MANAGING EXTREMES Willis Re

1ST VIEW

1 July 2014

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Renewals – 1 July 2014

1st View

This thrice yearly publication delivers the very first view on current market conditions to our readers. In addition to real-time *eVENT Responses*, our clients receive our news brief, *The Daily Willis ReView*, periodic newsletters, white papers and other reports.

Willis Re

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Competition Abounds

As anticipated, the June 1 and July 1, 2014 renewals have seen little change in the current market dynamics. Excess capital supply, chasing muted demand, is leading to significant rate reductions and, in some cases, an expansion in terms and conditions.

Continued benign loss activity during the first half of 2014 has compounded the market softening while inflows from capital markets continue to add capacity. Interestingly, much of the price competition has been driven by the traditional reinsurance markets. To date, most buyers have opted to take reinsurance premium savings into earnings rather than recycle them into additional reinsurance purchases.

Adding to reinsurers' concerns is the increasingly negative outlook from the major rating agencies on the global reinsurance sector. In particular, rating agencies have focused on the role of Insurance-Linked Securities (ILS) markets in driving down pricing in the high margin U.S. catastrophe market which has been a key element of reinsurers' overall return in recent years.

Despite these concerns, the move for non-traditional capital to spill over into non-catastrophe lines is accelerating as more fund-backed reinsurers, often developed in conjunction with existing reinsurers, enter the market. For a well-structured vehicle, investors can enjoy the benefits of accepting non-correlating insurance risk as well as being able to achieve useful tax advantages, further enhancing their competitive position. This spillover impact of ILS capacity to other non-catastrophe lines of business is also a concern highlighted by rating agencies.

To date, new nonlife catastrophe bond issuance has reached U.S. $5.7 billion in 2014 and the total outstanding amount has reached an all-time high of U.S. $21 billion. Despite the growth in catastrophe bond issuance, there are signs that in the softening conditions which impact risk / reward dynamics, new investment is slowing and we may be approaching dynamic equilibrium at current spread levels. This style of logical, considered investment bodes well for the long term sustainability of ILS capital and helps to answer the persistent question over the long term commitment of ILS investors.

Buyers' tiering of their reinsurance capacity suppliers, be it traditional, collateralized and/or ILS markets, is further adding competitive pressure and forcing reinsurers and fund managers to examine their strategies to successfully trade through a challenging period. Against this background, reinsurers have to speed up the implementation of their plans, which will lead to more change in terms of capital restructuring, formation of sidecars with ILS investors and M&A.

Looking forward to 2015, the current soft market poses an increasing challenge for most reinsurers. Below average loss ratios in the first half of 2014, allied with reasonably adequate reserve positions, are, barring any major underwriting or investment losses in the second half of 2014, likely to lead to another year of reasonable returns, further pressuring rating levels for 2015.

Finally, for primary insurance companies, the ability to recognize primary rate increases while reducing reinsurance cost may be coming to an end. Rate reductions are now being seen in most territories on primary insurance classes, though in many cases, the reductions are not directly linked to reinsurance savings. The tentacles of the softening market are spreading far and wide with no immediate signs of relief.

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Chairman, Willis Re
1 July 2014

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1 July 2014

Property – territory and comments

Australia

- Softening market driven by an abundance of capacity and, to some degree, a reduction in the overall market demand for reinsurance
- Supply of reinsurance capacity driven by traditional reinsurers looking to maintain market position
- Pricing reductions vary depending on portfolio transition, loss experience and the insurer's strategic alignment
- Reinsurers willing to lock in capacity early
- Emergence of multi-year transactions
- Reinsurers looking to package across multiple programs

China

- Market is still soft at July 1
- Losses in 2013 impacting 2014 pricing
- Tight reinsurance spending budget from buyers
- Continued underlying growth in exposures leading to large risk adjusted rate reductions

Latin America

- Interest in the Latin American region has increased significantly over the last year
- The newer reinsurers making most progress in this respect are those who are offering a wider range of products, not just catastrophe excess of loss; visiting the region is also important in order to become familiar with the markets
- The resurgence of pro rata capacity has continued, albeit in a modest way to date
- There is inevitably an important overcapacity for catastrophe excess of loss, partly due to the limits bought not growing that much and also to the trend towards regional and worldwide covers; the number of truly local standalone insurers of a certain size has reduced significantly in the past decade
- Depending on territory and, more importantly, on size of program, catastrophe excess of loss prices have been reducing in the range of -5% to -10% on a risk-adjusted basis
- Alternative forms of reinsurance capital have not yet started to be deployed within the region; this is mainly due to the lack of true underlying growth in insurance penetration and to the generally conservative attitude of Latin American buyers

