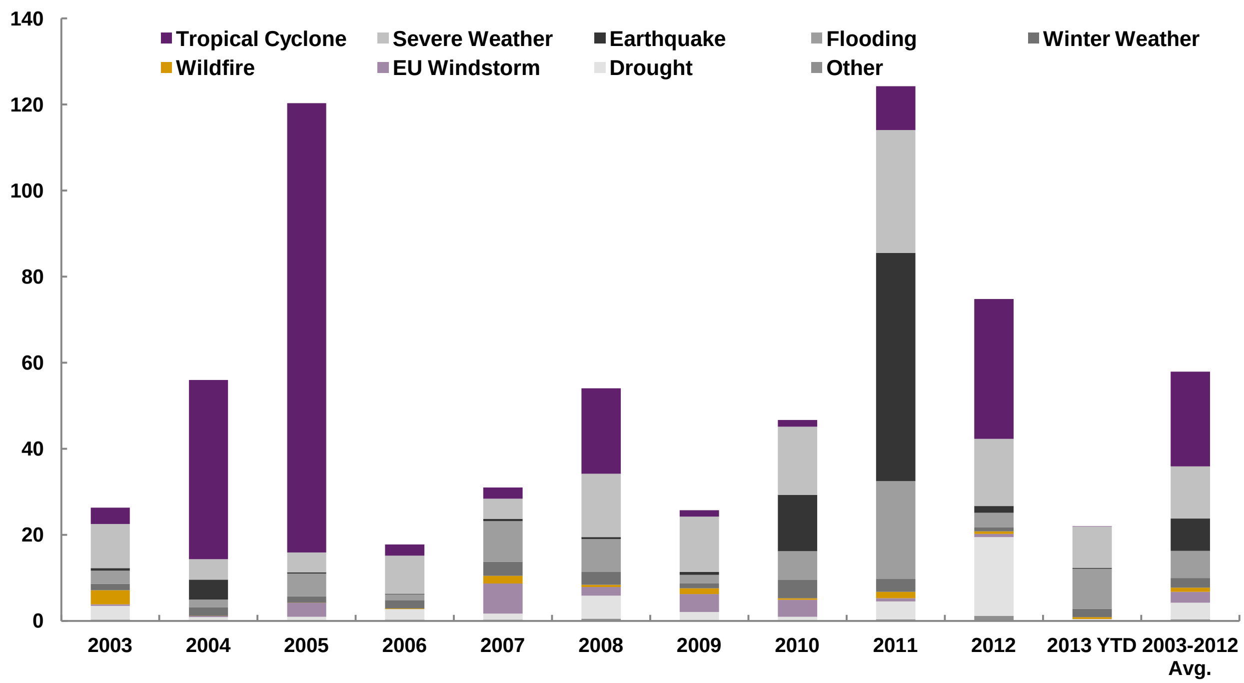
	2011	2012	Q2 2013
Commercial Auto	-0.15%	3.49%	4.57%
Commercial Property	2.24%	6.51%	6.79%
General Liability	-0.28%	3.79%	3.99%
Umbrella	-0.08%	3.72%	4.29%
Workers' Comp	3.64%	8.70%	9.22%

Source: Council of Insurance Agents & Brokers

Global Catastrophe Losses Maintain Below Normal Pace

The first half of 2013 experienced lower global catastrophe insured loss activity (as compared to the recent 10-year average (2003 to 2012)) across all major peril types except flood. Elevated flood losses were recorded across Central Europe, Asia, Australia, and Canada, with flooding continuing to be a major driver of losses during the first portion of Q3 2013. First half severe weather losses in the United States (approximately USD8.0 billion) were on par with the 10-year average, though well below what was sustained in 2011 (down 67 percent) and 2012 (down 42 percent).

Exhibit 16: Insured Losses by Year by Type (2003-2013 in USD billion)

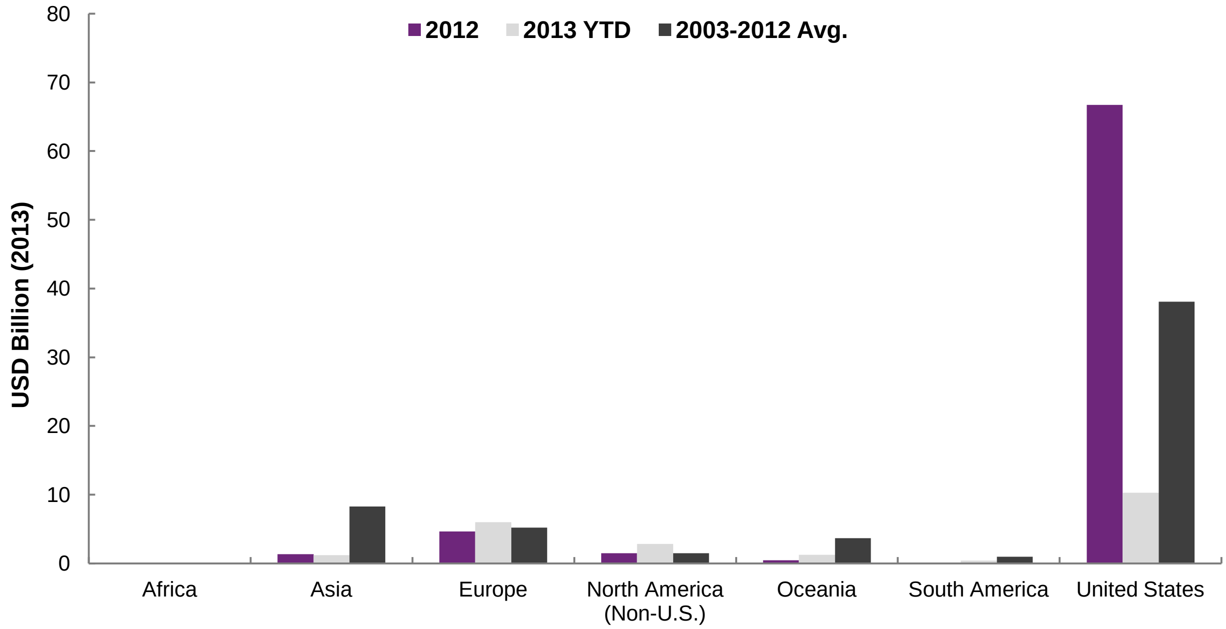


Source: Aon Benfield Analytics

Global insured losses during the first half of 2013 were below the recent 10-year average. Insured losses were USD20 billion (down 20 percent from the 10-year average of USD25 billion), with the flood peril comprising 43 percent of the insured loss. The U.S. sustained the highest level of insured losses (USD9.5 billion), which represented nearly 50 percent of the total. It should be noted that U.S. insured losses in 2013 were 54 percent less than what was sustained in 1H 2012 (USD20.8 billion) and 69 percent less than what was registered in 1H 2011 (USD30.9 billion).

For the most up-to-date global catastrophe loss data for 2013, and other historical loss information, please visit Aon Benfield's Catastrophe Insight website: www.aonbenfield.com/catastropheinsight.

Exhibit 17: 2013 YTD Insured Losses Compared to Recent Annual Averages by Region



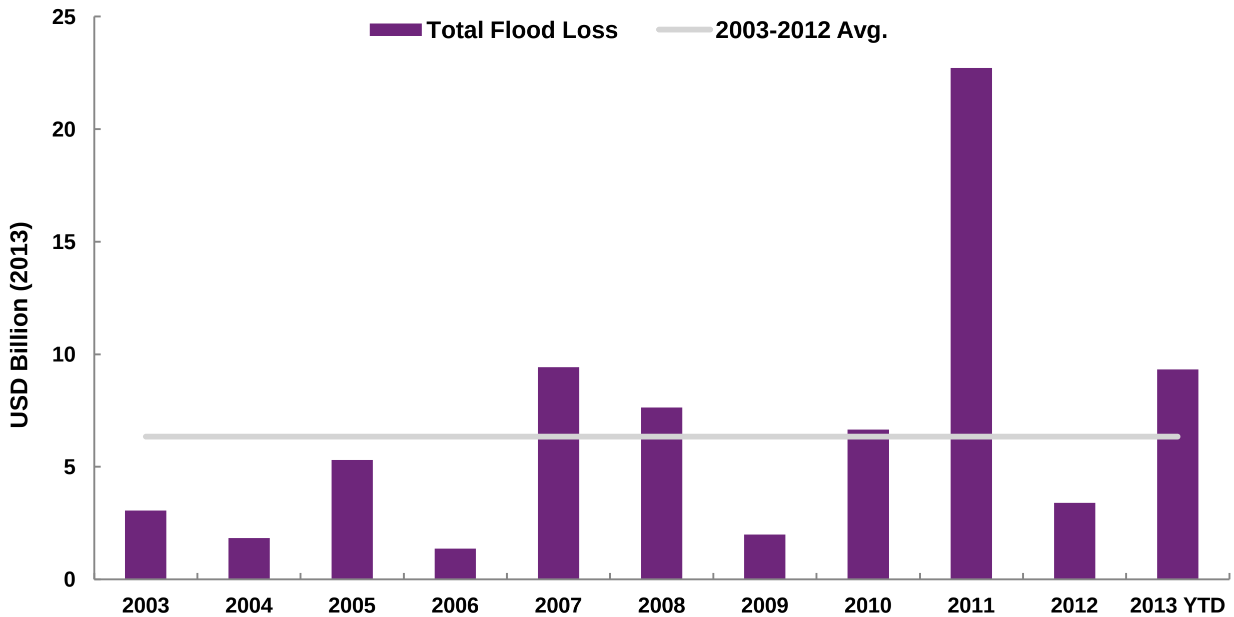
Source: Aon Benfield Analytics

Given current trends, only Europe and North America (non-U.S.) are poised to sustain annual insured losses above the 10-year average in 2013, as major floods have caused these regions to endure higher-than-average losses through late August. Despite the fact that loss activity in the U.S. is currently well-below recent averages, with the peak of the Atlantic Hurricane Season occurring during September, one significant landfalling hurricane could quickly reverse the trend. As a reminder, the U.S. remains in the midst of a record-setting stretch without a major hurricane landfall (Category 3+). 2005's Hurricane Wilma was the last such event.

