2012 Global Reinsurance Update

Improved Earnings Expected To Be Led By Underwriting Recovery

Special Report

2012 Earnings Improvement Likely: Fitch Ratings expects a marked rise in reinsurers' 2012 earnings, driven by a lower catastrophe burden and improving pricing conditions. The net written premium (NWP) growth expected in 2012 reflects upward pricing movements and greater sales of certain reinsurance protection, due to recent revisions of catastrophe models and in the wake of 2011 catastrophe losses. Growth will be marginally offset by lower levels of reinstatement premiums, reflecting an expected reduction in catastrophe activity during 2012.

Figure 1

2012 Non-Life Projections

(USDm)	2012F	2011A
Net written premiums	125,300	115,478
Catastrophe losses	10,900	27,900
Net favourable prior-year reserve development	5,000	7,886
Calendar-year combined ratio (%)	95.8	109.1
Accident-year combined ratio (%)	99.9	116.1
Accident-year combined ratio ex catastrophes (%)	90.9	91.3

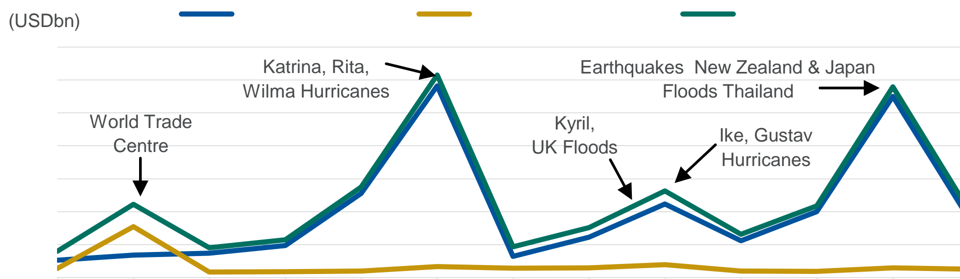
Source: Fitch-monitored universe of reinsurers

Catastrophe Losses Prove Manageable: The generally strong financial health of the reinsurance sector demonstrated that 2011 was an earnings rather than capital event for all but the most exposed players, despite near-record natural and man-made catastrophe losses of USD116bn. This is reflected in the continued stable rating outlook that Fitch maintains on the global reinsurance sector, as well as in the limited number of negative credit rating actions taken on individual reinsurers over the past 12 months.

Figure 2

Insured Catastrophe Losses 2000-2012F

(USDbn)



Source: Swiss Re Sigma, Fitch

Capital Development Uneven: The capitalisation of Fitch's monitored universe of reinsurers grew moderately in 2011 – by 3.4%. However, insured losses arising from catastrophes were unevenly distributed among the sector's players, eroding some companies' financial strength. This leaves them potentially more exposed should further major losses occur during 2012.

Asia-Pacific Catastrophes Highlight Shortcomings: The unprecedented focus of catastrophe losses across the Asia-Pacific region during 2011 highlighted some limitations of the industry's understanding of geophysical features within this part of the world. It also exposed important shortcomings of certain catastrophe model simulations used by reinsurers to assess their underwriting risks for this region. These factors have hampered the initial determination of exposure to events, making loss creep a regular feature of results updates.

Related Research

Bermuda 2012 Market Update (January 2012)

2011-2012 Global Reinsurance Review and Outlook (September 2011)

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Expectations Through 2012

Fitch believes that the reinsurance sector's capital, underwriting and operating trends will generally support reinsurers' current ratings over the next 12-24 months. The agency's central scenario anticipates continued capital strength and stronger 2012 earnings, led by improved underwriting results. The sector's earnings outlook remains uncertain, reflecting continued pressure on investment income and the sustainability of prior-year reserve surpluses. Fitch views the direction of pricing over the next 12-18 months as the key determinant of earnings performance through the rating period.

Fitch considers the exposure held by European reinsurers to peripheral eurozone countries' sovereign and bank debt as manageable, having stress-tested the investment portfolios of its rated universe of European insurers and reinsurers. Similarly, the low proportion of equity exposure held by the sector leads Fitch to conclude that asset quality does not constitute a rating concern at present.

