MANAGING EXTREMES Willis Re

1ST VIEW

Soft Market Slowdown in Pockets

1 July 2015

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Renewals – 1 July 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.

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Soft Market Slowdown in Pockets

Despite pricing remaining under intense competition in non-peak areas where traditional reinsurers still dominate, after a relentless period of rate reductions, early signs of pricing stabilization are starting to emerge in peak property catastrophe zones.

The swell in capacity from collateralized reinsurance markets, which has recently played a major role in driving pricing in the peak zones, appears to have abated. A number of these markets have shown pricing discipline by cutting the capacity they are prepared to offer as the market has continued to soften. This, in turn, has had a knock-on effect to traditional reinsurers, who in in recent years have relied on collateralized re to provide their retrocession capacity. The notable increase in demand for Floridian catastrophe capacity has also been a factor.

The thirst for risk diversification remains as strong as ever, especially in non-capital intensive classes and geographies. Further, the need to keep top line revenue moving is leading to reinsurers offering sufficiently attractive terms for some buyers to expand their proportional reinsurance buying.

The M&A frenzy continues to heat up. Despite the unappealing short-term outlook for nearly all reinsurers, M&A activity is helping to maintain the current high valuations. However, some of this activity is throwing up unexpected combinations, making it difficult for reinsurance buyers to judge the value to them over the medium-to-longer-term of some of the potential merged entities. It is important for those driving M&A deals to articulate a clear message about the value they can deliver to their clients, as opposed to the current focus on the value to each company's own shareholders and management.

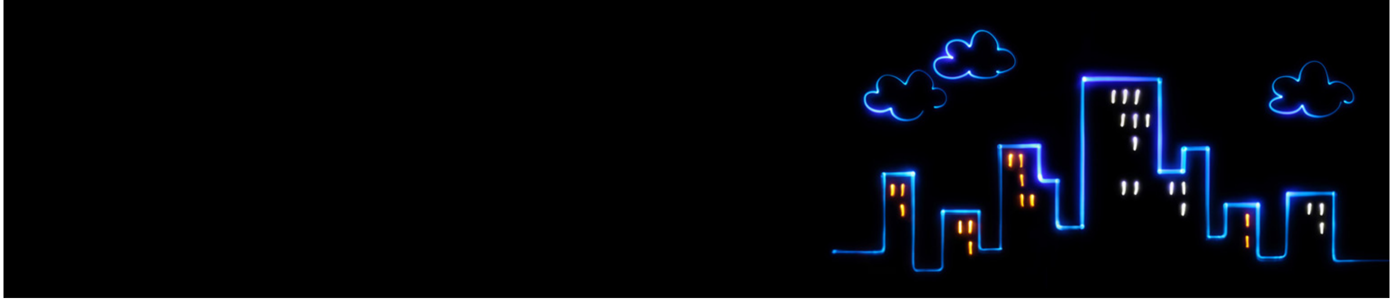
Despite the diminishing underwriting and investment returns being delivered by the reinsurance industry, investor capital continues to be attracted to the sector, with some of the insurance-linked securities (ILS) funds backing collateralized re, catastrophe bonds, and other solutions showing strong year-on-year growth of their assets under management. In addition to investing in ILS funds, fresh non-industry capital has also been making its presence felt through direct investment or acquisitions. The deployment of additional capital in a profitable way remains the central challenge for all companies, however most managers remain encouraged that reinsurance retains an attraction for investment capital.

With the continued growth of ILS non-life funds – now at approximately USD65 billion – there has been a proliferation of fund managers providing collateralized re in addition to investing in cat bonds, sidecars and related solutions. In a maturing market, sophisticated buyers of collateralized re are starting to look more closely at the operational models of ILS fund managers, in particular at their investment mandates and at the opaque area of how they are allocating risks to the funds they are managing. This scrutiny is largely being driven from a buyers' compliance standpoint; larger ILS fund managers and traditional reinsurers with associated fund management operations are likely to be better able to respond to the requested degree of transparency required by buyers.

With the North Atlantic Hurricane season now underway, the June 1 and July 1 2015 renewal season offers reinsurers some hope that even if the predicted low level of hurricane activity is realized, the outlook for 2016 might not be quite as bleak as may have been inferred from the recent January and April 2015 renewals.

