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GUY CARPENTER

CAPITAL STEWARDSHIP: CHARTING THE COURSE TO PROFITABLE GROWTH

MID-YEAR

MARKET OVERVIEW

SEPTEMBER 2013

MARSH & McLENNAN COMPANIES

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I. EXECUTIVE SUMMARY

OVER THE LAST 18 MONTHS USD 10 BILLION IN NEW CAPITAL HAS ENTERED THE MARKET, WITH THE GREATEST EFFECT IN THE U.S. PROPERTY CATASTROPHE REINSURANCE MARKET.

Guy Carpenter is pleased to present our mid-year report on the reinsurance market at a time of dynamic capital growth in the sector. The reinsurance marketplace has undergone significant change since early 2012 as investors continue to supply capacity through a convergence of alternative and traditional vehicles. This new supply has changed the nature of the sector's capital structure. It has also exerted downward pressure on reinsurance pricing, thereby delivering a more cost efficient source of risk transfer.

In total, around USD10 billion of new capital has entered the market in the form of catastrophe bonds, structured industry loss warranties (ILW) and collateralized reinsurance over the last 18 months as a growing number of institutional investors have been attracted to reinsurance by higher yields and low correlations. Capital emanating from alternative markets has grown significantly during this period and now accounts for an estimated USD45 billion, approximately 14 percent of global property catastrophe limit purchased.

The U.S. property catastrophe reinsurance market has been most affected by the influx of convergence capital, with double digit rate reductions observed during the 2013 mid-year renewals. While the impact was less dramatic elsewhere, general downward rate movements were recorded for property business in several other regions. There was also some evidence that competition was spilling over into other business segments. Market expectations are for these trends to continue for the rest of the year and into the January 1, 2014, renewal should no significant catastrophe loss occur in the second half of 2013. This is a positive development for reinsurance buyers.

In the current environment of soft pricing and excess capital, reinsurers are confronted with the difficulty of having to decide how to deploy this capital to generate returns that satisfy investors' and/or shareholders' expectations. The balance of options under consideration will include maintaining the status quo, returning capital to shareholders, pursuing organic growth or seeking merger and acquisition (M&A) opportunities.

Evaluating the merits of each option and the interplay between the options is not an easy assessment, with the best capital stewards often employing a strategy encompassing all four approaches.

Increasingly, the focus for growth and competitiveness in an evolving market is moving towards more M&A activity, particularly strategic bolt-on transactions as the need to adapt business models to achieve scale, global reach and a more diversified product suite increases.

Guy Carpenter is committed to assisting carriers in plotting their path to sustainable profitable growth and becoming their trusted strategic advisor. GC Securities*, a division of MMC Securities Corporation, a U.S. registered broker-dealer and member FINRA/NFA/SIPC, provides an industry-leading M&A advisory business with deep industry experience and a successful track record. The team is committed to advising and assisting Guy Carpenter clients with their M&A strategies to exploit growth opportunities as they arise. In Europe, GC Securities is a division of MMC Securities (Europe) Ltd. (MMCSEL), which is authorized and regulated by the Financial Conduct Authority.

II. CONVERGENCE CAPITAL AND EXCESS CAPACITY

FROM THE END OF 2011 TO THE END OF THE SECOND QUARTER OF 2013, CONVERGENCE CAPITAL CONTRIBUTED HALF OF THE GROWTH IN GLOBAL DEPLOYED REINSURANCE CAPITAL. THE NEW SUPPLY IS CHANGING THE NATURE OF THE SECTOR'S CAPITAL STRUCTURE.

The capital supporting the obligations of the global reinsurance sector has witnessed dynamic growth during the last 18 months. A significant contributor to this growth has been the influx of convergence capital. The surge in this capital has been driven by increased supply from institutional investors seeking access to a comparably high yielding, non-correlating asset as part of an allocation within an alternative asset management strategy. This new supply of what appears to be a permanent allocation to the reinsurance space is changing the nature of the sector's capital structure as it adds to the competitive environment for reinsurance capacity and comes with an expectation of a relatively lower return per unit of risk.

Convergence capital contributed half of the growth in global deployed reinsurance capital from USD178 billion at the end of 2011 to USD195 billion at the end of the second quarter of 2013. The most tangible evidence of the impact of convergence capital is being seen in the U.S. property catastrophe reinsurance market, with material pricing declines in areas where this capital is seeking to be deployed. General downward rate movements have also been observed in several other regions and across some other classes, including retrocession and casualty business.

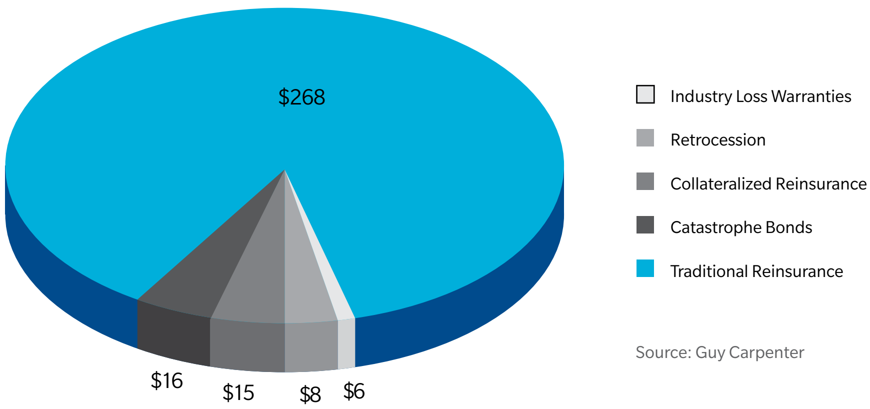
Despite the sustained headwinds of low investment yields and diminishing reserve releases, excess capital and the impact of convergence is challenging traditional reinsurers to reduce their price expectations and adapt their business models to remain competitive.

GROWTH OF CONVERGENCE CAPITAL

The sector has seen robust catastrophe bond, structured ILWs and collateralized reinsurance activity throughout the last 18 months. In total, around USD10 billion of new capital has entered the global market in these various forms over this period. This segment of the reinsurance market now accounts for an estimated USD45 billion of capacity, approximately 14 percent of global property catastrophe limit purchased, and the penetration of this capacity is growing.

Guy Carpenter continually monitors the breakdown of convergence capacity in the insurance-linked securities (ILS) market. As Figure F-1 shows, outstanding catastrophe bonds account for more than a third of this capacity (at USD16 billion), though the greatest rate of growth is being seen in collateralized reinsurance (currently USD15 billion).

