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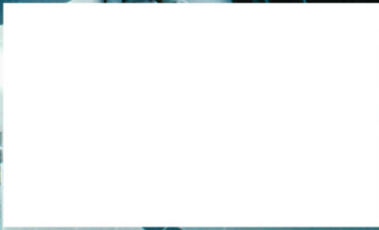
Willis Re 1st View

April 1, 2016

Will demand growth ease the pain?



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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.

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Will demand growth ease the pain?

As anticipated by many commentators, the April 1, 2016 reinsurance renewal season has seen a continuation of the softening market for the fourth consecutive year. Premium savings have yet again been the main thrust for most buyers and the opportunity to broaden contractual terms and conditions continues.

For reinsurers, relationship management and portfolio underwriting is evident as companies seek ways to maintain relationships with longstanding clients, which may be difficult to rebuild at a later stage.

However, amidst the gloomy picture of sustained pricing pressure, encouraging signs for reinsurers are beginning to show.

Firstly, price reductions overall at April 1, 2016 were marginally less than those achieved 12 months earlier. A number of factors, such as increased limits purchased as well as some modest losses, including the deterioration of earlier losses, have had an impact.

It is also becoming increasingly evident that while most reinsurers are accommodating client requests, many are now at the point where they are no longer prepared to grant any further concessions, irrespective of relationship considerations.

Demand for reinsurance is also picking up at last.

As observed during the January renewals, a number of larger insurers, which over the last few years were driving strategies to retain more risk on their balance sheets, are now looking to selectively reverse their thinking. This is now leading to an increase in cessions to selected third party reinsurers, both on traditional risk sharing reinsurance structures as well as loss portfolio transfers and adverse development covers.

The underlying reasons for this change in strategy are clearly company specific. But increased regulation, which has promoted a more holistic view of risk and reward, allied with shareholder pressure to improve ROEs by reducing the equity element of the calculation, are undoubtedly two key drivers in this development.

Despite this, it is premature to conclude that the current market cycle is bottoming out. The underlying imbalance of capital supply and muted demand allied to reinsurers' largely satisfactory 2015 results continues to hang over the market.

Indeed, despite the low interest rate environment and difficulty in achieving top line growth, most reinsurers have reported marginally lower but still acceptable full year results for 2015. Yet again, the twin saviors have been prior year reserve releases and the lack of major losses linked to active capital management strategies.

Those that have shown top line revenue growth have largely achieved this through their earlier strategic decision to develop a presence in the specialty insurance market. To date, the results of most reinsurers' specialty insurance portfolios have been satisfactory, although a few have started to report difficulties in some specific lines.

Ultimately, buyers continue to reap the rewards of competitive conditions and reinsurers will be hoping for yet another below average large loss year to produce acceptable results in the face of a tough 2016. But the apparent uptick in demand is certainly a positive sign.

John Cavanagh
Global CEO, Willis Re

Property

Commentary by territory

India

- Chennai floods affected most programs and market has responded with increased pricing, with public sector companies seeing higher increases
- Pro rata loss participation clauses have been widened to include natural catastrophe losses
- Primary catastrophe rates expected to increase

Japan — Property catastrophe

- **Excess of loss**
  - Capacity remains abundant with meaningful rate reductions achieved
  - Rate reductions on lower layers were tempered due to impact of 2015 wind flood losses and some adverse movement of 2014 snowstorm losses
  - Ongoing growth in appetite for Japanese catastrophe business from a number of expansive Asian reinsurers both existing and new, albeit with relatively small capacity
  - Signs of certain markets more willing to reduce or non-renew if pricing movement too significant
  - Additional wind and earthquake limit was purchased
    - The Non-Life companies drove the additional wind purchases and the mutuals drove the increased purchases of earthquake
    - For both perils, the additional coverage was typically at the higher end of programs
  - The trend of combining earthquake and wind layers continued such that this is now the norm
  - Non-life companies also starting to combine domestic covers with international exposures
  - Terms and conditions remained largely unchanged as most cedants chose to focus on price
  - Varied approach by cedant to Multi Year and pre-paid reinstatements

