Capital Markets and (Re)insurance

Prepared for the 2016 Mid-Year Meeting

Target Markets
Program Administrators Association

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Agenda

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- Some historical context – how did we get here?
- The investor view – why (re)insurance?
- The (re)insurer/sponsor view – why capital markets?
- What does all this mean for program managers?
- Some vocabulary and definitions:

Collateralized Reinsurance – contract secured in full at inception

Industry Loss Warranty (ILW) – contract triggered by industry financial loss metrics

Sidecar – investor co-investment in sponsor's/manager's underwriting results

Catastrophe Bond – security transferring specified risks from (re)insurer to investors

Hedge Fund Reinsurer – hybrid combining reinsurance underwriting + alternative asset management

What's in a name? It's all capital.

Capital Markets and (Re)insurance – Some Historical Perspective

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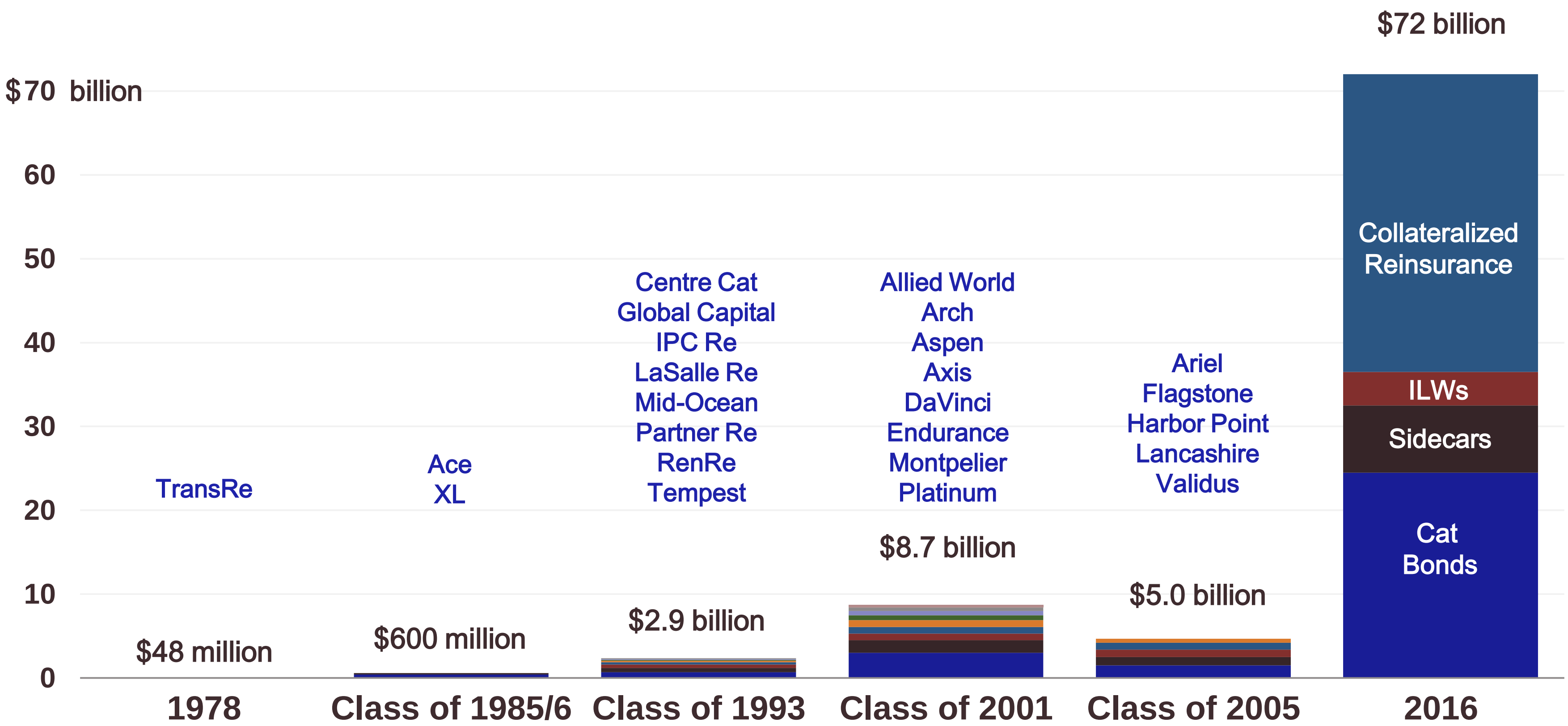
- Capital markets and (re)insurance have long worked together via equity investment
- Recent developments involve direct securitization of catastrophe, other risks



