State of the Reinsurance Market

Practical Perspective on Property Reinsurance/Reinsurers

TOWERS WATSON

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Practical Perspective on Property Reinsurance/Reinsurers

- Products
- Markets
- Macro and Industry Trends
- Rating Agency View
- Market Dynamics
- Managing Property Reinsurance

Products

Key Products in the U.S. Property Reinsurance Market

Key products

- Traditional
  - Quota share
  - Per risk excess of loss
  - Property catastrophe excess of loss
- Structured risk
- Capital markets

Quota share reinsurance (traditional)

Key Features	Marketplace Observations
• Pro rata sharing of primary subject premium and primary subject losses • Ceding commission to cover primary company expenses • Occurrence limitation to mitigate reinsurers' catastrophe exposure • No aggregate limitation on treaty recoveries • Typically bought in conjunction with other reinsurance (especially cat) • Key underwriting issues are portfolio profitability and exposure fit (with reinsurers)	• U.S. and Bermuda more receptive • London less interested in quota share

Per risk excess of loss reinsurance (traditional)

Key Features	Marketplace Observations
• Excess attachment on losses (per risk, per occurrence) • Reinsurance premium set via rate applied to primary subject premium • Occurrence limitation used to mitigate catastrophe exposure • Ceding commission, if any, built into rate • Treaty will have an aggregate limitation on overall recoveries • Bought in conjunction with other reinsurance (especially cat) • Key underwriting issues are reinsurance rate and exposure fit	• All markets actively pursuing per risk excess of loss business • U.S. more active in lower/middle attachment points • London more active in middle/higher attachment points • Bermuda active across the spectrum of attachment points

Property catastrophe excess of loss reinsurance (traditional)

Key Features	Marketplace Observations
• Excess attachment on company's net losses (per occurrence) • Reinsurance premium derived from rate-on-line approach • Treaty will have an aggregate limitation on overall recoveries • Usually bought in conjunction with other reinsurance (Q/S and Per Risk) • Key underwriting issues are reinsurance rate and exposure fit	• All markets actively pursuing property cat excess of loss business • U.S. more active in lower/middle attachment points • London and Bermuda active across the spectrum of attachment points

Structured property reinsurance treaties

Key Features	Marketplace Observations
• Highly customized reinsurance, so features tend to be deal-specific • Aggregate stop loss and structured quota shares are most common • Treaty will have an aggregate limitation on overall recoveries • Usually bought with other reinsurance (Per Risk and/or Cat) • Key underwriting issues are balancing risk transfer with upside/downside • Post-Spitzer, markets have added more risk to deals • More risk = higher premiums, so finding perceived value is harder	• Highly specialized marketplace, with limited number of players • Generally less competitive than traditional reinsurance markets

Capital markets

Key Features	Marketplace Observations
• Collateralized, multi-year capacity — generally non-reinstated limits • Primarily designed for peak peril zones (U.S. Wind, Euro wind, Cal. Quake, Japan quake) • Accordion-like capacity that surfaces in hard market conditions • In current soft market conditions, most of the capacity comes from dedicated investors that behave in a manner similar to traditional markets • Ability to trade risk year round builds seasonality features into pricing	• Excess capacity exists in this market as well, as money has moved in attracted by non-correlated nature of performance relative to other asset-backed markets • In other words, mother nature does not care about the mortgage on the home it is about to destroy

Capital markets — Cat bonds

- There are now almost 30 dedicated cat bond and ILS funds
  - Continued diversification away from reinsurers with multi-strategy hedge funds as the main investor base
  - These funds tend to dominate issuance transactions, although many of them are small
  - In some cases, multi-strategy funds and pensions are investing by way of the dedicated cat funds
- Increased focus on trust account stabilization and quality of collateral
  - Rejection of the “total return swap” approach that exposed buyers to Lehman bankruptcy
  - Inclusion of collateral provisions requiring “top-ups” upon a decrease in the market value of the assets
  - Improved disclosure of assets held in the trust portfolios