Sector Performance Highlights

Record Catastrophe Losses Drive 2011 Results

Non-life reinsurers reported depressed earnings and underwriting returns in 2011, largely tied to the catastrophe events during the year, particularly larger events such as the earthquakes in Japan and New Zealand, as well as severe flooding in Thailand and Australia. These events were especially notable given the size of reported losses by Fitch's monitored universe of reinsurers, but also that geographical areas traditionally considered "non-peak" catastrophe risks represented a significant proportion of aggregate losses (see Figure 3).

Figure 3

Largest Insured Natural Catastrophe Events, 2011

Date	Event	Location	Economic loss (USDbn)	Insured loss (USDbn)
Mar 2011	Tohoku earthquake, tsunami	Japan	210.0	35.0
Jul-Nov 2011	Flooding	Thailand	30.0	12.0
Feb 2011	Christchurch earthquake	New Zealand	15.0	12.0

Source: Swiss Re Sigma

The group of reinsurers Fitch tracks on an ongoing basis generated a 109.1% calendar-year combined ratio in 2011, up from a strong 94.7% reported by the group in 2010. Results also included modest favourable prior-accident-year reserve development of 7.0pp in 2011, ahead of Fitch's expectations and compared to 7.5pp in 2010. Most reinsurers reported a mid-single-digit to mid-teen percentage-point benefit on the combined ratio. This helped to partially offset the catastrophe losses reported by the group, which represented approximately 24.8pp on the sector's calendar-year combined ratio, up from 11.7pp in 2010.

Uneven Capital Development Leaves Some Reinsurers More Exposed

Even with the significant catastrophe losses, the reinsurer group reported an overall increase in shareholders' equity of 3.4% in 2011. This was primarily due to solid capital increases at several larger companies that have considerable equity which supports operations outside of property/casualty (re)insurance and catastrophe-exposed business, including Berkshire Hathaway, Hannover Re, Swiss Re and ACE Ltd. Individually, on an unadjusted currency basis, 15 of the 24 reinsurers reported lower shareholders' equity in 2011, with a median decline of 1.6% (see Figure 4).

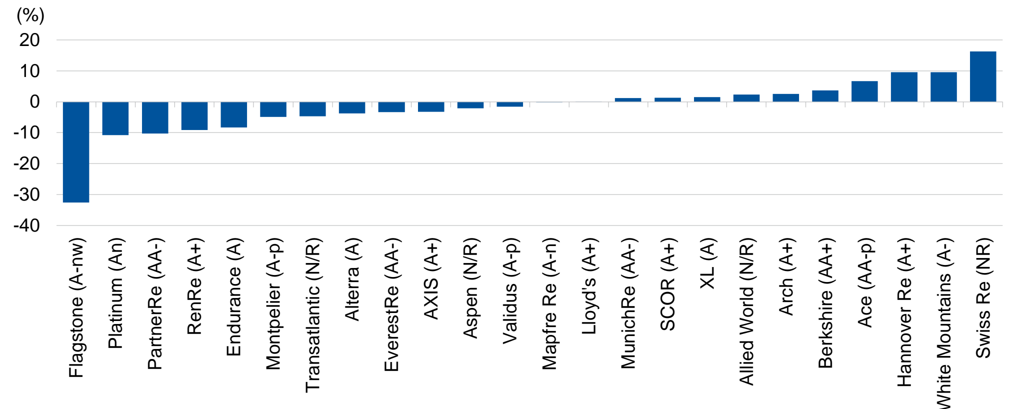
While total equity increased at a sector level, the financial impact of catastrophe losses did not fall evenly across Fitch's monitored universe (see Figure 4). Importantly, this raises the prospect of a negative outlook revision for the sector if 2012 proves to be another expensive catastrophe year, as weakened reinsurers will have a reduced ability to both absorb financial losses and take advantage of the further improved market conditions that would likely follow a second period of heavy losses.

Related Criteria

Insurance Rating Methodology (September 2011)

Figure 4

Change 2011 Equity – Reinsurers



IFS Ratings. N/R – Not Rated, n – Negative Outlook, p – Positive Outlook, nw – Rating Watch Negative
Source: Fitch

Loss-Affected Prices Rise Further, but Overall Rate Increases Modest

The near-record catastrophe losses appear to have provided a much-needed catalyst for pricing improvement in catastrophe-exposed lines. Rate hikes at the 1 April renewals were favourable but slightly below those at 1 January 2012. US catastrophe-exposed business was up 10%, while pricing for risk in areas directly affected by the earthquakes in Japan and New Zealand experienced double-digit rate increases for the second straight year.