Middle East

- Coinsurance and facultative inwards sessions have been tightened under the proportional treaties by reinsurers to control their accumulation in the market
- Marked increase in new capacity and interest in the region making it a buyers' market; this has given the cedents an option to improve the security ratings of their reinsurer panel across the board
- With increased investment in infrastructure projects, premiums in the region are expected to grow at a strong rate

United Kingdom

- Catastrophe excess of loss reinsurers continue to offer competitive terms for U.K. Property catastrophe treaties
- Capacity for excess of loss continues to be plentiful with reinsurers increasingly aware that differentiation of their offering (e.g., quoting, line size, structure alternatives) will be needed to ensure satisfactory signed shares
- Risk excess of loss capacity is similarly in good supply
- Pro rata reinsurers are aware of market forces and do not want to lose profitable income, typically offering some favorable adjustment in terms to secure continued participation
- Clients are cognizant of market forces but balance long-term relationship security with cost; they typically prefer reasonable compromise over “forced” agreement

United States – Florida

- Reinsurer quotations were less volatile at this renewal with many reinsurers quoting below expiring pricing, causing continued compression of reinsurer margins / returns
- The softening market continues to impact terms, conditions and price, i.e., extended hours clauses and multi-year agreements were more widely available at June 1 renewals
- Catastrophe bond pricing from alternative markets was more competitive on targeted excess layers with alternative markets providing an ample supply of capacity for specific products
- Notable increase in reinsurer appetite for pro rata programs despite year-on-year increases in ceding commissions
- Most cedents utilized cost savings to buy additional reinsurance to manage exposure growth, but not nearly to the magnitude to offset the year-on-year drop in reinsurance dollar expenditures
- Placements were not as fully subscribed compared to last year’s June 1 renewals as some traditional reinsurers reduced authorizations and/or declined to provide capacity while attempting to shift capacity to perceived higher margin programs

United States – Nationwide

- Abundant capacity from all market sources resulted in a continued softening for U.S. Property catastrophe renewals – some programs were down as much as 20% on a risk-adjusted basis, although any accounts with loss activity (Superstorm Sandy development, tornado / hail-affected accounts) did not see this level of downward adjustment
- The interest from the capital markets remains intense, and while many programs are still mostly placed with traditional reinsurers, the move towards a greater involvement from the collateralized reinsurers and catastrophe bonds continues at a strong pace; a number of programs now have some placement with alternative market segments
- Some cedents have taken advantage of soft reinsurance pricing to purchase more limit within their pre-established budget, but many other buyers have retained the savings
- Softening market continue to impact terms and conditions as well as price: extended hours clauses are becoming more widely available and the market is open to expanding terror coverage, but depending on the exposure, it may involve additional premium

Rates

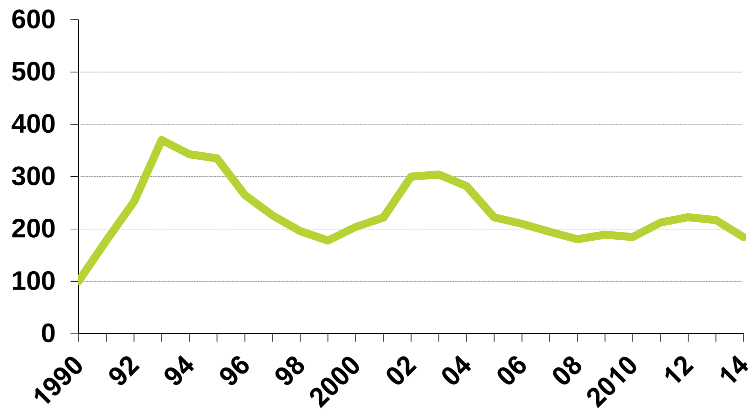
Property rates					
Territory	**Pro rata commission**	**Risk loss free % change**	**Risk loss hit % change**	**Catastrophe loss free % change**	**Catastrophe loss hit % change**
Australia	0% to +2%	0% to -5%	0% to +10%	-12.5% to -17.5%	0% to +5%
Caribbean	+1% to +2%	-5% to -10%	0% to -5%	-10% to -15%	-5% to -10%
China	+2%	N/A	0%	-20% to -50%	0% to -10%
Latin America	0% to -2.5%	-5% to -15%	-2.5% to +10%	-5% to -10%	N/A
Middle East	0% to +1%	-5% to -10%	0% to +10%	-7.5% to -12.5%	0%
South Africa	+2.5%	0%	+5%	-10%	+5%
United Kingdom	varies	N/A	N/A	-15% to -20%	N/A
United States – Florida	+2% to +5%	-5% to -15%	varies	-15% to -25%	N/A
United States – Nationwide	N/A	-10% to -15%	+5% to -5%	-10% to -20%	0% to -5%