Capital markets — Cat bonds

- Increasing investor willingness to invest in UNL triggers
  - Investors are digging deeper into the third-party models
  - Partly as a result of the growth and contraction of the “sidecar” market
- Secondary trading has seen vigorous growth
  - Market absorbed several large BWICs these past two years
  - Volumes for U.S. wind bonds most active
  - By some measures, trading volume has exceeded issuance volume

Markets

Key Market Centers for U.S. Property Reinsurance

Global reinsurance market is highly concentrated

Rank	Top Global Reinsurers	2009 Market Share	S&P Financial Strength Ratings YE 2001	YE 2008	Oct. 25, 2010	Current Rating Outlook
1	Munich Re	21%	AAA	AA-	AA-	Stable
2	Swiss Re	14%	AAA	AA-	A+	Positive
3	Hannover Re	9%	AA+	AA-	AA-	Stable
4	Berkshire Hathaway	8%	AAA	AAA	AA+	Stable
5	Lloyd's of London	6%	A	A+	A+	Stable
6	SCOR	5%	AA-	A-	A	Positive
7	Reins. Group of America	4%	A	A-	A-	Stable
8	Transatlantic	2%	AA	AA-	A+	Stable
9	Partner Re	2%	AA-	AA-	AA-	Negative
10	Everest Re	2%	AA	AA-	A+	Stable
	Top 10 Market Share:	**74%**				

U.S. property reinsurance marketplace

- U.S. is the largest market for property and casualty reinsurance
  - Most global reinsurers need a major presence in the U.S. market
  - Only question is how they will access U.S. property reinsurance
- Four principal vehicles for accessing U.S. property reinsurance
  - U.S. based reinsurers
  - Bermuda based reinsurers
  - Lloyd's of London
  - European based reinsurers

U.S. property reinsurance marketplace is not dominated by U.S. based reinsurers

- Few major U.S. based reinsurers have U.S. parents
  - National Indemnity/General Re (Berkshire Hathaway)
  - Transatlantic Re (Independent)
- Majority share of U.S. reinsurance ultimately goes to foreign reinsurers
  - Munich Re (multiple entities accessing U.S. market, including U.S. sub)
  - Swiss Re (multiple entities accessing U.S. market, including U.S. sub)
  - Hannover Re (multiple entities accessing U.S. market, but no U.S. sub)
  - Lloyd's (accesses primarily through London and Bermuda operations)
  - Bermuda based reinsurers (access directly from U.S. brokers)

General observations on U.S. based reinsurers

- Mature and declining platform
  - Over past five years, companies reporting to RAA dropped from 26 to 19
  - Trend of reinsurance companies domiciling elsewhere continues
- U.S. based reinsurers focus on more service-intensive underwriting
  - Quota share
  - Working layer property per risk excess of loss
  - Low to mid-level property catastrophe excess of loss
- Characteristics of U.S. based reinsurers
  - Write property clients who require higher servicing levels
  - Actuarially and model driven, but also with attention to relationships

General observations on Bermuda based reinsurers

- Bermuda domicile has been vibrant for past 20 years or so
  - Regulatory and tax advantages favored start-ups in Bermuda
  - Proximity to the U.S. also helped establish it as a favored location
- However, Bermuda has been losing ground since 2007
  - Companies increasingly moving/starting operations in Europe
  - Movement due to uncertainty over regulations and tax status
- Bermuda based reinsurers focus on less service-intensive underwriting
  - Mid-to-higher-layer property per risk excess of loss
  - Property catastrophe excess of loss
- Characteristics of Bermuda based reinsurers
  - Write transactional portfolios requiring limited service levels
  - Highly technical underwriting approach, with less regard for relationships

General observations on Lloyd's of London

- Lloyd's is the oldest reinsurance market and remains vibrant
  - Leading market for U.S. and internationally traded insurance and reinsurance
  - Heavily influenced by global regulatory changes as much as by underwriting
- Lloyd's tends to be strongest on specialty and exposure rated covers
  - Mid-to-higher-layer property per risk excess of loss
  - Property catastrophe excess of loss
- Characteristics of Lloyd's based reinsurers
  - Write a wide variety of clients due to their long presence in U.S. market
  - Use models/analytics, but are most relationship-oriented market

