

Willis Re 1st View

April 1, 2017

Disciplined Softening



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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: January 1, April 1 and July 1. In addition to real-time eVENT Responses, our clients receive our daily news brief, *The Willis ReView*, periodic newsletters, white papers and other reports.

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Foreword: Disciplined Softening

Reinsurers have now all finalized their 2016 accounts. While there is some divergence in individual companies' reported results, in terms of underlying loss ratios, investment returns and reserve releases, 2016 overall has generated an acceptable, though reduced, return for the global reinsurance industry. It is clear that in the face of a soft market offering a limited number of acceptably priced opportunities, many reinsurers remain prepared to let their top line revenue growth stall and are opting to return excess capital to their shareholders.

Against this background — and with little other change in market conditions in terms of loss activity and investment markets over the last three months — the 1 April 2017 renewal season has largely followed the direction set at the 1 January 2017.

Risk-adjusted rate reductions on short tail classes continued to moderate. While international buyers achieved slightly larger reductions as compared to U.S. and Lloyd's buyers, the extent of the reductions range from flat to mid-single digit reductions and not the low double digit range which were seen 12 months ago. Gratifyingly for reinsurers, overall limits purchased have not reduced, and some have increased, as more buyers seek additional protection. Retentions have remained largely stable.

The renewal season has been challenging for new reinsurance capacity coming into the market. In addition to depressed pricing, most existing reinsurers have managed to renew their shares through a combination of client-centric underwriting and some relief now that rate reductions are abating.

Capital markets have maintained the aggressive posture that emerged at the end of 2016 with many insurance-linked securities (ILS) funds looking to offset the decline in opportunities as existing catastrophe bonds mature. Capital markets are now often prepared to price more competitively for peak zone catastrophe risk and there is currently a differentiation in the pricing of catastrophe bonds compared to traditional markets. This erosion in the margin on catastrophe business puts additional stress on traditional reinsurers writing more diversified portfolios, since they have been relying on higher margin catastrophe business to balance their overall portfolios. With results on many diversifying non-catastrophe classes now marginal, there is

greater pressure on reinsurers to address the pricing in these classes.

In the U.S. the poor results in automobile business, both commercial and personal lines, and in excess workers' compensation, provide examples of classes where reinsurers are seeking improved terms. Further, it is evident that ceding commissions on large account liability business peaked towards the end of 2016 as for recent renewals flat pricing has largely been the norm.

2016 overall has generated an acceptable, though reduced, return for the global reinsurance industry



The March 2017 changes to U.K.-specific discount rates (in the government's actuarial "Ogden Tables") for assessing personal liability claims has not yet made a pricing impact in the wider reinsurance market despite generating much comment. The 1 April 2017 casualty renewals have, as in previous years, been driven by cedant- and territory-specific issues with pricing movements largely driven by loss activity and changes in exposure. Whether there will be a spillover into the broader international casualty markets from the revision of the U.K.'s Ogden Tables and other similar planned revisions in other European countries remains to be seen and is unlikely to become clearer over the remainder of 2017.

As reinsurers look to the rest of this year, they can draw comfort that in many cases reductions are slowing and unbridled competition is abating as managers face the buffers of tighter regulation, better pricing analytics and transparent shareholder expectations.

John Cavanagh, Global CEO Willis Re
April 1, 2017

Property

Commentary by territory

India

- General Insurance Corporation, India's national reinsurer, continues to be market leader as overseas reinsurers that established branches in India at the beginning of the year took a tough stand with respect to excess of loss pricing and conceded leadership on some programs
- Sliding scale commissions and loss participation corridors continue for most of the pro rata treaties
- Poorly performing pro rata treaties saw reductions in minimum commission levels and widening of loss participation corridors