Source: Aon Securities, Goldman Sachs, Guy Carpenter, TransRe

Milestones in (Re)insurance Securitization

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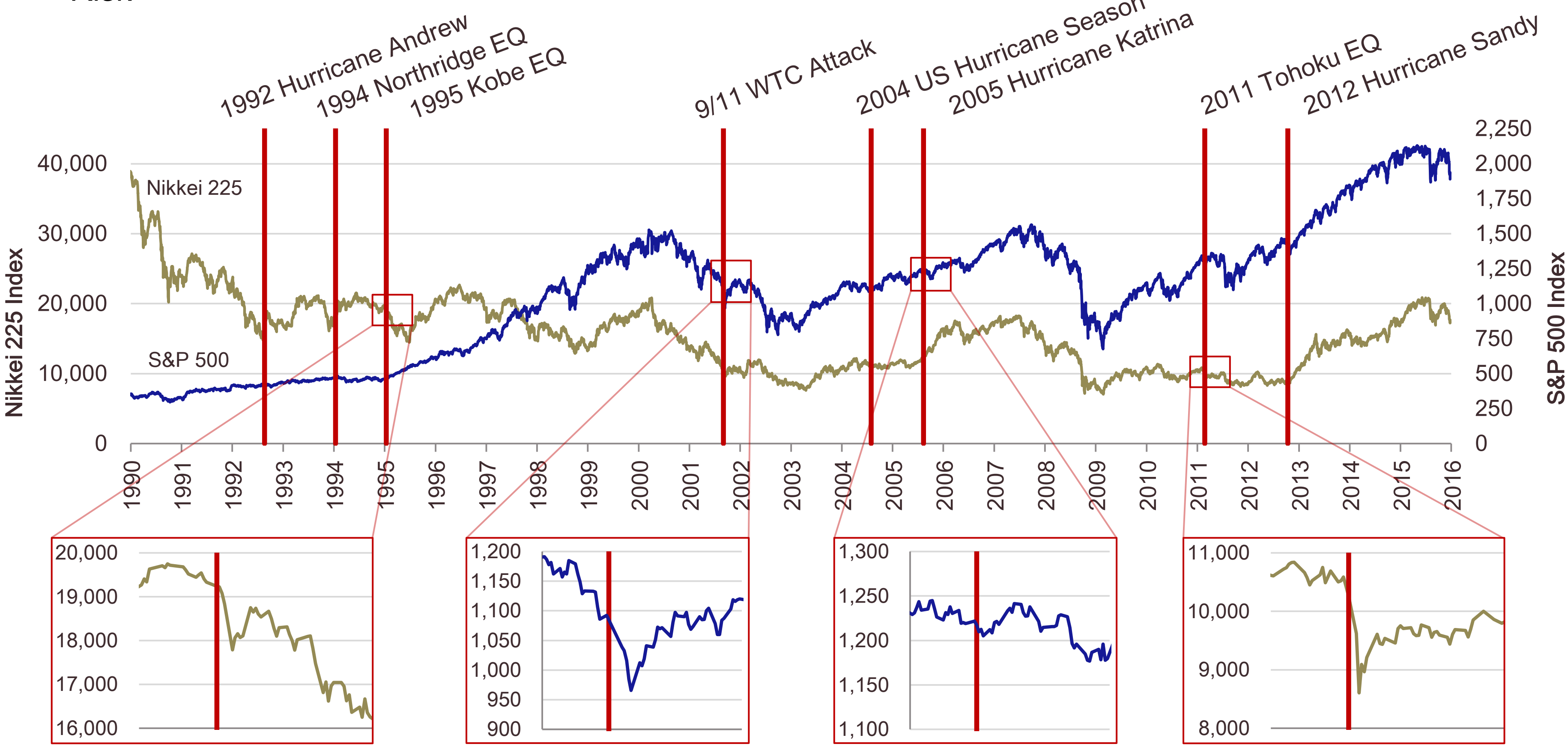
1973	*An Inquiry into the Feasibility of a Reinsurance Futures Market* (Goshay & Sandor, Journal of Business Finance)
1990	Chicago Board of Trade announces plan to trade insurance futures
1992	CBOT trades catastrophe futures and options following hurricane Andrew
1997	USAA places first large catastrophe bond, *Residential Reinsurance Ltd.*
1998	First dedicated catastrophe bond fund formed
2005	First publicly disclosed loss to a cat bond, *Kamp Re 2005 Ltd.*
2016	~$72 billion of investments outstanding

