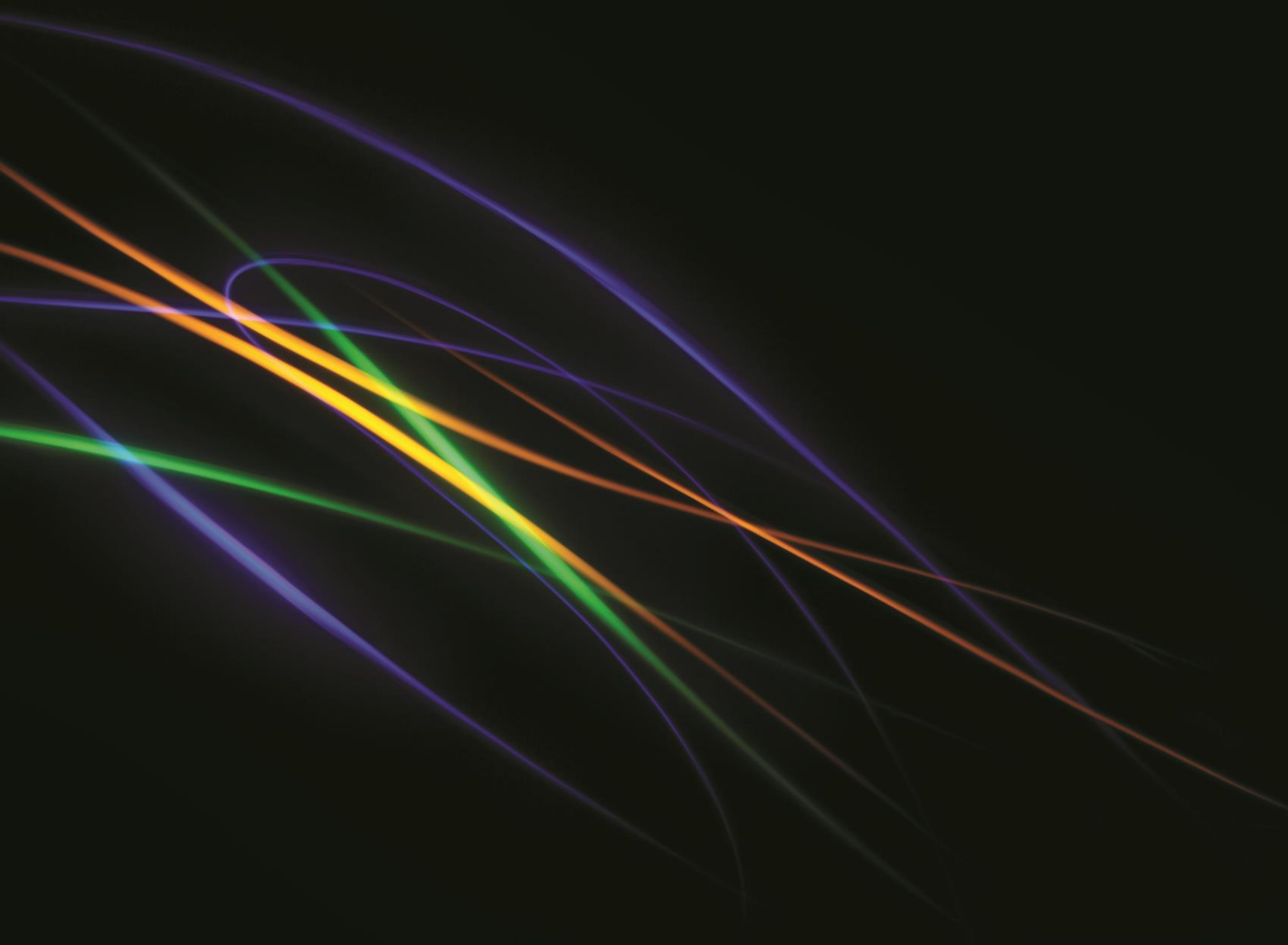
MANAGING EXTREMES Willis Re

1ST VIEW

Change fast forwards

1 April 2015



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Renewals – 1 April 2015

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

Global resources, local delivery

For over 105 years, Willis Re has proudly served its clients, helping them obtain better value solutions and make better reinsurance decisions. As one of the world's premier global reinsurance brokers, with 40 locations worldwide, Willis Re provides local service with the full backing of an integrated global reinsurance broker.

