

# Willis Re 1<sup>st</sup> View

April 1, 2018

Subdued markets —  
Lively M&A



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## 1st View

This thrice yearly publication delivers the very first view on current market conditions at the key reinsurance renewal seasons: 1 January, 1 April and 1 July. In addition to real-time eVENT Responses, our clients receive our daily news brief, *The Willis ReView*, as well as our global industry reports:

**The Reinsurance Market Report** is a biannual publication providing in-depth analysis of the size and performance of the reinsurance market. Analysis is based on the Willis Reinsurance Index group of companies. The report is issued in April covering full year results, and September covering half year results.

**The Global Risk Appetite Report** outlines the findings from our global survey of over 250 insurance companies worldwide. The report gives insight into global reinsurance and purchasing trends.

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# Subdued markets — Lively M&A

The trend set at 1 January continued at 1 April. Buyers were able to renew loss-free programs, broadly achieving flat year on year renewal pricing. While this has been disappointing for reinsurers looking to achieve real rate increases, increased demand from a number of buyers is resulting in some new opportunities and, consequently, some welcome premium growth. Furthermore, insurance companies, particularly within the C-suite, continue to assess the impact of reinsurance buying to support earnings and capital management, with the value of reinsurance seen as higher than it has been in recent years. Away from the headline property catastrophe renewals, many other classes managed uncontentious renewals and despite limited movement in original rating levels, underlying exposure growth has fed through into modest increased reinsurance premium volumes for reinsurers.

The “Big Balance Sheet” reinsurer model is being reinvigorated and the real test for management will be their portfolio management ability and the agile use of their large balance sheets.



Insurance-linked securities (ILS) maintains its advance. The impact of 2017 Hurricanes Harvey, Irma and Maria (HIM) losses is proving limited and this is leading to a continued oversupply of capital, which, in turn, is helping to restrain rate increases. Any potential issues over non-modeled losses, such as California wildfires, have been limited to a small section of the ILS market writing aggregate covers. Again, it appears there has been no impact on appetite. Many of the larger ILS funds are building up their own analytical skills and developing their “own view of risk.” This is helping them manage their investors’ expectations with regard to less obvious exposures.

During Q1 2018, reinsurers reported their full year 2017 results, and we saw, as anticipated, overall market results impacted by major natural catastrophe losses. But even more notable, and an increasingly worrying trend, is the deterioration of results in virtually all non-natural catastrophe lines and the limited reserve release now available from earlier years. While long predicted, the impact of this deterioration is now compelling virtually all managers to take decisive action. This is evident in many reinsurers and specialty carriers stepping up their efforts to reshape their portfolios, exiting unprofitable lines of business and implementing cost-saving programs.

The most dramatic shift in the last few months has been the dynamic change in reinsurance mergers and acquisitions with large primary carriers re-entering the reinsurance market, having largely abandoned the sector in the 1990s and early 2000s. Many major non-life primary companies with large personal line and small medium enterprises portfolios are facing the greatest disruption from new distribution models. Similarly, large primary companies with life portfolios are facing profitability challenges and an inability to differentiate their results from general investment markets. Against this background, buying large transparent, well-managed reinsurance companies with synergies in some areas of their existing portfolio is proving attractive.

It should be remembered that when primary companies exited the reinsurance market in the late 1990s and early 2000s, it was due to poor exposure management that had led to earnings volatility and, in many cases, large underwriting losses that resulted in capital strains. The assumption now is that access to diversified sources of risk, allied with greater confidence that historic technical issues are now better managed through advanced risk quantification techniques, is sufficiently enticing for large primary companies looking for growth. However, the biggest change may be on the social side with the management of large primary companies now being more confident that they have the skills to manage the different social dynamics of a reinsurance business versus a primary commercial/personal lines writer. The “Big Balance Sheet” reinsurer model is being reinvigorated and the real test for management will be their portfolio management ability and the agile use of their large balance sheets.

Any hopes reinsurers held for meaningful real rate increases to help offset difficult 2017 results have been dashed. Now, a slower upward trend across different lines of business is what observers are stating as the more likely trajectory, particularly if loss ratios on the underlying business continue to deteriorate.

