ILS MARKET UPDATE

Opportunities and Challenges Amid Continued Growth

WILLIS CAPITAL MARKETS & ADVISORY

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The Insurance Industry Experts

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Willis Capital Markets & Advisory

Q1 2015 Market Outlook

"While we remain in a buyers' market, paradoxically sellers are very much driving and will continue to drive the market for the remainder of 2015"

2015 has started out with a flurry of activity on the deal front. This should continue even as we migrate towards more stable risk spreads. This is no great surprise given the record setting 2014 year. Perhaps even more interesting are some investor trends that could fundamentally change the market.

While we remain in a buyers' market (for reinsurance buyers that is), paradoxically sellers (i.e., ILS investors) appear to be very much driving and will likely continue to lead the market for the remainder of 2015. Specialist ILS managers – and here, we are not talking about "real money" end investors such as pension funds – are competing intensely with each other. The gloves are off and this creates a lot of different options for buyers. Previously, the specialist investors driving the market primarily competed for investment mandates primarily on management approaches (e.g., high risk-return vs. low risk-return, active / alpha and relatively illiquid vs. passive / smart beta and liquid, independent vs. reinsurer affiliated, etc.). Now specialists also tout access, leverage, and product design as selling points in their competition with each other for investment mandates. Differentiation dominates the battleground.

Investors Compete on Access

Investors want to strengthen relationships with ceding companies and intermediaries to ensure that they see more risk, receive better allocations where desired as renewal markets, and at the same time prevent their competitors from achieving the same access. They realize that low risk spreads alone do not guarantee access and renewals (although it helps) because then the other specialist investors can use this against them when competing for mandates.

You have to give something to get something – access is no different. On the one hand, relationships do matter and can create a better understanding of ceding companies' portfolios, plans etc. On the other hand, the less syndicated the ceding company's reinsurance program, the higher the rate-on-line, all else equal. Make no mistake about it: many specialists tell end investors that access equals a higher spread for the same risk.

"Ceding companies know this dynamic too and need to maintain a healthy tension between broad syndication and more targeted placements"

Ceding companies know this dynamic too and need to maintain a healthy tension between broad syndication (largely in the cat bond market) and more targeted placements with key specialist investors (largely in the collateralized re market). While relationships can bring undoubted benefits for ceding companies, syndication allows true price discovery through competitive forces and gives the ceding side more bargaining power.

Even specialist investors give something up to get access. They may lose some of their ability to dynamically underwrite risks with strong relationships.

Investors Compete with Leverage

Investors are also finding increasingly creative ways to incorporate leverage. Reinstatements from fronting companies have been readily available for collateralized re for a while as has been portfolio financing for cat bonds. In addition, we see large investors trying out additional approaches.

Q1 2015 Market Outlook (Continued)

Credit Suisse's Kelvin Re provides leverage through a rated balance sheet without the front. Nephila's fronting relationship with State National provides the highly leveraged approach necessary for the investors to have meaningful penetration of primary insurance markets. To some extent, the increasing investor appetite for strategically motivated sidecars parallels what both Credit Suisse and Nephila are doing. These sidecars blend both leverage and access with the leverage provided by retained tail risk.

"Perhaps, the most promising trend is that investors are selling more of what ceding companies actually want as protection"

Investors Compete with Product

Perhaps, the most promising trend is that investors are selling more of what ceding companies actually want as protection: indemnity trigger cover that lines up with claims handling processes and reinsurance programs. Index triggers have not and probably will not disappear for retro or for individual insureds but do seem out of favor otherwise.

* * * * *

To sum up, competition among specialist investors is worth watching in the coming quarters. For the most part it should help grow the capital market footprint and not just each individual investor's assets under management. Ceding companies need to remain vigilant against swinging too heavily away from broad syndicated distribution. This is especially dangerous where yesterday's start-up specialist investor can be a market leader two or three years later, a quite different dynamic in comparison with the traditionally modest year-to-year market share changes for traditional reinsurers.