Change fast forwards

The 1st April 2015 renewal season has reinforced current trends and the market continues to favor the buyer. There are no signs the tide of falling rates and widening terms and conditions will be reversed. Faced with this reality – that the historic market cycle continues to come under extreme strain – there is a clear sense of urgency as reinsurers seek to implement major changes in their strategies and business models.

Adding to this sense of urgency is the growing transparency from major buyers around their core partner strategies and their reluctance to deal with smaller following markets. The recent move from ACE and BlackRock towards forming an innovative joint venture is a clear example of this trend, although the act of a major primary company directly accessing the lower-cost capital currently available via the capital markets has ramifications across the entire global reinsurance market.

The M&A starting gun was fired 12 months ago, and since then, activity has stepped up as the pool of potential partners shrinks with aspiring consolidators concerned about missing out on what many observe as a generational change in the industry. As investment bankers rush to orchestrate the new reinsurer model of the future, previous views about possible M&A transactions are being challenged, including any thoughts that size may be an obstacle. As ever, the key to a successful M&A transaction is demonstrating that the combination of two entities is greater than the sum of the two parts. Perversely, this imperative is likely to increase competition in the short-to-medium term, which may prolong the current soft market. Analysts are increasingly concentrating on the portfolio make-up of any potential new entity – and reinsurance is being seen as less attractive than specialty insurance business. The lure of diversification is growing ever stronger and speed of execution is becoming a key competitive advantage.

ILS funds are not immune from the current market challenges. Reduced returns and the downward pressure on fees are placing the business models of some smaller standalone ILS managers under duress. The most recent example would be AQR withdrawing from the ILS space. ILS fund managers that are evolving into more traditional reinsurer models, along with reinsurers that are expanding their own fund management activities, currently appear to be best placed to trade through this difficult period; they can manage investors and access business more effectively. While this convergence trend is both logical and anticipated, it is creating a conundrum. As ILS funds evolve their business models to look more like traditional reinsurers they are diluting the differentiation of their offering, which has proved so attractive to date for major primary buyers. In an increasingly consolidated and converged reinsurance industry, the ability to deliver a truly differentiated service offering is a critical element of sustainable success.

Against this background, the U.K. government recently announced that it will work with the (re)insurance industry and with regulators to develop competitive corporate and tax structures to attract more ILS business to the U.K. This move has been welcomed in the London market and serves as a timely reminder of the increasingly sustainable role of ILS within the wider global industry.

While the first quarter of 2015 has clearly demonstrated the urgency and diversity of change across the industry, this can only increase in the short-to-medium term as the global reinsurance market evolves and re-forms to a new paradigm.

Peter C. Hearn
Global Chairman, Willis Re

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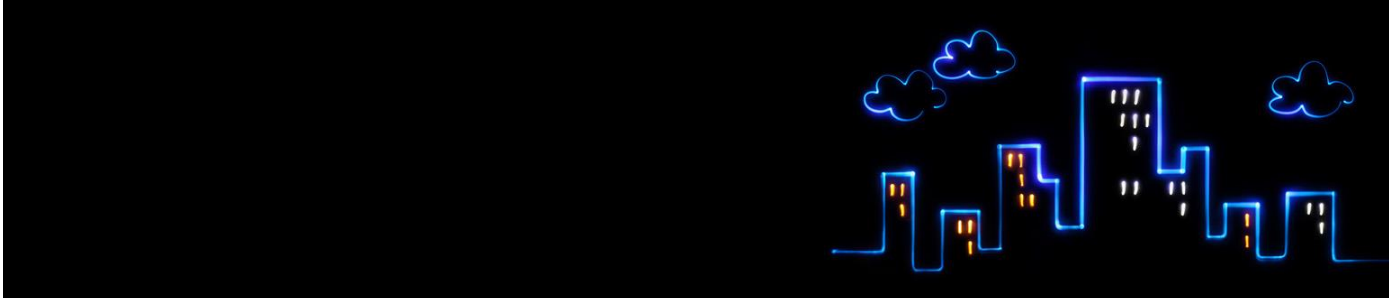
Global CEO, Willis Re



Property – territory and comments

India

- Improved terms and conditions on pro rata treaties in the case of positive results; in the case of deficit result programs, commissions adjusted to lower sliding scales
- Risk and catastrophe excess of loss programs with no loss experience continue to achieve reductions

