Fitch 2018 Outlook: Global Reinsurance

Update Following Recent Catastrophe Events

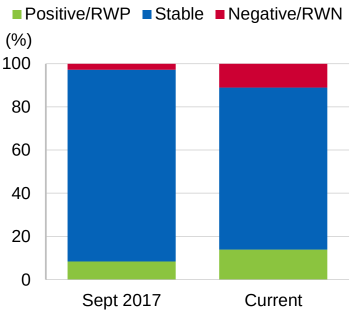
Outlook Report

Rating Outlook

STABLE

(2017: Stable)

Rating Outlooks



Source: Fitch

Sector Outlook

NEGATIVE

(2017: Negative)

- Profitability pressure from underwriting and investments
- Significant catastrophe losses may push improved market conditions
- Alternative capital is a key market driver

This outlook report updates the previous *2018 Outlook: Global Reinsurance* report dated 5 September 2017. The update reflects the impact of the significant catastrophe losses in 3Q17 and revised forecasts for 2017 and 2018 following these losses.

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Rating Outlook Stable: The 3Q17 catastrophe losses represent a significant percentage of capital for some reinsurers, leading to Negative Outlooks for several companies' ratings. However, the very strong capitalisation of most rated entities means that they remain well positioned to take advantage of any pricing improvement at 1/1 renewals and beyond. Fitch Ratings believes significant development in loss estimates or additional large loss events before year-end could change the sector's rating outlook to negative from stable.

Sector Outlook Negative: Fitch's fundamental outlook for the reinsurance sector remains negative. Intense market competition and the endurance of alternative capital have depressed prices in recent years. Low investment yields, which Fitch expects will persist, put further strain on reinsurer profitability. Combined ratios normalised for an average level of reserve releases and catastrophe losses have steadily deteriorated and the profitability of the sector remains under pressure.

Significant Catastrophe Losses: The devastation caused by Hurricanes Harvey, Irma and Maria, coupled with the significant losses from the earthquakes in Mexico and wildfires in California, generated potentially record insured catastrophe losses in 2017, with (re)insurance industry losses approaching USD100 billion. As a result, 2017 catastrophe losses will constitute a capital event for a number of (re)insurance companies. However, the industry's very strong capital levels at the beginning of 2017 limit any risks to solvency.

Rates Set to Rise: Fitch expects reinsurance rates to increase as a result of the significant catastrophe events in 3Q17, particularly on US catastrophe exposed lines and in the retrocessional market. Fitch believes, however, that excess capital in the market and the absence of an even costlier event, such as a direct hurricane landfall in Miami, which Irma avoided, leads to less certainty over more widespread rate rises.

Alternative Capital a Key Driver: A key driver of the magnitude of future rate increases depends on Insurance Linked Securities (ILS) market's appetite to invest more capital into reinsurance. The amount of capital that remains 'trapped' by lengthy claims settlements or protracted litigation, particularly in relation to Hurricane Harvey flooding losses, will also influence the degree that rates rise.

Outlook Sensitivities

Deterioration in Sector Profitability: The rating outlook could change to negative if medium-term calendar-year combined ratios or operating ratios exceed 100% and 90%, respectively (2018 forecast 95.8%, 88.8%), even if capital remains strong. These sensitivities reflect reinsurance results only, and will vary based on reinsurance versus primary insurance business mix. Negative rating actions are possible if the deterioration in reinsurance sector fundamentals threatens to weaken business profiles or reduce returns to at/or below the cost of capital.

Catastrophe Loss with Rate Spike: A significant catastrophe loss event of USD70 billion or more, coupled with significant unrealised investment losses from an abrupt jump in interest rates, of 300bp or more, could threaten the sector's stable rating outlook. Such a scenario would leave balance sheets temporarily more exposed to adverse events and would be particularly concerning if reinsurers lacked sufficient liquidity to pay claims and needed to sell investments at a loss and/or raise new capital at a higher cost.

Key Issues

Significant Losses from Catastrophes for Reinsurers

Rating Outlooks Affected by Losses

The majority of reinsurer rating outlooks remain stable. However, the ratings of XL Group Ltd and Axis Capital Holdings Ltd have recently been revised to Negative, reflecting a decline in capital adequacy as a result of catastrophe losses, near-term sensitivity to adverse adjustments to loss estimates or additional loss events and adverse underlying earnings trends. The rating of Lloyd's of London was maintained on Negative Outlook and Fitch believes that the 3Q17 catastrophe losses have placed further pressure on the Negative Outlook.