Flood Losses on Track to Become Second Highest in Last Decade

Multiple extreme flood events around the globe in 2013 are on track to prompt the second most flood-related insured losses in the last decade. If current trends persist, 2013 will likely end up as second only to 2011, which suffered nearly USD16 billion in losses from the massive flooding in Thailand. 2011 remains the costliest flood year for insurers in history.

Exhibit 18: Global Flood Losses by Year



During the first half of 2013, the costliest overall insured event was the May/June flooding across central Europe, where insurance payouts are anticipated to be at least USD5.3 billion. Most of those losses were attributable to flood damage in Germany. Additional billion-dollar insured loss flood events were registered in Canada and Australia.

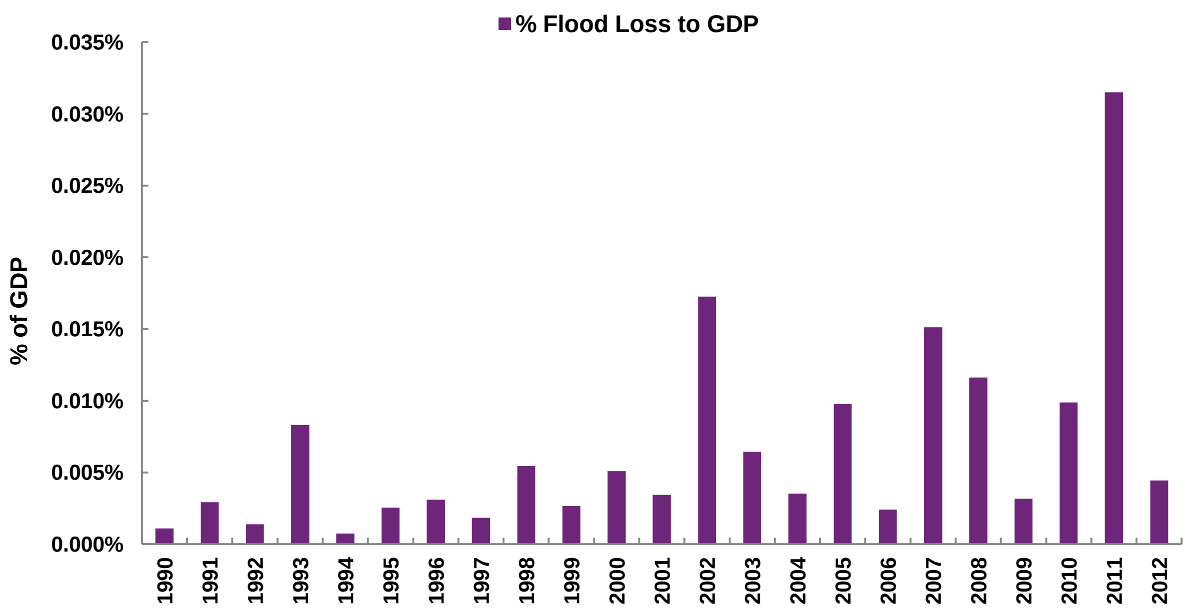
The flood peril is unique given that a higher percentage of damages are typically not covered by insurance as opposed to other disaster types. Since 2003, approximately 18 percent of all global flood losses (not including tropical cyclone-induced floods) have been covered by insurance. Policy language regarding what is covered (or not covered) varies by country.

In the U.S., the National Flood Insurance Program (NFIP) has limits on the amount of coverage it will provide, including: USD350,000 for residential properties (USD250,000 for structural damage and USD100,000 for content damage) and USD1 million for non-residential/commercial properties (USD500,000 for structural damage and USD500,000 for content damage).

The level of flood losses covered by insurance has grown in the last two decades as penetration continues to become more prevalent on a global scale. Insured losses from flood events (not tropical cyclone-induced) have trended upwards in nominal terms by 15 percent annually since 1990, and this trend slightly increases to 16.1 percent when looking at losses from just the last 10 years (2003-2012). These increases reflect the impacts of inflation, increased human population and economic activity as well as increased insurance penetration and growth in more exposed areas of the globe.

To better understand the increases, an analysis comparing flood losses to GDP was conducted. Since 1990, insured flood loss to GDP has increased 8.9 percent per year. That increase lowers to 8.0 percent per year in the most recent 10-year stretch (2003-2012). Analyzing losses to GDP removes the need for any inflation adjustment and also adjusts for changes in the level of human population and economic activity.

Exhibit 19: Global Flood Loss as a Percentage of Global GDP (1990-2012)



Source: Aon Benfield Analytics; World Bank (Current $ GDP)

For comparison's sake, overall global insured losses from all natural catastrophes has increased by more than 8.1 percent annually since 1990, but has accelerated to a larger 10.1 percent when looking at just the last 10 years (2003-2012). On a loss-to-GDP basis, insured losses have increased annually by 2.4 percent since 1990, which is identical to the 2.4 percent annual increase seen during the last 10 years.

Atlantic Hurricane Season Forecast Update

The August 2013 forecast update for the Atlantic hurricane season has varied across the three forecasting centers. In June, all three called for above normal hurricane activity. While CSU and NOAA have essentially maintained the amount to which the season is above average, TSR has decreased its original forecast for 2013. Despite TSR's reduction in forecasted events, it is still calling for an above average season in all three categories of storms.

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

	Named Storms	Hurricanes	Major Hurricanes
TSR (August 2013)			
Average	10.8	6.3	2.7
2013	14.8	6.9	3
Difference	+4.0	+0.6	+0.3
CSU (August 2013)			
Average	12	6.5	2
2013	18	9	4
Difference	+6.0	+2.5	+2.0
NOAA (August 2013)			
Average	12	6	3
2013	13-19	6-9	3-5
Difference	+4.0	+1.5	+1.0

Source: TSR, CSU and NOAA

Rating Agency and Regulatory Update

Impact on Reinsurance Supply / Demand Equation = Neutral

There are a number of rating agency and regulatory related topics that can influence reinsurance demand, which vary by the need for each ceding company.

Exhibit 21: Key Rating Agency and Regulatory Topics' Impact on Reinsurance Demand

Rating Agency Topic	Impact on Reinsurance Demand	Commentary
Strong Capital Adequacy	Neutral	Capitalization has remained flat for many companies as interest rates are increasing, resulting in unrealized losses offsetting underwriting profits.
Reserve Adequacy	Slight Increase	As companies start to record adverse loss development, they may consider either retroactive reinsurance to help manage this or prospectively lower retentions to cede more of the risk on a go-forward basis.
Expiration of TRIPRA	Slight Increase	Set to expire in December 2014, companies with significant exposures need to be prepared to present a strategy to the rating agencies in a scenario in which TRIPRA is not renewed. This will likely lead to an increase in demand for reinsurance by some to address rating agency concerns. There is uncertainty though as to whether or not the government will renew TRIPRA.
Earnings Volatility	Neutral	Has been the driver behind rating downgrades, even when capital adequacy remained strong; Aggregate treaties continue to be evaluated, but buyers are very price elastic (and rating agency capital credit is not always as explicit)
RMS v13	Neutral	After significantly increasing PMLs in v11, RMS v13 was released earlier this year, decreasing near-term PMLs for many companies. A significant number of companies had already moved towards a blended model approach for measuring catastrophe exposure, thus mitigating the impact of individual model changes on reinsurance buying strategies.
Evolving Criteria	Neutral to Slight Increase	S&P finalized their insurance criteria in May 2013, resulting in most ratings remaining unchanged. A.M. Best is moving forward with their stochastic BCAR, targeted for a parallel implementation in 2014 for the U.S. and 2015 elsewhere. Globally, regulators are strengthening capital requirements. There will be pockets of increased demand largely driven by local regulatory changes.
Sovereign Debt Concerns	Neutral	Despite capital constraints resulting from declining asset values, companies have generally not sought additional reinsurance to help manage the capital requirements within their underwriting portfolios. If evidence suggests

Rating Agency Topic	Impact on Reinsurance Demand	Commentary
		further Sovereign downgrades are likely, resulting in more asset devaluations, companies can help manage capital requirements with reinsurance.
Insurance Contracts Proposed Accounting Changes	Neutral	Many of the elements initially causing concern over additional income statement volatility have been muted. There may be some decrease in demand of multi-year reinsurance contracts due to complexity of accounting, but this demand would likely be replaced with single year contracts.