Japan – Property catastrophe

- Excess of loss
  - Abundance of capacity with a number of reinsurers willing to consider areas of the risk spectrum that have until recently been outside of their appetite
  - Broader terms and conditions achieved, hours clauses and event definitions being the most typical examples
  - No discernable move to pre-paid reinstatements although some buyers have explored the option
  - Most clients choosing to focus on price reductions
  - Largest reductions sought on standalone earthquake excess of loss due to pricing points remaining above pre-Tohoku Earthquake loss (2011)
  - Pricing reductions more tempered on wind and flood due to a general less favorable perception of margin adequacy
  - Some additional traditional limit bought both by Non-Life and Mutual sector, typically towards top of programs
  - Ongoing adjustment to reinsurer panels due to both M&A and tiering
- Earthquake quota share
  - Commission increases achieved, in part supported by a strong primary market
  - A number of cedants increased event limits to levels last seen pre-Tohoku Earthquake loss
  - Some continued move to multi-year arrangements

Japan – Property risk

- Broader terms and conditions achieved, although these varied by cedant
- Increase in overseas exposures, some due to FX movement, but under pro rata contracts, the event limits for overseas exposure were increased (these had been reduced to below x1 risk limit following Thai Floods 2011)
- Ongoing interest in the class from reinsurers although a preference for pure domestic portfolios
- Snow losses had varied impact on surplus treaties but performance of fire portfolio generally positive in 2014-2015

Korea

- Increased number of markets offering quotations on Property excess of loss; reinsurers trying to add further value to enhance signings
- Many of the clients renewing at 1st April missed the major fire losses in 2014; as such, price reductions were available
- Another catastrophe free year put further pressure on catastrophe pricing
- No significant change to contract conditions with structures remaining largely unchanged

United States – Nationwide

- Continued abundant capacity driving competition in terms of both pricing and conditions
- Some cedants are investigating buying more catastrophe coverage while pricing remains attractive
- Most national accounts now have diversified panels of security from all sectors, including collateralized reinsurers, sidecars / managed funds and other non-traditional vehicles, besides traditional reinsurers
- Non-standard reinsurance products, including aggregate protection and shared limit covers, becoming much more widely accepted

Rates

Property rates					
Territory	**Pro rata commission**	**Risk loss free % change**	**Risk loss hit % change**	**Catastrophe loss free % change**	**Catastrophe loss hit % change**
India	0% to +2%	-15% to -20%	0%	-20% to -25%	+2% to +5%
Japan – Earthquake	+2.5% to +5%	N/A	N/A	-10% to -15%*	N/A
Japan – Property risk	0% to +4%	-5% to -10%**	N/A	N/A	N/A
Japan – Wind and flood	N/A	N/A	N/A	-7.5% to -10%*	0% to +2.5%
Korea	N/A	-7.5% to -15%	-5% to -7.5%	-5% to -10%	N/A
United States – Nationwide	+2% to +3%	-10% to -15%	+5% to -5%	-10% to -15%	N/A

Note: Movements are risk-adjusted.

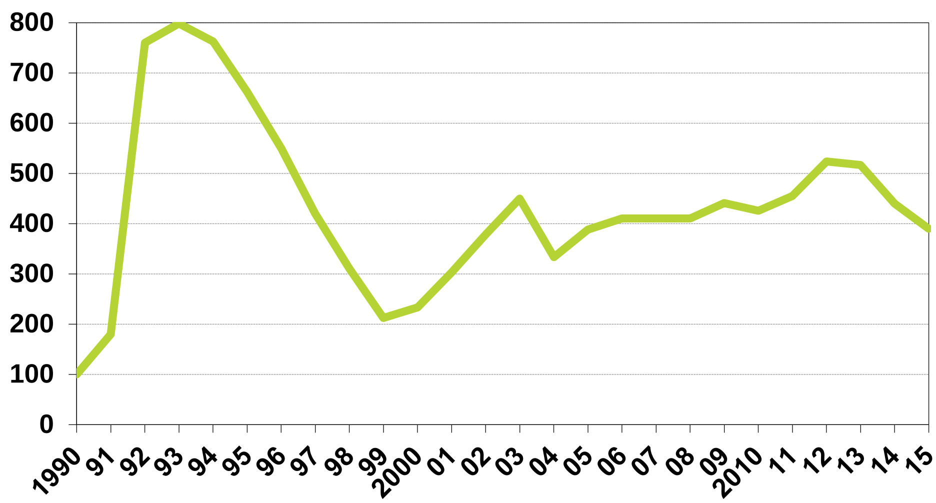
* *Japan catastrophe loss free % change for Japan combined perils: -10% to -12.5%*