Japan — Property Risk

- Structures remained largely unchanged
- Further broadening of coverage to enhance efficiency and reduce differences in conditions with primary business; this includes coverage to cater for property damage/contingent business interruption accumulation arising from the same event
- Wide variation in risk adjusted reductions as performance and exposure movement differed by buyer
- Overseas exposures reduced in part to the appreciation of the Japanese yen against a number of currencies

Japan — Property catastrophe wind and earthquake excess of loss

- Capacity continues to be abundant as Japan remains a core territory for existing reinsurers and a key target for a number of new reinsurers
- With continued oversupply of capacity, rate reductions have again been achieved, despite the backdrop of challenging margins and some deterioration to the 2014 Snow Loss
- A modest uptick in the number of reinsurers reducing written lines and declining business was observed
- Whilst there were variations by client, additional wind and earthquake limit was purchased
 - Non-Life companies typically drove the additional wind/combined purchases and the mutual companies drove the increased purchases of earthquake
 - For both perils, the additional coverage was typically at the higher end of programs although there was some growth in aggregate covers
- Non-life companies continue to explore domestic covers with international exposures
- Terms and conditions remained largely unchanged as most cedants again chose to focus on price
- Varied approach by buyers to multiyear purchases but an increase in overall limit secured on this basis
- General program restructuring to reduce number of layers placed

Japan — Property catastrophe earthquake quota share

- Attractive primary rates continue to hold and as such, significant reinsurer demand remains for earthquake quota share business
- Cession percentages adjusted depending upon cedant risk appetite and corporate objectives; this directly impacted the purchases being made on the excess of loss treaties
- Commissions flat to modestly increased with larger increases typically achieved where there was limited loss from the 2016 Kumamoto earthquake
- There was some re-evaluation of event limits

Korea

- The majority of per risk programs suffered first layer losses
- Price reductions were the key focus for most clients this renewal
- Capacity remained plentiful
- No meaningful change to conditions/exclusions

United States — Nationwide

- Lack of major catastrophe loss activity and abundant capital continues to drive the soft market with price changes generally in line with January renewals
- There are a few new market entrants who are competing to build North American portfolios, which contributes to the continuing pressure on incumbent markets
- ILS investors, both through private ILS backing collateralized re and catastrophe bonds are competing strongly for business, offering increased capacity at terms that are discounted over last year. The non-renewing catastrophe bonds are being largely replaced by new catastrophe bonds as investors continue to grow assets and market share
- Reinsurers are seeking to differentiate their response to programs based on their own view of absolute pricing adequacy and long-term partnership goals
- There is some evidence of clients lowering the attachment point of catastrophe programs but it is not sufficiently widespread to be viewed as an overall industry trend

