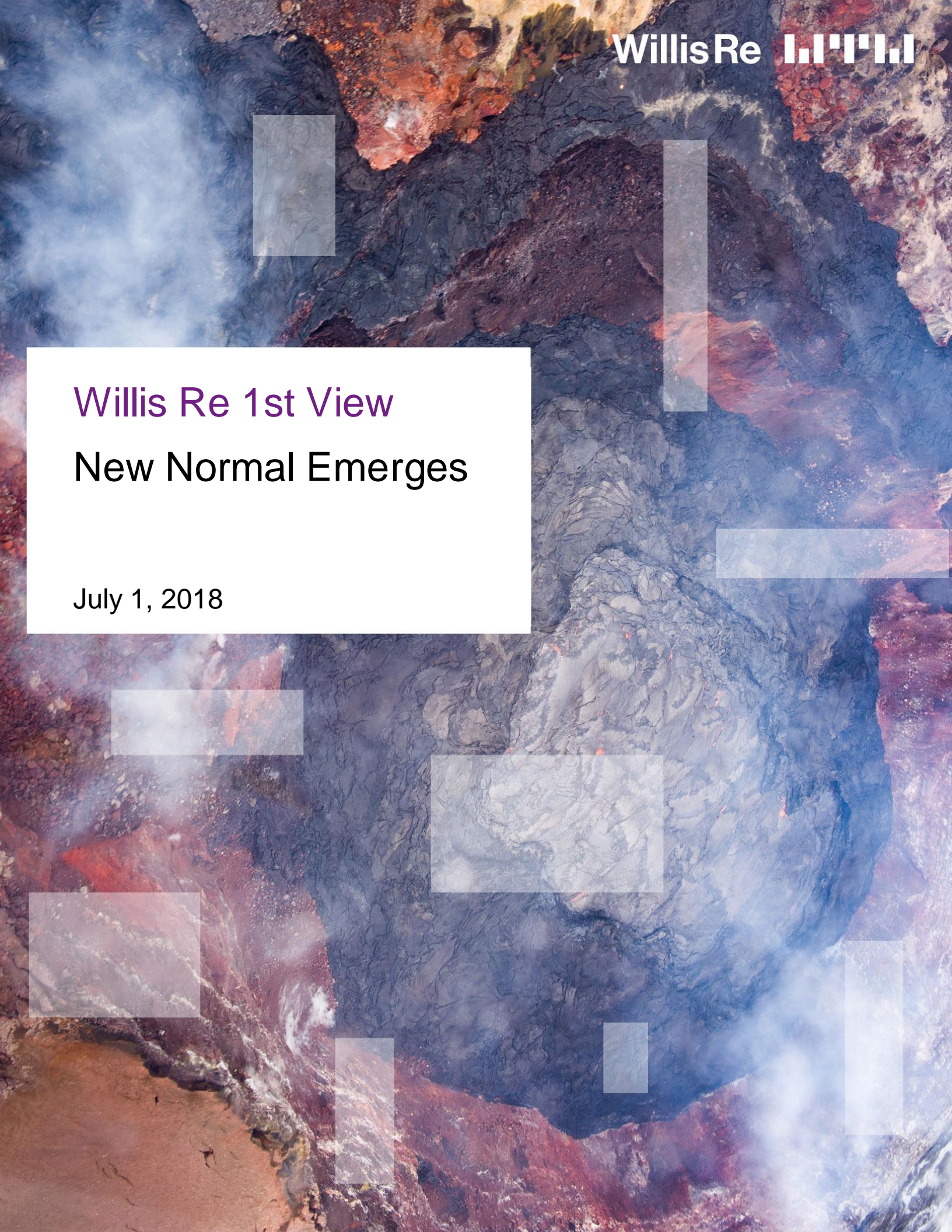


# Willis Re 1st View New Normal Emerges

July 1, 2018



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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 Reinsurance and Risk Appetite Survey 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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# New Normal Emerges

The pricing analysis within this report evidences a market that has seen the momentum for rate increases on non-loss impacted accounts dissipate for the June and July property catastrophe renewals. The drivers for the stalling impetus are threefold. Excess capital leading to a surplus of capacity from both traditional and insurance-linked securities (ILS) markets; the stabilization of the 2017 natural catastrophe loss estimates which remain below initial estimates and often retained net, in particular by the large global insurers; and finally, the benign loss activity for the first half year 2018 to date.