John Cavanagh
Global CEO, Willis Re

July 1, 2015



Property – territory and comments

Australia

- Significant loss activity in the last 12 months has affected many bottom layers of catastrophe programs, aggregate covers and insurer's retained natural peril budgets
- Reinsurers placing pressure on low retention levels, putting through rate increases on loss affected layers and reducing capacities at that level
- Increased capacity from ILS markets on low level Australian risks where the pricing appears acceptable
- Reinsurer mergers and acquisitions not impacting supply of capacity overall with traditional reinsurance capacity continuing to grow
- Rates on mid to upper layers continue to soften, albeit reductions are not as great as they have been over the last 12-24 months
- Pressure on minimum ROLs at the top end continues with increased capacity available at sub-2% ROL

China

- Plenty of reinsurance capacity in China
- Price achieved reaches reinsurers' bottom line
- Leaders are keen to maintain leading position
- Buyers are keen to purchase more catastrophe cover under soft market

Latin America

- Latin American reinsurance rates and conditions had not softened as much as some other areas of the World in previous renewal seasons but at this 1st July some catching up was evidenced
- Most Proportional Treaty renewals went relatively smoothly, especially for those with acceptable results
- There was some improvement for cedants in reinsurance commissions and/or agreed cession rates, sometimes out of necessity to reflect the worsening original rates in some local markets
- Catastrophe purchases and retention levels were relatively stable across the board with average risk-adjusted price reductions of between -5% to -15% or a bit more, according to country, client and portfolio
- The continuing consolidation of insurance markets in the region has meant there are fewer stand-along local programs to feed the appetite for diversification of many reinsurers
- The reduction in terms and rates has been also partly due to devaluation of local currencies against the U.S. Dollar (many programs are bought in USD but the majority of the original business is in local currency)

Middle East

- The ongoing flooding of the market with new capacity and new players continues unabated
- Excellent for clients who can now choose to align their reinsurance with long term partners who support across a range of classes
- The competition to retain premium has entered into unchartered territories with reinsurers abandoning discipline for top line growth
- Request for quota shares on traditionally retained classes is increasing

South Africa

- Significant oversupply of capacity in the market
- Locally registered reinsurers keen to protect their market shares
- Impending revised FSB regulations creating some concern in the market for reinsurers who are not locally registered as it is likely ceding companies will face capital loads for using unregistered reinsurers

United Kingdom

- There is a continuing steady capacity supply from reinsurers
- Despite some worry over margin pressure, there is a realistic recognition of current market dynamics
- Reluctance to offer price decreases on catastrophe business is tempered by enthusiasm for a further potential claim-free year
- Where results warrant, risk and pro rata covers are also attracting new offers of capacity, encouraging existing reinsurers to adjust prices to match

United States – Florida

- Overall average year-on-year risk adjusted price decrease of high mid-single digits with programs not as fully subscribed as previous 2 years
- Most cedents used savings to purchase more limit compared to last year adding to the overall increase in demand for capacity from buyers
- Significant increase in overall reinsurance market capacity demand from reinsurance buyers at this renewal (>$4Bn)
- Multi-year treaties remained available, but required a small increase price load over the single year price to garner reinsurer support
- Reinsurer demand for quota share treaties exceeded supply leading to improved terms for cedents
- Strong reinsurer demand for per risk programs led to oversubscriptions and cut-backs

United States – Nationwide

- Lack of catastrophe loss activity and abundant capital have driven the softening market in recent years
- However, following several years of compound price reductions, risk adjusted rate reductions began to slow
- The dynamics of supply and demand are starting to become more balanced as demand increases to meet supply
- Coverage enhancements including terrorism and expanded hours clauses continue to get market support

Rates

Property rates

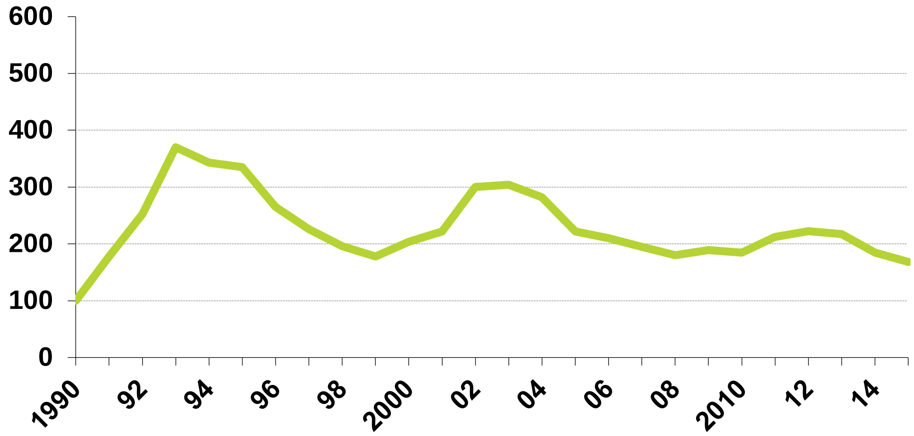
Territory	Pro rata commission	Risk loss free % change	Risk loss hit % change	Catastrophe loss free % change	Catastrophe loss hit % change
Australia	0% to +1.5%	-5% to -12.5%	0% to +15%	-5% to -12.5%	-5% to +7.5%
Caribbean	+1% to +2%	-10% to -15%	-5% to -10%	-10% to -15%	N/A
China	N/A	-15% to -20%	N/A	-15% to -25%	N/A
Latin America	0% to +2.5%	0% to -15%	0% to +5%	-5% to -15%	N/A
Middle East	0% to +2.5%	-10%	+2%	-10%	+2.5%
South Africa	0%	-5%	varies	-10%	N/A
United Kingdom	N/A	-10%	0%	-10% to -15%	N/A
United States – Florida	+1% to +3 %	-10% to -20%	varies	-5% to -7.5%	N/A
United States – Nationwide	+2% to +3 %	-5% to -10%	-5% to +5%	-2.5% to -7.5%	N/A