F-1 | GLOBAL PROPERTY CATASTROPHE REINSURANCE CAPACITY BY SOURCE (USD BILLION)



Source: Guy Carpenter

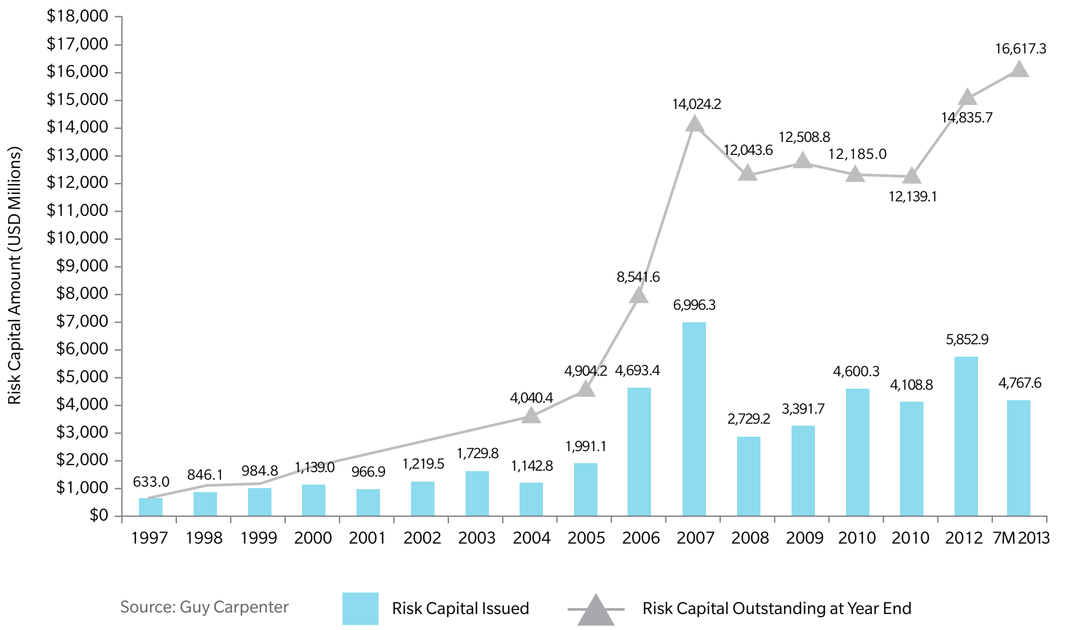
The capital supporting convergence capacity is increasingly stable institutional money that has made a long-term commitment to the reinsurance market.

Although some allocations to the sector may exit once investment returns in other comparable asset classes pick up, the commitment to the sector from such a broad range of institutional investors suggests this is a permanent alternative asset strategy allocation. This is a positive development for reinsurance buyers.

Institutional investors are gaining confidence in the asset class and, providing they do not experience material surprises significantly outside the range of modeled expected loss probabilities from the risks they are assuming, they will continue to support, or even increase, their allocations to the sector following a large catastrophe event.

Pension funds have been a major contributor to the growth in new capital. Their focus on relatively remote peak peril catastrophe risk has contributed to the boom in the catastrophe bond market during 2013, with issuance reaching USD4.8 billion in the first seven months (see Figure F-2). Risk capital outstanding also reached an all-time high of around USD16.6 billion during the same period. Given the strong demand that is anticipated for the remainder of the year, GC Securities expects 2013 catastrophe bond issuance to approach or exceed the record amount of USD7 billion recorded in 2007.

F-2 | CATASTROPHE BOND ISSUANCE AND CAPITAL OUTSTANDING – 1997 TO JULY 31, 2013



Source: Guy Carpenter

IMPACT ON THE REINSURANCE MARKET

The growth in convergence capital has resulted in ILS catastrophe risk pricing decoupling from price expectations in the traditional reinsurance market, with some ILS products now offering the most competitive terms for reinsurance buyers. Strong appetite for U.S. hurricane catastrophe bonds, for example, has tightened spreads in the secondary market by an average of approximately 45 percent on a weighted notional basis since issuance in 2012. Despite the significant decrease in ILS pricing over the last 12 months, investor demand continues to be robust. Indeed, projections by GC Securities indicate that the catastrophe bond market alone could reach USD23 billion by the end of 2016.

The decrease in traditional reinsurance pricing has been as equally dramatic as reinsurers have responded to this competitive threat.

Pricing for property catastrophe business in the United States in particular has fallen considerably.

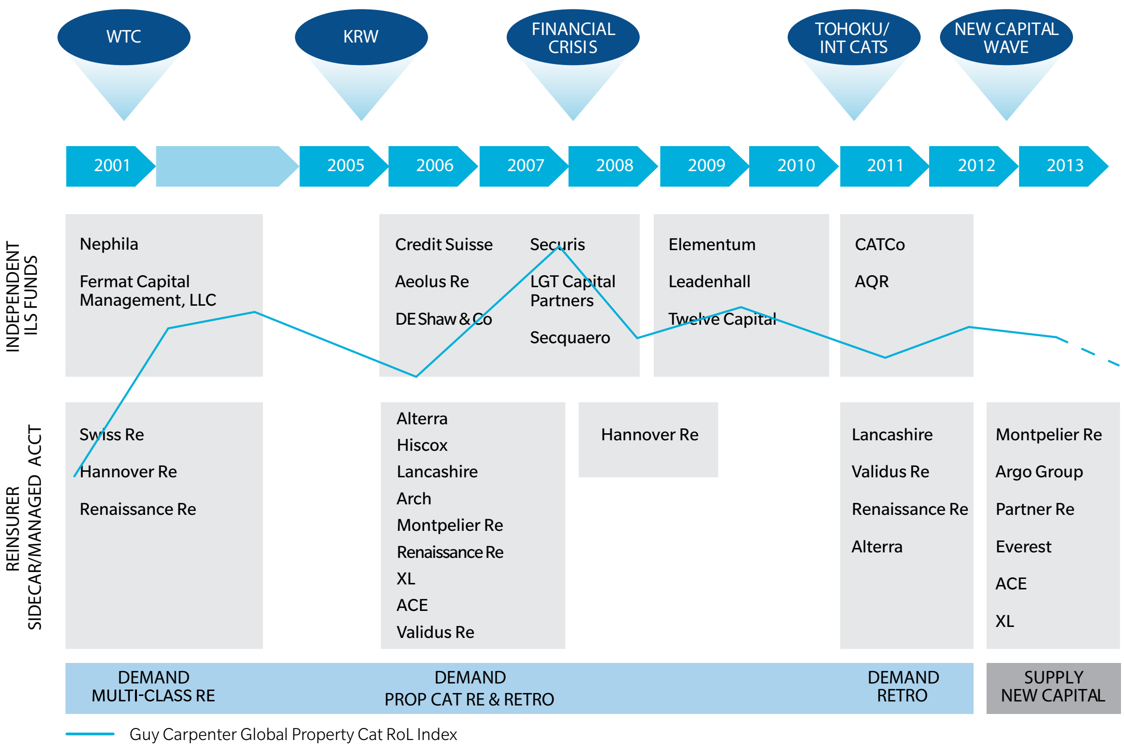
While the impact of convergence market participants has been less marked in non-U.S. property catastrophe classes, general downward rate movements have been observed for property business in several other regions. Furthermore, there was some evidence during the 2013 renewal season that competition was spilling over into other business segments as traditional reinsurers' capital was redeployed, convergence participants started to explore other modeled risk classes and a new wave of hedge fund sponsored reinsurers gained traction. Absent significant catastrophe losses in 2013, market expectations are for these trends to continue throughout the year and into the January 1, 2014, renewal.