Investor and Sponsor Motivations

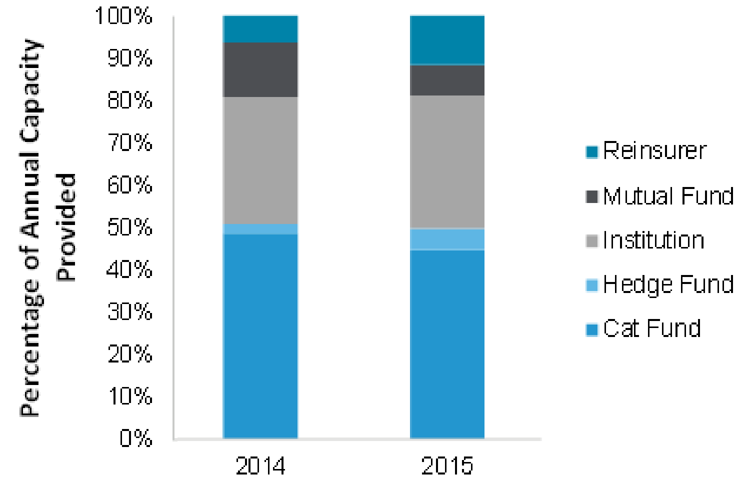
- Demonstrated "low-beta" asset class, with minimal correlation to the broader market
- *"The results suggest that CAT risks are basically uncorrelated with these other asset classes [stocks and bonds]. . . . Our findings . . . have an important implication for portfolios: adding CAT risk products improves overall portfolio performance."* – Froot *et al.*, July 1995, *The Emerging Asset Class: Insurance Risk*



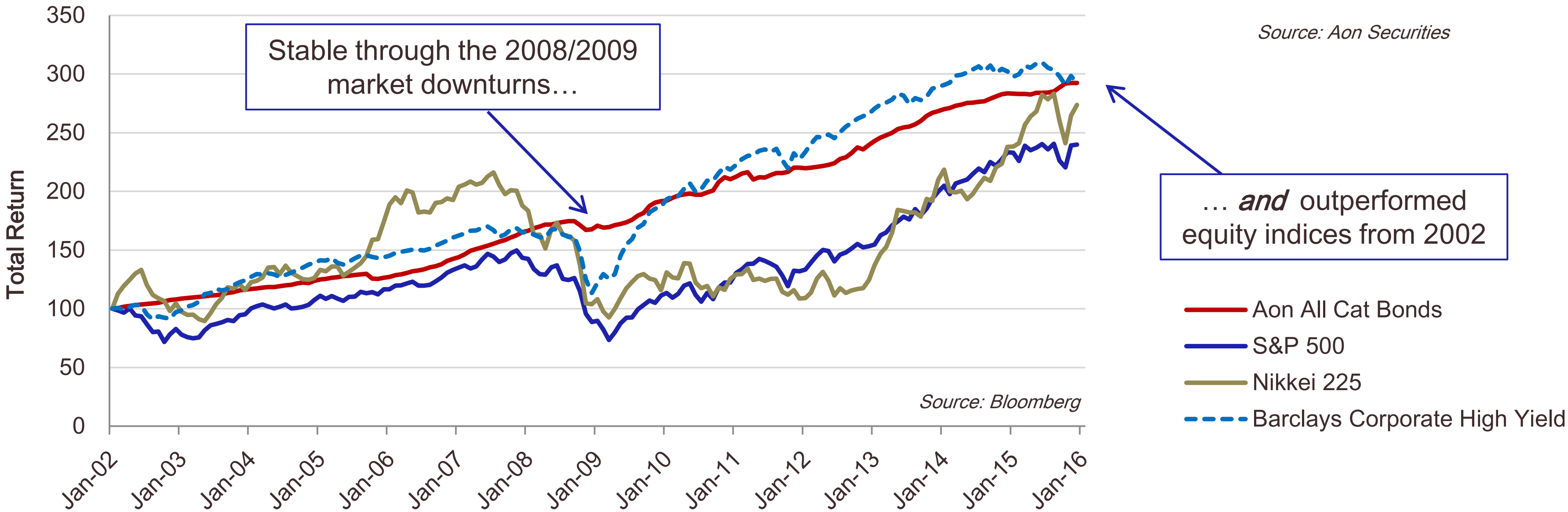
Investor and Sponsor Motivations, cont.

- Established risk-linked securities market since its founding in 1997, now estimated at $72 billion, and tested through catastrophe events (Katrina, Tohoku, Sandy) and credit events (2008/2009)
- Cat bond market returns have surpassed equity returns from 2002, and demonstrated their value as a broader market hedge during the 2008/2009 credit crisis
- Market participation from a wide range of investors: pension funds, sovereign wealth funds, endowments, mutual funds, high net worth individuals, and hedge funds

Risk-Linked Securities Capacity by Investor Type



Source: Aon Securities



Note: Aon Securities' analysis of investor category includes only those transactions on which the firm participated