($ in millions)

Q1 2015 Cat Bond Issuance

Sponsor	Issuer / Tranche	Issue	Maturity	Amount	EL	Spread	Basis	Risk	Trigger
Munich Re	Queen Street X Re 2015-1	Mar-15	Jun-18	$100	2.72%	5.75%	OCC	US Wind & Australia Cyclone	Index
Safepoint	Manatee Re Ltd. 2015-1	Mar-15	Dec-17	100	1.15%	5.00%	OCC	US Wind (Florida only initially)	Indemnity
Tokio M&F	Kizuna Re II 2015-1[a]	Mar-15	Apr-19	290	0.02%	2.00%	OCC	Japan Quake	Indemnity
State Farm	Merna Re 2015-1	Mar-15	Apr-18	300	0.41%	2.00%	OCC	US Quake (New Madrid region)	Indemnity
Chubb	East Lane Re VI 2015-1	Mar-15	Mar-20	250	1.34%	3.75%	OCC	US Wind & Quake (Northeast region)	Indemnity
SCOR	Atlas IX Capital 2015-1	Feb-15	Jan-19	150	3.76%	7.00%	AGG	US Wind & Quake, CAN Quake	PCS
Catlin	Galileo Re 2015-1	Feb-15	Jan-18	300	8.60%	13.50%	Ann. Agg.	US Wind & Quake, CAN Quake, EU Wind	PCS / PERILS
			Q1'15 Total:	**$1,490**					

Source: WCMA Transaction Database as of 3/31/2015.
(a) The Kizuna Re II 2015-1 offering size is JPY 35 billion, which is approximately $290m assuming a USD to JPY exchange rate of 120.5 at issuance.
Note: Data excludes private ILS deals.

Q1 2015 Cat Bond Market Issuance Overview

"P&C cat bond issuance for Q1'15 totaled $1.5 billion, on the heels of a record 2014"

In Q1 we witnessed several sponsors bring cat bonds to market on the heels of a record-setting year in 2014. Seven sponsors issued P&C cat bonds in the quarter via as many tranches, representing a total quarterly issuance of $1.5 billion.

Catlin returned to the market with the 3-year, $300 million Galileo Re 2015-1 covering U.S. and Canadian earthquakes, U.S. wind and Euro wind. This is Catlin's first issuance since its highly successful Galileo Re 2013-1 transaction, which secured the same amount of coverage as this quarter's deal. The 2015 Galileo bond was well-received by the market, resulting in the transaction's upsizing to $300 million from the initial $160 million. Investors may have been reaching for yield despite Galileo's relatively high expected loss, as the bond priced at the low end of guidance with a 13.50% spread.

SCOR sponsored its latest catastrophe bond, Atlas IX Capital 2015-1, securing $150 million of coverage against U.S. named storm, U.S. quake and Canadian quake. The 4-year transaction will pay investors a risk spread of 7.00% – the low end of initial guidance – against an expected loss of 3.76%.

Chubb tapped the capital markets for $250 million of coverage with East Lane Re VI 2015-1. The covered area is Chubb's core Northeast states for typical perils including U.S. wind, earthquakes, severe thunderstorms, winter storms and wildfires in addition to adding meteorite impact and volcanic eruption risks for the first time. This quarter's East Lane, which S&P rated 'BB(sf)', grew by $25 million from initial guidance and priced with a risk spread of 3.75%.

State Farm brought $300 million of Merna Re notes to the market. Merna Re 2015-1 covers U.S. earthquake in the New Madrid region. State Farm provided initial guidance of 1.75% to 2.00% for the single tranche, and the notes priced at the top end of guidance.

"Kizuna 2015-1 and Merna Re 2015-1 taken together suggest considerable appetite for risk remote diversifying transactions"

Tokio Marine & Fire secured coverage against Japanese earthquake via Kizuna Re II 2015-1. The 4-year notes have an expected loss of just 0.018% and pay a risk spread of 2.00%. This quarter's Kizuna is a JPY35 billion transaction (~$290 million USD) and covers losses from Tokio Marine's personal, commercial and industrial property exposures across Japan. This is the first investment grade cat bond since 2008. Kizuna 2015-1 and Merna Re 2015-1 taken together suggest considerable appetite for risk remote diversifying transactions.

Safepoint was a new sponsor to the market in the 1st quarter, with the $100 million Manatee Re 2015-1 transaction. This indemnity, per occurrence transaction will cover three full hurricane seasons for Safepoint. While the initial covered area is Florida only, the bond is allowed to expand to other U.S. states after the first reset.