The influence of products and pricing available from convergence market participants and hedge fund sponsored reinsurers poses important questions for the traditional reinsurance market.

Some reinsurers have already responded to the challenge by developing strategies to exploit the demand for the asset class from investors. Indeed, many reinsurers have hired capital markets executives and established operating divisions of their own to attract and manage capital from these investors. This allows reinsurers the opportunity to securitize the most capital-intensive parts of the business while providing valuable cost-efficient capacity to their clients by leveraging their access to business and depth of underwriting, risk management and claims management expertise. More firms are expected to follow this trend.

Figure F-3 shows that the recent wave of reinsurer sponsored ILS asset management products and platforms differs from previous activity and is in direct response to the threat from the convergence market. Previous moves into this market were demand driven in response to capacity needs and market hardening following major catastrophe events such as WTC (2001), Katrina (2005) and the New Zealand/Tohuku earthquakes (2011).

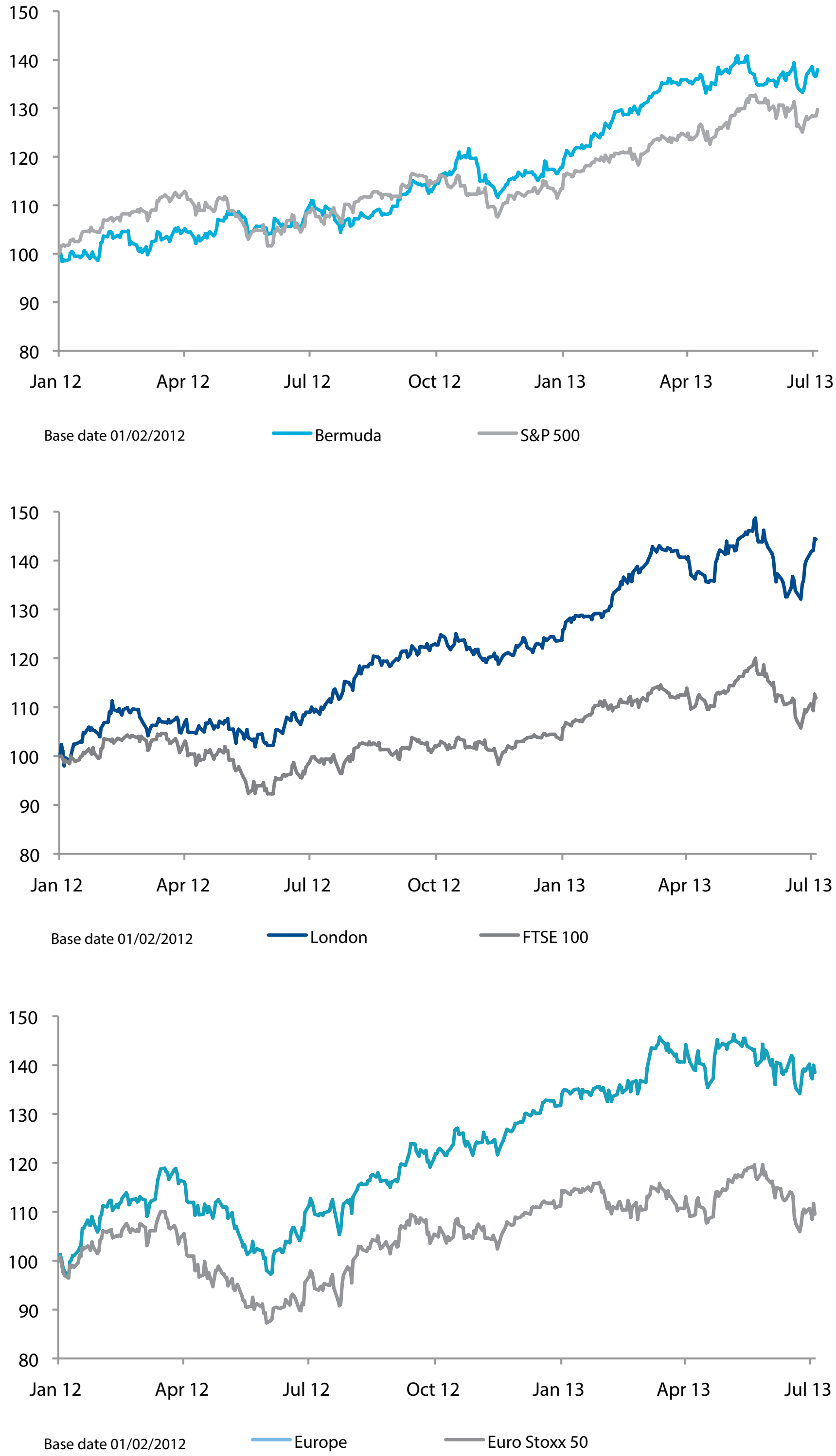
F-3 | ALTERNATIVE CAPACITY DEVELOPMENT – 2001 TO H1 2013



EFFECT ON VALUATIONS

Figure F-4 highlights the relative share price performance of the reinsurance sector since January 2012, which can be considered the start of the new wave of convergence capital. The clear upward trend has benefited investors during this time.