**James Kent, Global CEO, Willis Re**  
**April 1, 2018**

# Property

## Commentary grouped by territory

### India

- Following four consecutive catastrophe-hit years, the 1 April renewal has been benign with stable to moderately reduced risk-adjusted pricing against a backdrop of growing aggregates
- Large single-risk loss frequency increased but not sufficiently to cause significant pricing impact
- The General Insurance Corporation (GIC) consolidated its leading market position in proportional property despite imposing tightened terms and reduced commissions; foreign branches of global reinsurers remain largely passive or absent in this arena
- Risk and event capacity purchased remained broadly stable with some instances of modest retention uplift

### Caribbean (including Puerto Rico)

- Irma loss estimates are reducing as companies obtain more clarity on their losses
- Maria losses continue to be below the initial industry modeled estimates; however, some portfolio losses are higher than some models predicted; furthermore, uncertainty still remains on the business interruption losses
- Regulators have imposed pressure to insurance companies to settle outstanding claims with financial penalties for late payment
- Additional capacity available from certain reinsurers looking to increase participations and/or new entrants to the market attracted by higher rates
- Companies looking to increase event limits on pro rata treaties but not willing to concede on commissions
- Original underlying rates increasing by up to +60% in Puerto Rico
- Original rates are increasing across the Caribbean with some countries seeing higher increases than others

### Japan — Catastrophe Wind and Earthquake Excess of Loss

- Excess capacity remains both for Japanese Wind Flood and for Earthquake with both expiring reinsurers looking to deploy additional capacity and new reinsurers continuing to try and develop their portfolios
- The oversupply of capacity has capped any anticipated rate rises post-HIM; in general, risk-adjusted flat pricing was achieved
- General program restructuring was limited compared to previous years
- Occurrence limit purchased by non-life companies remained stable; additional earthquake limit was purchased again by the mutual companies
- The key objective for most cedants was to secure the appropriate premium, and as a result, material changes to terms and conditions were not pursued
- A modest increase in multi-year capacity was secured
- Limited impact from recent vendor model updates
- Cedants continue to access the catastrophe bond market with new and repeat successful issuances

**Japan — Earthquake Pro Rata**

- Significant reinsurer demand for earthquake quota share business as primary rates continue to remain stable
- Commissions flat to +2% points with the larger increases typically provided to those cedants who held commissions flat last year following the 2016 Kumamoto Earthquake
- Event limits remained unchanged

**Japan — Property Risk**

- Structures remained largely unchanged
- Coverage also remained mostly unchanged as cedants decided to focus on securing price
- Commissions remain flat given absence of major fire losses
- Changes in exposure differed by buyer and by layer which often resulted in a modest variation in pricing; where exposures increased significantly, risk-adjusted reductions were achievable

**Korea**

- Price reductions were the key focus for most buyers this renewal
- Capacity remains plentiful
- No meaningful change to conditions/exclusions

**Latin America**

- Mostly flat with instances of single digit rate adjustments of loss-free programs
- Significant pressure on non-economic terms and conditions
- Limited number of catastrophe losses but for loss affected programs there were modest adjustments depending on impact to individual programs

**United States**

- While reinsurers sought to push double digit price increases at 1 January, their desires were largely frustrated with the market settling on mid-single digit increases
- This has tempered the 1 April renewal price increases that reinsurers were seeking; however, loss-free cedants continue to push back with lower firm order increases or slight decreases
- Reinsurers' desire to increase prices was further frustrated by the latest vendor model changes which reduced technical expected losses as well as by clients with net retained losses holding a firm line on requested increases
- Capacity remains plentiful with non-traditional and collateralized markets increasing available capital and competing for participations