After withdrawing a Queen Street X Re bond in June 2014, Munich Re secured 3-year, per occurrence protection through a new Queen Street X Re Ltd. 2015 issuance. The $100 million bond has the same mix of exposure to U.S. hurricane and Australia cyclone risks but was pitched with a higher coupon that was ultimately accepted by the market.

Source: WCMA Transaction Database as of 3/31/2015.
Note: Data excludes private ILS deals.

Catastrophe Bond Trends

"Since 2012 there has been a sharp increase in bonds issued by Florida-domiciled sponsors"

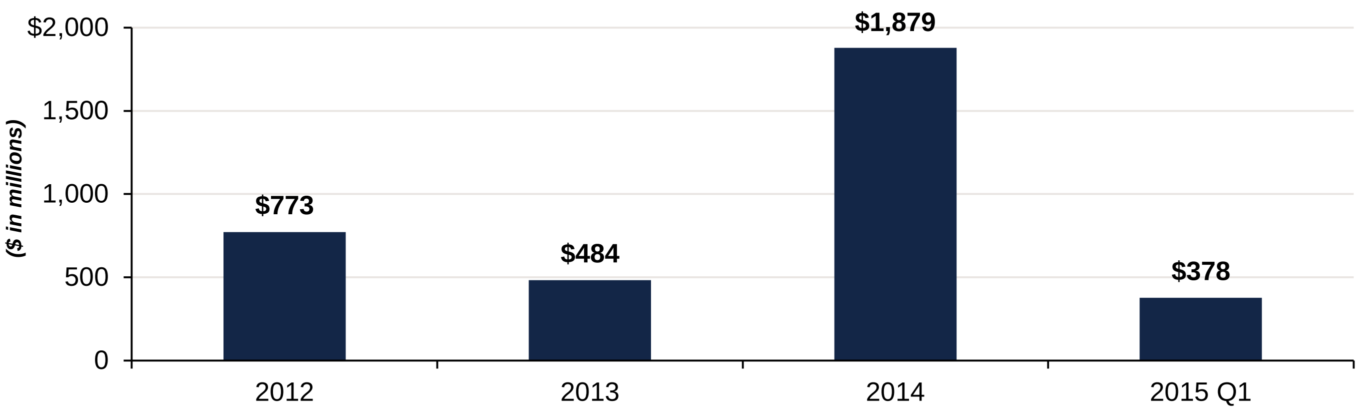
Since Florida Citizens initial catastrophe bond transaction Everglades Re 2012-1, there has been a sharp increase in catastrophe bonds issued by Florida-domiciled sponsors. In 2013 we witnessed a second Everglades Re bond as well as American Coastal's inaugural Armor Re 2013-1. In 2014, the trend continued. Citizens Property Insurance and American Coastal extended their cat bond programs with a $1.5 billion Everglades Re bond and a $200 million Armor Re bond respectively. Moreover, new entrant Heritage P&C sponsored two Citrus Re transactions, bringing the 2014 Florida-domiciled capacity to nearly $2 billion. In the first quarter of 2015, we have already seen a new sponsor in the market, Safepoint, and Heritage was in the market with another Citrus Re transaction.

At the same time, we noticed that since June 2013, the Price to Tangible Book Value multiple of Florida specialist insurers has been increasing sharply. Valuation has grown from just above 1.00x to nearly 2.50x.

Among other factors, the ability to get additional, diversified reinsurance capacity at more favorable terms has surely helped this spike in valuation.

