Aon Benfield

Insurance-Linked Securities

Q2 2016 Update

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Second Quarter 2016 Catastrophe Bond Transaction Review

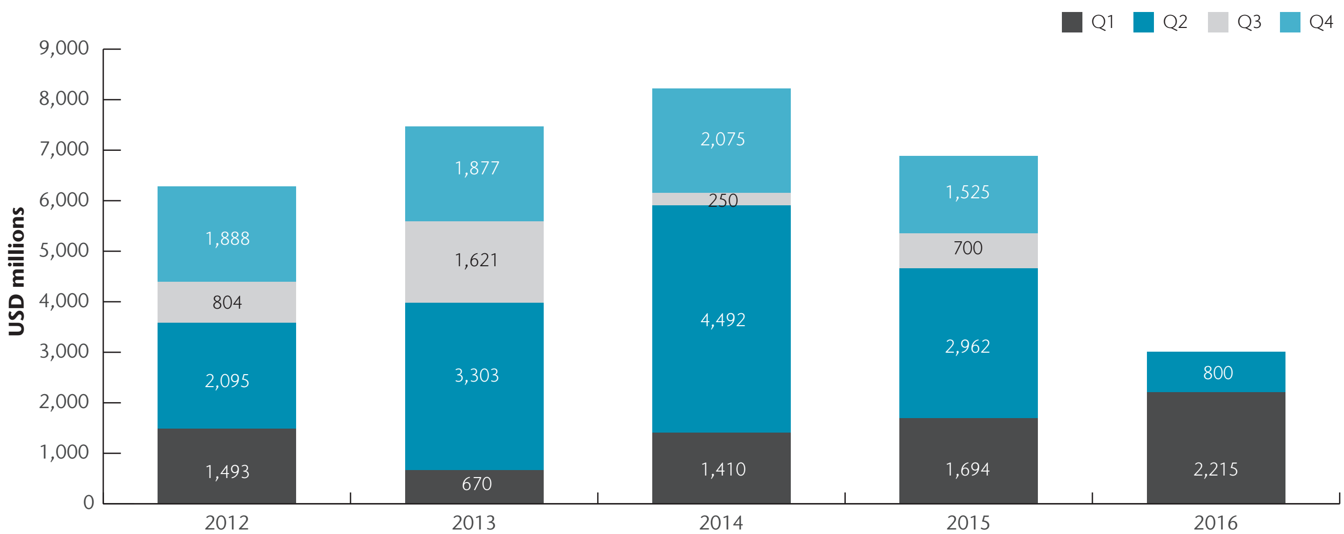
Following the record-breaking first quarter for catastrophe bond issuance, issuance in the second quarter of 2016 was relatively light. Total catastrophe bond issuance reached USD800 million, in what is typically one of the most active quarters. Such contraction can be in part attributed to competition from traditional markets as well as some sponsors' election to enter the alternative market earlier in the season. The impact of the light issuance was exaggerated by the significant amount of catastrophe bonds maturing in the quarter, with USD2.9 billion in limit coming off-risk.

Risk transferred to capital markets investors during the second quarter was at a relatively higher risk level—a trend that began in late 2015. The weighted average risk interest spread across Q2 catastrophe bonds was 8.40 percent, corresponding to a weighted average expected loss of 5.05 percent. This represented the highest average quarterly risk interest spread over the last four years, prior to which risk transfer costs were considerably higher on a relative basis.

The chart below shows catastrophe bond issuance by quarter since 2012.

First-time Florida cedants, Security First Insurance Company, and subsidiaries of United Insurance Holdings Corporation, secured coverage during the second quarter. The remaining Q2 cedants were all returning sponsors. A wide variety of risk-return profiles were available to investors across the five transactions brought to market—ranging from low single

Catastrophe Bond Issuance by Quarter



Source: Aon Securities Inc.

digits to almost 20 percent, a range that further demonstrates the flexibility of the capital markets over a broad spectrum of return periods. Further, the second quarter provided the most double digit yielding transactions since 2013.

In terms of perils, U.S. named storm and earthquake again dominated the market, with Queen Street XII Re dac the only bond to include a non-U.S. peril. United Services Automobile Association's latest issuance, Residential Reinsurance 2016 Limited, expanded coverage to include any natural event identified by Property Claim Services (PCS), excluding flood, and not already explicitly listed as a covered event.

During the quarter the increasing favorability of aggregate structures continued, with half of the tranches providing a form of aggregate coverage. This expansion was motivated by competitive pricing with aggregate spreads tightening relative to occurrence, as well as increasing numbers of perils and enhanced structures available on an aggregate multi-year basis. The quarter included a term aggregate structure in Blue Halo Re Ltd. Series 2016-1 ("Blue Halo Re"), where loss amounts accumulate over the course of a three-year risk period.

The table below summarizes the terms of the five catastrophe bond transactions that closed during the second quarter.

