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GC BRIEFING

*An update from GC Securities**

November 2011

GC SECURITIES* CATASTROPHE BOND MARKET UPDATE: THIRD QUARTER 2011

Diversifying Peril Issuance and Continued Net New Inflows Sustain Capital Markets as a Consistent Capacity Source; Significant Forward Pipeline Exists

The third quarter 2011 was one of the most active on record, as the catastrophe bond market responded to investor demand for additional investment opportunities, particularly for diversifying peril transactions. Three transactions totaling USD512 million were completed during the third quarter 2011, making it the third most active third quarter on record. Completed issuance contained no exposure to U.S. hurricane peril. Excluding quarters in which no cat bond issuance overall occurred, this is the first quarter since the third quarter 2002 in which there was no transfer of U.S. hurricane risk.

Issuance in the 144A market was supplemented by two transactions totaling USD172 million of risk capital placed via Section 4(2) private placements(1). Aggregating the 144A and 4(2) placement activity together, total issuance for third quarter 2011 amounted to five transactions of USD684 million of risk capital. Total risk capital outstanding increased by 0.56 percent (equivalent to USD60 million) during the third quarter, the first increase since the fourth quarter 2010 and the second quarterly increase in the last seven quarters.

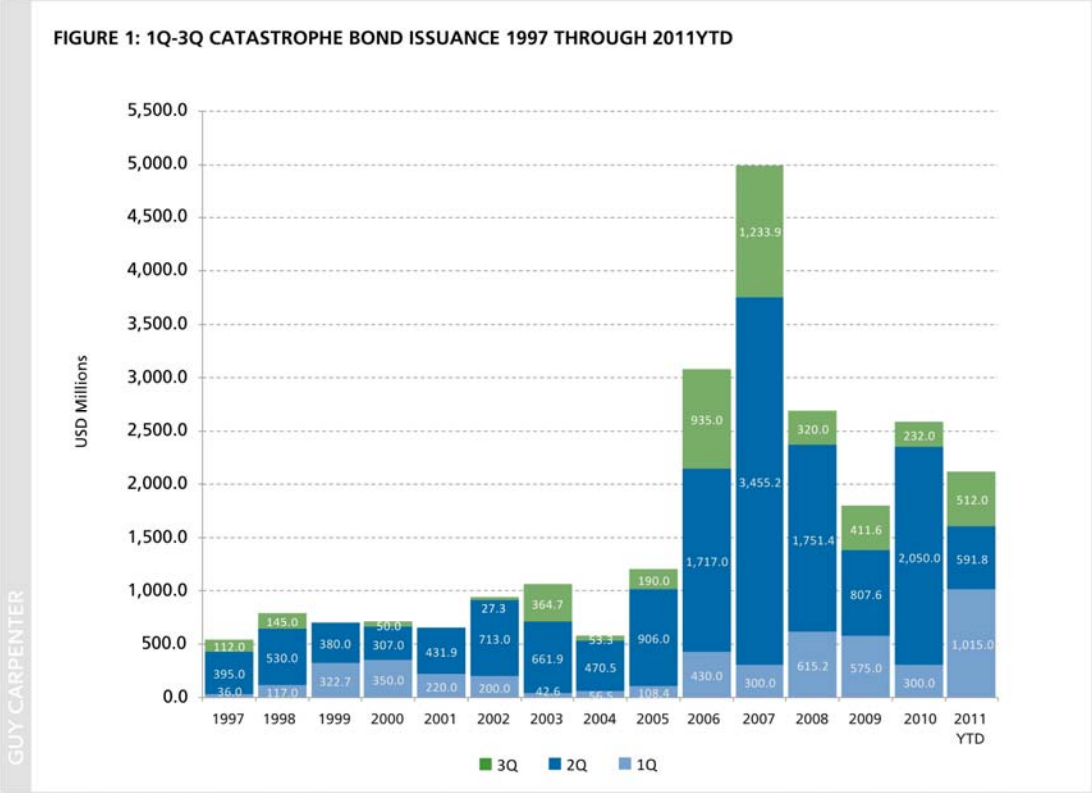
Demand for additional catastrophe bond issuance remains robust. Continued volatility in the broader financial markets and comparatively attractive returns are sustaining net new inflows to the sector. In recent years, the fourth quarter has been extremely active for new issuance. With U.S. wind season losses less than pre-season estimates suggested, and diversifying issuance providing ballast to investor portfolios, it is likely that the fourth quarter 2011 will be active as well. At the conclusion of the third quarter, total 144A issuance for the 2011 calendar year stood at USD2.12 billion, which is below the 2010 three quarter mark of USD2.58 billion. There is, however, a substantial transaction pipeline both for the fourth quarter 2011 and into first half 2012. Depending on how much of the pipeline converts to actual transactions and when these transactions come to market, it is reasonable to expect total issuance for the year to fall between USD3.5 billion and USD4.5 billion.