General observations on European based reinsurers

- European reinsurance market is dominated by industry leaders
  - Five of the six largest reinsurers in the world are based in Europe
  - Four of the five largest European reinsurers have major U.S. presence
- Europe has been gaining ground since 2007
  - Companies increasingly moving/starting operations in Europe
  - Switzerland and Ireland have been significant beneficiaries of this trend
- European reinsurers focus across the board
  - Working layers via their U.S. based subsidiaries
  - Higher layer property per risk and property catastrophe directly from Europe
- Characteristics of European based reinsurers
  - Write full spectrum of U.S. placements/clients via multiple access points
  - Tend to be technical underwriters, but also balance with relationships

Macro and Industry Trends

Trends Impacting the U.S. Reinsurance Market

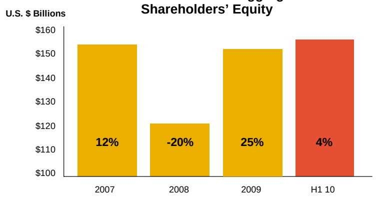
Major trends impacting U.S. reinsurance market

- Regulatory changes/uncertainty will have a major impact
  - Specter of U.S. threat to Bermuda domicile
  - Influence of Solvency II as an agent of global change
- Stagnant U.S. economy creates multiple challenges
  - Erosion of underlying premium base
  - Massive governmental stimulus and its impacts
- Restoration of capital markets is double-edged sword
  - Industry is now in excellent financial health thanks to restored capital base
  - Excess capital in industry serves only to further stimulate competition
- Depressed values for (re)insurance stocks complicates the situation
  - Natural expectation would be for consolidation to wring out excess capacity
  - Consolidation is more difficult with depressed valuations for (re)insurers

Abundant reinsurance capacity remains a primary driver of softening P&C (re)insurance rates

- The reinsurance market remains resilient, with capital returning to near 2007 levels as of year-end 2009
- Since year-end 2009, capital grew an additional 4% through six months, 2010, with no signs of retracting

Global Reinsurance Aggregate Shareholders' Equity



Sources: A.M. Best, Towers Watson.

Several factors contributed to reinsurers' improved balance sheet strength and overall financial flexibility

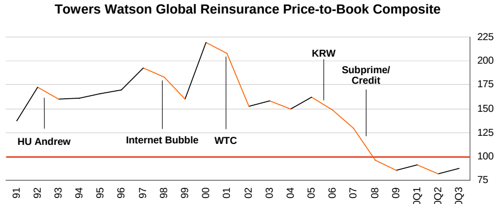
- Rising asset values driven by a strong rebound in the capital markets
- Relatively quiet 2009/10 U.S. cat season, with U.S. and Bermuda reinsurers reporting a strong combined ratio of 86% in '09, an improvement over '08 of 94%
- Strong liquidity and loss reserve positions
- Greater discipline fostered by ERM enhancements

Global Equity Markets Performance

Source: SNL Financial

Despite a rebound in reinsurer balance sheet strength, financial performance is lagging as reflected by stockholder sentiment

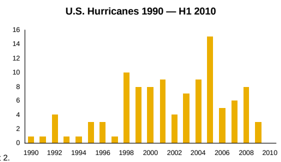
Towers Watson Global Reinsurance Price-to-Book Composite



Source: SNL Financial, Towers Watson.

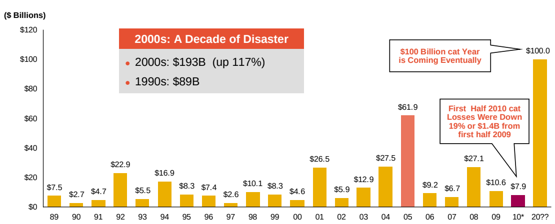
More 2010 catastrophe activity globally than in the U.S.