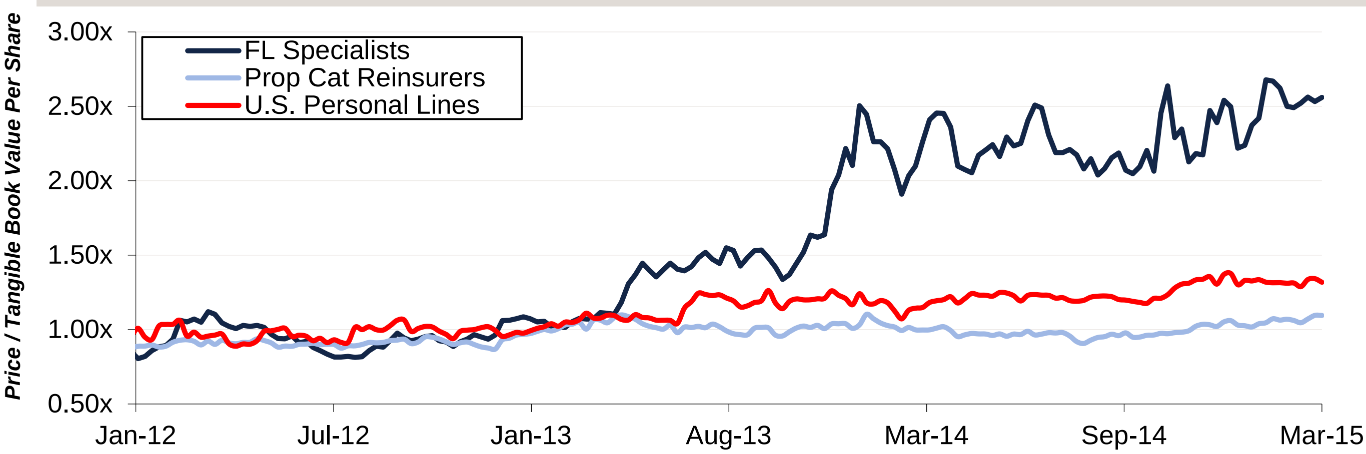
($ in millions)

Figure 1: Florida-Domiciled Issuance 2012 – 2015 Q1[(a)]



(a) Chart includes private placements and pending Citrus Re Ltd. 2015-1 notes.

Figure 2: Historical Price to Tangible Book Value of Florida Specialists



Source: WCMA Transaction Database as of 3/31/2015.
Note: Data excludes private ILS deals.

Catastrophe Bond Trends (Continued)

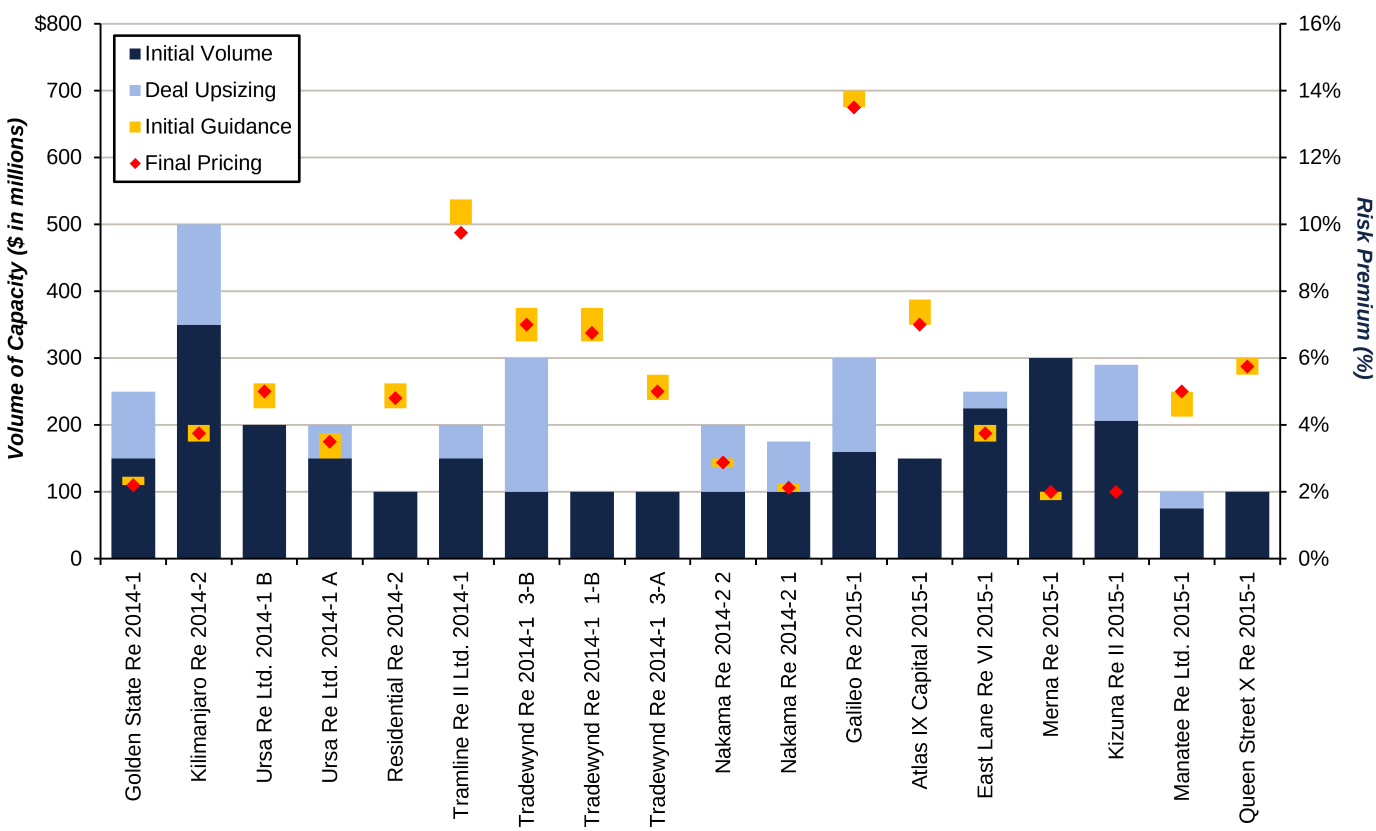
"The market may be reaching a floor in particular for very risk remote deals… However investors are still hungry for high-risk / high-return transactions"