- **Earthquake quota share**
  - Primary rates continue to hold
  - Commissions were increased again this year, in the region of +2% to +3% but increases were smaller than those achieved in 2015
  - Less pro rata purchased this year as some cedants opted to protect more of their EQ exposures under their excess of loss placements
  - Event limits remained largely unchanged
  - Reinsurers currently find these treaties to be the most attractive part of the Japanese portfolios due to satisfactory original rates

Japan — Property risk

- Risk excess of loss structures largely remained unchanged
- Wide variation in risk adjusted reductions as performance and exposure movement differed by cedant
- Overseas exposures increased significantly from previous years due to depreciation of the Japanese Yen against a number of currencies, particularly the U.S. dollar

- Domestic Loss activity in Q4 2015 meant that the results of some fire pro rata treaties remained uncertain going into the renewal; consequently, commission targets were adjusted for some cedants
- Ongoing appetite for Japanese Property risk business albeit to a lesser extent than for catastrophe business

Korea

- An increase in retention levels resulted in an increase in retained aggregate and income for many companies
- Slip pricing remained largely flat for loss free covers which resulted in a sizable risk-adjusted price movement
- Another catastrophe free year did little to slow down the over-supply of capacity
- A very price sensitive renewal with several leader positions changing hands
- Contract conditions/exclusions remained largely unchanged

United States — Nationwide

- With regard to pro rata, portfolios consisting of small to middle market business are seeing small increases in commissions; for portfolios consisting of large, risk managed accounts, which have experienced multi-year rate pressure, commissions are flat to down slightly depending on experience
- Lack of catastrophe loss activity and abundant capital have driven the softening market in recent years
- Following several years of compound price reductions, risk adjusted rate reductions continue for catastrophe reinsurance but have slowed with 4/1 renewals mostly in line with the 1/1 renewals
- Higher rate on line layers are deriving the bigger decreases and the most noticeable slowdown in price reductions is for top end tail protection at lower rates on line
- Some increased demand for catastrophe protection, which is expected to continue throughout 2016 as changes to A.M. Best's BCAR methodology become better understood
- Multi-year coverage remains available and is now largely standard across most large catastrophe programs

