

Willis Re – 1st View

Whose cycle is it anyway?

June and July renewals have now demonstrated that the softening in the reinsurance market continues unfettered, but a disparity remains between reinsurance and primary pricing levels. While recent reinsurance price reductions have provided some relief for many cedants, these gains may quickly reverse in what is a deceptively tenuous environment.

Insured losses from the recent earthquakes in Asia as well as this spring's typhoon in Myanmar, although devastating from a human perspective, have been comparatively modest. However, a series of major risk losses in the first six months (estimated to total \$6 billion) combined with a spate of US winter storms and tornados may make the first half of 2008 memorable as one of the worst in almost a decade. Nonetheless, these losses have not had an overall market impact. They are stark reminders that we transact business in a world steeped in catastrophe risk. With the brunt of the Atlantic hurricane season yet to arrive, the potential for further and more sizeable losses looms, and reinsurers' 2008 profits are anything but assured.

In the past, capital has flowed quickly into our industry following significant catastrophic events, but as the capital markets seek to emerge from their own storms, post-event liquidity is now less certain. Following the events several years ago, side-car investors have generally fared better than traditional equity investors. While these returns reflect the recent paucity of major losses, they may also indicate that (re)insurers will need to implement more transient capital structures and take on additional reinsurance leverage following future events, both of which have potential implications for ratings and overall business strategy.

With questions over how the industry might re-capitalize, the travails of Wall Street also pose a more direct threat to (re)insurers with over 400 subprime actions filed and more likely to follow. While the few rulings to date have generally been favorable to (re)insurers, considering the potential damages involved, even a handful of adverse outcomes would have a meaningful impact on insurers and their reinsurance partners.

Any subprime shock losses would exacerbate the effects of a casualty pricing environment facing several years of ongoing decline. Together, these factors present the industry with greater parameter risk, and a certain edginess surrounding reserve adequacy is now apparent.

The ultimate impact of any of the above remains uncertain, and the market continues to soften. As it does, I suggest that we should also consider what has transpired in the recent past.

No one anticipated the devastating events of September 11, 2001. "Unmodeled" losses from Katrina had a crushing impact on many (re)insurers. Twelve months ago, Bear Stearns was trading at \$143.16. Our industry faces numerous traditional risks, but it is these "tail" events that drive change in the intertwined global reinsurance marketplace.

Current pricing trends seem to indicate that the market is giving little weight to the potential for extreme events. Nevertheless, Willis Re is committed to working with our clients to proactively address the full scope of their risk profiles. We will continue to lead the way in Enterprise Risk Management in order to help our clients generate economic gain and long term stability for their firms.

Here's to a quiet and peaceful summer for all of us.

–Peter Hearn, CEO, Willis Re

Renewals – 1 July 2008

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Reinsurers may need to implement more transient capital structures and take on additional leverage if post-loss funding becomes less attractive to capital markets.

"Tail" events combined with the numerous traditional risks faced by our industry will drive change in the intertwined global reinsurance marketplace.

Contact Information

Doug Keighley
Communications Manager
douglas.keighley@willis.com
Phone: +44 20 3124 7659



Casualty

Territory and Placement Type

US Business – London

- Risk The working casualty marketplace is fairly small and does not have a significant number of new entrants. Pricing has therefore been fairly stable.
- Cat / Clash Excess casualty has seen much greater competition and this is the area that has suffered from the bigger price drops.
- Pro Rata Pro rata casualty suffers from declining original rates.

US Business

- Risk Most Reinsurers are maintaining a disciplined approach to the market. This is providing companies with established portfolios rate decreases and/or improvements in terms and conditions while penalizing those companies that are showing signs of loss emergence.
- Cat / Clash Smaller companies who purchased "per occurrence" casualty reinsurances are seeing rate decreases of 5-10%. Larger companies who purchased per event or claims made covers and have subprime loss exposure are trying to determine whether their reinsurances will respond.
- Pro Rata We have seen some movement from pro rata to excess of loss as cedents try to manage retained premiums in a softening market.