Reinsurance lines beyond property cat have seen varied results for the mid-year renewals. Where original loss ratios have deteriorated due to sequential years of rate reductions or high loss activity, reinsurance pricing has firmed. Examples would include business lines such as U.S. medical malpractice, commercial auto and international D&O. On lines showing better prospects of profitability, competition remains intense and pricing consequently continues to favor the buyer. If buyers want to find the lowest pricing point, a turnover in the reinsurer panel is often a necessity with new reinsurers largely comprised of lesser rating and/or capital.

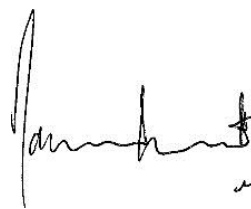
For traditional risk carriers, the imperative to react to the emerging new market normal and adjust their business models is intense. As commented on in earlier reports, a number of traditional carriers are well advanced in their plans to reduce their costs, including difficult decisions around headcount. In addition to cost savings, the more proactively managed carriers are applying far greater rigor in examining the profitability of every line of business they are accepting. It is clear that marginal lines which add a degree of diversity and help to increase the top line are no longer acceptable if they cannot earn an acceptable return. This approach is producing a number of recent announcements from carriers exiting lines of business. For those carriers who are not as well advanced in overhauling their business portfolios, the

recent announcement from Lloyd's about focusing on underperforming lines of business is likely to instigate additional withdrawals.

This approach, while undoubtedly painful for many, will ultimately prove beneficial, as it will promote better financial discipline to ensure that buyers continue to be able to access long-term stable support from financially secure counterparties. However, the process may yet result in some challenges for some of the more recent actively promoted business models, particularly around the expansion of MGAs. In an environment where there is greater emphasis on pure underwriting profitability and underwriting control as against top line growth, some carriers may be prompted to re-examine their MGA strategies.

Given the current market challenges, M&A retains a continued level of interest for many parties, though the lessons of some of the recent more heady valuations remain fresh in the minds of potential buyers, along with the pitfalls of rapid top line growth in recent years not translating into expected profitability. Acquirers are likely to exercise greater caution with sellers having to readjust their pricing expectations accordingly.

As reinsurers face the second half year with its greater exposure to seasonal natural catastrophes, many will be hoping that the below average run of larger losses continues while they continue to realign their business models to the new market norm.



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

# Property

## Commentary grouped by territory

### Australia

- Most reinsurers taking a client-by-client approach, with focus on supporting key relationships; historical buying philosophies are being factored in by reinsurers
- Reinsurer pricing pressure on loss-affected layers
- Some rate reductions available on loss-free layers where technical justification can be provided but dependent on overall perceived program price adequacy
- Risk selection and portfolio management important considerations and buyers with demonstrably better portfolios able to achieve more positive outcomes
- Some reinsurers looking to grow relationships with key clients, others starting to reduce capacity where rates are perceived to be inadequate; overall, plentiful capacity remains available
- Reinsurer appetite limited for low level catastrophe layers and aggregate covers, while a number of buyers are seeking these solutions; as a result, pricing remained challenging in this area

### Caribbean (including Puerto Rico)

- Hurricane Maria loss continues to increase as further development on business interruption losses arises, but still below the original modelled estimates
- Additional capacity continues to be available from certain reinsurers looking to increase participations and from new entrants to the market attracted by higher rates
- Wide range of risk adjusted final terms increasing by +10% to +40% on excess of loss programs depending on island and extent of loss
- Pro-rata ceding commissions reducing despite original underlying rates increasing by up to 60% depending on the island