Rates

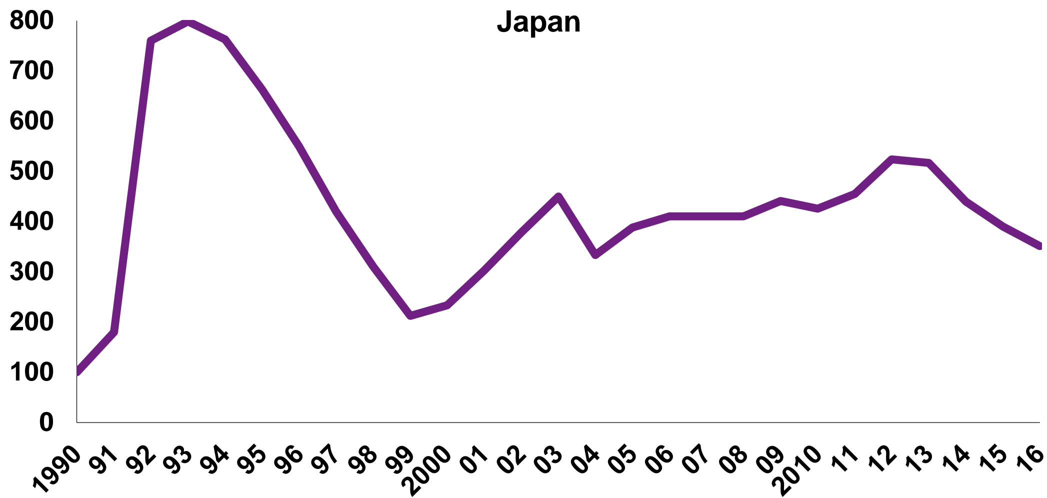
Property rates

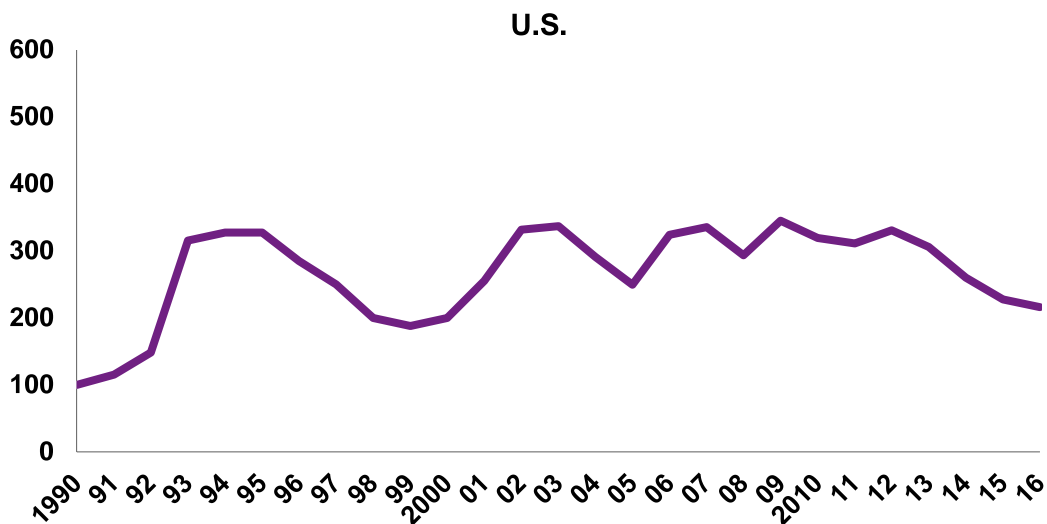
Territory	Pro rata commission	Risk loss free % change	Risk loss hit % change	Catastrophe loss free % change	Catastrophe loss hit % change
India	-2% to -3%	0% to -5%	0% to +5%	0% to -10%	+5% to +10%
Japan — Earthquake	+2% to +3%	N/A	N/A	-7.5% to -12.5%	N/A
Japan — Wind and flood	N/A	N/A	N/A	-7.5% to -10%	0% to -5%
Japan — Combined Peril	N/A	N/A	N/A	-7.5% to -12.5%	N/A
Japan — Property risk	0%	-2.5% to -10%	N/A	N/A	N/A
Korea	N/A	-12.5% to -20%	+15% to +25%	-10% to -20%	N/A
United States — Nationwide	-2% to +1%	-2.5% to -7.5%	-5% to +5%	-2.5% to -7.5%	N/A

Note: Movements are risk adjusted

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.





Casualty

Commentary by territory

Japan — General Third Party Liability

- The Japanese Liability market has seen some further loss emergence, in particular pharmaceutical insureds' U.S. operations
- Domestic business continues to perform very well
- Loss affected programs and programs expected to be loss affected are paying approximately flat to +10% risk adjusted increases — for some cedants this follows increases last year
- Ongoing growth in underlying D&O exposures driven by government directives around corporate governance which in turn is developing heightened interest in reinsurance solutions
- There continues to be ample capacity for Japanese Casualty with markets that previously were only cautiously writing the business now looking to grow on current programs and generally expand their portfolio
- Some minor improvements in coverage terms

Japan — Personal Accident

- The Personal Accident market continues to remain very soft as cedants have achieved flat to small premium reductions on portfolios that have observed significant exposure increases in recent years
- Some additional capacity in the market, including from MGAs
- Loss free risk adjusted reductions of -5% to -10%, with larger reductions seen on programs with increasing aggregates
- Some amendments were made to the passive war terms following the change in the interpretation of the Japanese constitution relating to the Japanese Self Defense Forces
- Some cedants also sought improvements to their reinstatements