The first quarter of 2015 saw only 29% of transactions price below the initial guidance range, a drop year-over-year as 71% of transactions in the first half of 2014 priced below the initially provided range. In the same vein, 2 out of 7 of this year's transactions priced at the high end of initial guidance. During the first quarter of 2014, no transactions saw final pricing above the midpoint while there was only one in the first quarter of 2013.

This phenomenon suggests that the market may be reaching a floor in particular for very risk remote deals despite the attempt to push spreads further down. However investors are still hungry for high-risk / high-return transactions which allow them to meet their internal target return. That is the primary reason why those cat bonds have priced at tight end of guidance on the back of very strong investor demand.

Sponsors upsized a smaller percentage of transactions brought to market thus far in 2015. 57% of 2015's transactions were upsized, compared to 71% for the first quarter of 2014.

Deal Upsizing and Pricing – Q3 '14 to Q1 '15



Source: WCMA Transaction Database as of 3/31/2015.
Note: Data excludes private ILS deals.

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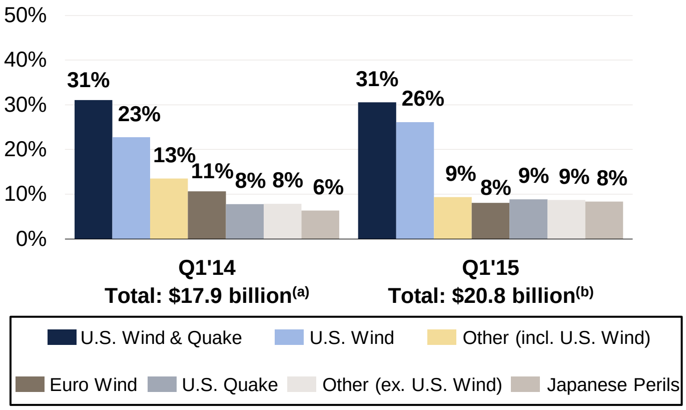
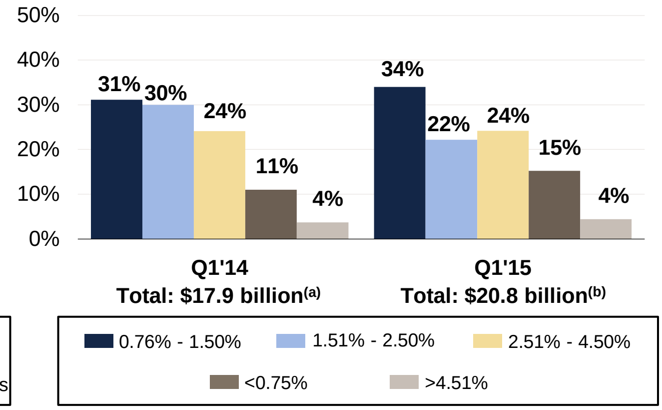
Q1 2015 Cat Bond Market Statistics