Note: Movements are risk-adjusted.

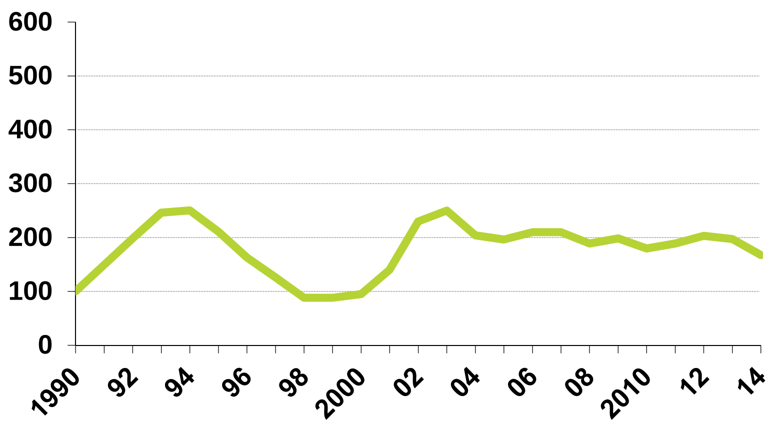
Property catastrophe pricing trends

The charts on these pages display estimated year-to-year Property catastrophe rate movement, using 100 in 1990 as a baseline.

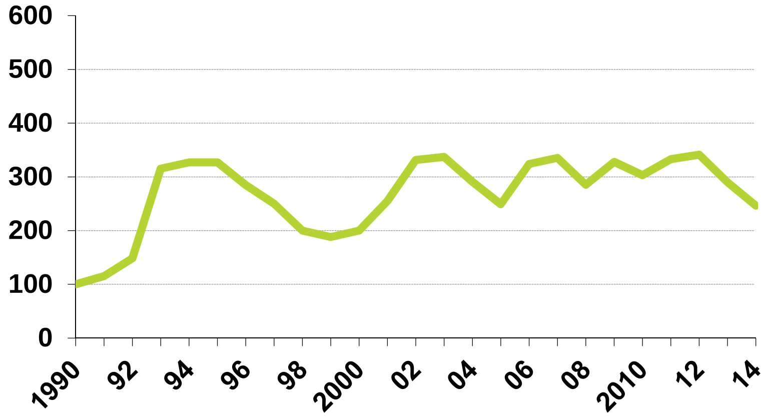
Australia

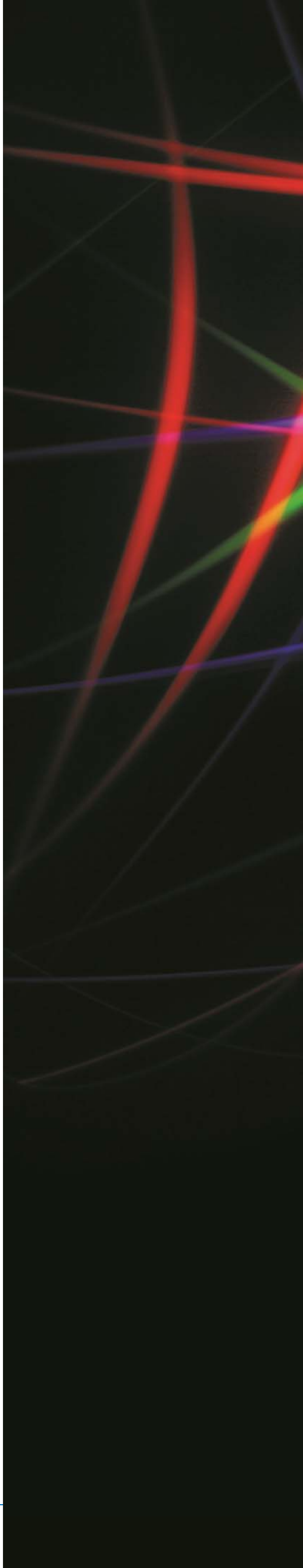


Caribbean



United States – Nationwide





Casualty – territory and comments

Australia– General Third Party Liability

- Continuation of softening market
- All reinsurance programs well subscribed
- Demand driven mostly by onshore or APRA-regulated reinsurers (including Lloyd's)
- Low investment yields are not having an effect on reinsurance rates
- Tort reform continues to hold maintaining stability on reinsurance rates
- Coverage continues to broaden