- Globally, 725 weather-related natural hazards occurred
  - Insured loss estimates of $18 to $20 billion
  - Second highest figure recorded for the first nine months of any given year since 1980
- Despite producing 19 named storms, the U.S. has been able to avoid major events
  - Since 1990, there is no precedent of an Atlantic hurricane season with 10+ hurricanes where none has struck the U.S.
  - The time period of 2006 through 2010 is one of only three five-year consecutive periods without a U.S. Major Hurricane landfall
  - There has never been a six-year period without a U.S. major hurricane landfall
  - Historically, one in four Atlantic hurricanes strikes the U.S. as a hurricane



Note: Hurricane Earl didn't make landfall and Ike made landfall as a Cat 2.
Source: Insurance Information Institute, University College London

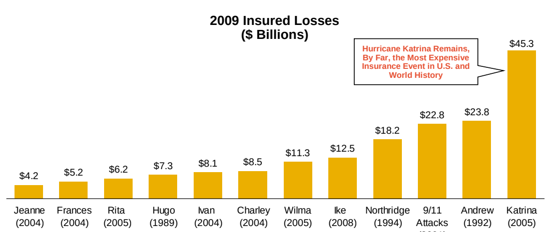
But the U.S. has experienced more than our share of cat losses since 2000



2010 cat losses are running below 2009
Figures do not include an estimate of Deepwater Horizon loss

Note: 2001 figure includes $20.3B for 9/11 losses reported through 12/31/01. Includes only business and personal property claims, business interruption and auto claims. Non-prop/BI losses = $12.2B.
*Through June 30, 2010.
Source: Property Claims Service/ISO; Munich Re; Insurance Information Institute.

Top 12 Most Costly Disasters in U.S. History

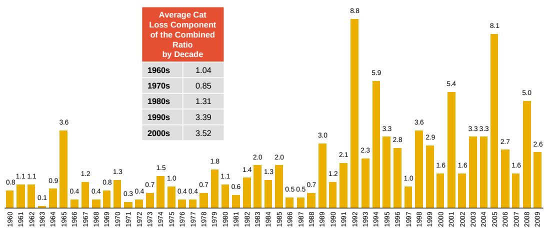


8 of the 12 most expensive disasters in U.S. history have occurred since 2004;
8 of the top 12 disasters affected Florida

Sources: PCS; Insurance Information Institute inflation adjustments.

Increased catastrophe loss activity has had a notable impact on combined ratios

Combined Ratio Points

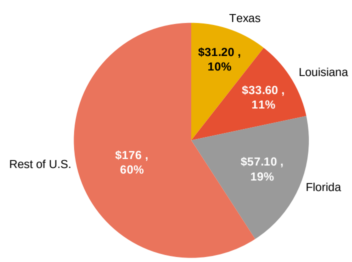


Average Cat Loss Component of the Combined Ratio by Decade	
1960s	1.04
1970s	0.85
1980s	1.31
1990s	3.39
2000s	3.52

The catastrophe loss component of private insurer losses has increased sharply in recent decades

Notes: Private carrier losses only. Excludes loss adjustment expenses and reinsurance reinstatement premiums. Figures are adjusted for losses ultimately paid by foreign insurers and reinsurers.
Source: ISO; Insurance Information Institute.

And the issue is even more acute in peak zones such as Florida, Louisiana and Texas*

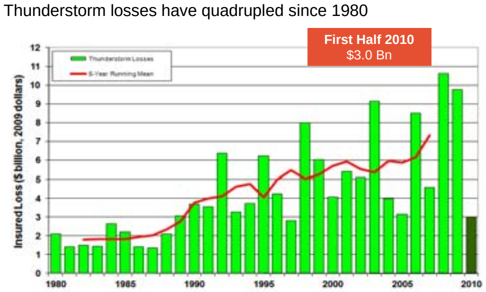


*All figures (except 2006 – 2008 loss) have been adjusted to 2005 dollars.
Source: PCS division of ISO.

