Why MLC has chosen AlphaCat

MLC has been researching insurance-related investments since 2004 and investing in them since 2007. These are investments in natural catastrophe risks. Investors take on the role of an insurer. They receive a yield - effectively an insurance premium - for taking the risk of a particular natural catastrophe causing losses above a certain level.

Insured events are typically for relatively low probability events, such as major hurricanes and earthquakes.

As the occurrence of natural catastrophes has no expected correlation with share market movements, the strategy is an attractive source of diversification. For example, during the global financial crisis, shares fell but insurance-related investments performed well.

MLC has appointed AlphaCat to manage insurance-related investments due to their investment experience and expertise in the management of natural catastrophe and weather-related reinsurance risk exposures.

AlphaCat enables us to access the risk exposures that we find attractive, more directly and cost effectively than via a pure specialist manager. This is because AlphaCat benefits from the sourcing and underwriting expertise of its parent company, the Validus Group (Validus), a specialist global reinsurance business.

Through AlphaCat we are able to tailor a portfolio of insurance risks more directly, which may enhance the prospective net of fee returns to our investors.

Philosophy on investing

AlphaCat seeks to maximise investment returns in the catastrophe reinsurance market through the prudent management of exposure in those geographic areas that provide the highest expected return per unit of risk.

Catastrophe reinsurance is a diversifying asset class with characteristics similar to traditional fixed income instruments in that with catastrophe reinsurance, an investor receives a coupon payment for accepting the risk of losing principal when a severe event, such as a hurricane or earthquake, causes property damage.

AlphaCat focuses on the peak exposure regions with the highest property values and largest insurance markets, primarily the USA, Europe and Japan. Due to the diversifying nature of reinsurance as a whole within our investors' overall portfolios, AlphaCat seeks only modest diversification outside of these peak exposure regions to prudently limit the impact of extreme scenarios.

Investment process

AlphaCat believes that reinsurance returns are maximised through deep access to the private reinsurance market complemented by advanced modelling capabilities to analyse the opportunities available. AlphaCat is able to call upon these attributes directly and through affiliate companies in the Validus Group.
Specifically, AlphaCat leverages the Validus Group underwriting network to achieve significant access throughout the approximately $458 billion1 (July 2015) global reinsurance market via multiple access channels. The Validus Group has a presence in all the major insurance and reinsurance markets around the world, including Bermuda and Lloyd’s of London, and has expertise in catastrophe risk management and assessment.

Furthermore, the risk selection capabilities of AlphaCat are supported by Validus Research, an affiliate company employing over 30 professionals and scientists dedicated to proprietary catastrophe risk research, modelling and application development. All contracts available to AlphaCat are modelled by Validus Research to create a comprehensive view of the reinsurance investment universe. AlphaCat then utilises internally developed optimisation tools to build customised portfolios for investors based on the available opportunities.

Using these resources, AlphaCat seeks to achieve the objective of maximising investment returns based upon MLC’s risk and diversification appetite.

**Investment people**

**Biographies**

**Lixin Zeng, CEO**

Lixin Zeng, Ph.D., is the Chief Executive Officer of AlphaCat and has directed portfolio construction activities since the manager’s formation in 2008. Prior to this role, he was Executive Risk Officer of Validus Reinsurance Ltd, responsible for developing and executing the catastrophe risk strategy of the entire Validus Group. Lixin was one of the original employees at the founding of Validus in 2005. His prior positions include: Chief Catastrophe Risk Officer at the ACE Group from 2004 to 2005, Head of Development at Willis Re Inc. from 2001 to 2004, Analyst at EW Blanch Co. from 1998 to 2001 and Research Scientist at Arkwright Mutual Insurance Co from 1996 to 1998. Lixin has expertise in insurance portfolio optimisation and risk management and has published multiple articles in professional journals on related topics. He has a Ph.D. in atmospheric sciences from the University of Washington where he graduated in 1996. He received a B.S. in Meteorology from Beijing University, graduating in 1990 and is a CFA charterholder.

**Paschal Brooks, Portfolio Manager**

Paschal Brooks is the Portfolio Manager of AlphaCat, a role in which he has served since 2011, and is responsible for investment decisions, investor relations activities and marketing to reinsurance purchasers. Prior to this role, he was a Vice President on the insurance structured finance desk within the investment banking division of Goldman, Sachs & Co. from 2006 to 2011. In this position, he advised insurance companies on risk securitisation transactions including catastrophe bonds, sidecars and embedded value securitisations. Prior to this role, he was a research analyst at Alleghany Corporation from 2003 to 2006, where he evaluated investment opportunities in public and private markets across a range of industries. Prior to this role, he was an analyst in the financial institutions group of the investment banking division of Goldman, Sachs & Co. from 2000 to 2003. He has a B.S. in Economics from Duke University where he graduated in 2000 and is a CFA charterholder.

**Investment story**

The Everglades Re Ltd., Series 2014-1 catastrophe bond was issued to provide reinsurance protection against severe financial losses from hurricanes in the portfolio of Citizens Property Insurance Corporation (“Citizens”), the government sponsored insurance company of the state of Florida. As the largest insurance provider in the state, Citizens maintains a well-distributed portfolio across Florida with meaningful coastal exposure. While the 7.5% coupon initially offered on the bond well compensated investors for the risk level calculated by commercially available models and the B rating from S&P, we believed the actual risk level of the bond was meaningfully lower and the expected returns therefore higher.

Our differentiated view of the risk of this bond was based on proprietary analysis conducted by the scientists of Validus Research and underwriters of Validus Re. Specifically, our scientists have spent considerable time developing a proprietary view of hurricane frequency, associated flooding severity and structural vulnerability, among other factors, to refine the damage estimates produced by our catastrophe modelling. In this case, we believe the coastal footprint of the Citizens portfolio resulted in overly conservative risk estimates by the wider reinsurance market. Our underwriters simultaneously carried out a detailed examination of the data capture processes and claims administration abilities of Citizens to benchmark the company against privately owned

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peers. Based on the favorable results of this peer comparison, we think the market was again placing a risk premium on Citizens based on reputation instead of objective research.

(This security may no longer be included in the manager's portfolio as their view may have changed since this document was prepared.)