Figure 5

Recent Reinsurance Renewal Pricing Trends

Renewal season	Developments
April 2012	Japanese earthquake (property): Up 30%-50% Japanese wind and flood (property): Up 15%
January 2012	Wind-exposed US programmes: Up 10%-15% Eastern Asia: Up 30% European/US casualty: Flat
June/July 2011	Wind-exposed US programmes: Up 5%-15% Extended Japanese programmes renewed up 30%-70% New Zealand property renewal: Up 100% US casualty: Flat

Source: Company and broker reports

Fitch believes market pricing fundamentals remain better in the global reinsurance sector than primary commercial lines, although the high single-digit rate increases anticipated by many reinsurers across their portfolios did not materialise in the key opening months of 2012. The agency will monitor closely the important US renewals in June and July to assess the strength of pricing momentum in a market that was relatively loss-free in 2011. US casualty pricing movements will be of particular interest, considering the challenges created by the prospect of a protracted period of high inflation and low investment yields.

Reinsurance Sector Suffers Smaller Losses in 2011 than in 2005

The high cost of natural catastrophe losses in 2011 presented the insurance industry with a bill of approximately USD116bn, second only to USD123bn of insured losses in 2005 fuelled by an expensive US hurricane season (see Figure 6). Then, as in 2011, the reinsurance sector demonstrated its ability to absorb the losses without significant financial consequences, with negative rating actions being limited to the most exposed reinsurers.

Figure 6

Largest Insured Natural Catastrophe Events, 2005

Date	Event	Location	Economic loss (USDbn)	Insured loss (USDbn indexed to 2011)
Aug 2005	Hurricane Katrina	US	135.0	74.7
Oct 2005	Hurricane Wilma	US	20.0	14.5
Sep 2005	Hurricane Rita	US	15.0	11.6

Source: Swiss Re Sigma

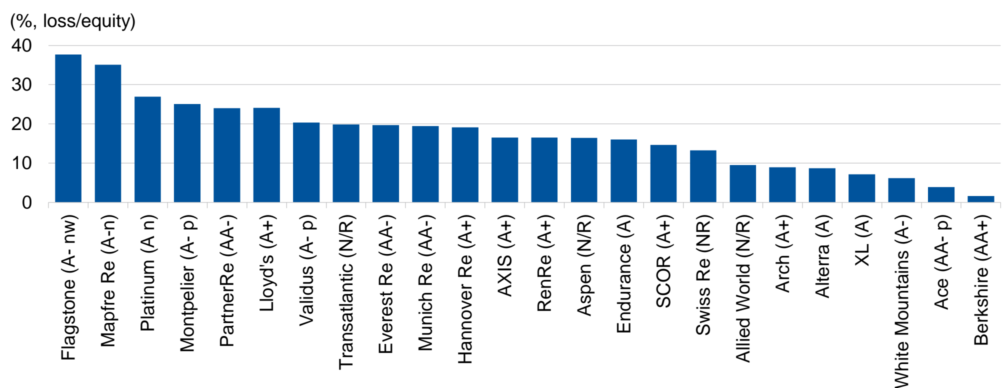
Further examination of the two years, however, highlights some key differences. The main regional focus of major losses in 2011 was the Asia-Pacific region, whereas in 2005 the US bore the brunt. It has recently become clear that the availability of loss data for the former region is more limited than for the US. The consequences of this are discussed in the section below: *Asia-Pacific Catastrophes Highlight Shortcomings*. The nature of the major loss events has also varied: US windstorms in 2005, in contrast to earthquakes and flooding in 2011. As a consequence, initial loss figures for 2011 events have proven harder to assess.