Thunderstorm losses are a growing problem

Annual Totals 1980 – 2009 vs. First Half 2010

- Thunderstorm losses have quadrupled since 1980



Source: Property Claims Service, MR NatCat*SERVICE*.
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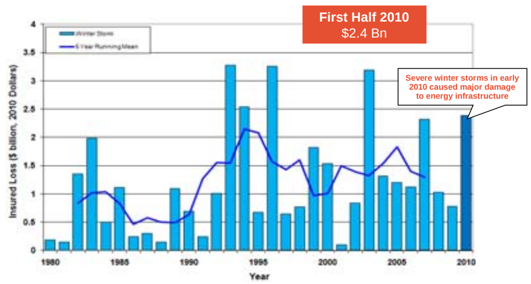
Erratic winter storms have also grown in significance

Annual totals 1980 – 2009 vs. First Half 2010

- Average annual winter storm losses have increased over 50% since 1980



Source: Property Claims Service, MR NatCat*SERVICE*.

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Rating Agency View

Rating Agency Perspective on the U.S. Property Reinsurance Market

P/C rating issues focus on cycle management, reserve adequacy and expanded risk retentions

- Battle between growth and profitability
  - Soft market is testing insurer's UW discipline
  - Competitive pricing may persist in 2011 as the U.S. economy slowly recovers and excess capacity remains
- Focus on long-term profitability in line with expectations
  - Differentiate insurers that proactively manage the cycle and mitigate earnings/surplus volatility
  - Best will increasingly challenge insurers to articulate long-term profitability expectations
- Weakening reserve adequacy
  - Adverse development is #1 reason for downgrades
  - Best is concerned with premature take-downs
- Increased risk retentions
  - Retentions have increased during past several years from increased reinsurance pricing and top-line growth pressures
  - May not be properly aligned with changes in risk tolerance, financial strength and ERM enhancements

While the reinsurance sector remains generally stable, individual markets face many challenges as cited by the rating agencies for 2011…

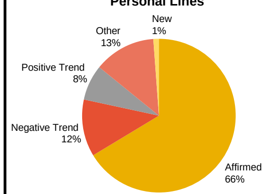
- Implications of Solvency II expected to extend beyond Europe
- U.S. government pressures on Bermuda tax havens
- Constrained market for mergers and acquisitions
- Reserve redundancies dried up
- Lower investment returns and conservative investment reallocations

Rating Outlooks by Agency

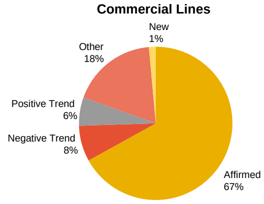
Sector	S&P	A.M. Best	Moody's	Fitch
U.S. Personal Lines	Negative	Stable	Stable	Stable
U.S. Commercial Lines	Negative	Stable	Negative	Stable
Global Reinsurance	**Stable**	**Stable**	**Negative**	**Stable**

Best's P/C personal and commercial lines segment rating actions for the first half of 2010

Personal Lines



Commercial Lines



Affirmed represents Affirmed/Affirmed Under Review/Under Review Developing
Negative Trend represents Downgraded/Downgraded Under Review/Under Review with Negative Implications/Affirmed Downgraded with a Negative Outlook
Positive Trend represents Upgraded/Under Review with Positive Implications/Affirmed with a Positive Outlook
Other represents a change in NR

Source: AMB rating statistics for 355 P/C Personal lines companies and 769 P/C Commercial lines companies as of Aug. 13th, 2010.

Key risk drivers that may impact future rating trends

- Pricing management (cycle management)
- Reserve adequacy
- Catastrophe risk management
- Enterprise risk management
- Macroeconomic conditions

Market Dynamics

What To Expect for 1/1/2011 U.S. Property Reinsurance Renewals

Primary insurance market remains very competitive

- "Buyer's market for insurance persists," *Business Insurance* (10/25/10)
  - Property pricing down 3% in Q3 of 2010
  - Source = RIMS Q3 Benchmark Survey
- "Newsflash: Rates remain resolutely soft," *Reactions (PCI Reporter*, 10/26/10)
  - Overall pricing down 5.2% in Q3 of 2010 (compared to -6.4% in Q2)
  - Source = CIAB Q3 Commercial P/C Market Index Survey
- "Raters raise reserving concerns," *Reactions (PCI Reporter*, 10/26/10)
  - "There is moderate to high competition in this soft market"
  - "..into 2011 we think it is a more moderate 0% to 5% reduction"
  - Quote from Damien Magarelli, S&P