Results Improve and Ratings Stabilize

The rating agencies maintain a generally stable view of the U.S. insurance industry as evidenced by the current outlooks published by the four global rating agencies. Unfortunately the rating agencies do not consistently publish outlooks for other regions. However, per discussion with A.M. Best in EMEA, they indicated a stable view of the non-life industry, although life companies are struggling given guarantees embedded in a number of products and the current interest rate environment. Likewise, in APAC, A.M. Best anticipates reduced underwriting volatility going forward, so it will be the global investment markets that will play a larger role in drawing the outlook for the region. The (developing) Asia market features fast evolution. What happened in developed market over the last 30 years will happen within the next 10 years in the developing APAC markets, and what is going to happen in the developed market over the next 20 years is going to happen in the developing APAC market in the next 20 years as well. All things are happening at once, not in stages like in developed market but all at once, so it is very challenging for all participants—especially the regulator.

Exhibit 22: Rating Agency U.S. Industry Outlooks

Sector	A.M. Best	S&P	Fitch	Moody's
Personal Lines	Stable	Stable	Stable	Stable
Commercial Lines	**Negative**	Stable	Stable	Stable
Reinsurance	Stable	Stable	Stable	Stable
Health Insurance	Stable	Stable	Stable	**Negative**
Life Insurance	Stable	Stable	Stable	**Negative**

Source: A.M. Best, S&P, Fitch, Moody's. Updated as of August 2013

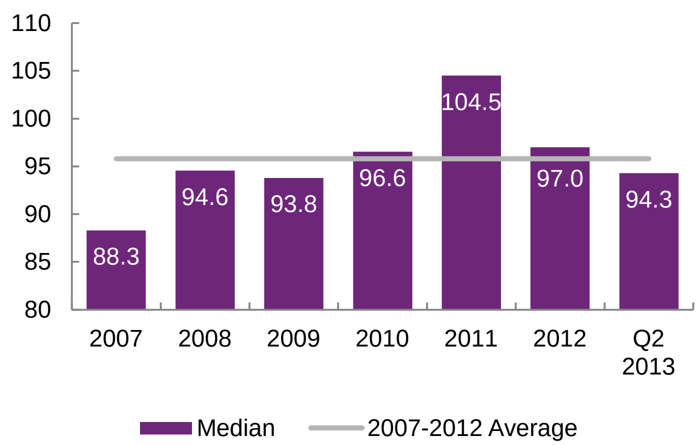
A.M. Best also published the following combined ratios for U.S. lines of business. 2013 projected combined ratios are expected to improve somewhat from 2012 final results, and show a material improvement over 2011 results. Notwithstanding a major catastrophe event, the reinsurance sector should have another profitable year. Personal lines will nearly break-even for the first time in many years, though commercial lines are still struggling with insufficient pricing and limited remaining reserve redundancies. These are the leading drivers behind A.M. Best's current Negative outlook on that sector.

Exhibit 23: U.S. Industry Combined Ratios

Sector	2011A	2012A	2013E
Commercial Lines	106.8%	105.0%	102.9%
Personal Lines	106.1%	101.6%	100.6%
Reinsurance	107.3%	93.1%	94.3%

Source: A.M. Best, March 2013

Exhibit 24: Median Combined Ratio for U.S. Public Companies



Operating performance for non-life companies continues to improve significantly over 2011 results. Based upon U.S. statutory financials reported through June 30, 2013, the median combined ratio for U.S publicly traded companies improved 2.7 points over year end 2012, to 94.3 percent. The combined ratio of the Aon Benfield Aggregate (a group of 31 companies that write a significant amount of reinsurance), which has more of a balance of U.S. and non-U.S. book, is 89.0 percent (90.7 percent for 1H 2012). Companies need this strong profitability to help offset declining investment yields given the current interest rate environment.

Source: A.M. Best, March 2013

Capital remains at near-record levels as discussed in “New Capital Horizon for Reinsurers” on page 4. This is also reflected in an analysis of A.M. Best’s BCAR scores as median BCARs are 170 percentage points to 209 percentage points above published minimums. Again, A.M. Best only publishes BCAR scores for U.S. companies, but the trend is reflective of overall industry movement. U.S. publicly traded companies’ median scores trail the overall median slightly, which is due to the number of mutual companies that comprise the total U.S. Industry and the need for those companies to hold additional capital as they cannot easily raise it in the markets.

Exhibit 25: Five Year U.S. Median and Minimum BCAR Scores by Rating Category

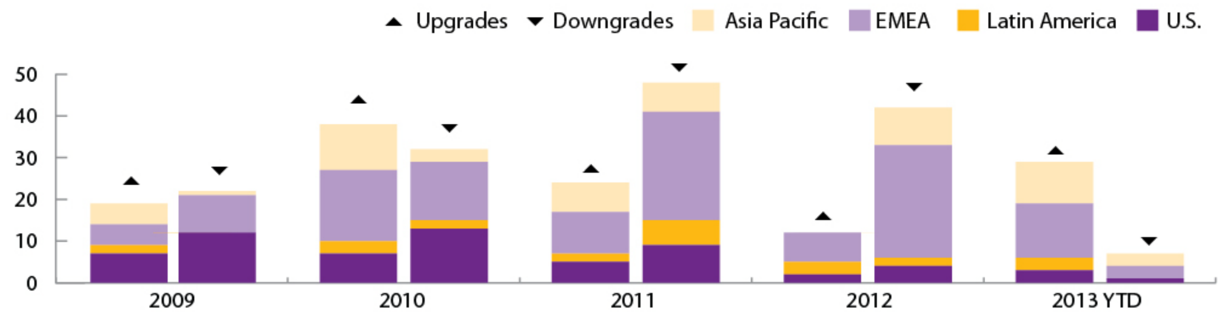
FSR	Published Minimum	2012 U.S. Industry Median	Median / Minimum	2012 U.S. Public Co. Median	Points lower than Industry Median
A++	175	298	170%		
A+	160	326	204%	277	15%
A	145	292	201%	232	21%
A-	130	272	209%	185	32%
B++	115	219	190%		
B+	100	175	175%		

Source: A.M. Best, Aon Benfield Analytics. Data as of July 2, 2013

Global Rating Changes

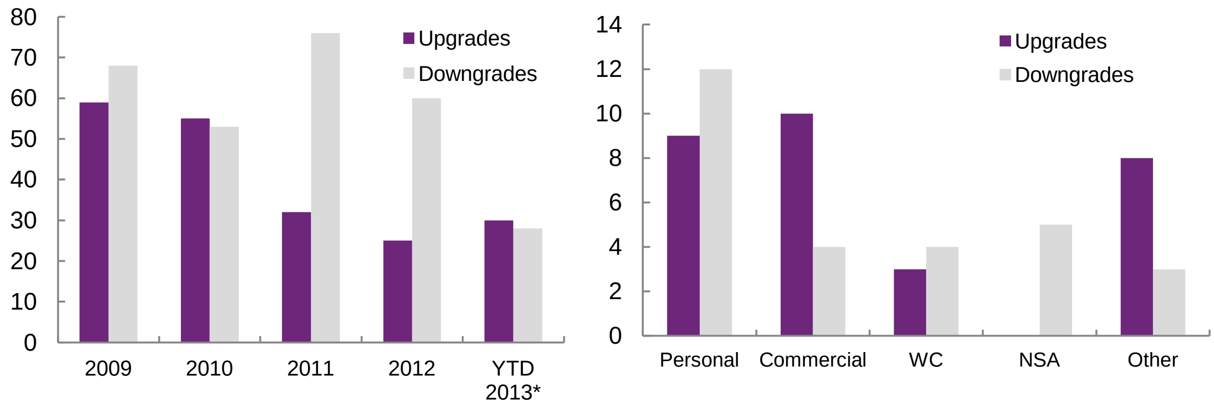
Below is a five year analysis of global S&P rating changes by region. In addition, there is a five year analysis of U.S. A.M. Best rating changes, with an additional chart of 2013 U.S. A.M. Best rating changes by composite. The former provides a global perspective of rating changes while the latter provides some context as to the segments, at least within the U.S., experiencing the most ratings momentum.

Exhibit 26: S&P Global Rating Changes



Source: S&P, Aon Benfield Analytics. Data as of August 26, 2013

Exhibit 27: A.M. Best Five Year U.S. P&C Rating Changes and 2013 YTD by Segment



Source: A.M. Best, Aon Benfield Analytics. Data as of August 26, 2013

Despite record industry capital levels and median BCAR scores well above published minimums, downgrades had outpaced upgrades in recent years. Globally, based on S&P non-life and composite rating changes, 2013 is the first year since 2010 where upgrades outpaced downgrades. EMEA has experienced the most rating changes over the past four years, many of which were a result of Sovereign downgrades emanating from the European debt crisis. However, in 2013, a number of EMEA companies were upgraded, thus helping shift the general trend to an upgrade environment. Likewise, APAC witnessed a number of downgrades in 2011 and 2012, which were a result of the catastrophe losses in Japan and Thailand as well as strains on capital from weakened equity markets. Similarly, in 2013 APAC upgrades are ahead of downgrades, a result of stabilizing asset values and improved pricing subsequent to the catastrophe losses.