### China

- Overall China still has enough capacity especially from onshore reinsurers
- After 1 January renewal, reinsurers did not hold high expectations of price increases
- With only a few typhoon losses in the first HY 2018, Catastrophe XL price movement has been modest
- VAT issue is still an issue for some small clients leading to delays in premium settlements

### Latin America

- Capacity at competitive terms remains plentiful, however capacity at slightly higher terms is abundant
- Pressure on non-economic terms and conditions continues
- Available proportional capacity has increased year on year and commissions reduced in some cases
- Relatively low instances of catastrophe losses with modest adjustments depending on degree of loss to program
- Layers exposed to Mexico earthquakes losses saw larger rate increases up to +15%, but overall program increases between +2.5% and +7.5%

## Middle East

- The influx of new capacity to the region has continued unabated
- Reinsurer focus has been to maintain a stable top line with a compromise on underwriting quality
- The implementation of VAT across United Arab Emirates and the Kingdom of Saudi Arabia has had a limited effect on reinsurance; claims inflation due to this is still unclear
- Most pro rata treaties have been renewed with unchanged capacities

## United Kingdom

- With a number of the major U.K. insurers not adversely impacted by the 2017 storm activity, the backdrop going in to this renewal was of yet another benign catastrophe year for U.K. buyers
- Capacity remains plentiful with existing reinsurers looking to maintain their positions and new market entrants looking to grow where possible
- Purchasing behavior was broadly consistent year-on-year for catastrophe treaties, a little more variation on risk treaties depending on loss activity
- Pricing broadly flat but in certain circumstances it was possible to achieve minor rate reductions, however these remained in the low single digit range

## United States — Florida

- Differentiation is the message reinsurers sent; companies that performed well in Hurricane Irma are in high demand and had the largest amount of capacity at their disposal specifically, claims handling and underwriting were key areas of renewal discussions
- Overall limit purchased in the market was slightly more than 2017; however, this was muted by new capital coming into the market
- Non-traditional reinsurers offered larger lines and had more interest in reinstatable layers, which has historically been dominated by traditional markets
- Assignment of benefits and reopening claims on Hurricane Irma caused many carriers to restate projected ultimate estimates with loss creep eroding reinsurer positions
- Quota share renewals faced downward pressure on ceding commissions, attributable to deterioration in underlying loss ratios and increased catastrophe activity

## United States — Nationwide

- The U.S. property treaty market has continued to have a supply/demand imbalance and is now seeing rates that are generally flat, with some rate decreases available on loss free layers
- Buyers for mid-year placements with non-loss impacted renewals have pushed back on rate increases in most instances
- Capacity remains plentiful with non-traditional and collateralized markets increasing available capital
- The continued growth in the collateralized market has caused traditional reinsurers to defend their held portfolios and forego rate increases, albeit many of these reinsurers are themselves using ILS capital to supplement their own capacity