Matching Risk and Capital: Mutually Beneficial Risk Transfer

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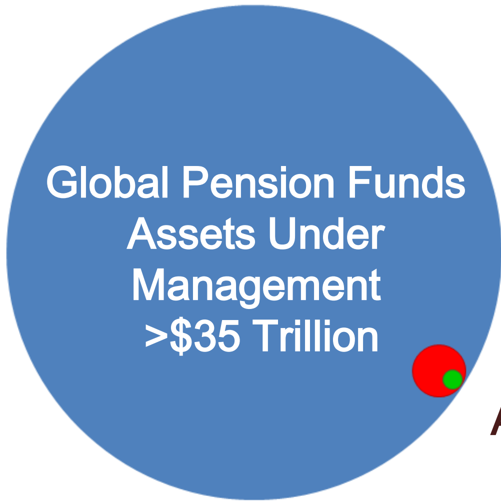

Total Reinsurance Capital $565 billion

Alternative Reinsurance Capital $72 billion

Uncorrelated Third-Party Capital

- Low frequency/high severity/high correlation *for reinsurers* → catastrophe reinsurance is capital-intensive (rating agency capital, economic capital)
- Third-party investor portfolios benefit from addition of (uncorrelated) catastrophe risk

The (Re)insurer Value Proposition

- Third-party capital combined with reinsurer equity capital strengthens reinsurer's market position → more influence on terms, additional opportunities, efficient capital
- Infrastructure and relationships to access third-party capital and business post-event

Source: Towers Watson, Aon Benfield

The Big Picture for Program Management

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- Secular industry shifts/challenges:
  - disintermediation
  - cost of capital/capital efficiency
  - gap between insured/economic losses
  - need for new product development
- Originate, underwrite, analyze, price and distribute portfolios of risk – move closer to original sources of risk and ultimate capital providers
- Homogenized, discrete risk units + underwriting skills + balance sheet → powerful, mutually beneficial combination

Alternative Capital: The Industry As It Undergoes Secular Change

William M. Jewett

“Hedge Fund Re” -- The Initial Model

- Offshore Domicile
- $500 Million+ in Capital
- Best’s Rating: A-
- Nimble, Agile, and Highly Regarded Management Teams
- Outsourced Administrative and Other services
- Open Market Reinsurer with Primary Focus on Low-to-Moderate Volatility Liability Business
- IPO within 36 months
- Hedge Fund Asset Management, i.e., Expected Return on Assets Greater that Traditional Reinsurers

“Hedge Fund Re” -- The Evolving Model

- Alignment with a Sponsoring Company
- Best’s Rating: Not Required
- Sponsoring Company to Contribute Significant Capital and Sufficient Premium
- Administrative and Select Other Services Provided by Sponsoring Company
- Access to Open Market Business NOT Critical
- Many Companies have Formed, Tried and Failed, or are Undergoing a Process

Investors: The Opportunity

- Results should largely track the returns on the assets under management
- The “float” associated with premium provides a gearing mechanism
- Tax efficient
- Operationally efficient
- Liquidity once public
- Potential to trade at a multiple of book
- Possible access to an enhanced investment strategy given different liquidity considerations
- Entity has an option to significantly enhance return when reinsurance market improves through ability to source attractive business and/or through enhanced multiple-to-book

Hedge Funds: The Opportunity

- Permanent capital, with investor liquidity provided through an IPO
- Tax efficient
- Operationally efficient
- Ability to access “float” associated with liability lines of business, amplifying AUM and ROE.
- Expanded “product offering” to investors and potential investors
- Potential to enhance investment strategy given different liquidity considerations
- Limited risk of substantial economic loss from reinsurance risk
- AUM could substantially increase if reinsurance market improves

Hedge Fund Re: The Opportunity ?

- THIRD POINT RE
  - Shares have fell 13% since going public in August of 2013
  - Investors in Third Point Capital are up 11%
  - Third Point Re has paid $98 million of asset management fees

- GREENLIGHT RE
  - Since May of 2007 shares have increased 14%
  - Investors in Greenlight Capital are up 50%
  - Greenlight Re has paid $280 million of asset management fees

“New” Capital and Secular Change

(or Capital is Cheap and Plentiful – Who Controls the Risk is the Winner)

- NEPHILA
  - Partners with AmWins for 10% of All “Shared and Layered” Primary Property Business
  - Provides U.S. Property Capacity to MGA Technical Risk Underwriters
  - Permission from Florida ORI to Participate in Citizens’ Take-Out Policies
  - Establishes MGA Velocity Risk Underwriters Offering HO and Small Commercial
- HAMILTON RE
  - Focus on both Reinsurance and Insurance, with Insurance Business Headquartered in Princeton
  - Relationship with AmWins to Provide Small Commercial Lines Risks
- Watford Re/Arch
  - Establishes Watford/Europe to write UK Motor, and have entered the U.S. E&S Market