In the U.S., A.M. Best ratings also appear to have stabilized as compared to the previous two years, noting upgrades are slightly ahead of downgrades for the year for the first time since 2010. Looking more closely at the 2013 activity, the personal lines carriers are experiencing the most downgrades while commercial lines writers are seeing the most upgrades. This is somewhat counter-intuitive based on A.M. Best's industry outlooks (personal lines are stable while commercial lines are negative). Ratings, unfortunately, have a tendency to trail the market. The most often cited driver of personal lines downgrades is poor or inconsistent underwriting profitability, which in many cases has been a result of the frequency of catastrophe losses in recent years. So while personal lines profitability has improved in 2012 and into 2013, there have still been a number of downgrades across the market due to several consecutive years of weak results, despite a recent shift in this trend. Likewise, concerns are emerging regarding the sufficiency of recent commercial lines rate increases as well as adverse reserve development, yet the commercial lines are seeing a number of upgrades. Current trends are more evident in the recent workers' compensation downgrades, as many reserving studies have indicated a shift to a reserving deficit in recent years, and the rating changes are reflecting this.

Terrorism Risk Insurance Program Reauthorization Act

The U.S. federal terrorism backstop, (known as TRIPRA) is set to expire on December 31, 2014 and has become a topic of concern for the insurance industry in 2013. Congressional hearings to extend the current legislation have been ongoing since 2012, but so far minimal progress has been made. Insurers are facing the possibility that TRIPRA may not be extended beyond 2014, or might be modified from its current format. In addition, rating agencies have released commentary regarding the potential expiration of TRIPRA and their expectations for managing the uncertainty going forward. Insurers will need to begin contemplating complex risk mitigation practices and modifying their ERM to reflect the adaptation to changes in TRIPRA as well as meeting the rating agency expectations

In the past several updates on the U.S. terrorism reinsurance market, it has been noted that the market remains relatively inactive. The general perception is the threat of terrorism is now lower than in the previous several years, an outlook reflected in reduced vendor-model expected loss from U.S. terrorism. Insurers have developed strategies to deal with terrorism exposure, without significant loss in over a decade and with benefit of the TRIPRA backstop.

It was also noted in the recent updates, however, that there were several factors that could turn the market, among them a reduction in or elimination of the federal TRIPRA backstop and increased scrutiny by rating agencies on clients' terrorism exposures. It now appears that these two influences are gaining strength and may lead to increased activity in the stand-alone U.S. terrorism market. The prospects for the extension of TRIPRA are less certain than at either of the two earlier scheduled lapses.

Should TRIPRA be allowed to lapse, Aon Benfield expects a withdrawal of insurance capacity for terrorism and a reversion to a post-9/11 environment. The intervening decade since 9/11 and the lack of loss will lead some insurers to allocate capital to terrorism, but without the federal backstop, overall capacity will reduce dramatically. For those insureds required to purchase terrorism insurance, premiums will increase substantially due to reduced supply. A more limited, more expensive market will be the result.

While the stand-alone terrorism reinsurance market has been characterized by over-supply for several years now, the lapse of TRIPRA could reverse that dynamic. The termination of the TRIPRA program would also eliminate the federal make-available provision; this does not mean, however, that insurers will not be required to make terrorism insurance available. Aon Benfield anticipates that in the absence of a federal make-available provision, insurance regulators in many states will step into the vacuum created and compel insurers in their various states to provide terrorism coverage.

Another drain on available reinsurance capacity should TRIPRA lapse will come from insurers seeking reinsurance for terrorism losses from statutory coverages, namely Workers' Compensation and Standard Fire Policy (SFP) requirements. The statutory nature of workers' compensation insurance means insurers cannot exclude terrorism from original policies. Reinsurers have generally provided conventional terrorism coverage in workers' compensation reinsurance but the bulk of terrorism reinsurance secured by insurers comes from the federal backstop. Should TRIPRA lapse, Aon Benfield anticipates a surge in demand for reinsurance generated by increased terrorism exposure retained. Similarly, an elimination of TRIPRA will mean insurers and reinsurers will have to address the massive potential accumulation of terrorism losses from fire occasioned by a terrorism event.

Private market reinsurance will step in to help replace the backstop that TRIPRA currently provides but the resources of the industry are insufficient to replace the USD100 billion backstop completely. The market has shown itself flexible in meeting the needs of client insurers over the years on a range of issues but this flexibility has its limitations, dictated by financial constraints and prudent business practice.

Regardless of the ultimate resolution of the TRIPRA matter, 2014 is an opportune time for clients to investigate alternatives to replacing TRIPRA protection, in the event TRIPRA should be non-renewed, or to enhance protection and fill in coverage gaps if it is extended.

The rating agencies have noted that TRIPRA provides a substantial level of capital support to insurers writing exposed lines of business. Both A.M. Best and S&P provide companies with qualitative credit for expected TRIPRA recoveries. As the potential expiration of the legislation draws nearer, rating agencies have begun placing more emphasis on terrorism loss scenarios gross of TRIPRA recoveries. Insurers with large gross accumulations or with an over-reliance on TRIPRA recoveries will be heavily scrutinized in 2013 and 2014.

According to A.M. Best, key concerns lie with companies whose net exposures to terrorism exceed 20 percent of policyholders' surplus (excluding the benefit of TRIPRA). Earlier this year, A.M. Best released a press release detailing the uncertainty behind the TRIPRA legislation and the resulting increases to rating pressure that would result. A.M. Best stated that: "Material changes in TRIPRA would raise rating concerns". Aon Benfield has noted that several companies have already felt additional pressure by A.M. Best in 2013 after their accumulations (gross of TRIPRA) were categorized as "elevated". In addition, Best has stated that they will reflect these changes by revising outlooks of applicable companies to "negative" in 2013 and 2014.

S&P has released statements on TRIPRA and the anticipated industry impact. According to their comments, they are closely monitoring the following areas within the P&C industry:

- How much of the backstop will congress reinstate?
- Absent a TRIPRA renewal, will terrorism coverage continue to be mandatory for applicable lines of business (particularly WC and commercial property)?
- How robust is the standalone terrorism insurance market?
- How are insurers changing their risk appetite in the event that TRIPRA expires?

In S&P's updated Insurer Rating Criteria, they include an assessment of terrorism risk in the Risk Position subfactor. Therefore, companies with significant exposure will have to address the risk otherwise their ratings will be impacted. Further, S&P has indicated that if a given insurer lost more than one year's worth of earnings, or experienced terrorism losses outside its stated risk tolerances and appeared as an outlier relative to its peers, they would likely take a negative rating action.

Exhibit 28: Rating Agency Treatment of Terrorism Risk

Financial Strength Rating	A.M. Best	S&P
Terrorism modeled	Yes	Yes
Model output utilized	Deterministic loss scenarios (5-ton truck bomb) and exposure accumulations for top individual as well as multiple locations	500 foot spider analysis and deterministic scenario loss estimates. Top individual location accumulations
TRIPRA included in model output?	Yes	No
Terrorism output included in capital modeling	Yes	No
Impact of TRIPRA	Quantitative and Qualitative	Qualitative
TRIPRA deductible collected in questionnaire	Yes	Yes
Potential rating action resulting from TRIPRA expiration	A.M. Best will apply rating pressure to companies who have high gross terrorism loss accumulations in the deterministic model	Currently uncertain, but possible if exceed stated risk tolerance levels or if the potential to lose more than 10% of earnings in a single event is apparent

Aon Benfield believes that TRIPRA continues to be a vital support mechanism for U.S. commercial insurance industry and provides necessary capital stability to the market as a federal backstop. The commercial terrorism market will be heavily impacted if TRIPRA is not extended. Reinsurance will be utilized to fill in a portion of the missing USD100 billion of federal terrorism coverage. Commercial exposures in key metropolitan areas will be the most significantly impacted, and pricing of terror coverage in these areas will likely increase as a result. Aon Benfield is a strong supporter of TRIPRA legislation being renewed and we believe that the legislation will ultimately be extended in some fashion.

In Europe, A.M. Best's analysis of terrorism risk is done on a company by company basis. Unlike in the U.S., companies in Europe can and do exclude terrorism for the most part. In the Middle East, due to social unrest, they have seen further tightening of the policy language to ensure that terrorism and war is excluded. For some writers that specifically write terrorism risk internationally, A.M. Best collects similar data as in the U.S. and completes a comparable analysis.

The UK has a federal backstop called Pool Re, which has sometimes forced commercial players to participate on high layers, if at all. Some other European countries have a government pool, but most do not, and coverage is optional.

Evolving Criteria

Similar to the trend in recent years, rating agency criteria continue to evolve. The driving factors behind this constant fine-tuning of rating criteria relate to an increasingly in-depth analysis requiring more non-public data, focus on ensuring global consistency of methodology and efforts toward increased transparency. The following provides a recap of key rating criteria developments.

S&P Criteria Changes

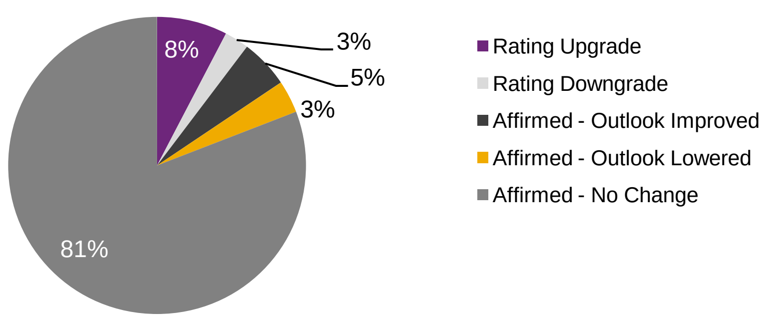
Since July 2012, S&P has released eight criteria updates, two additional criteria papers with draft status (in the request for comment process), and even more special reports. The key updates related to Enterprise Risk Management, Management & Corporate Governance, Equity Content for Hybrid Securities, and one in particular overhauled S&P's framework for rating insurance companies.