Potential subprime "shock losses" and falling rates / pricing present greater parameter risk – taken together, these may cause edginess about reserve adequacy.

Territory and Comments

Australia

- Withdrawal of 50% of unlimited WCA capacity by Hannover Re.

Caribbean

- Interest in Motor business continues to increase.

US Business – London

- The Working casualty marketplace is fairly small and does not have a significant number of new entrants. Pricing has therefore been fairly stable.

US Business

- Rates and terms continue to soften in the primary market, albeit at lesser magnitudes relative to what we have seen over the last 24 months.

Rates

Casualty	Pro Rata Commissions	XL – No Loss Emergence % Change	XL – With Loss Emergence % Change
Australia	N/A	Flat to -5%	Flat to +5%
Middle East	NA	-15%	0%
Caribbean	2.50%	-5%	Flat
US Business – London	Flat to +1%	-10% to -25%	+5% to +10%
US Business	+1% to +2.5%	-10% to -15%	Flat to +5%
US – Florida Business	NA	-15%	

Specialties and Workers' Compensation

Placement Type

Non-Marine Retro

- Risk Risk market waiting impact of very active start to the year, remains cautious and stable.
- Cat Market seems to have stabilized, probably due to competition for capacity from Florida renewals and US 1st July renewals.

Professional Liability

- Risk Excess of Loss and Quota Shares Treaties are renewing as expiring except those programs heavily impacted by subprime which are losing some support.

Workers' Compensation

- Risk Reinsurers offering expansion of sideways coverage and fewer exclusions to retain business.
- Cat / Clash Cedants reconsidering cat retentions and top end limits in response to recent industrial accidents.
- Pro Rata As primary profitability declines, interest in Pro Rata may grow. However, outlook remains for fewer sellers than buyers.

Comments

Non-Marine Retro

- July renewals following same trend as 1st Jan - approximately 5 to 10% reductions depending on scope

Professional Liability

- D&O pricing continues to deteriorate with rate change in the high single digits except for financial institutions which are renewing flat to significant increases depending on exposure to subprime.
- E&O pricing is off 10% or more as capacity is abundant and loss environment continues to be relatively benign

Workers' Compensation

- Rate / Rate on Line reductions are in addition to primary price reductions of at least 5%, creating a compounding effect
- Reinsurers are more competitive for new programs vs. expiring
- New capacity in Bermuda and London has led to a less disciplined pricing environment than what was seen at 1 January 2008.

Over 400 sub-prime actions filed, and more are likely to follow.

Rates

Specialty	Pro Rata Commissions	Risk – Loss Free % Change	Risk – Loss Hit % Change	Cat – Loss Free % Change	Cat – Loss Hit % Change
Non-Marine Retro		0	+5%	-7.5%	N/A
Professional Liability	Flat	Flat	Flat		
Workers' Compensation	+2.50%	-5% to -12%	Flat to +7.5%	-7% to -15%	Flat to +5%



Property – Territory and Placement Type

Australia

Risk No changes in terms or conditions, although there have been a number of significant property risk losses in the region
Cat APRA's review of reinsurance recoverables with non-regulated reinsurers may well impact marketing strategies and pricing in the future

Middle East

Risk More and more Risk and Catastrophe layers combined
Cat Sharp decrease in prices for well documented programs
Pro Rata Increase in Capacities and Commissions

Caribbean

Risk Fire losses were not significant on a market level
Cat ROL decreases in line with January's terms of 5 to 15% off expiring, depending on size & scope of program
Pro Rata Commission increases in line with January. Some increases to event limits achieved.