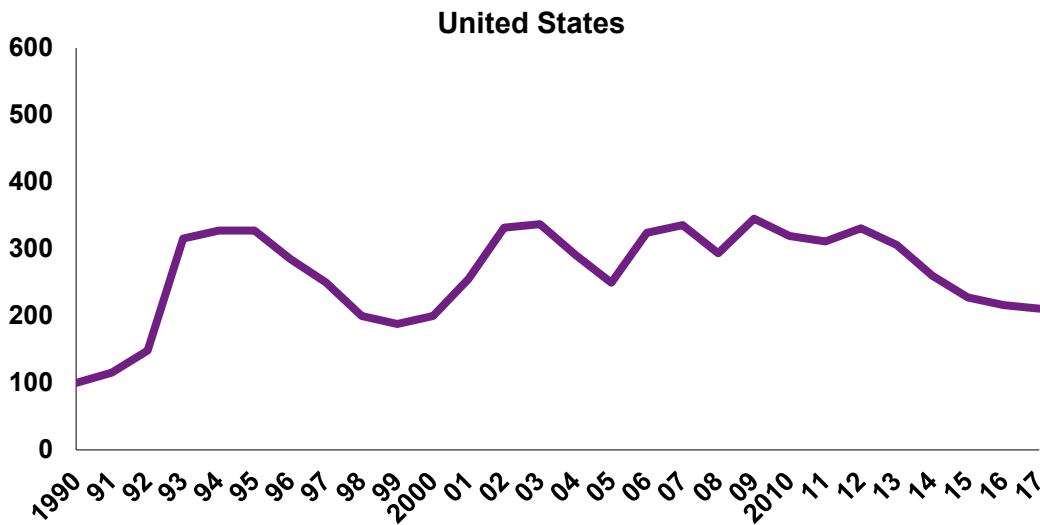
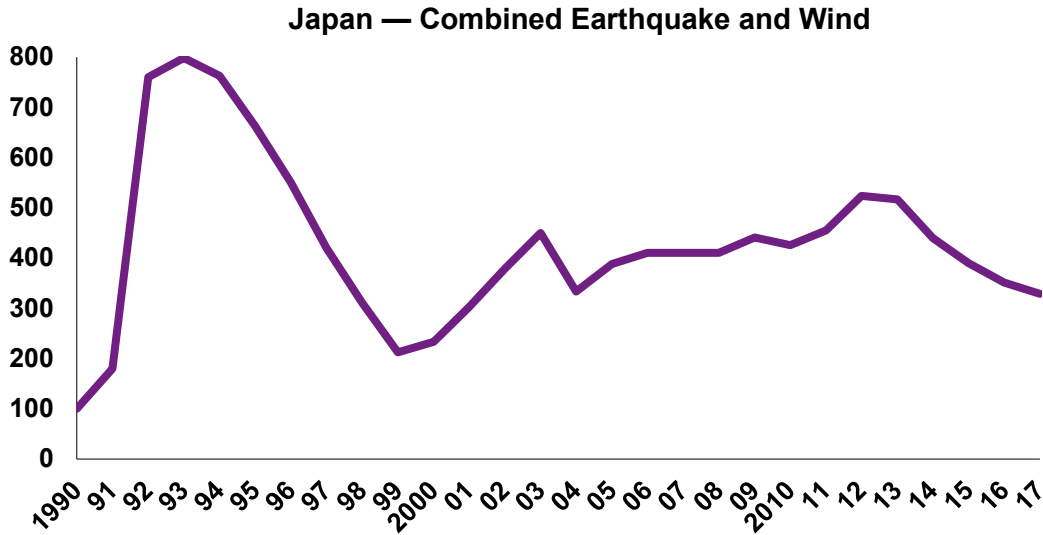
Property rate movements

Territory	Pro rata commission	Risk loss free % change	Risk loss hit % change	Catastrophe loss free % change	Catastrophe loss hit % change
India	-1% to -4%	-5% to -10%	0% to -5%	-5% to -10%	0% to +5%
Japan – Combined Earthquake and Wind	N/A	N/A	N/A	-5% to -7.5%	N/A
Japan – Earthquake	0% to +2%	N/A	N/A	-5% to -7.5%	N/A
Japan – Property risk	0% to +1%	0% to -7.5%	N/A	N/A	N/A
Japan – Wind	N/A	N/A	N/A	-2.5% to -7.5%	N/A
Korea	0%	N/A	-5% to +10%	-10%	0% to +10%
U.S. – Nationwide	0% to -2%	0% to -5%	+5%	0% to -5%	+5% to +15%

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

- For the bigger buyers of liability reinsurance, renewal was largely dominated by loss activity, particularly relating to pharmaceuticals product liability
- Losses affected programs differently leading to varied pricing impact
- Coverage relatively stable
- Some new interest from reinsurers who previously had no or only limited involvement in Japanese Casualty, although not all discussions resulted in offered capacity

Japan — Personal Accident

- Existing capacity is high; the market remains soft, with reinsurers especially keen to increase their signings
- Few new reinsurers were allowed onto quoting or following panels for the 1 April 2017 renewal
- No significant changes to coverage
- More significant price changes at 1 April 2017 than seen at 1 January 2017 with buyers able to achieve -5% to -7.5% risk-adjusted reductions

