Prepared by Aon Securities LLC

Potential Quota Share Replacement Capacity

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Why Insurers Issue Debt or Surplus Notes?

Debt and surplus notes can provide a number of strategic benefits for an issuer while providing a less expensive and flexible capital source of capital.

Flexible Source of Capital

- Provides the issuer with greater flexibility in its capital structure
  - No dilution of ownership / earnings
  - Call option to allow for re-financing or early redemption
- Cheaper form of capital than traditional equity

Accomplish Strategic Initiatives

- An Issuer can utilize this form of capital for any of the following strategic benefits:
  - Growth through either acquisition or organic expansion into additional products and markets
  - Improving rating agency or regulatory capital position
  - Re-financing existing debt or surplus notes
  - Cheaper form of capital compared to certain quota share programs
  - Technology system upgrades

Expanding Investor Base Leading to Favorable Terms

- The number and types of investors looking to deploy debt and surplus note capital into the insurance space has been rapidly rising
  - Investors now range from traditional asset managers and life insurance companies to insurance linked securities hedge funds and family offices
- Investor competition has led to favorable pricing and covenants for issuers

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Debt vs. Quota Share

	Debt	Quota Share
Duration	▪ Maturity anywhere from 2 to 30 years ▪ Call provision built in for additional flexibility 1-3 years after issuance	▪ Minimum one-year, but can be multi-year ▪ One-year options can be renewed upon expiration
Cost	▪ Gross cost of [8.00% - 10.00%] based on credit profile ▪ Net cost (assumes investment yield of 2.5%) of [5.50% - 7.50%] ▪ Allows for net income retention on profitable business	▪ Ceded margin of [4% to 8%], inclusive of ceded Inv. Inc. on ceded cash
Flexibility	▪ Limited opportunity to modify existing note amount or terms ▪ Generally redeemable at par after a certain amount of time (~1-3 years)	▪ Annually and sometimes adjustments in ceded volume allowing flexibility in response to evolving market opportunities
Capacity	▪ New and existing investor interest continues to expand. ▪ Personal lines businesses with an MGA extremely attractive	▪ Potential for price increases in loss impacted accounts ▪ More focused on alignment of interests and u/w the book; credit ratings less of a driver
Continuity	▪ Long-term capital, up to 30-year terms available, floating rates common	▪ Contract terms subject to review at treaty renewal; availability/pricing subject to u/w cycle
Risk Transfer	▪ None, must be paid back in full	▪ High levels of customized surplus protection from u/w volatility, based on capital needs
Audit and Regulatory Risk	▪ Notify the insurance regulator of issuance	▪ Subject to annual audit review under reinsurance accounting standards ▪ Features such as funds withheld, profit sharing, slides / annual caps are subject to regulatory review

Illustrative Quota Share Cost of Capital vs. Debt

Given the operating leverage and margin ceded through certain quota share arrangements, raising capital via debt or surplus note may be a meaningfully less expensive source of capital.

Illustrative Quota Share Cost of Capital Comparison

Quota Share Cost ($ millions, unless noted):	
Direct Premiums Written	$300.0
Ceded Premiums	(100.0)
Net Premiums Written	200.0
Ceded Underwriting Margin (%)[1]	5.0%
Ceded Underwriting Margin ($)	(5.0)
Operating Leverage Ratio (Ceded Premium / Surplus)	2.50x
Surplus Relief from QS	40.0
Lost Investment Income Yield	2.0%
QS Lost Investment Income	(0.8)
Total QS Annual Cost of Capital ($)	**($5.8)**
Total QS Annual Cost of Capital (%)	**14.5%**

Commentary

Key Assumptions for Discussion:

- Ceded margin of 5% to the reinsurer
- Targeted net operating leverage (CPW / Surplus) of 2.50x
- Company investment yield of 2.00% on lost investment income from quota share capital relief
- Debt annual cost of capital would be equal to:
  - New underwriting margin retained + investment income on debt proceeds) – new debt interest expense
- Aon Securities welcomes the opportunity to discuss this analysis in further detail