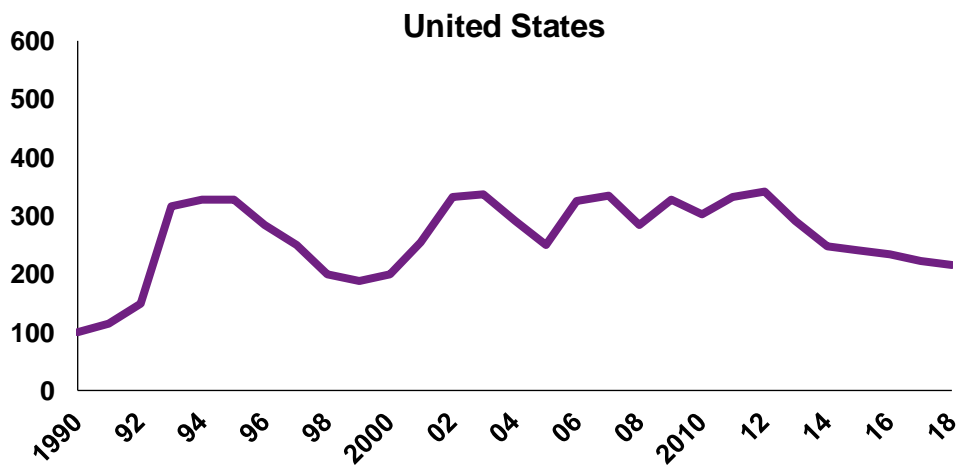
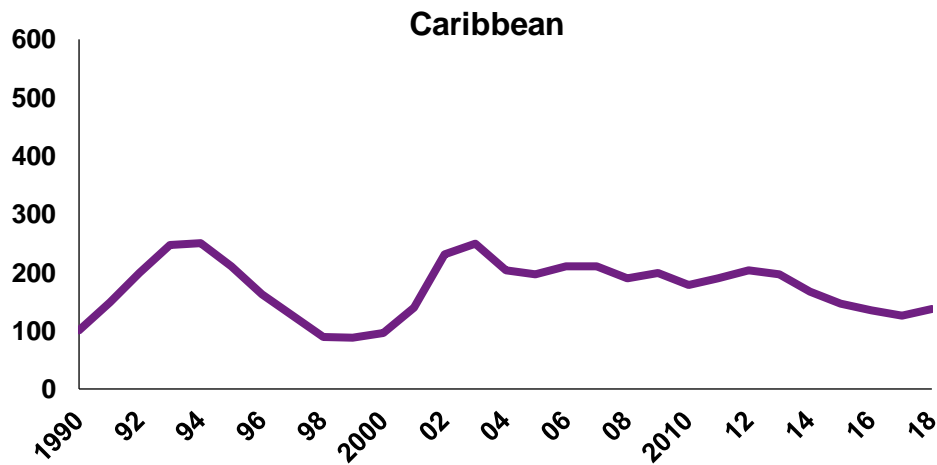
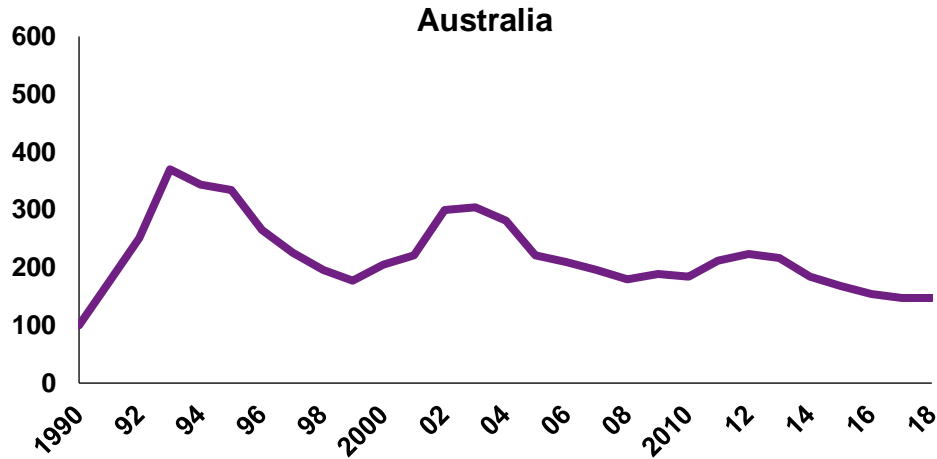
## Property rate movements