F-4 | INDEXED (RE)INSURER SHARE PRICES



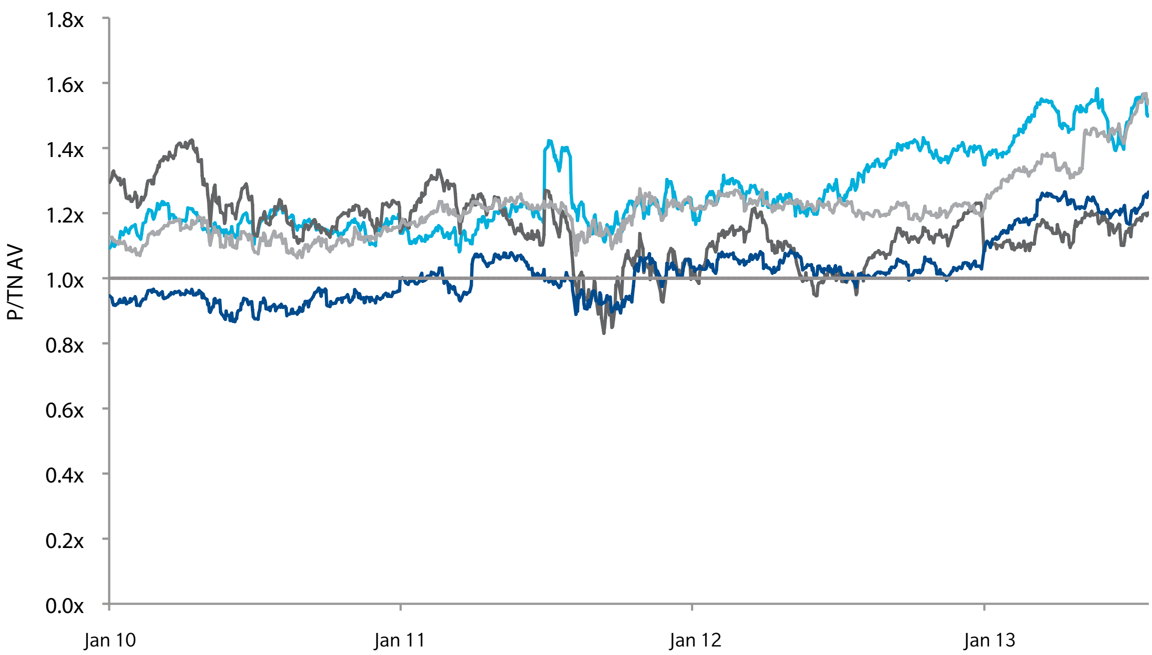
Source: Guy Carpenter, Bloomberg

The charts also show that while valuations were starting from a relative low point following the global financial crisis and significant catastrophe losses in 2011, the reinsurance sector has significantly outperformed the benchmark equity indices over the last 18 months. This outperformance has occurred despite challenging macroeconomic factors, including low interest rates, benign premium growth in mature markets, softening pricing and increased competition in the high margin property catastrophe market.

Positive sentiment from equity market analysts and investors continue to drive valuations higher, likely reflecting the recent improved economic outlook, absence of major catastrophe losses and confidence in (re)insurers' management teams to adapt to market conditions and deliver a positive total return to shareholders in excess of the cost of capital. The second quarter 2013 reporting season showed that good returns continued to be made across the sector following a period of relatively light catastrophe activity. However, there were signs of pressure on premium growth and volatility in the investment portfolio.

Figure F-5 highlights the relative valuation differential between the reinsurance markets of Europe and Bermuda, compared to the more diverse London and U.S. specialty markets.

F-5 | PRICE/TNAV CHARTS GUY CARPENTER GLOBAL REINSURANCE COMPOSITE – 2010 TO H1 2013



Source: Guy Carpenter, Bloomberg

London Europe Bermuda US Specialty

For the period 01/01/2010 - 07/25/2013

While there has been a pick-up in valuations across all (re)insurance markets since early 2012, specialty class markets in London and the United States continue to attract premium valuations. This is a reflection in part of the lower perceived earnings volatility in such specialty markets but it is also indicative of the positive pricing and competitive differential opportunities that exist in many specialty underwriting classes. With increasing competitive pressures from the convergence market building on reinsurers, a number of companies have expanded their platform beyond reinsurance and into specialty insurance.

III. CAPITAL STEWARDSHIP

With an abundance of excess capital, negligible growth in global reinsurance spend and the pricing outlook continuing to soften, one of the biggest challenges facing reinsurers is deciding how to deploy this excess capital to generate a return that meets or exceeds the expectation of investors or shareholders. In this section, we consider four options good capital stewards in the reinsurance sector are currently considering: maintaining the status quo, returning capital to shareholders, pursuing organic growth or seeking M&A opportunities. The decision is not an easy one, with the best stewards employing a strategy encompassing all four options, depending upon their judgment of the market outlook and opportunities for growth.

MAINTAINING THE STATUS QUO

The first option for carriers with excess capital to consider is simply to maintain the status quo. There has often been reluctance (perceived or otherwise) among reinsurers to return excess capital to shareholders and there are a number of reasons why this strategy makes sense. Excess capital acts as a buffer against future losses, particularly relevant in today's world of low investment returns, volatility in fixed income valuations and diminishing reserve releases.

While the catastrophe losses of 2012 and the first half of 2013 were earnings events for the sector, we only need to look back to the series of international catastrophe losses in 2010 and 2011 and the subsequent distressed acquisitions or recapitalizations of badly hit companies to observe the ramifications of overexposure to certain markets.

Following such events, (re)insurers want to be best placed to take advantage of a hardening rate environment. Maintaining an excess level of capital that can be quickly deployed is often considerably less time-consuming, less expensive and more certain than raising capital post event.