On May 5, 2013, S&P finalized their Insurance Rating Criteria. S&P has cited the following reasons for implementing this new criteria framework:

- Improved transparency of rating methodology
- Increased specificity of rating factors and sub-factors
- More forward looking approach that increases comparability and consistency
- Centralizing insurance criteria framework in one single criteria document

From the beginning, S&P stated they expect the majority of ratings will remain unchanged, with any movement most likely no more than one rating notch. S&P has nearly done updating all ratings based upon the new ratings framework. Below is a distribution of the rating actions following S&P's release of the new criteria. A detailed summary of S&P's new criteria framework is available in the Evolving Criteria report at http://thoughtleadership.aonbenfield.com.

Exhibit 29: S&P Rating Distribution



Source: S&P, Aon Benfield Analytics. Data as of year-end 2012

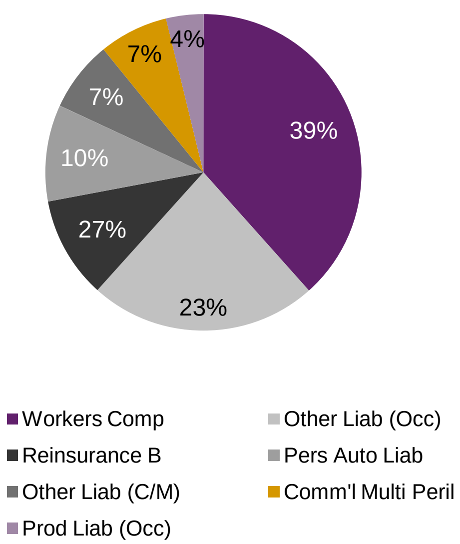
81 percent of companies had their ratings affirmed, while 8 percent were upgraded and only 3 percent were downgraded; and another 8 percent had an outlook change.

The criteria did not change existing ERM criteria, or S&P's capital model used for estimated insurer capital requirements.

A.M. Best Criteria Changes

Since July 2012, A.M. Best has released 15 criteria updates and 5 additional criteria with draft status (again in the request for comment process). Likewise, they have released many special reports, 'Best Briefings' and various press releases on current industry hot topics. Many of the updates have been clerical in nature, or relate to a specific piece of criteria, such as the Florida Hurricane Catastrophe Fund's haircut in BCAR (reduced from 5 percent on the mandatory layer to 0 percent). A.M. Best released a briefing on the expiration of TRIPRA, covered in the preceding section, as well as new criteria for rating run-off insurers and specialists.

Exhibit 30: U.S. Capital Impact by Line of Business



Source: A.M. Best, Aon Benfield Analytics. Data as of year-end 2012

A.M. Best had made a number of changes to BCAR, most notably reducing the discount rate in the reserve factor from 5 percent to 4 percent. In the U.S. non-life industry alone, this was equivalent to a USD25.2 billion hit to industry capital. The lines most impacted are clearly the long-tailed lines with material discounts embedded in the business. The chart to the right shows the distribution of the impact across U.S. Annual Statement lines of business.

In the non-U.S. BCAR model, A.M. Best incorporated asset risk factors for individual country risks. In the U.S. BCAR model, A.M. Best added a new component to the Business Risk charge related to post-retirement and pension fund obligations. Neither of these had material industry impacts, but certainly increased capital requirements for companies operating in countries with Sovereign debt struggles or companies that have significant under-funding of their benefit obligations.

Finally, A.M. Best announced in March 2013 that they are developing a new stochastic BCAR model. The current goal is to include stochastic features for the risk of bond defaults, stock volatility, reinsurer default, pricing risk and reserving risk. The process will entail a "request for comment" period that will allow the market to review the proposed methodology and provide feedback.

A.M. Best expects a one year transition period, where they will run the current model parallel with the stochastic model. A.M. Best anticipates a 2014 parallel run for U.S. statutory reporting companies, and a 2015 or later parallel run for non-U.S. companies.

Sovereign Debt Concerns

Over the past year, as the Eurozone crisis continued, there were further sovereign downgrades in the EMEA region from Fitch, Moody's and S&P. France, Italy, South Africa, Egypt and Slovenia were among the many that were downgraded. As a result, insurers' financial strength ratings are feeling the strain with downgrades and/or downwards pressure applied to some of the world's leading insurers.

The continued low interest rate environment is now the number one risk per European Insurance and Occupational Pensions Authority's (EIOPA) latest Financial Stability Report. For life companies, guaranteed business continues to become a liability and makes them more vulnerable to insolvency if the rates remain low; as was the case for many Japanese life insurers in the late 1990s. For non-life companies, this means profits must come from underwriting, perhaps at the cost of market share and via a change in the traditional business model.

Signs of a Eurozone recovery may be fragile and the low interest rate environment will likely continue in the short-to-medium term, stressing insurers' financials. Companies, however, have not generally utilized reinsurance as a means to lower capital requirements on the underwriting side to help offset increased asset capital requirements (or reductions in available capital related to devalued asset portfolios). Nonetheless, opportunities are present to address capital stresses that increased asset risk bring to insurers balance sheets, with reinsurance and alternative risk transfer solutions prominent in the marketplace.

Insurance Contracts Accounting Change

The FASB and IASB have both been working towards updating the accounting requirements for insurance contracts, in an effort to reduce the diversity of approaches that currently exist. While common ground was found in several areas, full convergence does not appear to be achievable in the near term. Each issued an Exposure Draft (ED) in June 2013 that proposes to fundamentally change the accounting for insurance contracts. The EDs each have an approximate 120 day comment period.

Both FASB and IASB have proposed two principles based methods of accounting for insurance contracts, the Building Block Approach (BBA) and the Premium Allocation Approach (PAA). The BBA provides guidance on accounting for insurance contracts with a contract duration greater than one year—so most life insurance contracts—while the PAA approach provides guidance for contracts with a duration less than one year—so most property and casualty contracts.

Below is a summary of the impact of the proposed changes on the PAA accounting model, as this will be the model primarily adopted by the non-life industry. We will start with a description of the changes between current U.S. GAAP and the FASB ED, and then provide a description of the changes between the FASB and IASB proposals.

The PAA is intended to be a somewhat simplified approach compared to the BBA. It does not require a present value of cash flow claim measurement until claims are incurred, though this is still a change over current accounting as today reserves are not discounted. The liability related to remaining coverage is essentially 'locked in' rather than remeasured each period, which is required under the BBA model. The PAA proposal is very similar to current U.S. GAAP accounting for short-duration contracts.

For FASB, the Premium Allocation Approach, or PAA will only be allowable if the coverage period is
- Less than one year, *or*
- At contract inception it is unlikely that during the period before a claim is incurred there will be significant variability in the expected value of the net cash flows required to fulfill the contract.

Most contracts that qualify as short duration contracts under existing U.S. GAAP would meet the PAA criteria under the FASB proposal. However, the proposed guidance may be subject to varying interpretations as it relates to whether or not there is significant variability in cash flows for contracts longer than one year. For example, the FASB specifically cites 18 month workers' compensation policies as being included; however, it is unclear based on the guidance whether multi-year contracts will be considered as having likely variability in expected cash flows.

From a balance sheet perspective, the premium receivable is the expected future premiums arising from the contract, and initially corresponds to pre-claim obligation (currently known as the unearned premium reserve). The pre-claim obligation, however, will be net of allowable direct acquisition expenses, which differs from current accounting. Revenue will be recognized over the coverage period based on timing of incurred claims, if that pattern differs significantly from the passage of time. This could be a change in revenue recognition for companies using a straight line pattern that have seasonal loss patterns (e.g. catastrophe writers) or aggregate coverages where claims are expected to be incurred in later periods after deductibles are met.

In another change, companies will be required to discount the liability for remaining coverage and outstanding claims in certain situations. Discounting is not required if the effects are immaterial or when the incurred claims are expected to be paid within one year of the insured event. The liability for incurred claims (currently known as reserve for claims and claim adjustment expenses) is the present value of the unbiased, probability-weighted estimate (e.g. the mean) of the future cash outflows for incurred claims (including IBNR). The statistical mean may be different from the current measure of management's best estimate that companies are required to reserve to under existing U.S. GAAP. In another change from current accounting, cash flows that are contingent on claims experience (e.g. loss sensitive features) are considered part of the claims cash flows rather than accounted for as premium adjustments, which is the industry norm today.

The selected discount rate used should reflect the characteristics of the liability. The selected discount rate at the initial recognition of the contract should be used to estimate the initial expense for claims incurred on the Income Statement. Any change in that discount rate subsequently will be reflected in the Statement of Other Comprehensive Income (OCI). This will help reduce the volatility in the income statement from changes in the discount rate.