*** Heavily dependent on recent loss history, this range is general*

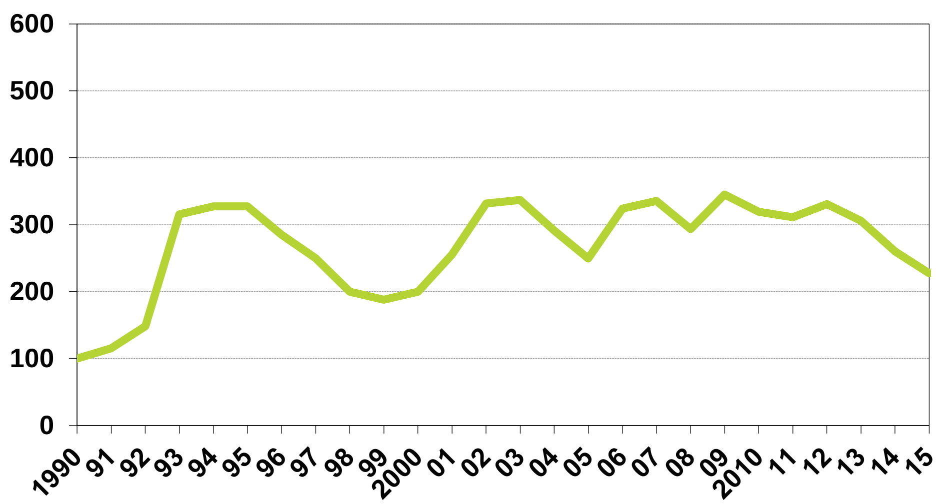
Property catastrophe pricing trends

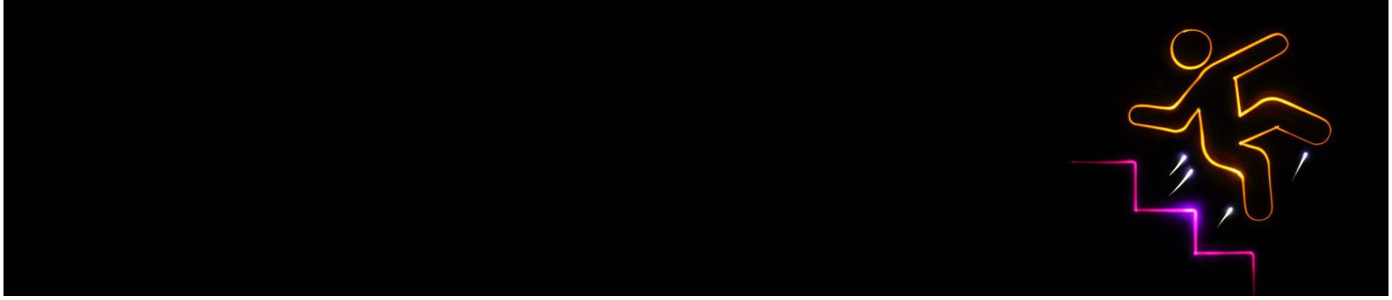
The charts on these pages display estimated year over year Property catastrophe rate movement, using 100 in 1990 as a baseline.

Japan



United States – Nationwide





Casualty – territory and comments

Japan – General Third Party Liability

- Expansion in coverage is also finding changes tailored to individual client requirements
- More limit being purchased
- Broad acceptance of changes being sought from existing reinsurers and heightened interest from new markets, with strong interest from Lloyd's
- Renewal undertaken against backdrop of loss emergence for some clients
- Premium on slips often increased but risk-adjusted reductions achieved