Transaction Activity

Risk capital issued in the third quarter more than doubled from the third quarter 2010. Last year, two transactions resulted in USD232 million in risk capital issued, while this year, USD512 million of risk capital was issued through three transactions.

The first transaction to close during the third quarter 2011 was the USD150 million Queen Street III Ltd., on which GC Securities acted as sole bookrunner. This transaction provides sponsor Munich Re with multi-year fully collateralized protection for European windstorms and utilizes a PERILS-based trigger. Queen Street III Ltd. was the first European windstorm-only deal of the year and was significantly upsized in response to strong market demand. Embarcadero Re, providing reinsurance to the California Earthquake Authority (CEA), was the second transaction of the third quarter. The transaction was also supported by significant investor demand as the market was eager for California earthquake risk on a standalone basis and also eager to support a significant first time sponsor. Embarcadero Re was significantly oversubscribed and the market expects additional issuance from the CEA during the 2012 calendar year. The final 144A transaction of the third quarter was EUR150 million Pylon II Capital Limited (Pylon II). Pylon II, which provides protection for French windstorms on a parametric basis, marked the return to the catastrophe bond market by the corporate sponsor Electricité Réseau Distribution France (EDF), which last accessed the catastrophe bond market in 2003. Pylon II, which has a 4.75 year risk period, priced below the low end of its initial price guidance, benefiting from a clean transaction structure and strong demand for European wind risk on a standalone basis.

For the first three quarters of 2011, a total of 11 catastrophe bonds were issued, providing USD2.11 billion in risk capital(2). Year-to-date issuance is down 18 percent relative to the USD2.56 billion issued during the first three quarters of 2010.



Source: GC Securities Proprietary Database, September 30, 2011

Catastrophe Bond Redemptions

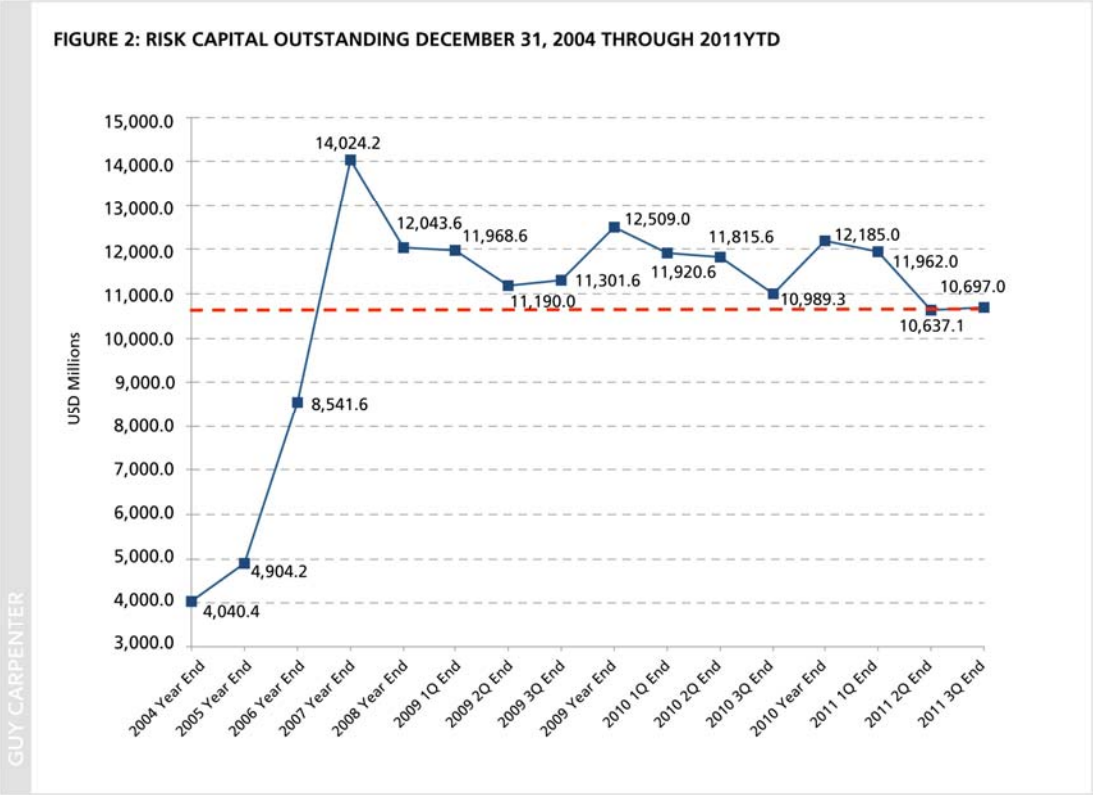
In the third quarter 2011, USD400 million of risk capital matured comprising the USD200 million Fhu-Jin transaction, which was exposed to Japanese Typhoon risk, and the USD200 million Topiary Capital transaction, which was exposed to multiple perils on a second event basis. The maturity of these transactions strengthened the bid for non-first event exposed and non-U.S. wind transactions during the third quarter.