There are also some proposed changes that will affect the accounting of reinsurance contracts:

- Reinsurance contracts must be accounted for using the same approach used to account for the underlying insurance contracts issued.
- For multi-year reinsurance contracts, one factor to be considered is whether or not at inception the insurer will significantly change premium pricing for future contracts written with similar risks (e.g. for multi-year catastrophe contracts if pricing is expected to change materially due to a market changing event). If possible, this could result in a change to the BBA approach.
- Currently risk transfer is assessed as a significant chance of a significant loss, and has unofficially been translated into practice as the 10/10 rule (a 10 percent chance of a 10 percent loss). The ED focuses on whether an insured event could cause a reinsurer to incur a significant loss (rather than a reasonable possibility of an insured loss). The proposal simply requires at least one scenario where the present value of net cash outflows can significantly exceed the present value of the premiums; the one exception is when substantially all of the insurance risk is transferred from the cedent to the reinsurer.
- Ceded premiums will be net of ceding commissions and other fees expected to be received from the reinsurer that are not contingent on claims experience.

- Reinsurance recoverables on unpaid losses will be adjusted for any loss sensitive features and estimated returnable amounts.
- Ceded reinsurance contracts assets would be recognized at the start of the reinsurance coverage period when coverage is based on aggregate losses of a portfolio of underlying reinsured contracts.
- Cedent accounting for retroactive reinsurance is relatively consistent with current guidance. Any day one gain would be deferred and earned over the remaining 'settlement period' (this is inconsistent with revenue being recognized over the coverage period rather than the settlement period). Any day one loss is recognized immediately. The ED, however, does not provide guidance on accounting for an assuming reinsurer. The assuming reinsurer can in theory account for it consistently with the ceding company, over a settlement period, though this would imply that there is not a coverage period. This would make it difficult to assess a BBA versus a PAA approach, which focuses on the length of the coverage period and the significance of variability in expected cash flows in the period before a loss is incurred. Questions also remain related to how to subsequently account for any margin on portfolio transfers.

The proposal would require retrospective application to all prior periods. Applying this approach would require restating all prior periods as if the new accounting model had existed since contract inception dates. The FASB did not provide an effective date, and instead will seek input from users to assist in determining this date.

Currently, companies reporting under IFRS are accounting for insurance contracts using their local GAAP guidance. This has led to great inconsistencies for insurance contracts accounting globally. As such, the likely outcome of the IASB project is a comprehensive IFRS standard on insurance. The IASB released its initial ED in July 2010, so the current ED reflects revisions resulting from comments on the original ED. Many of the key concepts in the updated ED are similar to those initially exposed in July 2010, however, the IASB made changes to address concerns regarding earnings volatility, and the presentation of OCI.

The ED has a 120 day comment period, but as this is a revised draft that already incorporates significant industry feedback, the IASB will only accept comments on the following five areas:

- Adjusting the contractual service margin
- Treatment of certain types of contracts with participating features
- Presentation of premiums and claims in the statement of comprehensive income
- Determining the interest expense in profit or loss, including the use of OCI for presenting the effect of changes in discount rates
- Approach to transition

The revised ED does not propose an effective date, but states that the effective date will be three years after the issuance of the final standard.

Again, the following comments will reflect key differences between PAA accounting under the proposed FASB and IASB exposure drafts.

- The IASB will only allow election of the PAA for coverage periods greater than one year when it is a reasonable approximation of the BBA. The IASB views the PAA as a proxy for the BBA whereas the FASB views the PAA as a separate model, aligned with existing IASB and FASB revenue recognition models.
- Qualifying direct acquisition costs under U.S. GAAP only include costs related to the successful acquisition of new business, whereas the IASB proposal would include costs related to the unsuccessful acquisition of new business.
- The IASB requires revenue recognition to be recognized on a basis consistent with the pattern of transfer of services rather than the coverage period as per the FASB.
- When calculating reserves, the IASB requires a specific risk margin in addition to the discounting of reserves, to ensure a gain at inception is not recorded. This margin represents the compensation that the entity requires to bear the uncertainty inherent in the amount and timing of the remaining cash flows.
- For reinsurance accounting, the IASB would require application of the classification criteria (e.g. use PAA only if it is a proxy for the BBA) rather than defaulting to the classification of direct contracts as per the FASB.

In terms of financial statement presentation, the FASB would require separate presentation for the BBA method and the PAA method if both are used; the IASB proposal would present this in one combined line item.

M&A Activity Update

Merger and acquisition (M&A) activity in the global insurance and reinsurance market rebounded in 2013. According to Capital IQ, global insurance sector M&A deal volume through the first seven months of 2013 totaled USD11.0 billion[3], compared to USD6.9 billion for the same period of 2012, an increase of almost 60 percent.

In the recent past, the market's improved underwriting conditions and increased (re)insurer valuation multiples have helped to defer M&A appetite. We believe the long-term trends of anemic growth, excess capital, increased alternative capital competition and the resulting inability for many (re)insurers to earn their cost of capital will increase the pressure to grow and improve returns via traditional M&A.

A summary of the current market trends affecting capital raising and M&A activity is as follows:

- **(Re)insurer stock price performance has been strong, tracking the broader equity markets.** As summarized in the ABS Weekly Public Market Recap[4], most global (re)insurers have enjoyed relatively robust stock price appreciation this year. This stock price performance has been greater than 13 percent for each of the major P&C (re)insurance indices, with several indices above 20 percent.
- **The resulting tangible book value multiples have returned to pre-crisis levels.** For many (re)insurers, especially specialty commercial (1.51x)[5] and personal line insurers (1.79x)[3], the recent stock price appreciation has elevated TBV multiples to levels not experienced for several years.
- **Incentive to continue or increase share repurchases is waning.** While the vast majority of (re)insurers have maintained share repurchase authorizations, most (re)insurers have lowered the priority of share repurchases given the economic benefit decline caused by richer valuations.
- **The generally favorable pricing environment has been offset by increased alternative capital competition in catastrophe reinsurance.** While commercial (re)insurers have continued to achieve rate increases in most lines of business, the alternative capital's dramatic increase in property catastrophe reinsurance has and will continue to impact the traditional markets' premiums and capital allocation. Many reinsurers are attempting to manage third party capital to ameliorate this impact.
- **Continued interest exists in specialty managing general underwriters (MGUs), wholesalers and fee for service providers.** Both strategic and private equity investors continue to demonstrate interest in acquiring distribution sources and services providers, including third party capital managers.
- **Hedge funds continue to develop permanent capital vehicles.** Hedge funds continue to establish off-shore reinsurers. These vehicles provide the hedge fund with a permanent asset base and fund investors with a more tax efficient investment vehicle along with the potential for greater future liquidity.

Over the near term, Aon Benfield Securities expects strategic investors to pursue consolidation in a focused "bolt-on" approach expanding into new geographies or products via acquisitions of underwriting teams or specialty units. Over the medium to longer-term, however, we expect the need to grow and improve returns via traditional whole-company M&A will intensify.

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[3] Based on publicly disclosed deal values in the global insurance brokerage, multiline and property and casualty subsectors.

[4] Aon Benfield Securities Weekly Public Market Recap is prepared and distributed to Aon Benfield clients each week. Please call your Aon Benfield representative to be added to the distribution list.

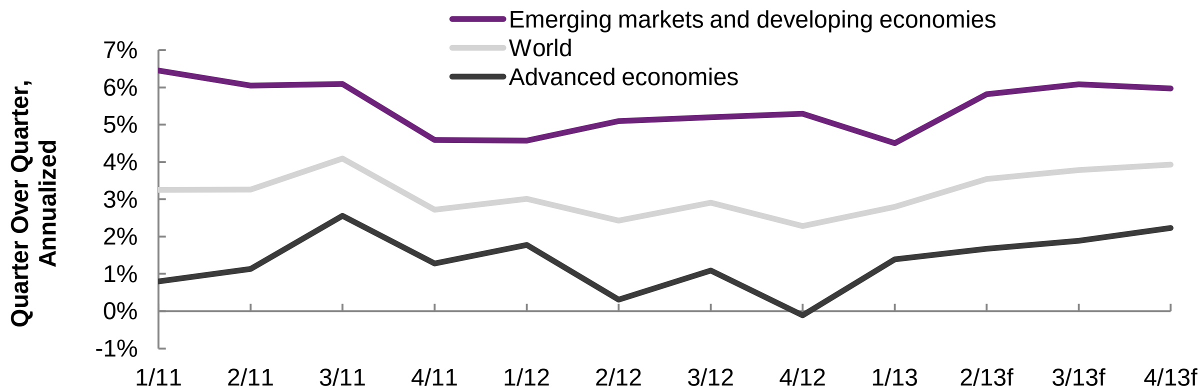
[5] Price to 6/30 Tangible Book Value multiple as of August 23, 2013.

Economic and Financial Market Update

The Global Economy

The second quarter of 2013 saw an acceleration of economic growth with global GDP estimated by the International Monetary Fund (IMF) to grow by an annualized 3.5 percent, up from 2.8 percent in the first quarter. Growth was driven primarily by China, the U.S., Japan and Germany and the U.S. remains a key growth engine, despite the limiting effect of cuts in public expenditure introduced earlier in the year. Notwithstanding these positive developments, in July the IMF lowered its growth projections for global GDP growth in 2013 and 2014 to 3.1 percent and 3.8 percent, respectively, both down by 0.2 percentage points compared with its projections in April 2013. The reduction was prompted principally by weakening demand and slower growth in several emerging economies and the protracted recession in the eurozone.

Exhibit 31: Global GDP Growth



Source: IMF World Economic Outlook

Projected growth in emerging and developing economies continues to outstrip that of the advanced economies, as illustrated below.