Very Strong Industry Capitalisation

The reinsurance industry holds significant excess capital and is well positioned to absorb the losses from recent catastrophe activity. On an individual company basis, however, the losses have had a capital impact for some. Fitch focuses on reinsurers with disproportionate exposures, on a combined or individual basis, to the recent hurricanes, especially where losses greatly exceed the reinsurer's modelled estimates, as this could indicate some weaknesses in risk management. An important consideration for the ratings of these reinsurers is the extent to which they are able to recapitalise quickly.

3Q17 Record Quarter for Losses

The three costly hurricanes of 2017 – Harvey, Irma and Maria – were unique events that will affect the (re)insurance market in different ways. Hurricane Harvey generated limited homeowners' insurance losses, as personal property damage relates to flood losses for which the majority of households are either uninsured or covered by the US government's National Flood Insurance Program. Substantial commercial business interruption and flood claims are likely to entail lengthy complex settlement processes.

Hurricane Irma was predominantly a wind-loss event, with significant reinsurance programmes in place. This shifted a substantial portion of the claims burden from primary participants to reinsurers and ILS markets, as smaller Florida homeowners' specialty writers that hold considerable market share are highly reliant on catastrophe reinsurance capacity to manage risk.

Losses from Hurricane Maria were more concentrated on reinsurers with exposures in Puerto Rico, where the majority of losses occurred, as local insurers also cede a large portion of catastrophe exposures. The extent of devastation and challenges in disaster-recovery efforts in Puerto Rico add greatly to the difficulty in adjusting and settling claims from this event.

2017 Combined Ratio Highest Since 2011

The significant 3Q17 catastrophe losses will push the global reinsurance sector to an underwriting loss for the year, with a forecast 2017 aggregate combined ratio of 109.7% for Fitch's universe of monitored reinsurers. This is the weakest underwriting result since the 112.9% posted in 2011 when the (re)insurance industry experienced record insured losses

Non-Life Reinsurance Results and Forecast

(USDm)	2018F	2017F	2016A
Net premiums written	108,840	107,275	102,167
Catastrophe losses	8,300	24,000	6,384
Net prior-year favourable reserve development	4,150	4,300	6,877
Calendar-year combined ratio (%)	95.8	109.7	91.0
Accident-year combined ratio (%)	99.8	113.9	97.9
Accident-year combined ratio excl. catastrophes (%)	91.8	92.0	91.5
Calendar-year operating ratio (%)	88.8	102.7	84.1
Shareholders' equity (excluding Berkshire Hathaway)	267,540	264,890	267,564
Net income ROE (excluding Berkshire Hathaway) (%)	7.1	2.1	8.5

Note: Shareholders' equity and net income ROE reflect entire company results, not just non-life reinsurance operations
Source: Fitch monitored universe of reinsurers

from multiple significant global catastrophe events, including the Tohoku earthquake and tsunami in Japan, New Zealand earthquake and Thailand floods.

Earnings from investments and operations outside of non-life reinsurance will likely enable the group to produce positive earnings for the full year, with a net income return on equity (ROE) projected at 2.1% in 2017, down from 8.5% in 2016.

Reinsurance Market Conditions Poised to Improve

2018 Underlying Underwriting Results Forecast to Improve

Fitch forecasts a calendar-year combined ratio of 95.8% in 2018, reflecting an average level of market catastrophe losses of eight points on the reinsurance combined ratio in 2018, down from 22 points in 2017. Prior-year development on reinsurance segment reserves should remain favourable overall, but decline to about 4.0% of net earned premiums in 2018 from 4.2% in 2017 as redundancies subside. We project the underlying accident-year combined ratio excluding catastrophes to improve slightly to 91.8% in 2018 from 92.0% in 2017 as reinsurance market pricing appears to have reached a bottom in 2017 and is expected to turn positive in 2018. Fitch projects an ROE of 7.1% in 2018, just above the estimated 6%-7% cost of capital, as both underwriting and investment results remain under pressure.

Significant Rate Rises on Loss Affected Lines, Wider Price Rises Less Certain

Fitch believes that as a result of the significant catastrophe events in 3Q17, reinsurance rates will improve, particularly on US property catastrophe lines and in the retrocessional market, but the extent of these rises and the impact on capital in the sector is unclear. With three major hurricanes alongside other catastrophe events, such as the Mexico earthquakes and California wildfires, 2017 could end up being a year for record insured catastrophe losses. Fitch expects that excess capital in the market and the absence of an even costlier event, such as a hurricane making direct landfall in Miami that could have been the case with Irma, leads to less certainty over more widespread rate rises.