Fitch believes that there has also been a marked contrast in the way that financial losses have accumulated in different parts of the insurance industry between the two years. In 2011, approximately half of the USD35bn insured loss arising from the largest event, the Japan earthquake, was covered by Japanese state programmes, while the primary insurance sector absorbed a further share. In contrast, the largest event in 2005, Hurricane Katrina, was almost entirely covered by the primary commercial and personal insurance industry, exposing reinsurers to higher losses. Collectively, the overall loss burden incurred by reinsurers from 2011's major events was lower than in 2005.

This is reflected in Figures 7 and 8 below, which show that the overall sum of catastrophe losses as a proportion of total equity was generally greater in 2005 than in 2011.

Figure 7

2011 Catastrophe Losses/2010 Total Equity

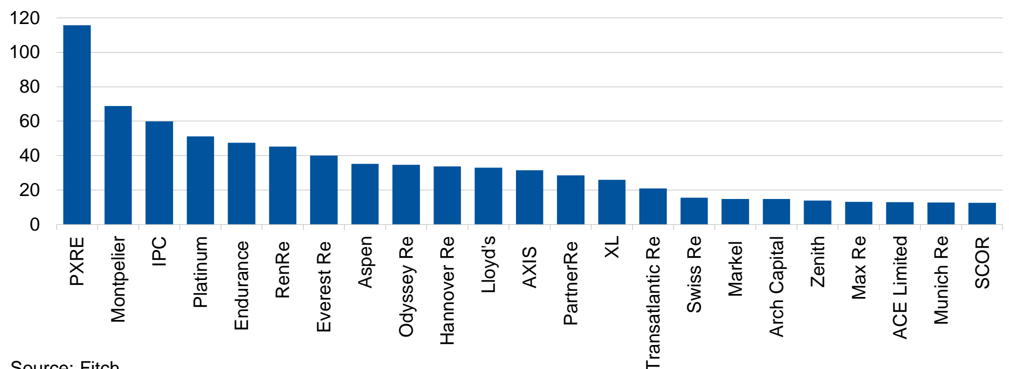


IFS Ratings. N/R – Not Rated, n – Negative Outlook, p – Positive Outlook, nw – Rating Watch Negative
Source: Fitch

Figure 8

2005 Catastrophe Losses/2004 Total Equity

(%, loss/equity)



Source: Fitch

What Would Lead to a Negative Outlook for the Sector?

Fitch continues to view a further significant catastrophic loss as the most likely trigger for a negative outlook for the sector at this time. The occurrence of the flooding in Thailand since the publication of Fitch's report, *2011-2012 Global Reinsurance Review and Outlook – Capitalisation Still Strong Despite Unprecedented H111 Losses*, dated 2 September 2011 and available at www.fitchratings.com, has created a further significant loss for the reinsurance sector to absorb. Subsequently, the agency has lowered the single-loss event value it considers likely to trigger a sector outlook revision, to USD50bn from USD75bn.

While the overall level of capitalisation grew for Fitch's monitored universe of reinsurers at end-2011, the revision recognises that some carriers are currently more exposed to further losses than they were 12 months ago. It should be noted that any negative rating action would be as a result of further losses being accompanied by capital markets losing confidence in the sector, at least temporarily, preventing weakened companies from repairing their balance sheets. Such combinations are considered to be rare.

Asia-Pacific Catastrophes Highlight Shortcomings

In Fitch's view, the key industry shortcoming highlighted during 2011 is the limited availability of historical loss and exposure data relating to certain parts of the Asia-Pacific region (where insurance penetration has increased in recent years) and its physical intricacies, compared with the US and western Europe. This shortcoming has been compounded by the insurance industry's increasing reliance on catastrophe models to assess the risk contained within their underwriting portfolios.

An assessment of the three major events (see Figure 3) has highlighted model shortcomings. While modelled earthquake scenarios for both Japan and New Zealand are widely used by the industry, the severity of liquefaction that occurred during the February earthquake in Christchurch, New Zealand appears to have been underestimated. In the case of the Thai floods, where modelled scenarios were available, a lack of historical loss data prevented their use. Of particular concern in both Thailand and Japan was the extent of losses from business interruption and contingent business interruption, which have proven to have been significantly underestimated in the modelling and underwriting of risks.

The lack of reliable loss estimates is also a challenge for ratings agencies. Following a major event, Fitch will review insurers' initial loss estimates to determine whether rating action is warranted. A lack of reliable and comparable data makes it harder for an agency to assess the true financial impact on an insurer or sector.