Note: Movements are risk-adjusted

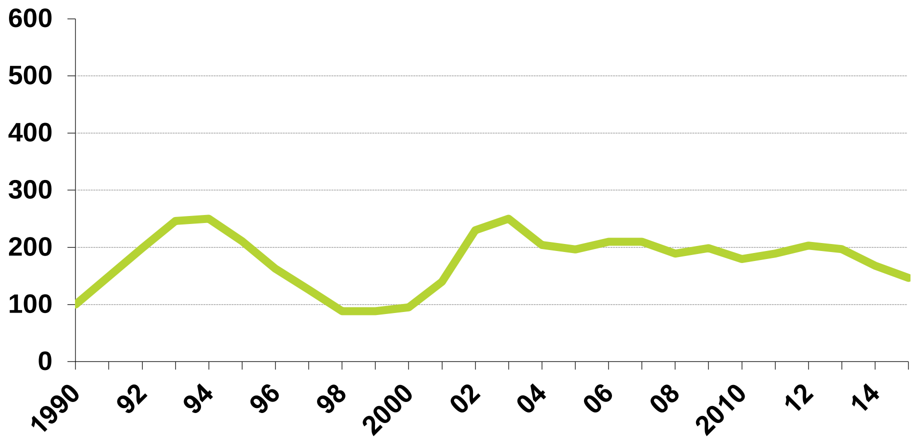
Property catastrophe pricing trends

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

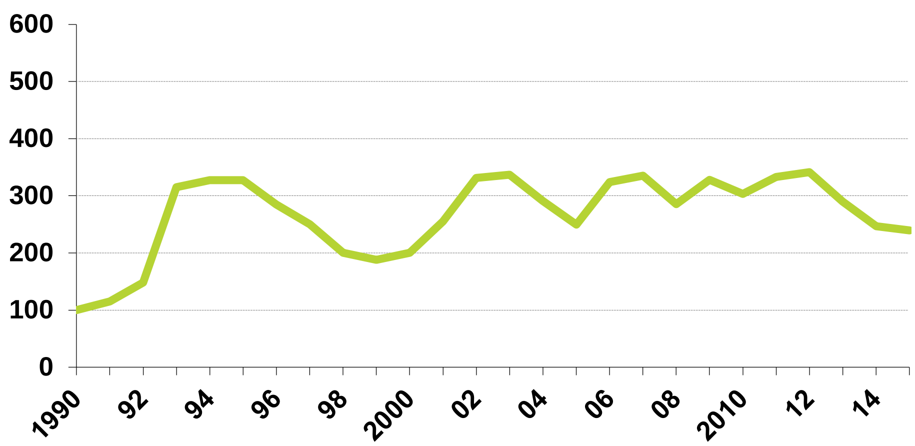
Australia

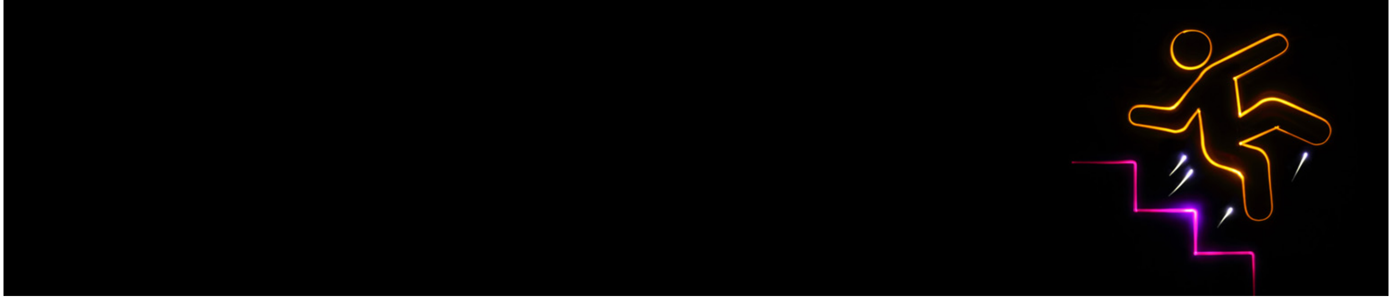


Caribbean



United States – Nationwide





Casualty – territory and comments

Australia

- Capacity for Casualty programs continues in abundance, despite reinsurer merger and acquisition activity, with programs largely oversubscribed
- Treaty Terms and Conditions continue to expand with buyers seeking to remove existing exclusions and limitations
- Rates continue to fall with reductions consistent with prior renewals
- Privatization of government statutory schemes continues to focus the attention of insurers and reinsurers alike, as the next genuine opportunity for growth

United States – General Third Party Liability

- Increased capacity for excess of loss programs
- Quota share ceding commissions increasing but at a slower rate
- Increased interest in Casualty catastrophe exposure and coverage

United States – Motor Liability

- Personal Auto pro rata reinsurance continues to generate significant interest from traditional reinsurers and alternative capital sources; programs with good loss experience have seen increased minimum commissions and profit sharing
- Personal Auto excess of loss reinsurance pricing is competitive for strong companies with good experience; experience, instead of exposure, tends to be more heavily weighted for the most competitive programs
- Commercial auto reinsurance rates remain competitive above policy limit attachments; “working layer” reinsurance pricing more heavily weighted towards experience, rather than exposure
- The primary Non-Standard Auto market has seen consolidation and increased pressure from standard carriers, which amplifies the need for scale and technology
- Portfolio segmentation, ability to price tier, frequent evaluation of agent loss ratios, and credit scoring are more necessary than ever to sustain experience and/or grow profitability