Par Outstanding by Risk Peril

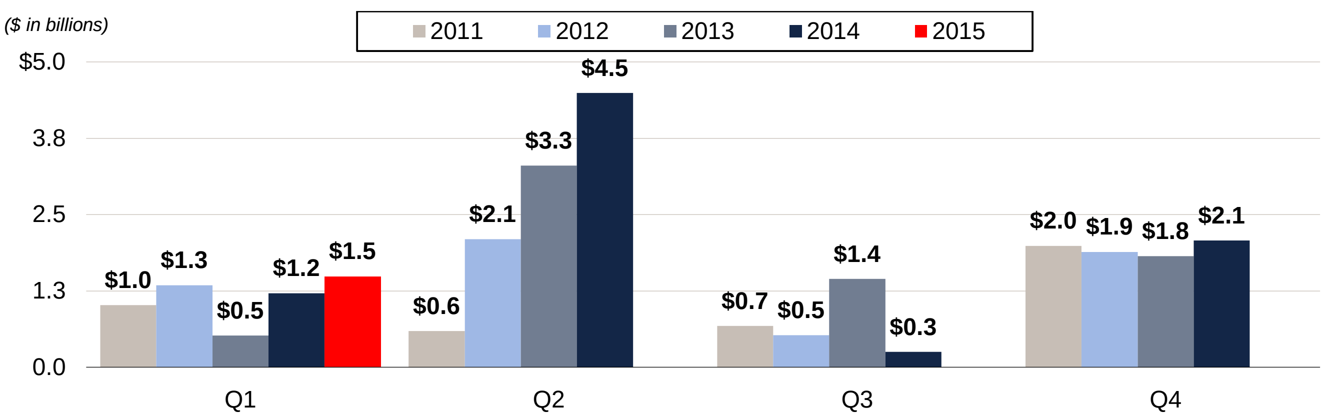


Par Outstanding by Expected Loss at Issuance

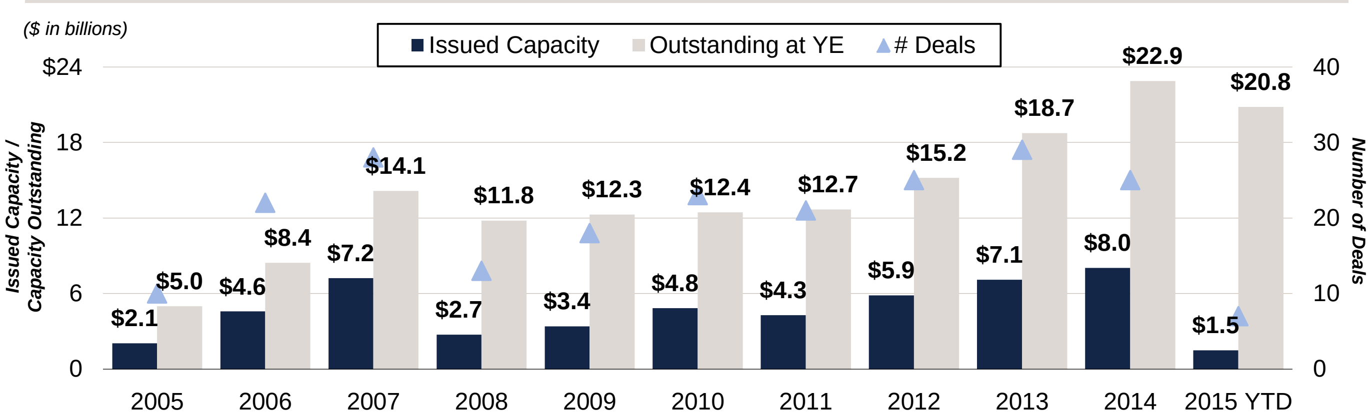


Source: WCMA Transaction Database as of 3/31/2015.
(a) In aggregate, 67% of all capacity outstanding exposed to U.S. Wind.
(b) In aggregate, 66% of all capacity outstanding exposed to U.S. Wind.