Rates

Casualty rates

Territory	Pro rata commission	XL — No loss emergence % change	XL — With loss emergence % change
Japan — General Third Party Liability	N/A	0% to -5%	0% to +10%
Japan — Personal Accident	N/A	-5% to -10%	N/A

Note: Movements are risk adjusted

Specialty

Commentary by line of business

Aerospace — Global

- The direct Aviation insurance market continues to show some further signs of softening, although the level of risk-adjusted reduction is showing some signs of slowing down, especially on loss affected accounts or those accounts with a high level of attritional loss activity
- Aviation reinsurance pricing continues to favor buyers, with excess of loss pricing reductions in the range of 10% to 15%
- New support for under-performing proportional treaty contracts, especially those with a heavy airline content, has proved to be slightly more difficult to obtain; furthermore, commission levels under certain existing quota share placements have come under some scrutiny
- Aviation retrocessional business has continued to follow the trend established earlier in the year, with pricing reductions in the region of 10%

Healthcare — United States

- Some investors have received significant inflows of new capital
- Many investors continue to shift towards riskier layers with higher absolute returns

Marine — Global

- We have seen a move towards composite structures for retro placements
- The pricing environment has been tougher than compared to the D&F renewals we have seen this year
- Increased verticalization, with markets being bound for their own terms
- Reductions still widespread as markets become more creative to retain business; however, certain leaders trying to slow the pace of reductions
- Once terms are set capacity remains abundant
- Sanctions clarifications continue to be topical

Marine — Japan

- Marine market now 99% concentrated within three primary companies
- World economic slowdown having an impact on cargo income
- Hull rates holding up
- Government actively encouraging (through subsidies) Japanese to invest in distressed Energy companies
- Iran a focus for the Japanese Government, trading companies and hence insurance capacity requirements
- 2015 saw some suffer a Tianjin loss to their cargo reinsurances
- Layers with losses renewed "as before," clean layers enjoying reductions
- Leaders demonstrating more resistance than at 1/1
- Following market still hungry and ample capacity available
- Clients increasingly taking a "tiered" approach to marketing, rewarding leaders with additional opportunities

Non-Marine Retrocession — Global

- Year on year catastrophe reductions in line with January renewals
- Abundance of capital from both traditional and insurance-linked securities (ILS) players
- Reinsurers pushing back on widening of conditions and inclusion of incidental exposures such as Cyber and Terrorism
- Continued interest in multi-class protections as cedants look to maximize cost efficiencies through consolidation
- Small number of large risk losses (including Tianjin) has halted rating decline in risk market and loss affected programs paying rises

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%	-10% to -15%	-5% to -10%	-10% to -15%	N/A
Healthcare — United States	0% to +10%	N/A	N/A	N/A	N/A
Non-Marine Retrocession	N/A	-10%	+15% to +20%	-10%	N/A

Note: Movements are risk adjusted

Capital Markets

- Some investors have received significant inflows of new capital
- Many investors continue to shift towards riskier layers with higher absolute returns
- Investors taking varied approaches to attract more natural catastrophe investment opportunities
- Some funds expanding nonlife investments ex-natural catastrophe with a preference for proportional approaches
- 2015 saw a record volume of global insurance M&A, with $126B of reported activity, up 83% from 2014
- Buyer demand has led to transactions taking place at unprecedented metrics (MSI acquisition of Amlin at 2.4x TBV and 29% TBV dilution on ACE's acquisition of Chubb)
- This activity is set against the backdrop of a continuing soft market, a weak interest rate environment, and the ongoing inflows of capital into the sector
- Key driving forces of consolidation have been contraction of the insurance value chain, the importance of absolute scale on competitive positioning and operational efficiency, and overseas expansion of Asian buyers (particularly Japanese and Chinese)
- We expect to see continued activity in 2016, although at somewhat lower levels than 2015, with Asian buyers and the quest for scale expected to continue as the major drivers

Note: Capital Markets commentary provided by Willis Capital Markets & Advisory http://www.willis.com/client_solutions/services/wcma/

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