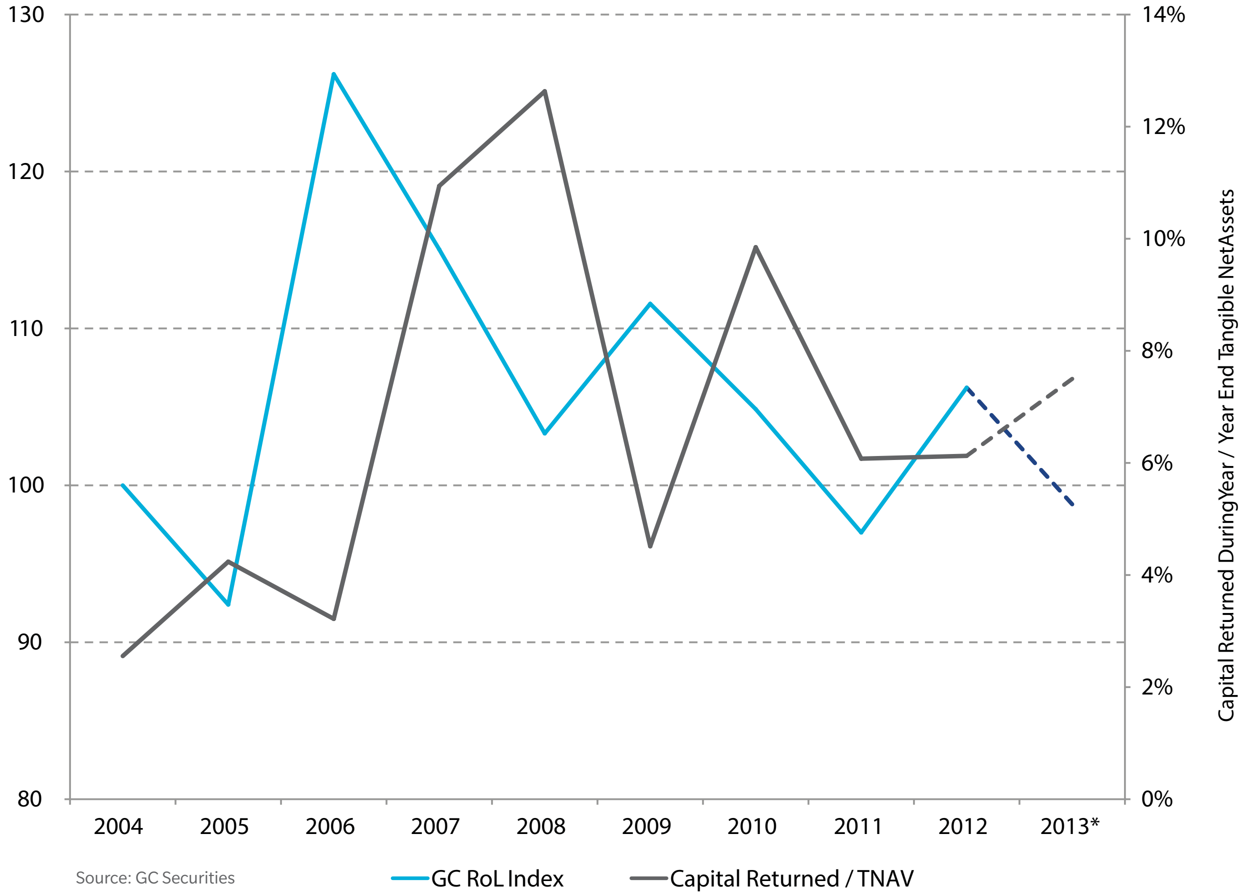
Increasing retentions and cutting reinsurance spend is another way to apply excess capital. However, given current capacity and competitive rates available in the reinsurance and retrocession markets, it is debateable whether this is time to be retaining more risk.

Despite the merits of such strategies, disciplined capital stewards should be wary of holding on to excess capital for too long. Excess capital is dilutive to return on equity, and consequently dilutive to market valuation. To the extent capital cannot be used to generate a return greater than its cost in the short to medium term, the more appropriate course of action is to return it to shareholders.

RETURN TO SHAREHOLDERS

As a principle, excess capital should be returned to shareholders in periods of low return opportunity (particularly below cost of capital) while more capital should be retained/deployed during periods that offer higher returns. Figure F-6 shows that reinsurers have been relatively disciplined over the last eight years, with carriers returning more capital when the pricing environment has softened. This was clearly evident during the soft market of 2008, when 13 percent of tangible net asset value (TNAV) was returned to shareholders. Conversely, only 3 percent of TNAV was returned to shareholders when the market hardened in 2006. Given the relatively soft pricing environment of 2013, we expect the level of capital returned to increase from the 6 percent of TNAV seen in 2012.