China

- Market is still soft at July 1
- Tight reinsurance spending budget from buyers

International – General Third Party Liability

- There has been a wide range of outcomes
- Longer established programs have shown more stable rate changes
- Those with better data have enjoyed superior out-turns
- Transparency of direct underwriting quality has been a differentiator
- Reinsurance market capacity is abundant, with new players emerging
- Existing markets have looked to protect their positions

International – Motor Liability

- With the exception of certain territories where legislative developments are causing concerns, capacity for International Motor remains reasonably abundant; programs are relatively straightforward to place, and tensions remain between existing reinsurers who are keen to hold on to their shares and new markets who have to show price competitiveness to stand a chance of dislodging the status quo; programs in these non-controversial territories can generally be placed at lower rates than expiry, with reductions of up to 10% not uncommon
- The broadly soft market for International Motor is being further stimulated by the demonstrably soft market for Property catastrophe, as reinsurers are looking to find ways to supplement falling catastrophe budgets by writing income from other classes
- Territories defying this general soft-market trend for Motor would include U.K. and France, where developments in terms of the long term settlement of severe bodily injury claims have led to an increasing value in the excess of loss product, a reduction in the supply of reinsurance capacity and a concomitant increase in rates charged; rates in the U.K., for example, have generally shown increases of up to 10% for renewals with broadly similar year-on-year exposures

United States – General Third Party Liability

- Quota share ceding commissions increasing +2% to +7.5%
- Excess of loss pricing down -5% to -20%
- Increased acceptance of excess of loss on excess business
- Consolidation of programs continues

United States – Motor Liability

- Personal Auto is experiencing increased interest and capacity from carriers and reinsurers alike
- For Personal Auto, primary rate increases have improved many carriers' results and is attracting new pro rata capacity
- Some new Personal Auto reinsurers require lower margins than traditional reinsurers and are attracted to the low volatility
- Suppressed margins on Property business have caused some reinsurers to consider Personal Auto as a way to maintain top line premium
- Personal Auto is seeing significantly improved reinsurance terms that include increased minimum commissions, improved commission swings, waived deficits and other enhancements in terms and conditions
- Some carriers and reinsurers have expressed new interest in Commercial Auto opportunities

United States – Professional Liability

- Underlying insurance premium and loss fundamentals remain stable and positive with no major discernable threats
- Attritional loss ratios considered profitable and attractive based on continuing low frequency of large losses
- Carriers raising retentions and reducing reinsurance spend despite favorable reinsurance pricing
- Reinsurance appetite and capacity at record levels not seen since prior to 9/11

Rates

Casualty rates			
Territory	**Pro rata commission**	**XL – No loss emergence % change**	**XL – With loss emergence % change**
Australia	N/A	Casualty -2% to -5% Professional Lines -5% to -7.5%	0% to -2%
China	N/A	-15%	N/A
International – General Third Party Liability	+2% to +7%	-5% to -20%	0% to -10%
International – Motor Liability	varies	-10% to +10%	0% to +15%
South Africa	N/A	-5%	0%
United States – General Third Party Liability	+2% to +7.5%	-5% to -20%	0%
United States – Motor Liability	+1% to +4%	-10% to -20%	+5% to -5%
United States – Professional Liability	+5%	-15% to -20%	varies

Note: Movements are risk-adjusted.