Mexico

Risk Risk XL rates stable or reduced owing to large supply and reinsurance broker competition
Cat ROLs down up to 20% in view of no major Events since Wilma (2005) although floods in State of Tabasco (2007) did hit some residential accounts
Pro Rata No more Pro Rata for large companies other than one notable exception

South America – Chile

Risk Very large Risk losses have produced an increase in ROLs but this varies from company to company
Cat No large Events means ROL reductions of between 5% and 10%
Pro Rata Treaties still in place notwithstanding large losses

South America – Colombia

Risk Not a significant Risk market
Cat ROLs are down on average 7.5% (this was already a very competitive market in 2007)
Pro Rata Treaties still in place despite depressed original rates

South America – Peru

Risk ROLs barely up notwithstanding large losses / frequency losses
Cat Despite the Ica EQ in 2007 which affected most companies, ROLs have remained static
Pro Rata No Pro Rata cover for large companies and no change as regards the rest of the market

US Business – London

Risk E&S carriers, concerned at the pace of rate reduction in their market, have been seeking pro rata coverage. Reinsurers with the same concerns have been reluctant to give it!
Cat The amount of cat limit bought (in terms of return time) has been stable this year as have retentions. There has been increased interest in aggregate excess of loss protection
Pro Rata Steady as she goes with just small tweaks to terms and conditions

US Business – Bermuda

Risk Risk losses in Q1 appear to have a low impact on risk pricing unless a renewal account was directly hit by a number of these Q1 losses
Cat More competition for layers sitting alongside and above the FHCF. This helps explain the pricing range for this sector
Pro Rata Reinsurers continue to pull back from writing pro-rata business as soft rates in the original market show no sign of abating

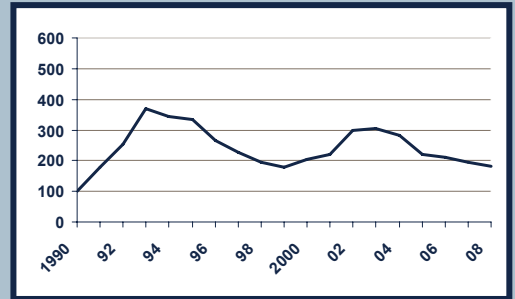
US Florida Business

Risk Good pricing resulted in clients buying more
Cat Good pricing resulted in clients buying additional top capacity or 3rd/4th event coverage
Pro Rata Limited market with some improvement in terms on deals with long standing relationships

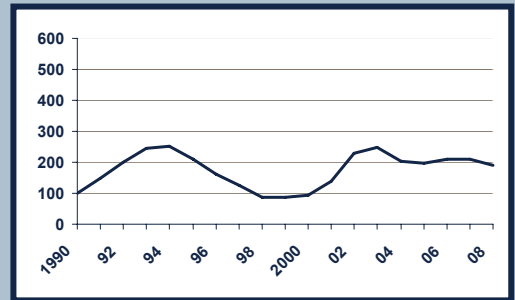
Property Catastrophe Pricing Trends

The charts in the Willis Re – 1st View relate to overall property catastrophe excess of loss pricing movements. They are indexed to 100 in 1990.

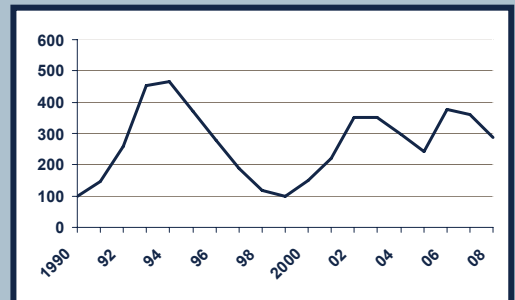
Australia



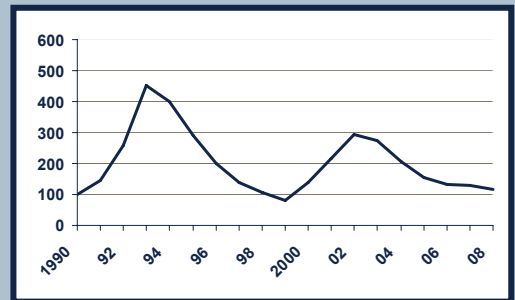
Caribbean



Mexico



Chile





Property – Territory and Comments

1st View – Willis Re
Renewals 1 July 2008

Australia

- Regulator's reforms mean that clients are deciding to what extent to use only APRA-authorized reinsurers
- No new coverage restrictions being imposed by property / casualty reinsurers