Japan — Professional Liability

- Increased focus on Cyber and Directors & Officers liability to meet demands in original market
- There is a particularly strong demand for Directors & Officers liability following regulatory changes; consequently, an increase in reinsurance limits was seen
- Some new interest from reinsurers as they continue to look to grow relationships with Japanese clients, although not all discussions resulted in offered capacity
- Reinsurance pricing generally remains 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
Japan — General Third Party Liability	N/A	0%	+20% to +30%
Japan — Personal Accident	N/A	-5% to -7.5%	N/A
Japan — Professional Liability	N/A	0%	N/A

Note: Movements are risk adjusted

Specialty

Commentary by line of business

Aerospace

- In the direct airline market, there was some resistance for some of the largest placements in Q4 2016; however, there is still significant overcapacity for smaller placements
- While the direct market continues to be verticalized, differentials between lead and following market terms are converging and, in some instances, following markets are achieving better than lead terms
- The general aviation and aerospace sectors continue to suffer from sustained overcapacity and reductions are in the region of -20%
- There has been no significant change in reinsurance market capacity: Excess of loss renewals continue to see reductions of -10% on a risk-adjusted basis, although proportional treaty commissions are largely flat, due to the soft underlying market conditions

Marine

- Each buyer continued to be treated individually based on its merits and results
- Reinsurance leaders are being disciplined with terms and conditions where possible
- Capacity remains plentiful where the leader's terms are sensible but markets declined where terms are felt to be insufficient

Non-Marine Retrocession — Global

- Repetition of pricing floor seen at 1 January 2017 renewals
- Capacity and demand for tail risk increasing
- Tail risk pricing more reflective of exposure rather than perceived minimum price requirements of reinsurers
- Focus on frequency and attrition in both the underwriting of original business and cedants' reinsurance purchasing

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% to +1%	-7.5% to -10%	N/A	-7.5% to -10%	N/A
Marine	N/A	N/A	N/A	N/A	N/A
Non-Marine Retrocession	0%	-5% to -10%	0% to +5%	0% to -5%	+2.5% to +7.5%

Note: Movements are risk adjusted

Capital Markets

ILS and M&A commentary

- Catastrophe bond spreads have continued to decline as many investors have become keen for increased liquidity.
- Sponsors have responded to the reduced spreads by ramping up issuance to match the demand.
- The pipeline and range of private ILS transactions continues to grow, adding speed and flexible options for those companies unable to access capacity in more liquid forms.
- Treasury money market funds are no longer the clear collateral of choice in catastrophe bond transactions with AAA International Bank of Reconstruction and Development (IBRD) putable notes becoming more common.
- Merger and acquisitions activity in the global insurance sector picked up in H2 2016 and has remained at a healthy pace YTD in 2017. In Europe, for example, deal volume (for transactions above \$500 million) in 2016 ended up being \$10 billion — still well below the \$20+ billion seen in 2014-15, but H2 activity accounting for well over half of the year's volume.
- In the U.S., cautious optimism about deregulation in the Trump presidency may inspire some acquirers to become more active opportunistically. In Europe, greater comfort with the new Solvency II rules is emboldening potential buyers while at the same time giving clarity to the capital benefit accruing to sellers.
- The most noteworthy deals from the past six months — Liberty's acquisition of Ironshore, Fairfax's acquisition of Allied World and Sompco's acquisition of Endurance — also demonstrate that scale and global diversification remain highly relevant drivers.
- Additionally, there is growing interest in run-off markets, both for life and non-life books.
- Heightened buyer interest is also manifesting itself in higher deal valuations. This has been particularly noteworthy in the insurance services area. Double-digit multiples of trailing EBITDA have become more normal with, for example, KKR paying 12x trailing EBITDA for the broker USI.
- We expect M&A activity to remain at a buoyant level as we progress through 2017.

Note: Capital markets commentary provided by Willis Towers Watson Securities www.willis.com/securities

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