Territory	Pro rata commission	Risk loss free % change	Risk loss hit % change	Catastrophe loss free % change	Catastrophe loss hit % change
Australia	varies	0%	varies	0% to -1%	0% to +5%
Caribbean	-2% to -5%	0%	0% to +20%	+5% to +15%	+10% to +40%
China	N/A	-5%	+15%	N/A	-4% to +4%
Latin America	0% to -2.5%	0% to -7.5%	0% to +10%	0% to +5%	+2.5% to +7.5%
Middle East	0% to +2%	-7.5%	0%	-10%	-5%
South Africa	N/A	0%	+5% to +10%	-5% to +5%	+10% to +20%
United Kingdom	N/A	N/A	N/A	0% to -2.5%	N/A
United States — Florida	0% to -2.5%	0% to -5%	0% to +2.5%	0% to -7.5%	0% to +7.5%
United States — Nationwide	0%	0% 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

### Australia

- Most reinsurers took a client-by-client approach; however, previous resolve for wholesale rate increases, or even risk adjusted flat, had dissipated for some July renewals
- Reinsurer resolve remained firmer on accounts with adverse loss development or where portfolios experienced growth in areas considered riskier
- On some programs, reinsurers demonstrating adaptability and appetite for coverage expansion set themselves up to enjoy share increases to the detriment of those reinsurers showing a reluctance to change
- Buyers continued to consider casualty systemic and accumulation risks, with reinsurer appetite broadly meeting buyer requirements
- Reinsurer appetite for cyber risks continued to grow, albeit more cautiously than in the past; however, still exceeding demand from buyers

### China

- Overall China still has enough capacity, especially from onshore reinsurers
- After 1 January renewal, reinsurers did not have an expectation of price increases

### Global — Cyber risk

- Increasing number of insurers looking to protect against silent cyber exposure
- Reinsurance capacity for affirmative cyber remains plentiful
- Excess of loss, industry loss warranty and other reinsurance solutions growing in popularity as alternatives to quota share

### International — General Third Party Liability

- Capacity in the international casualty market continues to rise as reinsurers are looking to broaden their offering to clients and also divert capital to casualty lines given muted pricing change in other lines
- Significant interest in new product development and multi-line opportunities
- Reinsurers are applying more discipline on achieving an adequate margin and are walking away from accounts that do not meet hurdle rates; this is particularly the case where there are concerns around potential future loss emergence centered around geographies, products, trades and professions
- Therefore, while "theoretical" capacity continues to grow, we are observing measured deployment



### International — Motor Liability

- Limited renewal activity in International Motor at this time of year
- General view is that renewals were flat
- Caribbean Motor saw pricing pressure on some islands following market wide loss activity and earlier motor own damage experience
- Pricing corrections following the UK Ogden review were not generally available with some reinsurers walking away if prices reduced
- In the Central and Eastern Europe region, there has been pressure from some reinsurers to increase deductibles and/or rates

### United States — General Third Party Liability

- Insurance and reinsurance capacity remains robust for general liability and excess casualty
- Insurance rates are generally improving on primary general liability and lead umbrella, with slight improvements on excess casualty
- Reinsurance terms are generally flat, with some minor corrections on loss affected accounts

### United States — Healthcare

- The reinsurance market for healthcare liability lines of insurance is firming although it remains rational
- Loss severity trend selections are moving higher; claim frequency trends remain flat
- After several years of increased ceding commission, the potential to achieve further increases is limited
- Reinsurance capacity remains adequate with an ample number of reinsurers supporting the class

### United States — Motor Liability

- Commercial auto continued to see rate increases in +8 to +10% range as evidenced in the year over year premium growth; however, it is still not clear if these increases are enough to offset the increased claim severity and frequency trends
- Continued downward pressure on quota share ceding commissions and excess of loss layers depending on loss experience
- The promise of the use of telematics is affording hope to carriers but the actual economic benefit needs more time/experience to play out
- Commercial driver shortage remains a big issue for the industry
- Generally speaking, reinsurers' interest in commercial auto remains tepid and focused on expertise and track record of the buyer
- In personal auto, carriers continue to push rate increases to offset frequency/severity trends but this trend is flattening