F-6 | GUY CARPENTER GLOBAL REINSURANCE COMPOSITE RETURN OF CAPITAL OVER THE CYCLE (ROL AND VALUATION) – 2004 TO 2013



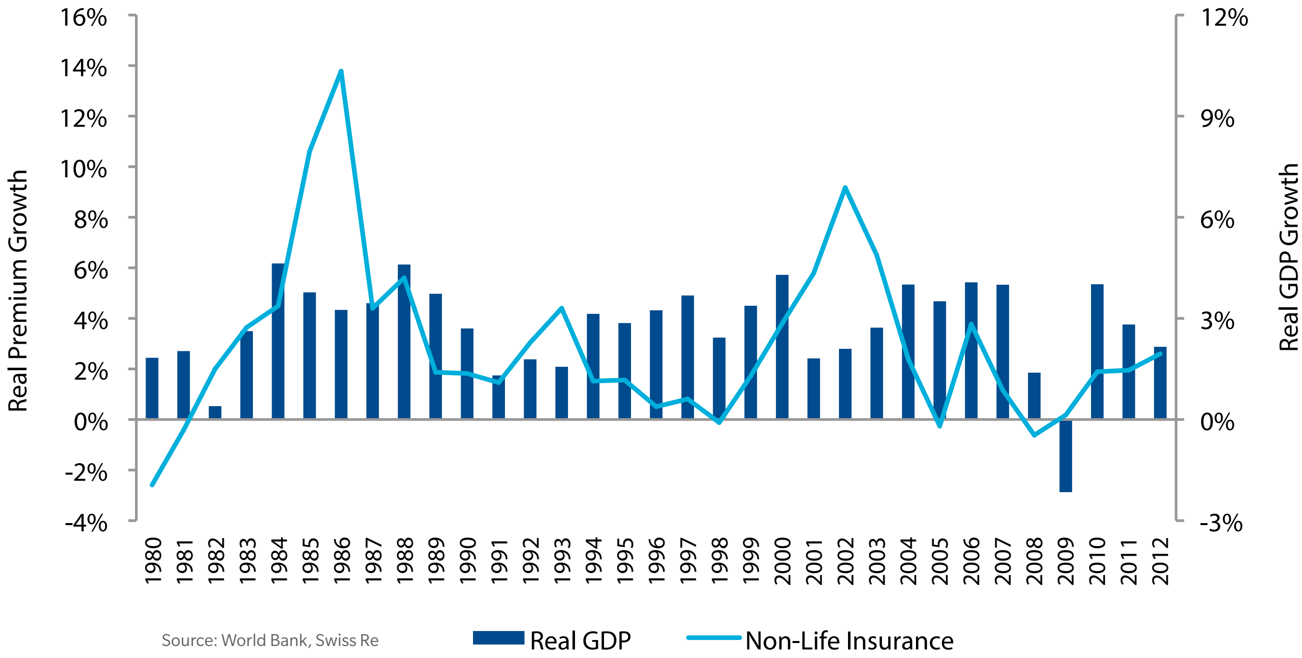
Source: GC Securities

* 2013 figures are Guy Carpenter estimates

ORGANIC GROWTH

Organic growth is often perceived as being the low risk growth option. However, this is difficult to achieve in the current economic environment. Figure F-7 shows the inherent correlation in mature markets between gross domestic product (GDP) growth and insurance premium spend. In the current weak macroeconomic environment, the outlook for (re)insurance premium spend in mature markets is expected to continue to be benign. Even with a disciplined underwriting approach, the current excess capital available in the reinsurance market and increased competition from convergence players means 2013 will likely see more risks being assumed for the same, if not less, return than 2012. These challenging market conditions make accretive organic growth opportunities in mature markets very limited.

F-7 | REAL GDP GROWTH VERSUS INSURANCE GROWTH – 1980 TO 2012



Source: World Bank, Swiss Re

When deciding on a growth strategy, managements need to take into consideration a number of issues in determining whether organic or acquisitive growth is most appropriate. In reality, a combination of both is likely to feature in the most successful strategies, with decisions made on an opportunity-by-opportunity basis. Table T-1 highlights some of the key considerations when developing a growth strategy.

T-1 | ORGANIC GROWTH VERSUS ACQUISITION

CONSIDERATION	ORGANIC GROWTH	ACQUISITION	
Regulatory risk	✘	✓	• Licensing and local market regulators require time and money to be achieved and are not given • Acquisition approval is a less substantial hurdle
Target availability	–	✓	• Many potential worldwide acquisition targets. Starting a new LoB requires identification and hiring of suitable personnel or developing in house capability
Timetable to market	✘	✓	• Time from first considering a new line to commence underwriting likely to be > 9 months and can take materially longer. Acquisition follows normal M&A timetables (3 to 6 months)
Cost	?	?	• Opportunity cost and start-up expenses incurred in building a new business line need to be compared to acquisition goodwill
Transaction profile	–	✓	• Acquisition likely to be percieved as a stronger statement of intent regarding international expansion ambitions
Speed to critical mass / pipeline	✘	✓	• New line of business generally looking at <$10m of first year GWP. Acquisitions will be larger and benefit from pipeline profitablilty of in force portfolio. • Organic growth in an established market means cannibilisation of existing premium. Acquisition means removal of competition
Legacy risk	✓	✘	• Starting a new LoB comes with a clean balance sheet
Strategic portfolio alignment	✓	–	• Start-up will reflect targeted underwriting areas while an acquisition's portfolio will likely require adjustments
Integration risk	✓	✘	• Loss of key personnel is a risk following any transaction
Capitol ratio & expenses	✘	✓	• Start-up LoBs often incur higher capital ratios and are written at a higher combined ratio
Likelihood of success	?	?	• Acquire proven skills or build and fail / succeed yourself. Though not all acquisitions are a success!

Source: GC Securities

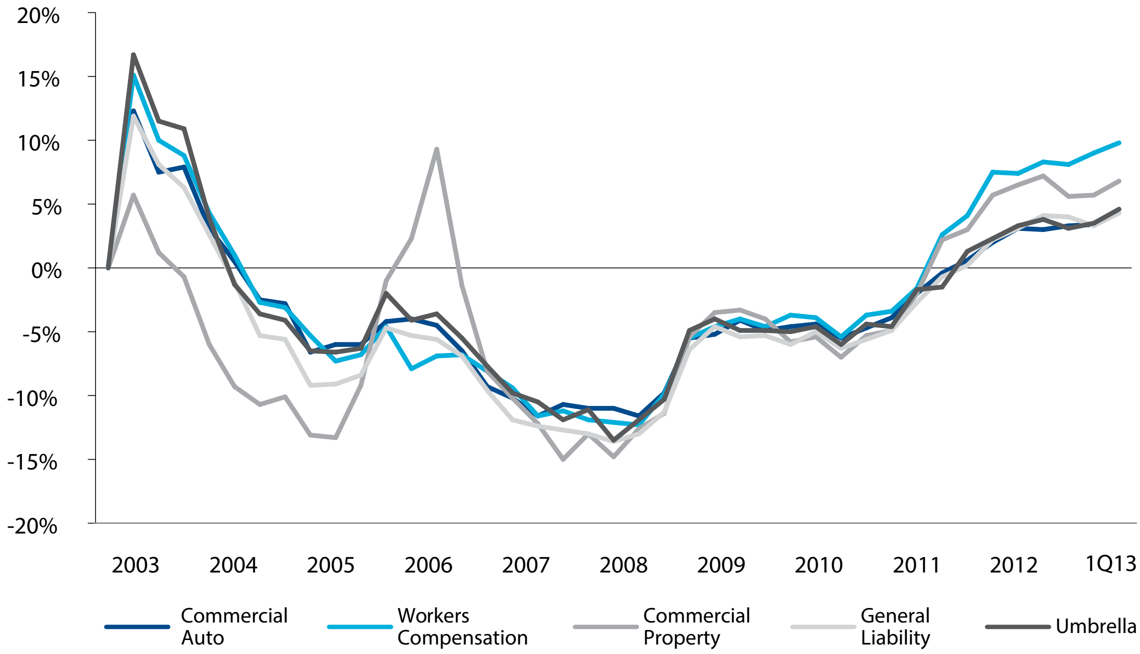
MERGERS AND ACQUISITIONS

As carriers explore M&A opportunities to grow in the current environment, there is strong interest from potential buyers looking for bolt-on opportunities rather than transformational transactions. Although this demand has not to-date triggered a significant increase in M&A transactions, the ingredients for more activity are now in place.

Grow/Diversify by Product Line (e.g. Specialty Insurance)

Specialty insurance is one of the few market sectors where underwriting and claims management expertise and client/broker relationships are still the predominant differentiators for a successful business, posing a significant barrier for convergence market participants. The specialty pricing environment has recently improved (see Figure F-8), though there are signs that this pricing momentum may begin to diminish with increased competition and competitively priced reinsurance.