Regulatory Update

Emerging Economies Seek Solvency II Transitional Equivalence

A number of emerging economies including several Asia-Pacific reinsurance centres have sought approval for transitional equivalence ahead of the introduction of Solvency II, currently set to begin on 1 January 2014. Transitional equivalence stops short of the full equivalence being sought by more established centres including Bermuda, but, if approval is granted, would provide a "glide path" for locations including Singapore, Hong Kong and Australia. This potentially assists their progress to achieving equivalence at a later date.

Equivalence Assessments Issued, with Bermudian Results Varying Widely

The European Insurance and Occupational Pensions Authority (EIOPA) published its report in October 2011 on equivalence assessment for Bermuda, Switzerland and Japan, the first three jurisdictions seeking Solvency II equivalence status. Switzerland received the most favourable assessment of "equivalent" on almost all principle measures, while Japan was deemed either "equivalent" or "largely equivalent". Bermuda's results varied, ranging from "not equivalent" to "equivalent" on different principle measures and subject to many caveats regarding criteria.

Nevertheless, the Bermuda Monetary Authority (BMA) appears optimistic that the jurisdiction is on the right path to achieve unqualified Solvency II third-party country equivalence by implementation in 2014. Third-country equivalence is seen as particularly important by the BMA to insulate the island's (re)insurers from potential competitive disadvantages. However, uncertainty remains surrounding how the equivalence distinction will be interpreted by European regulators. For example, Bermudian (re)insurers may face disadvantages relating to capital requirements, in addition to facing additional regulatory expenses if they are required to calculate their capital under Solvency II schemes as well as under Bermudian regulation.

Regardless of how the strengthened Bermudian regulatory regime is ultimately viewed by European regulators, Bermuda's regulatory framework will at a minimum create additional hurdles for companies. As such, Bermuda may lose part of the appeal that allowed it to become one of the optimal domiciles for reinsurers, but its market reputation should improve, with further enhancement of the island's solvency protection standards.

More Relaxed Collateral Rules Continue to Benefit Non-US Reinsurers

Following several years of preparation, in November 2011 the National Association of Insurance Commissioners (NAIC) adopted revisions to the Credit for Reinsurance Model Law and Regulation, reducing reinsurance collateral requirements for "alien" (non-US) reinsurers. These revisions allow for less than the 100% collateral requirements that are normally required from non-US reinsurers on their US obligations in order for a US ceding insurer to be allowed full credit for the reinsurance ceded. A non-US reinsurer certified by a state will now be able to post reduced collateral ranging from 0% to 100% based on a rating assigned by the state.

These new rules are very similar to those that were first adopted in 2010 by Florida, then New York, Indiana and New Jersey, that set minimum collateral requirements for alien reinsurers based on a sliding scale by insurer financial strength ratings. Most Bermuda-based reinsurers have already received approval or expect to be approved for reduced collateral requirements in Florida and New York – both large states with coastal exposure and thus significant global reinsurance needs.

With the new NAIC rules providing a framework for other states to adopt the model laws, Fitch expects that the pace at which additional states implement lower collateral requirements should quicken. This gradual opening of the US market to more reinsurance competition and a more level playing field should prove beneficial for non-US reinsurers, as more relaxed collateral requirements increase liquidity, reduce the overall costs associated with LOCs and stand-by credit facilities, and potentially allow for an increase in underwriting capacity.