### United States — Professional Liability

- Market capacity remains plentiful
- On pro rata treaties, there is continued downward pressure on ceding commissions although there is a significant gap between quoted terms and final terms
- Existing excess of loss placements renewed very close to expiring unless there is a significant change in exposure or experience
- We are starting to see renewed interest in exploring excess of loss alternatives as commissions come down on existing quota shares

## United States — Workers' Compensation

- We distinguish workers' compensation as two separate markets
  - Working layers that include single claimant coverage are actuarially priced and based on experience and exposure
  - Catastrophe layers that commonly require two or more claimants in the same loss occurrence are primarily priced based on capacity charges
- Working layer pricing continued to experience modest increases as reinsurers try to offset some of the rate decreases taking place in the primary market; programs experiencing loss emergence should expect rate increases
- The catastrophe market again is experiencing some softening following a pause at January 1

## Casualty rate movements

Territory	Pro rata commission	XL — No loss emergence % change	XL — With loss emergence % change
Australia	0%	0% to -5%	+5% to +10%
China	N/A	-5%	N/A
Global — Cyber	0% to -2%	N/A	N/A
International — General Third Party Liability	0% to -1.5%	-2.5% to +2.5%	+2.5% to +7.5%
International — Motor Liability	N/A	0%	0% to +5%
United States — General Third Party Liability	0% to -1%	0% to -5%	0% to +10%
United States — Motor Liability	-1% to -3%	-8%	+12%
United States — Professional Liability	0% to -2.5%	0%	-5% to +5%

Note: Movements are risk adjusted

Territory	Pro rata commission	Risk loss free % change	Risk loss hit % change	Catastrophe loss free % change	Catastrophe loss hit % change
United States — Healthcare	0% to -5%	0% to +5%	+2% to +10%	0%	+5% to +25%
United States — Workers' Compensation	0% to -2%	0% to +3%	+2% to +5%	0% to -5%	N/A

Note: Movements are risk adjusted

# Specialty

## Commentary by line of business

### Marine

- Reinsurers continue to maintain pricing discipline as management teams seek to stabilize portfolio performance in light of continued negative attritional loss experience pressures and 2017 hurricane losses (Harvey, Irma and Maria)
- Regional catastrophe loss experience and specialism specific performance have influenced renewal terms in localized international/niche product markets, slowing the pace of upwards rating pressures in certain areas
- Capacity remains abundant across marine classes curbing pressure for upwards movement in rating
- International reassureds look to expand coverage and territorial scope as a means of obtaining additional value from their reinsurance partners
- The specie market continues to hold firm on rating with underwriters resisting requests for reductions; attempts to broaden coverage at no additional premium are being closely monitored by underwriters with such requests being deemed technical reductions
- Energy facultative reinsurances are experiencing flat to slightly increased rating conditions; with market capacity at an all-time high, buyers are able to weigh the benefits of maintaining existing relationships against potential pricing reductions offered by alternative partners; coverage within the energy sphere has remained consistent with the exception of cyber buy backs where client/broker pressure is leading many markets to offer limited coverage
- Carriers offering cargo lines are under extreme pressure to seek rating increases; with the impact of the hurricane losses still fresh and following the context of negative cargo results in general over successive years, reductions on cargo accounts have largely become a thing of the past
- The Protection and Indemnity reinsurance market saw reinsurers hold firm on maintaining rating levels with requests for reductions being firmly resisted, and reassureds opting to focus on coverage expansion when forming renewal strategies
- The majority of facultative purchases continue to closely follow the rating of original business with certain risks attracting pricing in excess of original rating as cedants seek to manage net exposures on competitively rated, large exposures
- Excess of loss pricing maintains stable to moderately upwards trajectory with scale of pricing adjustment subject to changes in portfolio exposure and loss experience
- Gulf of Mexico windstorm coverage continues to attract rating increases as reinsurers seek to redress the balance between sustainable pricing and supporting clients in challenging market conditions