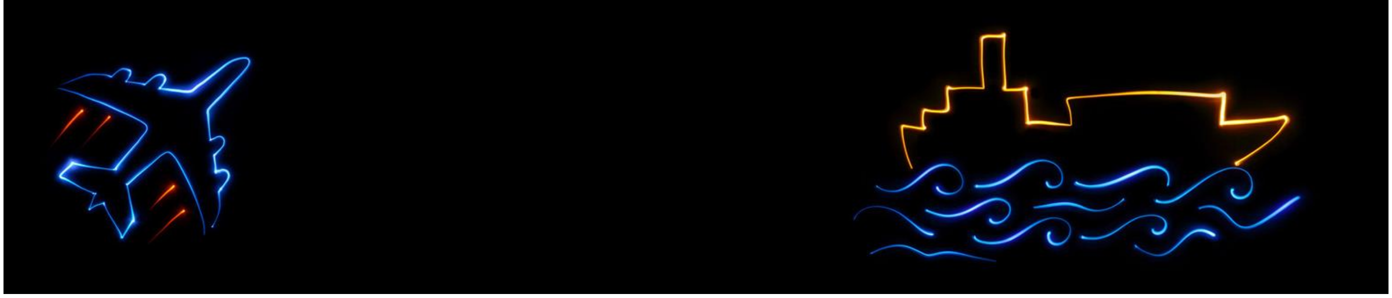
Japan – Personal Accident

- Continued softening of the Personal Accident market
- New capacity available, although this typically has not been taken up due to current reinsurer appetite for increased shares
- Some increases in coverage predominantly focused on event definitions and reinstatements
- Some interest in pre-paid reinstatements, although these were ultimately not taken up due to pricing

Rates

Casualty rates			
Territory	**Pro rata commission**	**XL – No loss emergence % change**	**XL – With loss emergence % change**
Japan – General Third Party Liability	N/A	Varies	N/A
Japan – Personal Accident	N/A	~+10%	N/A

Note: Movements are risk-adjusted.



Specialties – line of business and comments

Aerospace

- No sign of any directional change within the Aviation segment; oversupply of capacity and consequent demand for business continue to drive direction of pricing
- Recent direct market loss activity may drive a reappraisal of pricing
- The tragedy of Germanwings flight 4U 9525 is not expected to significantly impact the non-proportional market
- Reinsurance capacity remains abundant and buyers are continuing to benefit from competitive pricing, although this has been in the context of a continually weakening underlying market
- Aviation retrocession pricing has similarly come under pressure with new participants providing additional capacity; consequently we are seeing reductions in pricing

Japan – Marine

- Marine market is limited, and as such, competition amongst reinsurers is exceptional
- Following recent losses, 2014 has proved very profitable for reinsurers
- Price reductions in excess of 10% achieved on some excess of loss placements
- Improved original underwriting results produced opportunities to increase commission on pro rata contracts
- Once firm order terms fixed, placement is swift

Marine

- All lines of business continue to be competitive; the question is where will it end and/or what will it take to change it?
- As expected following the 1st January renewal season, clients continue to have high expectations
- Reinsurers are trying to maintain their position in tough market conditions
- The International Group Program saw further restructuring with the club's captive, Hydra, retaining more risk within the first general excess layer and a second long-term placement absorbing an additional 5% participation across layers 1 and 2
- As for individual club programs, reinsurance clients enjoyed favorable renewal conditions with overcapacity, low occurrence of severity losses and a soft direct market rating environment driving lowered reinsurance pricing

Non-Marine Retrocession

- More ILS capacity
- Greater demand for aggregate and multi-class
- Fewer territorial specifics being bought
- Increased demand for worldwide coverage

Rates

Specialty rates					
Territory	**Pro rata commission**	**Risk loss free % change**	**Risk loss hit % change**	**Catastrophe loss free % change**	**Catastrophe loss hit % change**
Aerospace	+5% to +10%	0% to -10%	0% to +5%	0% to -7.5%	N/A
Non-Marine Retrocession	0%	0%	0%	+15%	0%

Note: Movements are risk-adjusted.

Capital Markets

- Catastrophe bond deal flow is heavy in the run-up to the U.S. hurricane season
- Investors seem keen to take more risk and risk spreads for riskier deals continue to compress
- For more remote risks, demand is steady with risk spreads remaining in equilibrium
- Investors competing vigorously with each other to create bespoke natural catastrophe solutions to avoid syndicated placements and command higher returns for a given level of risk
- Transactions are becoming substantially more efficient enabling broader and more rapid access to Insurance-Linked Securities (ILS) tools
- Life ILS activity is heating up across the range of products.
- Following an extremely active Q4 highlighted by RenaissanceRe's acquisition of Platinum, ASI's sale to Progressive, XL and Catlin's merger and Meadowbrook's sale to Chinese investor Fosun, M&A activity continued in Q1 2015
- Q1 2015 activity included PartnerRe's merger with Axis Capital and Brit's sale to Fairfax
- Bermuda focused (re)insurers continue to look for M&A opportunities to increase scale; the increased activity could eventually rationalize capital and create additional market opportunities
- Asian investors, such as Fosun, also continue to be highly active in searching for insurance investment opportunities in developed insurance economies

Willis Re

MANAGING EXTREMES

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Whether your operations are global, national or local, Willis Re can help you make better reinsurance decisions, access worldwide markets, negotiate optimum terms and boost your business performance.

How can we help?

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

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