Appendix A

Figure 9

Data on Select Non-Life Reinsurance Operations

(USDm)	Net premiums written				Combined ratio				Shareholders' equity			
	2011	2010	2009	2008	2011	2010	2009	2008	2011	2010	2009	2008
ACE Limited	979	1,075	1,038	914	85.5	72.5	59.2	75.9	24,516	22,974	19,667	14,446
Allied World Assurance Holdings	570	522	465	428	94.2	80.8	81.3	82.6	3,149	3,076	3,213	2,417
Alterra Capital Holdings Ltd.	787	445	409	327	95.8	86.8	92.1	87.4	2,809	2,918	1,565	1,280
Arch Capital Group Ltd.	952	852	1,059	1,148	87.3	74.1	73.7	85.2	4,628	4,513	4,323	3,433
Aspen Insurance	1,098	1,119	1,117	977	125.5	88.3	70.3	91.6	3,172	3,242	3,305	2,779
AXIS Capital Holdings Limited	1,953	1,815	1,791	1,533	119.2	88.6	73.1	92.1	5,444	5,625	5,500	4,461
Berkshire Hathaway Inc.	9,867	9,171	9,321	7,960	107.1	95.2	94.4	83.7	164,850	157,318	131,102	109,267
Endurance Specialty Holdings Ltd.	974	934	866	804	126.0	86.9	75.9	90.2	2,611	2,848	2,787	2,207
Everest Re Group, Ltd.	3,288	3,325	3,274	2,888	119.7	100.7	84.8	92.3	6,071	6,284	6,102	4,960
Flagstone Re	558	669	618	694	153.6	99.9	71.4	88.7	789	1,135	1,211	986
Hannover Re	8,651	7,514	7,418	6,554	104.5	98.5	97.3	95.7	7,262	6,732	6,101	4,655
Lloyds	29,725	27,194	27,008	26,201	106.8	93.3	86.1	91.3	28,320	28,380	28,930	20,747
Mapfre Re	2,041	1,707	1,631	1,520	102.3	103.7	100.1	101.2	1,098	1,115	1,204	1,038
Montpelier Re Holdings Ltd.	624	669	602	541	131.1	82.0	62.2	91.0	1,549	1,629	1,729	1,358
Munich Re	22,053	18,664	19,468	19,782	114.1	101.0	95.7	99.7	30,190	30,291	31,931	29,493
PartnerRe Ltd.	3,688	3,961	3,351	3,392	125.4	95.1	81.8	94.1	6,468	7,207	7,646	4,199
Platinum Re	652	761	898	1,038	143.0	86.0	76.7	91.9	1,691	1,895	2,078	1,809
RenaissanceRe Holdings Ltd.	913	810	839	872	114.3	38.4	15.4	69.0	3,609	3,939	3,841	3,033
Scor	4,993	4,463	4,204	4,245	105.8	99.8	99.7	100.0	5,712	5,725	5,591	4,773
Swiss Re	13,571	10,669	11,883	14,598	101.5	94.2	90.6	98.4	31,287	26,906	25,344	20,453
Transatlantic Holdings, Inc	3,860	3,882	3,986	4,108	113.9	98.2	93.5	98.5	4,083	4,284	4,034	3,198
Validus Re	1,040	1,038	673	625	94.5	77.5	48.7	86.0	3,448	3,505	4,031	1,939
White Mountains Insurance Group, Ltd	916	866	807	931	100.1	94.2	80.1	105.9	4,088	3,653	3,657	2,899
XL Group plc	1,726	1,538	1,470	1,753	97.8	80.1	82.1	90.4	10,769	10,613	9,432	6,115
	115,478	**103,661**	**104,195**	**103,832**	**109.1**	**94.7**	**88.7**	**94.1**	**357,614**	**345,807**	**314,325**	**251,946**

Combined ratio – Net losses and loss-adjustment expenses divided by net premium earned plus underwriting expenses divided by net premiums earned
Shareholders' equity is organisation-wide equity and therefore depends on the company's reporting practices; may include equity that supports operations other than property/casualty reinsurance operations
Financial statement figures for some European reinsurers have been translated into US dollars using year-end or 12-month average rates of exchange, as appropriate. This has led to some exchange-rate distortion between financial years.
Source: Company annual reports, financial supplements, and SEC filings

Appendix B

Figure 10

Catastrophe Losses Reported by Reinsurer, 2011

(USDm)	Aggregate catastrophe losses
ACE Limited	899
Allied World Assurance Holdings	292
Alterra Capital Holdings Ltd.	253
Arch Capital Group Ltd.	404
Aspen Insurance	534
AXIS Capital Holdings Limited	931
Berkshire Hathaway Inc.	2,600
Endurance Specialty Holdings Ltd.	467
Everest Re Group, Ltd.	1,238
Flagstone Re	451
Hannover Re	1,365
Lloyds	7,390
Mapfre Re	414
Montpelier Re Holdings Ltd.	409
Munich Re	6,240
PartnerRe Ltd.	1,733
Platinum Re	510
RenaissanceRe Holdings Ltd.	777
Scor	887
Swiss Re	3,566
Transatlantic Holdings, Inc	852
Validus Re	712
White Mountains Insurance Group, Ltd.	262
XL Group plc	761