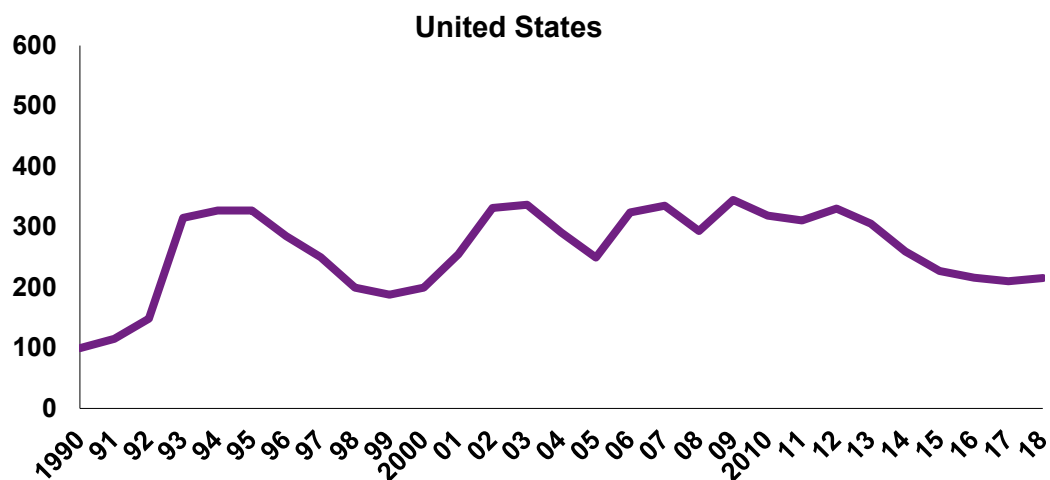
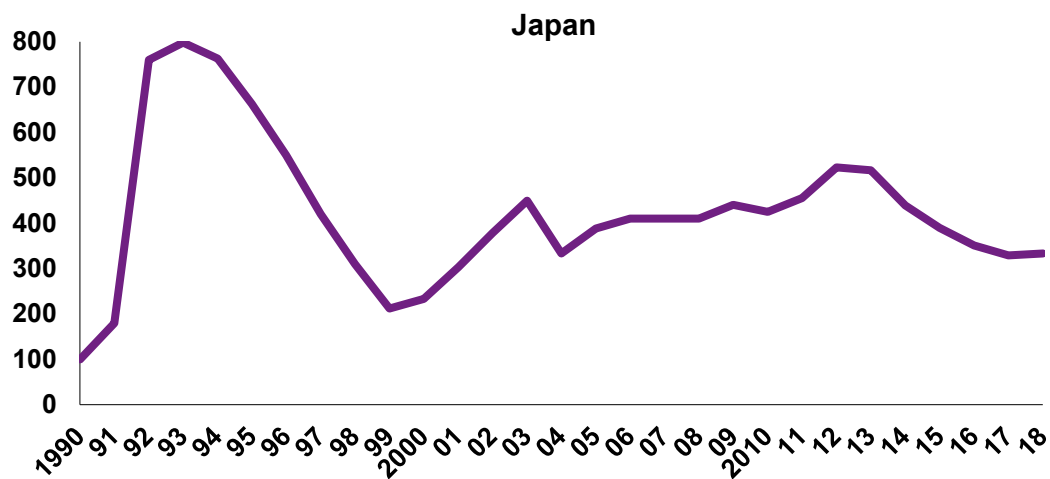
## Property rate movements

Territory	Pro rata commission	Risk loss free % change	Risk loss hit % change	Catastrophe loss free % change	Catastrophe loss hit % change
India	0% to -2%	0% to -1%	+2% to +5%	0% to +2%	N/A
Caribbean	-5% to -10%	varies	varies	+10% to +25%	+20% to +35%
Japan — Earthquake	0% to +2%	N/A	N/A	0%	N/A
Japan — Property Risk	0%	-2.5% to +2.5%	N/A	N/A	N/A
Japan — Wind and Earthquake	N/A	N/A	N/A	0% to +2.5%	N/A
Korea	N/A	0% to -5%	N/A	0% to -5%	N/A
United States	0 to -2.5%	-5% to +5%	0% to +10%	0% to +5%	+5% to +10%

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

### Global — Cyber

- Increased global interest in protection for silent cyber
- Growing number of enquiries from insurers looking to develop cyber products ahead of General Data Protection Regulation (GDPR)
- Some carriers purchasing cover on a standalone basis
- Quota share capacity remains relatively plentiful with increase in excess of loss capacity in the London market

### Japan — Bond and Credit

- Continuing good underlying results led to a smooth renewal
- Capacity plentiful as reinsurers attracted to good results of the Japanese portfolios with an increasing number adopting more client centric underwriting approaches writing across all lines
- Trend of modest improvements in commission levels maintained

### Japan — General Third Party Liability

- Focus of renewal discussions remained on the development of pharmaceutical product liability lawsuits in the U.S. and the implications for (re)insurance losses
- Firm order terms driven by treaty performance and underlying exposure movements
- Reinsurers increasingly interested in understanding the cedants' primary underwriting in recently loss-affected areas
- Capacity remains stable with few markets withdrawing or reducing their renewal lines; some new entrants showed appetite and the treaties were generally oversubscribed

### Japan — Personal Accident

- A relatively unchanged dynamic from prior renewals, with abundant capacity and reinsurers willing to offer some degree of risk-adjusted reduction
- Reinsurer approaches varied depending upon cedants' portfolio movements, reinsurance purchasing philosophy and past renewal history.
- Movements in earthquake exposures remain an important consideration for reinsurers' pricing
- Clients have shown a preference to trade with existing partners, with panels largely stable

### Japan — Professional Liability

- Primary Directors & Officers liability market continues to grow, resulting in increased reinsurance treaty income
- Sufficient reinsurance capacity available and the treaties generally over-subscribed.
- Reinsurance pricing generally remains risk-adjusted flat in light of little-to-no loss experience