- Reinsurer consolidation has not yet had an impact on Auto reinsurance pricing or capacity

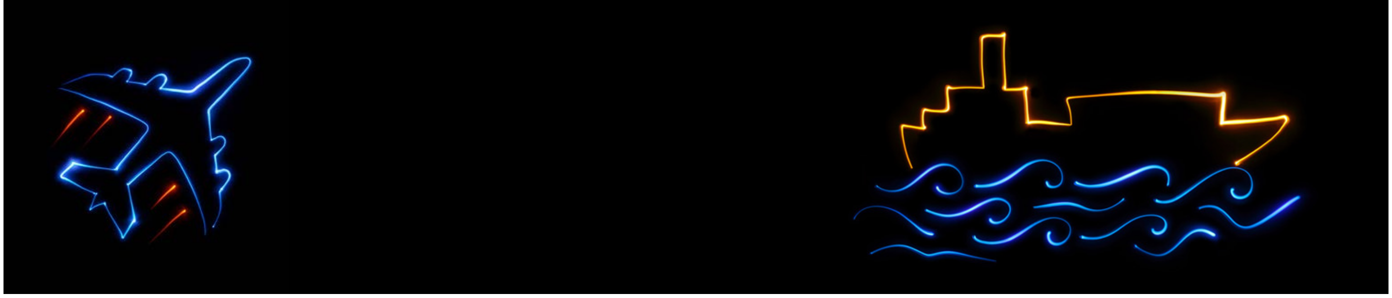
United States – Professional Liability

- Attritional loss ratios considered profitable and attractive based on continuing low frequency of large losses
- Carriers trend continues to merge product or geographic specific treaties to single programs
- Some interest in lower retentions reflecting favorable reinsurance pricing and increasing attention to downside risk
- 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	-5% to -10%	0% to -2.5%
United States – General Third Party Liability	+1% to +3%	-5% to -10%	-5% to +5%
United States – Motor	-3% to +3%	-5% to -15%	0% to +15x%
United States – Professional Liability	+2%	-5% to -10%	Varies

Note: Movements are risk-adjusted



Specialties – line of business and comments

Marine

- The market in all areas remains soft as losses continue to be benign and capacity remains in abundance; there have been two consecutive Pemex losses (1st April 2015 and 5th May 2015) in the Energy market but these are unlikely to have any impact on current market conditions
- The Gulf of Mexico Offshore Energy Wind renewals also experienced further softening of rates due to severely depressed oil prices, shrinking demand and extreme overcapacity although conditions have held
- Notable increase in demand for proportional business, particularly for Energy
- Radioactive Contamination Exclusion (RACE) Convention Amendment has been the topic of some discussion in the market with its application becoming widespread, although some reinsurers have resisted the automatic nature of paragraph G which allows any other conventions or protocols adopted by the International Maritime Organization (IMO) to be automatically agreed
- The Insurance Act 2015 has been enacted by Parliament and will come into force for Contracts governed by English Law on 12th August 2016; this Act is the most significant reform of UK Insurance Contract Law since the Marine Insurance Act 1906