Illustrative Quota Share Cost of Capital Comparison

Investment Yield (%)	Underwriting Profit & Reinsurer Margin Ceded (%)				
	3.0%	**4.0%**	**5.0%**	**6.0%**	**7.0%**
1.0%	8.5%	11.0%	13.5%	16.0%	18.5%
1.5%	9.0%	11.5%	14.0%	16.5%	19.0%
2.0%	9.5%	12.0%	**14.5%**	17.0%	19.5%
2.5%	10.0%	12.5%	15.0%	17.5%	20.0%
3.0%	10.5%	13.0%	15.5%	18.0%	20.5%

Target Net Operating Ratio	Underwriting Profit & Reinsurer Margin Ceded (%)				
	3.0%	**4.0%**	**5.0%**	**6.0%**	**7.0%**
2.00x	8.0%	10.0%	12.0%	14.0%	16.0%
2.25x	8.8%	11.0%	13.3%	15.5%	17.8%
2.50x	9.5%	12.0%	**14.5%**	17.0%	19.5%
2.75x	10.3%	13.0%	15.8%	18.5%	21.3%
3.00x	11.0%	14.0%	17.0%	20.0%	23.0%

Note: (1) Assumes 5.0% quota share override / underwriting margin.

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Illustrative Senior Note Transaction Structure

With a relatively simplistic transaction structure, a senior note is an attractive way for an insurance company to raise additional capital.

Merits and Considerations

Merits

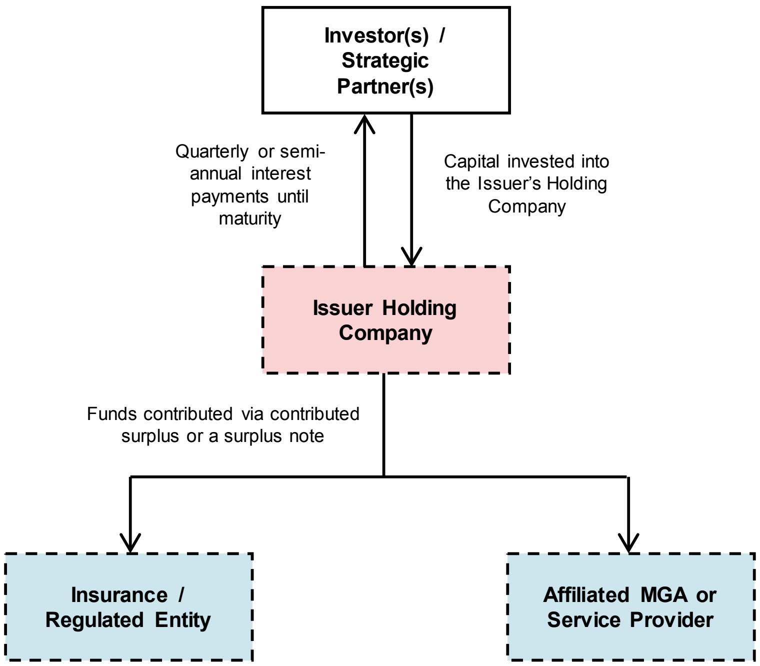
- ▲ Cheaper cost of capital
  - Can be cheaper/more profitable than existing or prospective quota share
- ▲ Ability to retain risk and profits
- ▲ Number of strategic benefits/opportunities:
  - Organic growth – new lines or states
  - Acquisitions
  - Technology investments
  - Improve capital position (rating agency & RBC)
- ▲ Relatively short process to raise capital (3-4 months)
- ▲ Tax savings

Considerations

- ▼ Less flexibility than a quota share
- ▼ No risk transfer
- ▼ Restrictive covenants by investors:
  - Minimum reinsurance buy
  - Maximum debt/capital ratio
  - Interest rate "step-up" upon rating downgrade
  - Acceleration upon default
- ▼ Default could lead to reputational repercussions

Illustrative Transaction Structure

Senior Note Transaction



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