### Non-Marine Retrocession

- Capital supply remains strong from both traditional and Insurance-linked securities (ILS) players
- ILS capacity is more constrained than this time last year as funds deployed more of their limit earlier in the year at January 1 and April 1
- Competition for business among reinsurers is high with buyers benefiting from better than expected pricing and significant line sizes
- Industry loss warranty pricing flat year-on-year

### Personal Accident/Life Catastrophe

- Number of new entrants increasing the capacity of an already over-subscribed market
- Nuclear, biological, chemical terror (NBC) becoming standard inclusion due to broadening of market conditions

### Political risk

- No significant change in reinsurance capacity
- Terms and conditions for proportional covers unchanged

### United States — Medical Excess

- The medical excess market continues to experience increase in frequency and severity of large medical claims
- Over the last few years, specialty pharmaceutical claims have become the biggest challenge for all players
- The medical excess reinsurance market has had shakeups due to large losses
- Key medical reinsurance markets have pulled out or pulled back due to losses
- New entrants and significant capacity are keeping the medical excess market competitive
- There is expected continued growth in the self-funded and employer stop-loss market

### Specialty rate movements

Territory	Pro rata commission	Risk loss free % change	Risk loss hit % change	Catastrophe loss free % change	Catastrophe loss hit % change
Marine	0%	N/A	N/A	N/A	N/A
Non-Marine Retrocession	0%	0%	0% to +10%	0% to +10%	0% to +10%
Personal Accident/Life Catastrophe	0%	0%	0%	0%	N/A
Political Risk	0%	0%	0%	0%	0%
United States — Medical Excess	0%	0% to +10%	+10% to +30%	N/A	N/A

Note: Movements are risk adjusted

# Capital Markets

- Insurance-linked securities (ILS)
  - H1 2018 catastrophe bond issuance has proved quite high with another record year possible
  - New issue risk spreads on balance remain flat, year-on-year
  - The loss development process on collateralized reinsurance impacted by 2017 events and supported by catastrophe bonds and private ILS continues to work largely as expected
  - ILS activity beyond property-catastrophe has increased now that the 2017 events have become less of a distraction
  - Sidecar and similar activity has increased in 2018 but seems strategically driven rather than a reaction to the 2017 losses
- Mergers and acquisitions (M&A)
  - 2018 YTD has seen a significant pick-up in M&A activity across the global insurance sector. YTD deal volume is running at \$44 billion. This compares to \$61 billion for the whole of 2017. It puts 2018 on a pace to be the most active year since 2015 (when volume was \$121 billion, boosted in particular by the ACE-Chubb merger).
  - The most significant deal so far in 2018 is of course AXA's purchase of XL, valued at \$15 billion. Other noticeable deals include AIG's purchase of Validus (\$6 billion) and Phoenix's purchase of Standard Life Aberdeen's life business (\$4 billion).
  - The pipeline remains active, with press reports indicating that sales processes are currently in progress on Aspen, several Lloyd's platforms and a prominent closed life insurance book in Germany
  - Drivers of consolidation include:
    - The changing Bermuda landscape and a view that “bigger is better” (e.g., Validus, Aspen)
    - A continued keen interest from incumbents in adding to distribution and the product suite (e.g., AXA-XL)
    - In tandem, an interest from incumbents in improving focus on core activities (SLA's disposal to Phoenix) and in making more efficient use of capital (the numerous life and non-life legacy transactions announced and in the pipeline)
    - As well as the trade, private equity remains a very interested buyer. Perceived value levers include acting as a consolidator (i.e., expense savings from follow-on transactions) and opportunities to leverage capital (e.g., bringing alternative capital into a carrier's capital mix)

Note: M&A commentary provided by Willis Towers Watson Securities [www.willis.com/securities](http://www.willis.com/securities)

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