Risk Capital Outstanding

Total risk capital outstanding increased from the second to the third quarter 2011, reaching USD10.70 billion - up from USD10.64 billion, representing a net increase of 0.56 percent (USD60 million). This is the first quarter that risk capital outstanding increased since the fourth quarter 2010. The sector continues to sustain net new cash inflows and the first and second quarters 2011 included significant maturities of existing cat bonds. Consequently, the market is still seeking additional issuance. These factors should manifest as strong support for transactions coming to market during the fourth quarter 2011 and into the first quarter 2012.

Risk capital outstanding peaked at the end of 2007, at USD14.02 billion. It then fell to USD11.19 billion by the end of the first quarter 2009 and thereafter remained within a range of USD10.9 billion and USD12.5 billion before dropping to USD10.6 billion at the end of the second quarter 2011. Comparing the current pipeline with the modest (USD2.15 billion) amount of scheduled maturities prior to June 30, 2012, we expect

that total risk capital outstanding should trend upwards, potentially significantly, over the balance of 2011 and during the 2012 calendar year.



Source: GC Securities Proprietary Database, September 30, 2011

Industry Loss Warranties (ILW)

Consistent with seasonal trading patterns, ILW activity tailed off in the third quarter relative to pre-U.S. wind season levels. Prices were driven down by increased available capacity (from sellers looking to take advantage of price increases available at the conclusion of the first quarter) and a demand reduction from protection buyers as the U.S. wind season proved less damaging than forecasts suggested.

LiveCat trading activity did pick up around Hurricane Irene, which threatened the East Coast, but trades were few in number as the industry suffered less than USD5 billion in insured losses.

With regard to expected activity for the remainder of 2011, the market is likely to remain quiet. Unsurprisingly, profit protection covers - which generally make up a significant portion of fourth quarter trading - are not a priority this year as the catastrophe losses for the 2011 calendar year have reduced or eliminated profits available for protection.