Alternative Capital Influences Market Capacity, Pricing

The ILS and catastrophe bond funds will lose about USD10 billion from the 3Q17 catastrophe events, according to industry estimates. In addition to these losses, ILS funds will have to collateralise reinsurance layers that are potentially loss affected, even if they have not yet suffered a loss. This ‘trapped capital’ will be unavailable until there is certainty on losses, and this is unlikely to be known in advance of 1/1 renewals. It is unclear the degree to which alternative capital is inclined to deploy additional capacity to the market while considerable collateralised funds are unavailable, but will have a tremendous influence on pricing and program structure in the next round of renewals.

Recent Losses to Stimulate Demand for Reinsurance

Fitch believes that demand for reinsurance will increase as a result of the recent hurricanes. Hurricane Harvey, in particular, is likely to stimulate greater demand for flood cover, for which a significant portion of losses were uninsured. Insurers may also seek to purchase more aggregate reinsurance cover, given the nature of the losses in 2017, or manage specific exposures through per-risk or facultative cover.

This increase in demand in combination with a potential constraint in supply is likely to contribute towards an improvement in rates across US catastrophe-exposed lines of business, which may also extend to non-US or non-catastrophe-exposed lines.

Appendix

Fitch's International-Scale Ratings on Select (Re)Insurance Organisations

Group	IFS Rating	Long-term IDR	Rating Outlook
Allied World Assurance Company Holdings, Ltd.		BBB+	Stable
Allied World Assurance Company, Ltd.	A		Stable
Arch Capital Group Ltd.		A−	Stable
Arch Reinsurance Company	A+		Stable
AXIS Capital Holdings Ltd.		A−	Negative
AXIS Reinsurance Company	A+		Negative
Beazley plc		A	Stable
Beazley Re Designated Activity Company	A+		Stable
Berkley Insurance Company	A+		Stable
Berkshire Hathaway, Inc.		AA−	Stable
China Taiping Insurance Holdings Co. Ltd.		A	Stable
Chubb Limited		A+	Stable
Chubb Tempest Reinsurance Ltd.	AA		Stable
DEVK Rueckversicherungs-und Beteiligungs-AG	A+		Stable
Echo Rueckversicherungs-AG	A−		Stable
General Reinsurance Corp.	AA+		Stable
Hannover Rueck SE	AA−	A+	Stable
Hiscox Insurance Company (Bermuda) Ltd.	A+		Stable
Hiscox Insurance Company (Guernsey) Ltd.	A+		Stable
Hiscox Ltd.		A−	Stable
JSC Russian National Reinsurance Company	BBB-		Positive
Lloyd's of London	AA−		Negative
Malaysian Reinsurance Berhad	A−		Stable
Mapfre Re Compania De Reaseguros S.A.	A−		Positive
Mapfre SA		A−	Positive
Markel Corporation		A−	Stable
Markel Bermuda Ltd.	A+		Stable
Munich Reinsurance America, Inc.	AA		Stable
Munich Reinsurance Company	AA	AA−	Stable
MutRe S.A.	A−		Positive Watch
Nacion Reaseguros S.A.	B		Positive
National Indemnity Co.	AA+		Stable
One Re Ltd.	BBB−		Stable
Pacific Life Re Ltd.	A+		Stable
Partner Reinsurance Company Ltd.	A+		Stable
PartnerRe Ltd.		A−	Stable
PT Reasuransi Indonesia Utama (Persero)	BB+		Stable
QBE Insurance Group Ltd.		A−	Positive
QBE Re (Europe) Ltd.	A+		Positive
QBE Reinsurance Corporation	A+		Positive
Reaseguradora Patria, S.A.	A−		Stable
Reinsurance Group of America, Inc.		BBB+	Stable
Renaissance Reinsurance Ltd.	A+		Stable
RenaissanceRe Holdings, Ltd.		A	Stable
RGA Reinsurance Company	A		Stable
SCOR Global Life S.E.	AA−		Stable
SCOR Global P&C S.E.	AA−		Stable
SCOR Holding (Switzerland) AG		A+	Stable
SCOR S.E.	AA−	A+	Stable
SIGNAL IDUNA Rueckversicherungs AG	A−		Stable
Sirius America Insurance Company	A−		Negative Watch
Sirius International Group Ltd.		BBB	Negative Watch
Sirius International Insurance Corporation	A−		Negative Watch
Society of Lloyd's		A+	Negative
Swiss Re Ltd.		A	Stable
Swiss Reinsurance Company Ltd.	AA−	A+	Stable
Taiping Reinsurance Co. Ltd.	A		Stable
Transatlantic Holdings, Inc.		A−	Stable
Transatlantic Reinsurance Company	A+		Stable
Validus Holdings, Ltd.		A−	Stable
Validus Reinsurance, Ltd.	A		Stable
W.R. Berkley Corporation		A−	Stable
XLIT Ltd.		A−	Negative
XL Bermuda Ltd.	A+		Negative

Ratings at 1 December 2017
Source: Fitch

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