Second Quarter 2016 Catastrophe Bond Issuance

Beneficiary	Issuer	Series	Class	Size (millions)	Covered Perils	Trigger	Rating	Expected Loss[1]	Interest Spread
Second Quarter									
United Services Automobile Association ("USAA")	Residential Reinsurance 2016 Limited	Series 2016-1	Class 10	$65.0	US HU, EQ, ST, WS, WF, VE, MI, OP	Indemnity	Not Rated	8.80%	11.50%
			Class 11	$75.0			Not Rated	2.47%	4.75%
			Class 13	$110.0			BB- (S&P)	0.73%	3.25%
Münchener Rückversicherungs-Gesellschaft Aktiengesellschaft ("Munich Re")	Queen Street XII Re dac			$190.0	US HU, EU Wind	Industry Index	Not Rated	2.90%	5.25%
Security First Insurance Company	First Coast Re Ltd.	Series 2016-1	Class A	$75.0	FL HU, ST	Indemnity	Not Rated	1.31%	4.00%
United Property & Casualty Insurance Co, Family Security Insurance, Inc., Interboro Insurance Company	Laetere Re Ltd.	Series 2016-1	Class A	$30.0	US HU, EQ	Indemnity	Not Rated	2.76%	6.00%
			Class B	$40.0				5.98%	9.50%
			Class C	$30.0				13.18%	17.50%
Allianz Risk Transfer (Bermuda)	Blue Halo Re Ltd.	Series 2016-1	Class A	$130.0	US HU, EQ	Industry Index	Not Rated	8.56%	13.75%
			Class B	$55.0				13.19%	19.75%
Total Closed During Q2 2016				$800.0					

1 *Expected loss represents initial one-year annualized figures with WSST sensitivity when applicable*

Source: Aon Securities Inc.

Legend

EU – Europe
FL – Florida
US – United States
EQ – Earthquake
HU – Hurricane
MI – Meterorite Impact
OP – Other Perils
ST – Severe Thunderstorm
VE – Volcanic Eruption
WF – Wildfire
WS – Winter Storm

First Coast Re Ltd. provides Security First Insurance Company with USD75 million of indemnity protection against named storms and severe thunderstorms. The transaction utilizes a top and drop structure, common with Florida cedants, allowing the covered layer to lower for subsequent events.

Laetere Re Ltd. provides cascading indemnity protection to subsidiaries of United Insurance Holdings Corporation, allowing the covered layer to lower as underlying stated reinsurance is eroded. The three classes of notes provide a total of USD100 million of coverage for losses arising from named storms and earthquakes in peak-exposed regions (excluding California quake). The one-year notes were issued at a discount to par, which is relatively uncommon in the capital markets. The notes provided investors with a wide range of risk with modeled expected losses between 2.76 percent and 13.18 percent (WSST sensitivity basis).

Blue Halo Re provides three-year term aggregate U.S. multi-peril coverage to Allianz Risk Transfer (Bermuda) Limited. The transaction, which was upsized from its initial target size, provides USD185 million of coverage on an industry index basis for losses arising from named storms and earthquakes in the United States. Of further note, Blue Halo Re was the first transaction to utilize Aon's CATstream® program—a streamlined issuance platform which allows an expedited process for issuance—and was also the first multi-peril and the first U.S.-exposed term aggregate catastrophe bond to come to market since 2011.

Second Quarter 2016 Secondary Trading Update

Secondary markets were less active in the second quarter of 2016 than in the first quarter of 2016. According to FINRA's Trade Reporting and Compliance Engine (TRACE), there were 218 trades totaling USD245.23 million in the period[2] . This represents a decrease in trade volume of more than 32 percent compared to Q1 2016, while the dollar volume of reported trades decreased just over 20 percent from Q1 2016. This was partially due to a reduction in primary issuance as there were only five new bonds issued in the second quarter.

Prices continued to rise in the secondary market due to the lower amount of new issues as well as the maturity of USD2.9 billion in bonds in the quarter. Investors continued to utilize the secondary market to redeploy available capital, resulting in more buyers than sellers. This trend held steady throughout the quarter especially as there were no primary issuances in April. The one notable exception to this was Gator Re Ltd. Series 2014-1 ("Gator Re") whose aggregate retention was partially eroded due to thunderstorm losses, causing the price to decrease significantly to 76 cents in mid-June before partially rebounding to 80.5 later in the month.

Catastrophe bonds that reported 10 trades or more included Everglades Re Ltd. Series 2014-1 ("Everglades Re 2014-1") and Acorn Re Ltd. Series 2015-1 ("Acorn Re 2015-1"). Of note, Vitality Re V Limited Series 2014, Class A ("Vitality Re V A") reported only six trades but the dollar volume of trades was nearly nine percent of the total for Q2 at USD21.5 million. Most of these trades occurred on a single date and prices were stable throughout.

Everglades Re 2014-1 traded heavily in the last few days of the quarter, with prices slightly lower from the all-time high in April. The slight reduction in pricing correlates with the U.S. hurricane season, which began June 1. By contrast, the west coast earthquake exposed Acorn Re 2015-1 continued to be utilized as a portfolio diversifier, having achieved steady price increases throughout the quarter, rising from 101.25 to 103.25. Similar price increases were achieved for other portfolio diversifiers, as strong demand endured throughout the quarter for earthquake and non-U.S. bonds.