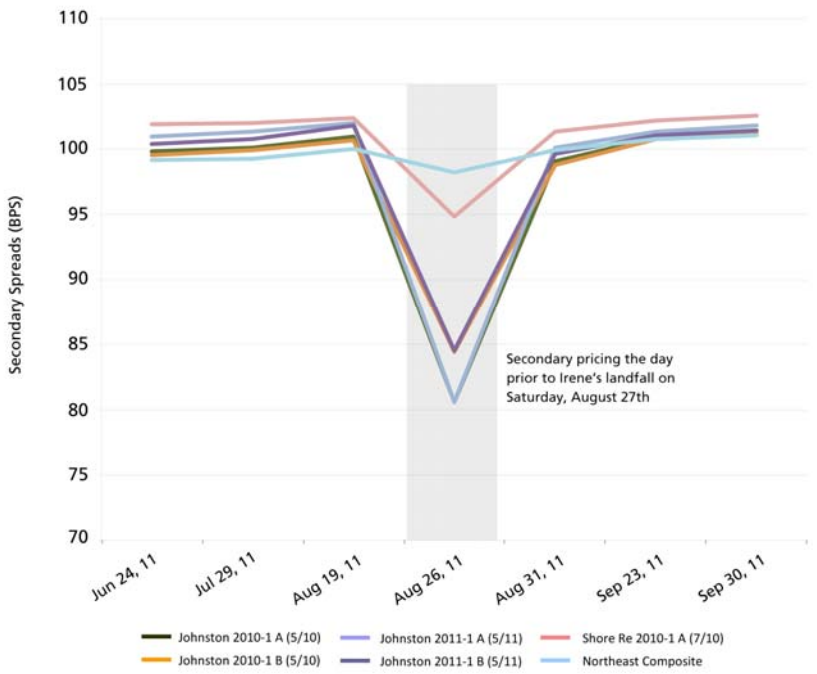
Some protection buyers have made early moves to renew January 1, 2012 covers and these discussions will continue throughout the coming weeks.

Looking into 2012, the ILW arena should remain a robust capacity resource. It is an active market capable of providing cost effective and rapidly implementable solutions to protection buyers and also attractive returns for protection sellers over an extended period of time.

Third Quarter Market Dynamics

The 2011 hurricane season has been active to date with 17 named storms, but has not yet caused any principal losses to the catastrophe bond market. The greatest threat for major damage and potential losses came from Hurricane Irene, which headed toward the eastern United States during the week of August 22. Projections leading up to the landfall of the storm in North Carolina on August 27 varied greatly. Some projections indicated losses of a magnitude large enough to impact the USD505 million of Johnston Re bonds, which have a large exposure to the Barrier Islands of North Carolina. As such, the Johnston Re bonds traded below 50 percent of par on the Friday afternoon before landfall. There were also more modest price declines in other bonds containing exposure to the U.S. wind exposed transactions, as credible modeling scenarios suggested Hurricane Irene had the potential to bring category 2 wind speeds into the northeast.

FIGURE 3: SECONDARY PRICING ON SELECTED U.S. COAST HURRICANE EXPOSED TRANSACTIONS (THROUGH SEPTEMBER 30TH 2011)



Source: GC Securities Proprietary Database, September 30, 2011

However, the storm lost intensity and did not bring the type of wind speeds that were originally projected. It was clear after the weekend that none of the cat bonds were in danger of being attached by the event. Immediately, bond prices returned to pre-Irene levels and have continued to increase as more of the hurricane season passes without any loss-threatening storm systems developing.

The main drag on the ILS market in the third quarter was the mounting losses to the Mariah cat bonds. At the time of this writing, it is expected that the USD100 million 2010-2011 tranche has been triggered (which has been downgraded to CC by Standard & Poors) and that the USD100 million 2010-2012 tranche will sustain a total loss.

Outlook for Fourth Quarter 2011, First Quarter 2012

Looking ahead to the fourth quarter 2011 and into 2012, the catastrophe bond market appears poised for significant issuance activity. Issuance should be diverse with transactions containing exposure to peak perils of U.S. hurricane and earthquake on broad geographic bases, as well as regional transactions. Additional transactions with exposure to European wind and Japanese perils are also expected to come to market. Further variety by risk profile, trigger type and occurrence versus aggregate transactions should also be available. Given the losses of the 2011 calendar year, it is likely that severe convective storm will remain a peril of interest for both sponsors and investors despite the losses sustained by the Mariah tranches. Finally, as the investor base continues to evolve and demonstrate its ability to understand and price new perils, additional activity involving risks previously unsecuritized in the catastrophe bond market is also probable.