F-8 | U.S. COMMERCIAL LINES RATE MOVEMENTS – 2003 TO Q1 2013



Source: CIAB

The market's response to the new competitive threat from Berkshire Hathaway's excess and surplus (E&S) vehicle has yet to be seen, but it would not be unreasonable to assume that it will have a dampening effect on the pricing outlook. This may in turn lead to further consolidation/acquisition of small to mid-sized E&S participants, dependent on E&S business being a major source of revenue.

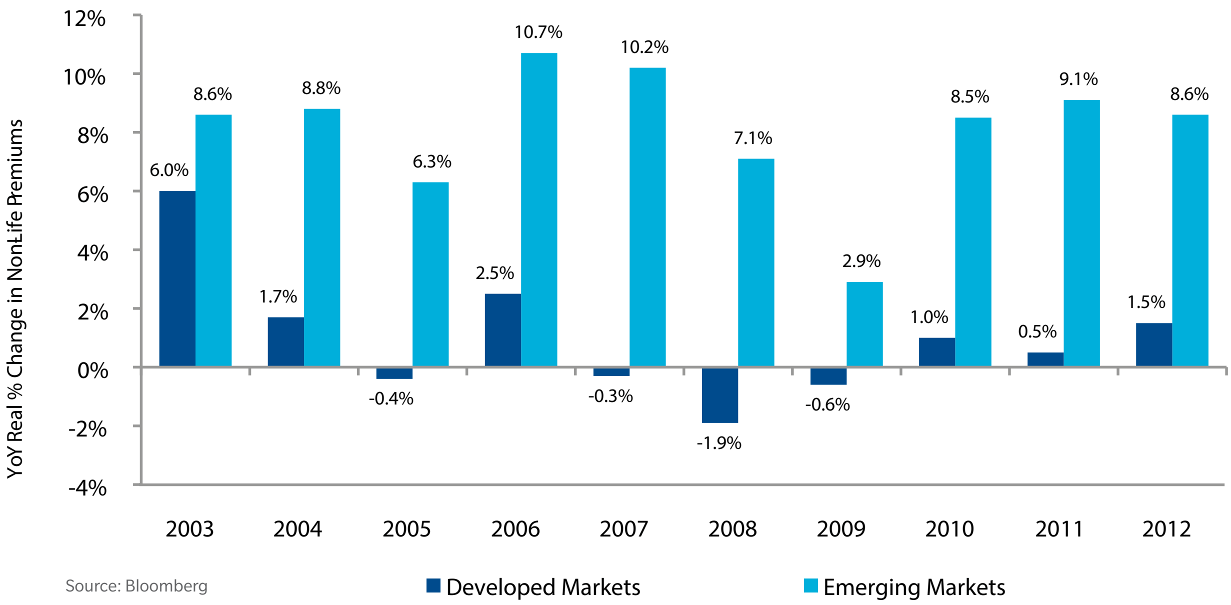
The successful penetration of convergence market participants is evidence that some reinsurance structures are more efficient in collateralized form, backed by capital from a lower cost provider. One of the major challenges these relatively new reinsurance market entrants face is their ability to secure a regular flow of risk to assume on behalf of their investors.

Recent evidence has demonstrated that some of the larger participants have closed funds as they have been unable to deploy available capital within their investment guidelines and return targets. To date, ILS funds' growth strategies have focused on the distribution side, with several funds entering partnerships with other asset management firms to expand the potential sources of new capital. This demand/supply paradigm may prompt a shift in strategy with some convergence participants likely to consider a direct investment or a strategic partnership with a reinsurance company to enhance the source of accessible risks and reduce their dependency on brokers.

Grow/Diversify by Territory

With growth opportunities limited in mature markets, many insurers are looking to emerging markets for future expansion, in particular China, Southeast Asia and Central and Latin America. Figure F-9 highlights gross written premium (GWP) growth in emerging markets compared to developed markets from a 2003 base.

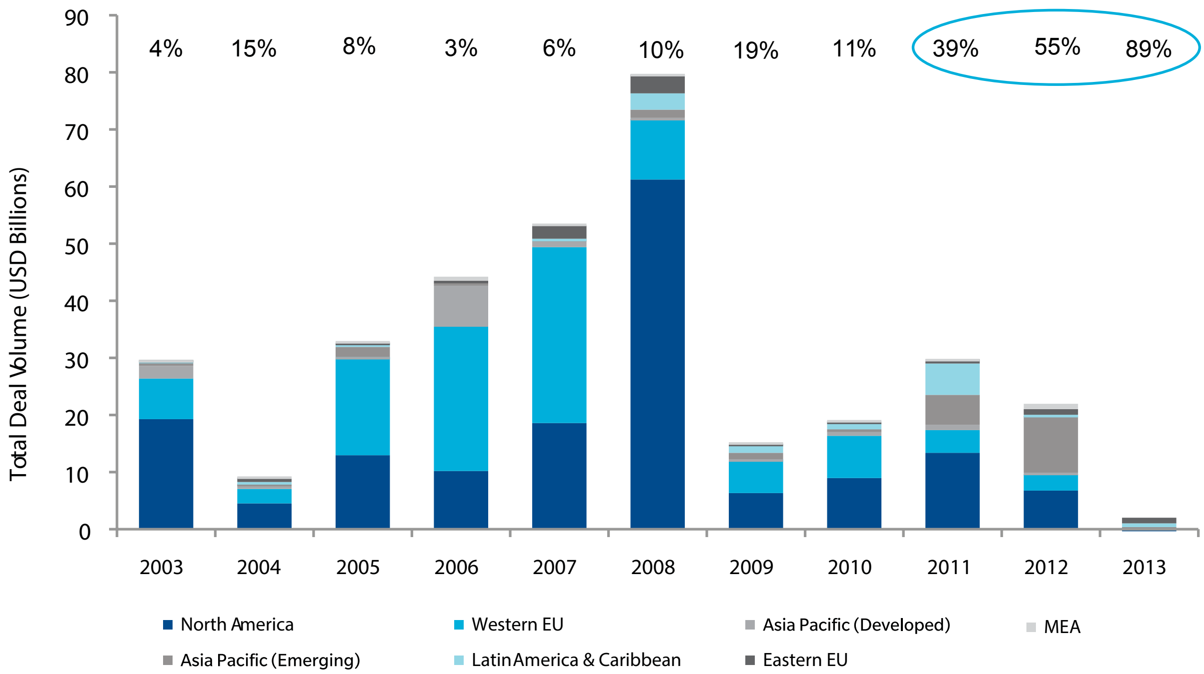
F-9 | PREMIUM GROWTH IN DEVELOPED AND EMERGING MARKETS – 2003 TO 2012



Source: Bloomberg

While the number of non-life insurance M&A deals in emerging markets as a percentage of the total has remained fairly constant across the cycle (following a peak in 2009), the proportion of capital deployed (aggregate deal value) is on the increase (see Figure F-10). Given the benign growth conditions in mature markets and the over capacity within, this trend is likely to continue in the short term. The potential scarcity of viable targets will ensure that supply lags demand, which will in turn continue to drive premium valuations.