Non-Marine Retrocession

- Abundance of catastrophe capacity putting further downward pressure on pricing
- Cedents continue to purchase more aggregate cover replacing catastrophe occurrence covers
- Smaller decreases in ILW catastrophe; pricing and signs of hardening in U.S. wind ILW market driven by demand
- ILW price hardening was dependent upon timing and capacity size but ranged from between a 5-15% increase from January 2015
- ILW demand was seen in US first event wind, more specifically Florida, both from ILS funds looking to hedge exposures and traditional reinsurers looking to manage their PMLs

Personal Accident / Life Catastrophe

- Lack of catastrophic insured loss of life since 2001
- Very competitive market driving underwriting discipline weaknesses
- Retro market continues to soften: -10% to no minimum rate of line considerations
- Abundance of capacity for 2015 – larger lines to maintain or increase participation offered
- ILS – limited appetite at lower ROL levels , continue to pose threat to traditional market
- Facultative market very competitive – using capacity for peak exposures versus treaty

Political Risk

- Reinsurance capacity remains in abundance
- Placements at terms led off by recognized leaders, tend to be heavily over subscribed
- Reinsurance pricing for risk Excess of Loss contracts are typically down 10%
- There has been an increase in proportional covers sought and placed

United States – Healthcare

- 1 July reinsurance renewal pricing has been observed to be flat to modestly lower
- Ceding commissions on excess cession layers continued to climb, tracking with cedent expense ratios
- Reinsurers have been more willing to support expanded coverage definitions and provide increased vertical limits
- Reinsurance capacity remains plentiful despite the consolidation occurring

United States – Medical Excess

- Continued increase in capacity and competition
- While capacity and competition put downward pressure on Excess Medical Rates, continued increases in frequency and severity of large medical claims (over $500,000 per person / year) continue to drive up excess medical rates
- Continued uncertainty regarding risk profile post ACA and in particular, business sold via the state exchanges
- Many of the Health Co-ops are struggling, with some already out of business
- Growth of market is in the Government plans: Medicaid expansion and Medicare Advantage. Large growth of revenue has resulted in need for capital in this segment of the market

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	-10% to -15%	0%
Personal Accident / Life catastrophe	N/A	-5% to -20%	N/A	-5% to -20%	N/A
Political Risk	+1%	-10%	0% to -5%	N/A	N/A
United States – Healthcare	0% to +10%	0% to -5%	0%	N/A	N/A
United States – Medical Excess	0%	0% to 10%	5% to 25%%	N/A	N/A

Note: Movements are risk-adjusted

U.S. Workers' Compensation

- The softening trends we saw through the January 1 renewals have continued through July 1; similar to the Property market, the rate of softening has slowed. Much of the Workers' Compensation catastrophe capacity is provided by the same traditional reinsurers that provide the Property capacity
- Working layer pricing continues to be relatively stable at the lower attachment points (below $2M); there is modest softening at the attachment points get higher
- The catastrophe capacity pricing continues to soften
- So far, the mergers and acquisitions have had almost no impact on market capacity, but we are in the very early stages of most of the announced transactions

Rates

Workers' Compensation rates

Territory	Pro rata commission	Catastrophe XL – % change	Per life XL – % change
United States	+2%	0% to -5%	0% to +5%

Capital Markets

- Broadly speaking, catastrophe bond new issue spreads were flat
- Nonetheless, some sub-segments saw slight spread declines or increases
- Elevated mergers and acquisitions activity with some (re)insurers seeking enhanced scale, product diversification and geographic expansion while other carriers are focused on internal efficiencies, underwriting leverage and third party capital management
- Mergers and acquisitions remains an attractive alternative given excess capital in the industry during a challenging rate and underwriting environment
- Mergers and acquisitions activity continued in Q2 2015 after an active Q1 highlighted by Catlin's sale to XL, Brit's sale to Fairfax and PartnerRe's proposed merger with AXIS
- Q2 2015 activity included Italian conglomerate Exor's hostile takeover attempt of PartnerRe
- Asian players continued to be highly focused on international expansion in Q2 2015 as exhibited by Fosun's acquisition of the remaining unowned stake in Ironshore, and Tokio Marine's acquisition of HCC for 1.9x reported book value

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