While the primary market is not typically as active during the third quarter due to the U.S. hurricane season, our firm does expect an active second half of 2016. Many investors have capital to deploy which should continue to lead to further secondary price increases. Overall, we believe the market will continue to be attractive for sponsors that choose to incorporate alternative capital.

2 *Note that this is an underestimate of total market volume as trades in bonds rated below investment grade are capped at USD1 million, and foreign trades as well as trades by non-U.S. broker dealers are excluded*

Aon ILS Indices

The Aon ILS Indices are calculated by Bloomberg using month-end price data provided by Aon Securities Inc.

During the quarter, all Aon ILS Indices posted gains. Similarly, the Aon ILS Indices all posted gains in the second quarter of 2015, but the growth rate was much larger in 2016. The U.S. Earthquake Bond index posted the greatest growth for the quarter with a return of 1.92 percent. The All Bond and U.S. Hurricane Bond indices posted similar returns of 1.67 and 1.66 percent, respectively, while the BB-rated Bond index posted a return of 1.39 percent. The Aon ILS Indices performed with mixed results relative to benchmarks, outperforming the 3 to 5 year U.S. Treasury Notes index and with comparable returns to the S&P 500 and the CMBS 3 to 5 year Fixed Rate indices.

The annual returns for the year ended June 30, 2016 of all Aon ILS Indices also exceeded the prior year's annual returns, a continued pattern from the year ended March 31, 2016. The index gains are in part attributable to price appreciation driven by increased demand in the secondary market, which has persisted in the continued absence of a major catastrophe event. The 10-year average annual return of the Aon All Bond Index, 8.56 percent, further produced superior returns relative to all other benchmarks. This demonstrates the value a diversified book of pure insurance risks can bring to long term investors' portfolios.

Aon ILS Indices[3]

Index Title	Return for Quarterly Period Ended June 30		Return for Annual Period Ended June 30	
Aon ILS Indices	2016	2015	2016	2015
All Bond Bloomberg Ticker (AONCILS)	1.67%	0.54%	6.84%	2.81%
BB-rated Bond (AONCBB)	1.39%	0.36%	5.34%	0.46%
U.S. Hurricane Bond (AONCUSHU)	1.66%	0.37%	7.73%	5.66%
U.S. Earthquake Bond (AONCUSEQ)	1.92%	0.39%	4.85%	2.59%
Benchmarks				
3-5 Year U.S. Treasury Notes (USG2TR)	1.20%	-0.24%	4.10%	2.05%
3-5 Year BB U.S. High Yield (J2A1)	3.97%	0.69%	3.90%	2.18%
S&P 500 (SPX)	1.90%	-0.23%	1.73%	5.25%
ABS 3-5 Year, Fixed Rate (R2A0)	1.94%	0.11%	3.58%	2.36%
CMBS 3-5 Year, Fixed Rate (CMB2)	1.63%	-0.26%	4.28%	2.21%

Source: Aon Securities Inc., Bloomberg

[3] *The 3-5 Year U.S. Treasury Note index is calculated by Bloomberg and simulates the performance of U.S. Treasury notes with maturities ranging from three to five years.*

The 3-5 Year BB U.S. High Yield index is calculated by Bank of America Merrill Lynch (BAML) and tracks the performance of U.S. dollar denominated corporate bonds with a remaining term to final maturity ranging from three to five years and are rated BB1 through BB3. Qualifying securities must have a rating of BB1 through BB3, a remaining term to final maturity ranging from three to five years, fixed coupon schedule and a minimum amount outstanding of $100 million. Fixed-to-floating rate securities are included provided they are callable within the fixed rate period and are at least one year from the last call prior to the date the bond transactions from a fixed to a floating rate security.

The S&P 500 is Standard & Poor's broad-based equity index representing the performance of a broad sample of 500 leading companies in leading industries. The S&P 500 Index represents price performance only, and does not include dividend reinvestments or advisory and trading costs. The ABS 3-5 Year, Fixed Rate index is calculated by BAML and tracks the performance of U.S. dollar denominated investment grade fixed rate asset backed securities publicly issued in the U.S. domestic market with terms ranging from three to five years. Qualifying securities must have an investment grade rating, a fixed rate coupon, at least one year remaining term to final stated maturity, a fixed coupon schedule and an original deal size for the collateral group of at least $250 million.

The CMBS 3-5 Year, Fixed Rate index is calculated by BAML and tracks the performance of U.S. dollar denominated investment grade fixed rate commercial mortgage backed securities publicly issued in the U.S. domestic market with terms ranging from three to five years. Qualifying securities must have an investment grade rating, at least one year remaining term to final maturity, a fixed coupon schedule and an original deal size for the collateral group of at least $250 million.

The performance of an index will vary based on the characteristics of, and risks inherent in, each of the various securities that comprise the index. As such, the relative performance of an index is likely to vary, often substantially, over time. Investors cannot invest directly in indices.

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