Reinsurance market remains competitive but disciplined, suggesting more "orderly softening" as 2011 unfolds

Supply Factors for Reinsurers	Supply Effect	Demand Factors for Insurers	Demand Effect
Capital restored to near-peak levels	+	Strong capital position; flat-to-down exposure/premium growth	-
"Adequate" profitability and returns on capital	+	"Weak" profitability may drive higher retentions	-
'09 Benign cat loss activity and risk of unexpected cats in '10	+/-	Lower PMLs for certain key perils from recent cat model changes	-
Increased focus on ERM and risk tolerances	+/-	Increased focus on ERM and risk tolerances	+/-
Less redundant reserves; lower investment yields	-	Less redundant reserves; lower investment yields	+
More active cat bond market	-	Fear of inflation (casualty insurers)	+
Increased share buy-backs	-		
Reinsurer capital: expected to grow modestly in 2010/11	+	**Reinsurance Demand: flat-to-down in 2010/11**	-

What is the impact on each key reinsurance product?

- Quota share (traditional)
  - Declining primary rates are challenging viability of quota shares
  - Expense pressures also make ceding away so much premium difficult
  - Expect marginal further softening of pricing/terms, but not by much
- Property per risk excess of loss (traditional)
  - Declining primary rates have companies pushing for per risk rate reductions
  - Expect pricing to be slightly down overall, but very much client-specific
  - Key variables will be experience and amount of exposure reduction in layer
- Property catastrophe excess of loss (traditional)
  - Lack of catastrophe losses and excess capital call for further softening
  - Specter of RMS v11.0 creates opportunity for reinsurers to push back
  - Pending model changes make market direction difficult to forecast

Meanwhile, several "wildcard" issues could materially change current expectations for the (re)insurance marketplace at 1/1/2011

- Significant and/or unexpected catastrophic event(s)
  - Natural cats beyond Chile Quake and Xynthia Winterstorm in Europe
  - Terrorism
- Significant and/or unexpected inflation (economic or social)
- Impact of Catastrophe Model changes
  - RMS v11 release February 2011
  - AIR v12 released August 2010
- Unexpected regulatory and legislative impacts
- Lingering effects of global financial credit crisis

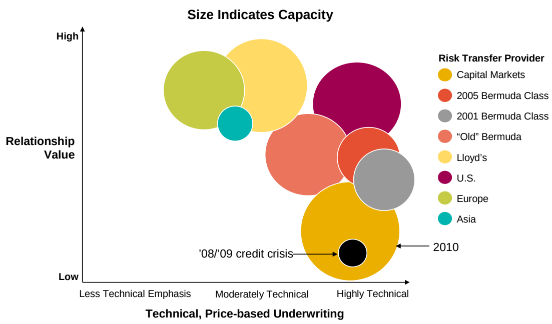
Managing Your Property Reinsurance

Practical Guide To Enhancing Your U.S. Property Reinsurance Placements

Do relationships matter anymore?

- Relationships do matter
  - Long-term planning horizon is different than a short-term horizon
  - Long-term allows for lower risk margin due to ongoing trade
  - Relationships = long-term partnerships
- Property reinsurers are primarily driven by technical analysis/models
- Influence of relationships is on the margins — relationships…
  - Aren't going to secure radically different pricing
  - Aren't going to secure radically different terms
  - Do secure capacity, temper rate increases and allow partners to develop increasingly favorable terms and conditions over time

Markets can be differentiated based on trading style and relative emphasis on pricing and relationship



How to get the most from your reinsurance partners

- Commit to a longer-term view of reinsurer relationships
  - Incremental annual gains can create wider benefits over time
- Seek partners who can provide value-added assistance in:
  - Managing your risk appetite via ERM tools and consulting
  - Optimizing property portfolios (return on capital optimization)
  - Providing mapping/management tools to aid in underwriting/claims
  - Improving your underlying business via other consulting services


Thank you!