Source: Company reports

Appendix C

Fitch's International-Scale Ratings on Select (Re)Insurance Organisations

Group	IFS Rating	Long-Term IDR	Rating Outlook
ACE Ltd.		A+	Positive
Ace Tempest Reinsurance Limited	AA−		Positive
Alterra Capital Holdings Limited		A−	Stable
Alterra America Insurance Company	A		Stable
Alterra Bermuda Limited	A		Stable
Arch Capital Group Ltd.		A	Stable
Arch Reinsurance Company	A+		Stable
Arch Reinsurance Europe Underwriting Limited	A+		Stable
Arch Reinsurance Limited	A+		Stable
Axis Capital Holdings Limited		A	Stable
Axis Reinsurance Company	A+		Stable
Berkshire Hathaway, Inc.		AA−	Stable
Brit Insurance Holdings, Limited		BBB+	RWN
Brit Insurance Limited	A		RWN
China Taiping Insurance Holding Co. Ltd.		BBB+	Stable
Endurance Reinsurance Corporation of America	A		Stable
Endurance Specialty Holdings Ltd.		A−	Stable
Everest Re Group		A+	Stable
Everest Reinsurance (Bermuda) Ltd.	AA−		Stable
Everest Reinsurance Company	AA−		Stable
Flagstone Reassurance Suisse SA	A−		RWN
Flagstone Reinsurance Holdings, S.A.		BBB+	RWN
General Reinsurance Corp.	AA+		Stable
General Security Indemnity Co. of Arizona	A+		Stable
Hannover Rueckversicherung AG	A+	A+	Stable
Hiscox Insurance Company (Bermuda) Limited	A		Stable
Hiscox Insurance Company (Guernsey) Limited	A		Stable
Hiscox Ltd.		BBB+	Stable
Lloyd's of London	A+		Stable
Mapfre Re Compania De Reaseguros S.A	A-		Negative
Mapfre SA		BBB+	Negative
Montpelier Re Holdings, Ltd.		BBB+	Positive
Montpelier Reinsurance Ltd.	A−		Positive
Munich Reinsurance America, Inc.	AA−		Stable
Munich Reinsurance Company	AA−	AA−	Stable
National Indemnity Co.	AA+		Stable
Odyssey Reinsurance Company	A−		Stable
Odyssey Re Holdings Corp.		BBB	Stable
Pacific Life Re Limited	A+		Stable
Partner Reinsurance Company Ltd.	AA−		Stable
PartnerRe Ltd.		A+	Stable
Platinum Underwriters Bermuda, Ltd.	A		Negative
Platinum Underwriters Holdings, Ltd.		A−	Negative
QBE Insurance Group Limited		A	Stable
QBE Reinsurance (Europe) Limited	A+		Stable
QBE Reinsurance Corporation	A+		Stable
Reaseguradora Patria, S.A.	BBB+		Stable
Reinsurance Group of America, Inc.		A−	Stable
Renaissance Reinsurance Ltd.	A+		Stable
RenaissanceRe Holdings, Ltd.		A	Stable
RGA Reinsurance Company	A+		Stable
SCOR Global Life S.E.	A+		Stable
SCOR Global P&C S.E.	A+		Stable
SCOR Holding (Switzerland) AG		A+	Stable
SCOR S.E.	A+	A+	Stable
Sirius International Insurance Corporation	A−		Stable
Society of Lloyds		A	Stable
Taiping ReinsuranceCo. Ltd.	A		Stable
Validus Holdings, Ltd.		BBB+	Positive
Validus Reinsurance, Ltd.	A−		Positive
Sirius International Group Ltd.		BBB+	Stable
Sirius America Insurance Company	A−		Stable
XLIT Ltd.		BBB+	Stable
XL Re Ltd.	A		Stable

Ratings at 24 April 2012
Source Fitch

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