Exhibit 32: GDP Projections

Percent	2011	2012	2013f	2014f
World	3.9	3.1	3.1	3.8
Advanced economies	1.7	1.2	1.2	2.1
Euro area	1.5	-0.6	-0.6	0.9
France	2.0	0.0	-0.2	0.8
Germany	3.1	0.9	0.3	1.3
United Kingdom	1.0	0.3	0.9	1.5
United States	1.8	2.2	1.7	2.7
Japan	-0.6	1.9	2.0	1.2
Emerging market and developing economies	6.2	4.9	5.0	5.4
Central and Eastern Europe	5.4	1.4	2.2	2.8
China	9.3	7.8	7.8%	7.7
Brazil	2.7	0.9	2.5	3.2

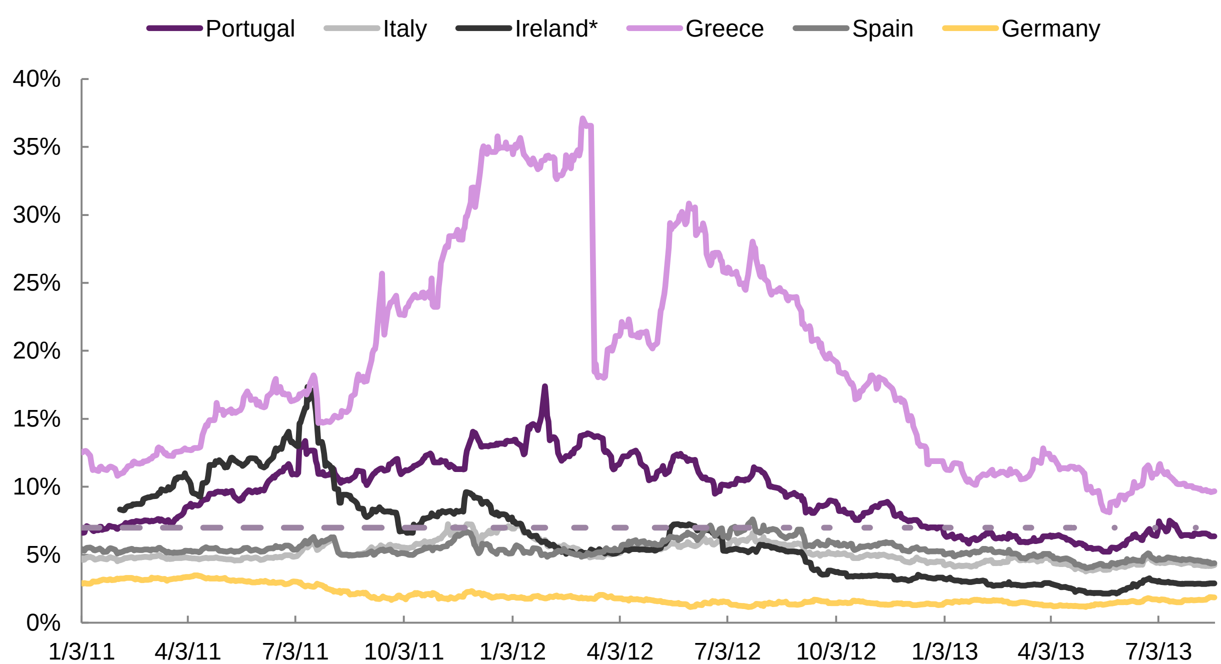
Source: IMF World Economic Outlook

Recent statistics show that, in the second quarter, the eurozone finally emerged from 18 months of recession with GDP growth of 0.3 percent or 1.1 percent annualized, a result which was stronger than many observers had expected. The upturn was led by Germany with growth of 0.7 percent and France which was up 0.5 percent. However, difficult conditions continued to prevail in Southern Europe with second quarter GDP declining 0.2 percent in Italy and 0.1 percent in Spain, although the fall was less severe than in recent quarters. Recovery gathered pace in the UK and there is evidence that second quarter GDP growth in the U.S. was stronger than initial estimates. The main monthly indicators in China have continued to improve through July, easing fears of a "hard landing", but growth in Japan slipped back to 2.6 percent from 3.8 percent in the first quarter. The Economist noted "macroeconomic policy in the rich world has become more growth-friendly"[6] but cautioned that conditions in Europe and Japan still did not point to a rapid and lasting recovery, and that internal adjustments in the Chinese economy mean it will not be a major spur to global growth. Consequently, it anticipates a recovery which is fragile and heavily dependent on the U.S.

The EU Debt Crisis

Concerns over the peripheral European sovereign debt crisis appeared to abate through early 2013 with increasing optimism that Europe might finally be emerging from recession and financial markets gained further confidence in the political will to manage through the eurozone's problems. Yields on government debt fell gradually, but there was an abrupt reversal in July prompted by the U.S. Federal Reserve's indication that it would reduce its asset purchase program which provoked a sharp rise in yields worldwide.

Exhibit 33: Eurozone 10-year Government Bond Yields



Source: Bloomberg (data as of August 19, 2013). * Ireland is 5-year

The crisis is still far from resolved and the so-called peripheral economies of Spain, Portugal, Italy, Ireland and Greece all have unsustainably high levels of government debt outstanding as a proportion of GDP.

[6] The Economist, A rickety rebound, August 17, 2013

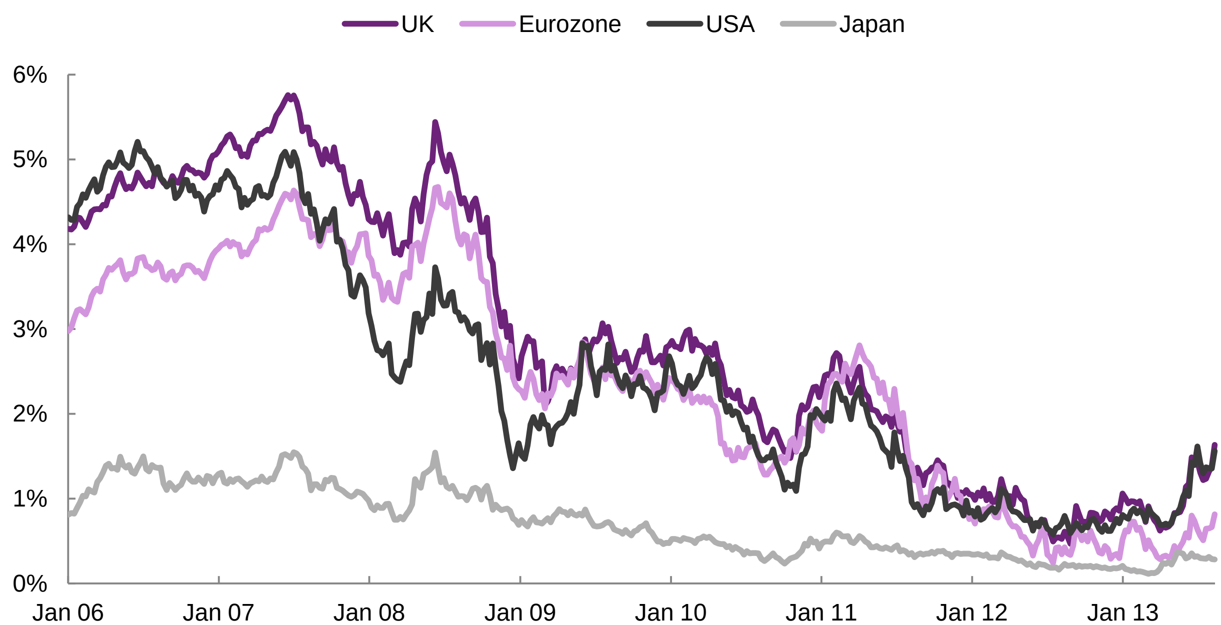
Thanks to its resilient economy, Ireland is due to leave the bail-out program at the end of the year, as planned, and return—at least partially—to the private markets for its financing needs, but the picture is less clear for Portugal and Greece (the other two recipients of European Central Bank assistance). Portugal remains dogged by a deep and persistent recession while Greece is saddled with debt projected to reach 175 percent of GDP at the end of the year and the size of its refinancing needs in the coming months suggest further aid will be required. While calm has descended on the markets in the run-up to the German elections in September when Chancellor Angela Merkel seeks a third term of office, economists fear a return of discord after the polls when the prospect of further bail-out funding emerges.

Financial Markets

Financial market volatility increased in the second quarter of the year compared to the first quarter, in reaction to comments from the U.S. Federal Reserve suggesting it would curtail its asset purchase program. Yields on government bonds rose sharply and there were major price fluctuations on global stock markets.

Governments around the world have targeted low interest rates and expansive monetary policy as key measures to stimulate economic recovery. The key U.S. Federal Funds Rate has been kept at a record low of 0.25 percent since December 2008 and the UK Bank Rate has been at 0.5 percent since March 2009 while the central banks of both countries have continued their government bond purchase programs. The European Central Bank lowered its benchmark Main Financing Rate by another 0.25 percentage point to 0.5 percent on May 2, 2013 and the Japanese Central Bank announced its intention to double its monetary base within two years (chiefly by buying government bonds) to promote economic growth and bring an end to deflation.