F-10 | INSURANCE M&A DEAL VOLUMES – 2003 TO H1 2013



Percentages show volume of emerging market deals as a % of total
Source: Bloomberg

While acquiring an emerging market platform has its obvious attractions, there are a number of considerations that should not be overlooked. In order for an acquisition to be value accretive, it should create a return greater than the cost of the capital deployed. The key to this is the successful implementation of an integration strategy. This may involve fully absorbing the target and implementing a full re-branding and re-structuring exercise to promote the culture and values of the acquirer. For emerging market acquisitions, the integration strategy can be a major challenge as local cultures and ways of doing business can be very different to those that exist in mature markets.

The opportunity to achieve specialty product diversification and territorial growth are two factors driving the strong interest in the Lloyd's market at present. Its reputation as a specialty underwriting center of excellence and the availability of its extensive global insurance and reinsurance licensing are the key catalysts. This gives participants access to specialty business via the Lloyd's broker network together with, subject to business plan approval, the capability to underwrite business in emerging markets from a London base.

Achieve Meaningful Scale in Reinsurance

In a reinsurance market with abundant excess capital and where most reinsurance programs are oversubscribed, the need for a meaningful line size or differentiated underwriting contribution has never been more relevant.

Achieving shareholder return expectations is not easy, particularly in the current low investment yield environment. An obvious tool for the management of expense ratios is achieving economies of scale and diffusing the semi-variable expense base over a larger portfolio of premiums. Equally, capital efficiencies are more obvious for larger entities, with greater diversification credit, better access to financing (both in terms of proportion and quantum) and an implied reduction in the cost of equity.

At the January 1, 2013, renewal, there was tangible evidence that some large U.S. buyers were focusing their reinsurance program on providers of capacity that were meaningful in relation to the overall size of the program or strategically important in terms of the value of the underwriting relationship. This was also evident during the June and July renewals with the ratio of successful signings increasing with the line size offered up to a tipping point of approximately USD50 million – a level where concentration and counterparty credit risks will become important factors in the allocation process.

This drive to scale could and is translating into more consortium arrangements among some of the smaller specialty class players to enable them to compete with the dominant market players, both on the revenue and cost efficiency fronts. The other obvious outcome is an increase in consolidation among smaller participants.

The Evolving Legacy (Run-Off) Market

The recent completion by legacy solution specialists of a number of acquisitions in the live insurance space could be a watershed moment for the standalone run-off market.

The original business concept of a run-off manager was a pure focus on legacy business – to achieve finality in legacy claims and manage the outstanding book of legacy business in the same cost efficient way that an insurer would manage a renewal book of business.

In the past 12 months, run-off players have deployed around USD1 billion of capital in acquiring live insurance entities, including paying a significant amount of goodwill. The reason for this apparent change in strategy is to become more competitive with reinsurers whose run-off divisions are able to offer rated reinsurance paper. Having the capital resources to complete a legacy acquisition are on their own not sufficient for some vendors, and the reputational risk associated with claims management strategies still remains an important factor.

Given the pressures in the reinsurance market, some reinsurers see legacy transactions as an opportunity to deploy capital at attractive returns. This opportunity is not solely predicated on a more aggressive investment strategy for the assets supporting reserves and a more aggressive claims settlement strategy for the reserves themselves. The ability to use one's own rated paper to renew profitable parts of the run-off portfolio enhance deal economics and enable higher premiums to be paid. By contrast, a standalone run-off entity would need to partner with a live insurer to dispose of the renewal rights in a secondary transaction. This both increases the execution risk of the primary transaction and squeezes the economics for the run-off provider, reducing the acquisition price that can be paid.

Executive Summary
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Conclusion

IV. CONCLUSION: MAXIMIZING VALUE WITH GUY CARPENTER

Executive teams adapting to the changing dynamics of the specialty insurance and global reinsurance markets in an environment of excess capital, growing influence of convergence participants, low investment returns and diminishing reserve releases are presented with a series of strategic dilemmas and opportunities.

Guy Carpenter is committed to helping our clients navigate these challenges and map the path to sustainable, profitable growth. Part of this commitment is our on-going investment in developing the solutions and expertise that assist our clients in achieving their strategic goals.

Continuing to build our GC Securities division, we have recently recruited some of the best financial advisors in the insurance market. GC Securities banking professionals dedicated to insurance operate from bases in London and New York. GC Securities is a recognized leader in structuring and placing insurance-linked securities – over the past ten years, this deeply experienced team has been involved in over 50 financial advisory transactions and 75 ILS transactions.

Because GC Securities works closely with Guy Carpenter specialty brokers and industry-leading analytics teams across the globe, clients benefit from our unique perspective and deep industry knowledge. Grounded in a solid understanding of each client's strategic, financial, regulatory and operational imperatives, we are able to assist them wherever they do business. This unique knowledge of the insurance marketplace combined with capital advisory expertise enables us to help our clients maximize their risk adjusted returns in any market condition.

As part of Guy Carpenter's integrated offering to clients, GC Securities provides an industry-leading M&A advisory business, deep industry experience and a successful track record. The team is dedicated to advising and assisting Guy Carpenter clients with their M&A strategies to exploit growth opportunities as they arise.

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Reactions magazine named Guy Carpenter Best Global Reinsurance Broking Company Overall and Best Reinsurance Broking CEO of the year in 2012. At the *Reactions* London Market Awards, Guy Carpenter was also named Reinsurance Broker of the Year and took home Reinsurance Broking Team of the Year honors for both Property and Aviation. In the past year, Guy Carpenter has also won: Global Best ILS Advisor (GC Securities*), US Best ILS Advisor (GC Securities*) and US Best Broker for Casualty Reinsurance from *Intelligent Insurer, Insurance Day's* 2012 ILS Transaction of the Year (GC Securities*), and Reinsurance Broker of the Year for the Asia-Pacific region at the 16th Annual Asia Insurance Industry Awards.

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