Non-Life Cat Bond Issuance by Quarter (2011 – 2015 Q1) [c]



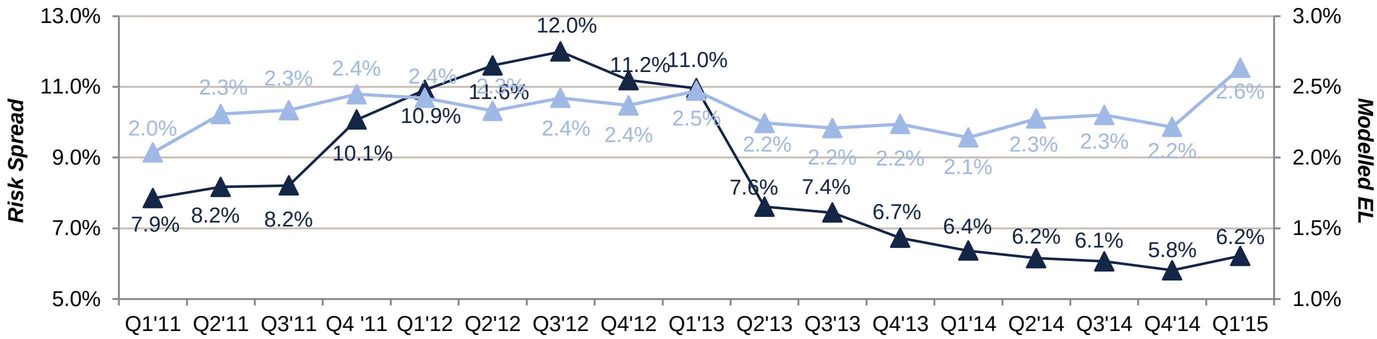
Capacity Issued and Outstanding by Year [c]



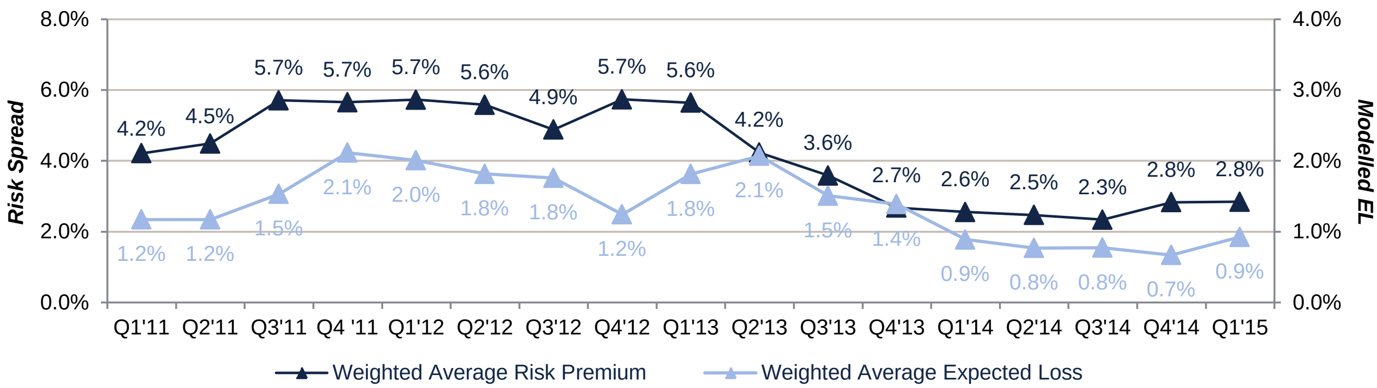
(c) All issuance amounts reported in or converted to USD on date of issuance.
Source: WCMA Transaction Database as of 3/31/2015.
Note: Data excludes private ILS deals.

Q1 2015 Cat Bond Market Statistics (Continued)

Quarterly LTM U.S. Wind Exposed Weighted Average Risk Premium & Expected Loss



Quarterly LTM Non-U.S. Wind Exposed Weighted Average Risk Premium & Expected Loss



Source: WCMA Transaction Database as of 3/31/2015.
LTM = Last twelve months. Data is for primary issuance and does not reflect secondary trading.
Note: Data excludes private ILS deals which, in some cases, have the potential for some of the liquidity present in more traditional Rule 144A cat bonds.

Secondary Market Trading Overview

"Secondary trades throughout the quarter cleared towards the bid side of the pricing sheets"

Secondary trading was off to a slow start in the beginning of January. Most investors reserved their trading decisions until after they saw the primary offerings. The primary issuance had something for everyone and as a consequence, many players used the opportunity to make adjustments to their portfolios. With most managers reserving capital for primary issuance, secondary trades throughout the quarter cleared towards the bid side of the pricing sheets. The market demonstrated there still remains a preference for high yielding bonds.

Source: WCMA Transaction Database as of 3/31/2015.
Note: Data excludes private ILS deals.

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