Exhibit 34: Five-year Government Bond Yields

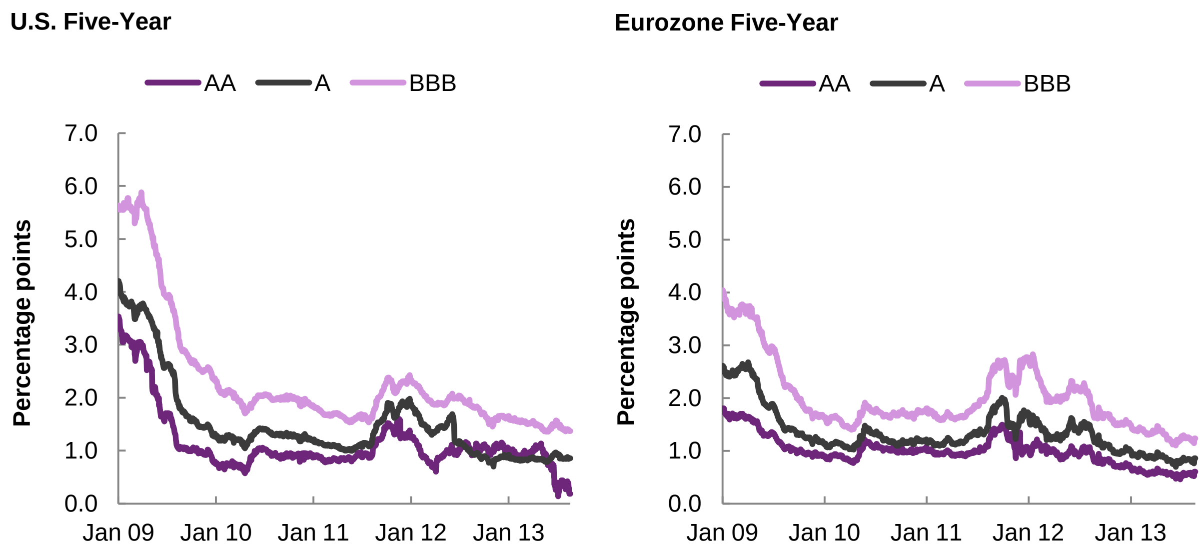


Source: Aon Benfield Analytics, Bloomberg

Weak economic conditions and measures to boost the global economy kept government bond yields at historical lows throughout 2012 and these conditions persisted into 2013. Yields were broadly stable during the first quarter, but those on European and U.S. debt rose sharply from late June and have remained high.

Starting the year at 0.71 percent, the yield on five-year U.S. Treasuries more than doubled to 1.56 percent by mid-August. At the same time, the yield on UK bonds rose from 0.85 percent to 1.63 percent, while that of Eurozone debt was up from 0.30 percent to 0.82 percent. The yield on Japanese bonds started the year at 0.19 percent, rising in April to peak at 0.37 percent before falling back to 0.28 percent.

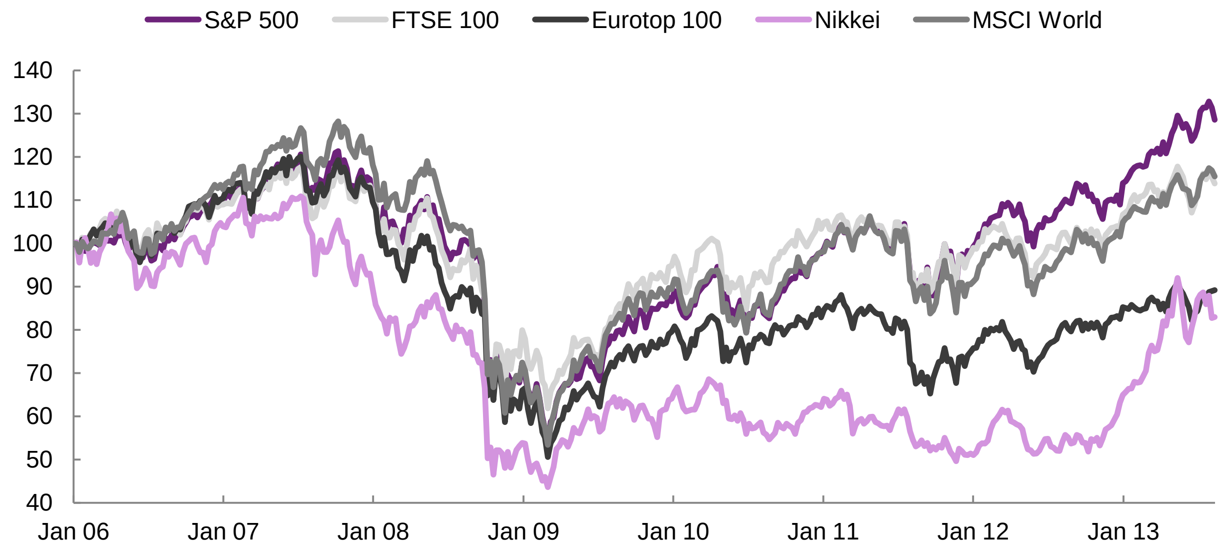
Exhibit 35: Five-year Corporate Bond Spreads over Government Debt



Source: Aon Benfield Analytics, Bloomberg

Investors’ credit risk appetite continued to grow through 2013 as spreads over Treasuries/government bonds tightened further, with the spread of U.S. AA rated issues just 0.19 percentage points over Treasuries. Spreads on lower rated issues from Europe and the U.S. were broadly equivalent at mid-August.

Exhibit 36: Equity Markets Index (January 2006 = 100)



Source: Aon Benfield Analytics, Bloomberg

Equity markets made a strong start to 2013 and the positive trend was only briefly interrupted by the Federal Reserve's comments. At mid-August, the S&P 500 index was up 18 percent since the start of the year. Stock markets in Europe (Eurotop 100) and the UK (FTSE 100) were up 8 percent and 10 percent, respectively, while Japan's Nikkei index jumped 31 percent over the period. The MSCI World index rose 14 percent.

Bank Leverage

Analysis of the 20 largest banks globally shows that total asset leverage, measured by total assets to shareholders' equity, continues to decline. Since year end 2012, ratios have declined steadily to 20.6, from 21.4. Implementation of the leverage ratio requirement begun in January 2013, and will proceed with public disclosure starting January 1, 2015. Any final adjustments to the definition and calibration of the leverage ratio will be made by 2017, with a view to migrating to a Pillar 1 treatment on January 1, 2018 based on appropriate review and calibration.

As of August 2013, Basel II has been adopted by 24 of the 27 Basel Committee member jurisdictions, Basel 2.5 has been adopted by 22, and Basel III has been adopted by 11 with varying degrees of progress in rulemaking for the remaining countries that have not adopted the various levels.

Exhibit 37: Top 20 Largest Banks Total Leverage

Name	6/30/08	9/30/08	12/31/08	12/31/09	12/31/10	12/31/11	12/31/12	3/31/13	6/30/13
Industrial & Commercial Bank of China L	17.1	16.1	16.2	17.5	16.4	16.2	15.6	15.4	15.4
HSBC Holdings PLC	20.1	23.0	27.0	18.8	16.9	16.4	15.6	15.3	15.2
Deutsche Bank AG	62.4	59.2	71.7	40.9	39.0	40.5	37.3	36.4	33.2
JPMorgan Chase & Co	14.0	16.4	16.1	12.9	12.6	12.9	12.1	12.1	12.3
BNP Paribas SA	42.1	45.2	48.6	33.5	30.0	28.9	24.3	22.4	23.6
China Construction Bank Corp	15.5	15.3	16.2	17.3	15.5	15.1	14.8	14.6	14.6
Mitsubishi UFJ Financial Group Inc	26.2	27.5	29.2	24.3	23.3	23.1	22.1	20.7	20.4
Barclays PLC	61.3	58.4	56.1	29.2	29.3	28.1	27.8	30.6	30.0
Credit Agricole SA	40.5	35.7	42.4	36.4	37.2	43.2	49.0	46.2	46.9
Agricultural Bank of China Ltd	-30.7	136.3	24.2	25.9	19.1	18.0	17.7	17.9	17.9
Bank of China Ltd	15.0	14.5	15.0	17.0	16.2	16.3	15.4	15.3	15.3
Bank of America Corp	12.4	13.4	13.0	11.5	10.7	10.1	10.1	10.0	9.8
Citigroup Inc	19.3	20.8	27.3	12.2	11.7	10.6	10.0	9.9	9.8
Royal Bank of Scotland Group PLC	30.5	34.7	40.8	21.8	19.3	20.1	19.3	18.5	17.6
Mizuho Financial Group Inc	52.5	64.9	80.1	57.4	39.3	45.3	35.8	32.0	31.4
Societe Generale SA	34.5	32.9	31.3	28.7	28.4	28.2	28.1	27.9	27.9
Banco Santander SA	18.5	19.0	18.2	16.2	16.2	16.4	17.0	17.5	17.2
Sumitomo Mitsui Financial Group Inc	35.0	35.4	41.9	34.1	26.6	28.3	25.4	23.4	22.2
Wells Fargo & Co	12.9	13.4	19.3	12.0	10.7	10.2	9.8	9.7	9.7
Lloyds Banking Group PLC	34.1	38.9	46.4	23.7	21.5	21.1	21.0	20.6	20.2
Average	**26.7**	**36.1**	**34.1**	**24.6**	**22.0**	**22.5**	**21.4**	**20.8**	**20.5**

Source: Aon Benfield Analytics

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