## Casualty rate movements

Territory	Pro rata commission	XL — No loss emergence % change	XL — With loss emergence % change
Global — Cyber	0%	-5% to -10%	N/A
Japan — General Third Party Liability	N/A	0%	varies
Japan — Personal Accident	N/A	-5% to +2.5%	N/A
Japan — Professional Liability	N/A	0%	N/A

*Note: Movements are risk adjusted*



# Specialty

## Commentary by line of business

### Aerospace

- The trend of no further rate reductions in (re)insurance that began in Q3 2017 has continued in the Q1 2018
- The direct and facultative market was quiet with only a handful of major renewals in Q1; it appears capacity remains committed to holding pricing levels
- The reinsurance market remains a little more stringent in maintaining risk-adjusted pricing than the primary market; 1 April renewals generate the largest premium volume to the reinsurance market and buying philosophies look to be considerably varied with certain large buyers retaining significantly more exposure and others taking an opposing stance
- Excess of loss reinsurance pricing was flat with some loss-affected layers paying small increases; capacity for super catastrophe layers appears to be tightening, albeit this is for layers priced at below 1% rate on line
- Commissions on pro rata treaties are under more pressure than for many years and, linked with varying buying strategies, are likely to result in less ceded income to reinsurers
- Retrocessional pricing also remains stable with modest rate increases between 0% to +5%

### Marine

- The market remains “hard” following the impact of HIM losses
- Little evident dislocation of markets and capacity remains plentiful for correctly rated programs
- Reduced commissions quoted/ordered on loss-making pro-rata treaties and very few excess of loss reductions offered
- The circumstances for any excess of loss reduction require exceptional circumstances (and probably senior management sign off)
- Retrocession has less available capacity and as a volatile product attracts the most scrutiny and potential increase dependent on loss activity
- HIM losses have created “a line in the sand,” stopping the trend of reductions in recent years and the market is adjusting itself accordingly

### Non-Marine Retrocession

- Market stabilizing as the 2017 loss estimates start to settle down and capital continues to flow into the market
- A narrower range of pricing than was seen at 1 January
- Resistance from reinsurers limited as it is clear that there is an abundance of capacity for buyers
- Continued focus by buyers on frequency protection

## Specialty rate movements

Territory	Pro rata commission	Risk loss free % change	Risk loss hit % change	Catastrophe loss free % change	Catastrophe loss hit % change
Aerospace	0%	0%	+5%	0%	N/A
Non-Marine Retrocession	-1% to -3%	0% to +10%	+5% to +20%	+5% to +10%	+5% to +20%

*Note: Movements are risk adjusted*

# Capital Markets

- Insurance-linked securities (ILS)
  - ILS assets under management both inside and outside the larger ILS funds continue to grow
  - Catastrophe bond new issue and secondary spreads for peak risks remains stable with plentiful capacity
  - Non peak issuance has proved strong so far in 2018 with ILS beyond property catastrophe very much in play
  - Loss development and claims collection from 2017 catastrophe events continues to proceed in an orderly fashion with few surprises
- Mergers and acquisitions (M&A)
  - Changing Bermuda carrier landscape and support of the macro theme “bigger is better;” long term sustainability and independence of sub-scale operations are being reevaluated, e.g., AXA’s \$15.3 billion acquisition of XL, AIG’s \$5.6 billion acquisition of Validus and Aspen’s preemptive hiring of investment bankers to advise on go-forward strategy
  - Continued market interest in both life and non-life legacy transactions and management teams, e.g., Voya’s sale of its closed block VA business along with reinsurance of annuity business to a consortium of investors including Apollo Global Management, Crestview Capital and Reverence Capital with annuity reinsurance to Athene; also of note is Aquiline’s \$500 million investment into run-off specialist, Armour and RenRe’s investments with Catalina and RGA
  - Specialty carrier valuations and M&A activity remain robust in part due to increased scarcity value; valuations for Lloyd’s market companies of ~2.2x Tangible Book Value (TBV) and U.S. Specialty ~1.7x TBV, e.g., Stone Point’s investment into AmTrust Financial at a valuation of ~1.9x tangible book value (TBV)
  - Meaningful uptick in insurance services consolidation in recent years (\$8.0 billion in 2017) as investors place a premium on capital-light MGA models. Examples include Madison Dearborn’s acquisition of AmTrust’s fee business and USI’s acquisition of Wells Fargo’s insurance services business
  - A shifting global regulatory landscape, e.g., U.S. Tax Reform, Brexit, Solvency II, China’s increased scrutiny of outbound M&A activity
  - Elevated 2017 global natural catastrophe losses not seen as a major catalyst for rate hardening, soft market conditions remain

*Note: Capital markets commentary provided by Willis Towers Watson Securities [www.willis.com/securities](http://www.willis.com/securities)*

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