A sustained period of elevated and diverse issuance activity will no doubt be welcomed by a primed and ready investor community. Looking back at past periods of elevated issuance activity, such as the fourth quarter 2010 or the first three quarters 2007, significant issuance totals tend to be concentrated in one peril or a small peril group. In 2007, due to the impact of model revision and the losses from the Katrina/Rita/Wilma storms, issuance was dominated by U.S. hurricane risk. In 2010, driven by new issuers coming to market and favorable market conditions, issuance was dominated by U.S. wind and earthquake perils offered on a combined basis. In some instances, this created a crowded deal environment in which clearing spreads were pushed upwards due to concentration and capacity issues for a particular peril, even in the context of high and increasing cash levels for investors, generally. Ultimately, this temporal dislocation contributed to a deadweight loss for the market as sponsors did not issue as much as they would have in the context of higher prices, and investors did not get access to sufficient overall deal flow to match their cash deployment targets. With a more broad-based issuance forecast for the balance of 2011 and into 2012 coupled with sustained strong investor demand, there is reason to expect that the catastrophe bond market could be in for a banner year. It should continue to serve an important role as a complementary source of capacity to the traditional reinsurance market.

APPENDIX: 2011 144A CATASTROPHE BOND ISSUANCE THROUGH SEPTEMBER 30, 2011

ISSUE DATE	TRANSACTION/ TRANCHE NAME	SPONSOR	TRIGGER	COVERED PERIL(S)	TRANSACTION/ TRANCHE TERM (YEARS)	TRANSACTION SIZE (SSM)[1]	TRANCHE RATING (S&P / MOODY'S)	ROL AT AT ISSUANCE[2]
18-Feb-11	Successor X 2011-1 IV-E3	Swiss Re	PCS / Parametric	U.S. HU / Cal Q	3.02	$160.0	B	9.25%
18-Feb-11	Successor X 2011-1 IV-AL3	-	-	-	3.02	$145.0	Unrated	13.00%
18-Feb-11	Foundation Re III 2011-1	The Hartford	PCS	U.S. HU	4.02	$135.0	BB+	5.00%
7-Mar-11	East Lane IV 2011-A	Chubb	Indemnity	U.S. All Perils	3.01	$225.0	BB+	5.75%
7-Mar-11	East Lane IV 2011-B	-	-	-	4.01	$250.0	BB	6.65%
22-Mar-11	Queen Street II	Munich Re	PCS / PERILS	U.S. HU / EUWS	3.03	$100.0	BB-	7.50%
15-Apr-11	Blue Fin Series 4	Allianz	Modeled	U.S. HU / EQ	2.12	$40.0	Unrated	8.50%
17-May-11	Johnston Re 2011 Class A	NC JUA/IUA	Indemnity	U.S. HU (North Carolina only)	2.98	$70.0	BB-	7.60%
17-May-11	Johnston Re 2011 Class A	-	-	-	2.98	$131.8	BB-	6.90%
31-May-11	Residential Re 2011 - 1	USAA	Indemnity	U.S. All Perils	4.02	$57.0	B+	9.00%
31-May-11	Residential Re 2011 - 2	-	-	-	4.02	$33.0	B-	12.00%
31-May-11	Residential Re 2011 - 5	-	-	-	4.02	$160.0	B+	8.75%
17-Jun-11	Loma Re 2011-1	Argo Re	Various	U.S. HU / EUWS / JPEQ	1.50	$100.0	BB-	9.50%
28-Jul-11	Queen Street III	Munich Re	PERILS	EUWS	3.00	$150.0	B+	4.75%
1-Aug-11	Embarcadero Re	CEA	Indemnity	CA EQ	3.00	$150.0	BB-	6.60%
11-Aug-11	Pylon II A	EDF	Parametric	France Windstorm	4.75	$92.0	B+	5.50%
11-Aug-11	Pylon II B	-	-	-	4.75	$120.3	B-	9.00%
		SUMMARY STATISTICS				RISK CAPITAL	DEAL COUNT	
		TOTAL ISSUANCE - 2011				$2,119.1	11	

Notes
(1) Non-U.S. dollar denominated transactions are converted to U.S. dollars using the prevailing exchange rate on the issuance date
(2) Expressed as a spread above the applicable benchmark rate
-> GC Securities Transactions

Source: GC Securities Proprietary Database, 2011

Notes:

[1] Section 4(2) private placements are typically marketed to a smaller investor group, do not require the provision of uniform disclosure information to all investors and tend to have more restrictions pertaining to resale in the secondary market relative to 144A placements.

[2] This figure only includes broadly distributed 144A catastrophe bond transactions.

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