Specialties – line of business and comments

Marine

- Softening through Q2 with plentiful capacity, but pricing still dependent on claims record and exposure analysis; clients balancing price savings against re-investment for a more efficient program on renewal
- New, or revitalized, reinsurers entering the market fuelling increasing capacity and impacting pricing levels as Marine reinsurance continues to be a diversifying class of business where rates have held compared to some Non-marine classes
- Clients continue to seek improvements in terms and conditions where possible, with varying degrees of success
- Trend towards multi-class, composite structures

Non-Marine Retrocession

- Further, but less acute, softening in the retrocession market
- On peak zone retrocession, additional rate reductions of -2.5% to -5% compared to January 1, with more regional specific programs enjoying larger reductions
- Supply: continuing ample capacity has assisted further rate reductions and stimulated instances of new purchasing
- Demand: an inconsistent market, with some clients capitalizing on pockets of competitive capacity for additional protection and others, facing the uncertainty of signings plus the effect of rate reductions on the inwards portfolio (particularly Florida) which are in general outstripping those on outwards protections, are under additional pressure to secure competitive retro protection going forward
- Increasing volume of Industry Loss Warranty activity as buyers respond to attractive pricing in the approach to the hurricane season

Personal Accident / Life Catastrophe

- Significant catastrophe capacity and appetite in the class, with existing reinsurers looking to grow existing and new business
- Pricing on catastrophe continues downwards
- Event durations continue to move out from 72 hours to 168 hours and notably, travel event increasing to 336 hours
- Overall broadening of coverage continues
- Capital markets interest in the class is growing a recent example being SCOR's U.S. Extreme Mortality Bond

Political Risk

- Even with six new Lloyd's syndicates this year end offering Political and Credit Risk insurance (and with all purchasing new reinsurance programs), there remains an abundance of insurance capacity chasing less business which, in turn, has led to ongoing price softening
- Despite the growth in the number of insurers there remains sufficient reinsurance capacity to accommodate both existing and new market entrants to the market
- Recent developments and unrest in Ukraine / Russia and Iraq potentially give rise to losses with initial incident reports starting to surface; to what extent they will impact the market / pricing is still unclear
- Reinsurers' good experience up until now has continued to keep pressure on renewal pricing, with improvements continuing to be secured on April 1 and May 1 renewals on both proportional and excess of loss programs
- The recent changes broadening Lloyd's regulations have been implemented and it is again somewhat early to feel the full effect of this move

United States – Healthcare

- The Medical Professional Liability market continues to perform favorably for insurers and reinsurers alike
- Reinsurance pricing continues to moderate reflecting improved frequency and severity trends on the original business
- Reinsurance capacity remains plentiful
- Reinsurers are largely supportive of carriers' initiatives to meet the needs of their insured base

Rates

Specialty rates

Territory	Pro rata commission	Risk loss free % change	Risk loss hit % change	Catastrophe loss free % change	Catastrophe loss hit % change
Non-Marine Retrocession	N/A	N/A	N/A	-12.5% to -15%	N/A
Personal Accident / Life Catastrophe	0%	-5%	0%	-5% to -20%	N/A
United States – Healthcare	0% to +2%	N/A	N/A	N/A	N/A

Note: Movements are risk-adjusted.

U.S. Workers' Compensation

- The flow of alternative capital into the Property market has had a major spillover effect in the Workers' Compensation market
- Reinsurers are trying to make good use of their capital where they can
- Reinsurance buyers are finding favorable pricing and flexibility in terms and conditions
- Working layers (generally below $10 million attachment points) are receiving modest rate reductions subject to loss experience
- Pricing on catastrophe program is softening significantly
- Alternative capital is directly competing for quota share and low layer excess

Rates

Workers' Compensation rates

Territory	Pro rata commission	Catastrophe XL – % change	Per life XL – % change
United States	+3% to +5%	-5% to -15%	0%

Capital Markets

- Record levels of ILS activities in Q2 across a range of products
- Catastrophe bond sponsors rewarded with substantially lower risk spreads relative to collateralized reinsurance for certain perils, structures and return periods
- The investor mix varies substantially by product with many collateralized re investors not supporting all cat bonds and vice versa
- Lower spreads have attracted substantially more interest than normal from new catastrophe bond and sidecar sponsors with limited or no exposure to U.S. risks
- The risks spreads for similar deals have declined 20% to 30% on a year-on-year basis
- ROLs for traditional reinsurance capacity remain competitive for a number of non-U.S. perils vis-à-vis catastrophe bond capacity
- Cash inflows from end-investors continue to substantially exceed withdrawals, but the market is getting closer to an equilibrium given the persisting fall in spreads

Willis Re MANAGING EXTREMES

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How can we help?

To find out how we can offer you an extra depth of service combined with extra flexibility, simply contact us.

Begin by visiting our website at **www.willisre.com** or calling your local office.

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