Middle East

- Abundance of Proportional capacities from first class securities
- Following Excess of Loss markets are quoting now
- Number of Regional Reinsurers is increasing every two weeks

Caribbean

- Increases on fire section of pro rata commissions for well performing portfolios.
- Cat XL pricing falls in line with January 1 – around 10% off

Mexico

- Original Property market is increasing fast
- Competition has increased on beachfront properties
- Significant Pro rata capacity has been reactivated for EQ/Windstorm for one particular company

South America – Chile

- Original Property rates down minimum 10%
- Large Risk losses keeping Risk XL rates up but varies greatly from company to company

South America – Colombia

- Original Property rates down minimum 20% on Commercial / Industrial business
- Pure Fire Loss Ratios for some companies are up significantly
- Reinsurance results still good

South America – Peru

- Original Property rates down over the past 12 months
- Personal Lines segment developing fast due to continuing economic upturn in the country
- Competition in Commercial / Industrial segment keeping reinsurance rates depressed

US Business – London

- Property pro rata renewals continue to be subject to lower original rates. However, increases since 2001 and continuing in 2004 and 2005 have generated a sufficiently long run of good results that allow for modest increases in commission
- Property per risk reinsurance rates are reducing more slowly than original insurance rates putting a squeeze on clients
- Reinsurers reducing lines and some coming off certain programs all together are signs (at least for now) that the bottom of the market may have been reached in cat pricing

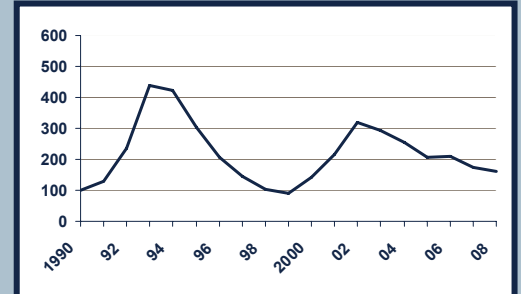
US Business – Bermuda

- Continued convergence of non-traditional reinsurance markets into the primary cat market sector created competition on FL renewals at June 1
- Combination of reinsurers' discipline and use of the same / similar pricing models means that most programs (especially for wind) have a "cliff price" at which reinsurers will walk away from the business. This is especially true of programs where more than \$100M of limit is being purchased
- A recent hardening of pricing in the Property Retro market post June 1 means that some reinsurers, unable to obtain retro cover, are limited on the amount of capacity available for programs renewing in the second half of the year

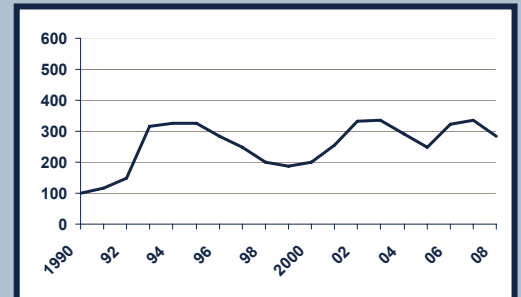
US Florida Business

- Cat XOL had wide range of price reductions, depending on carrier and position of layer relative to the Florida Hurricane Catastrophe Fund. Average reduction of 10% to 20% with higher reductions on layers attaching alongside and/or above the Florida Hurricane Catastrophe Fund.
- Collateralized markets increased participation across programs. Overall, property covers had improved terms & conditions. In addition, multi-year Cat and Aggregate product was available in the market. Some expansion of proportional markets but capacity is still limited.

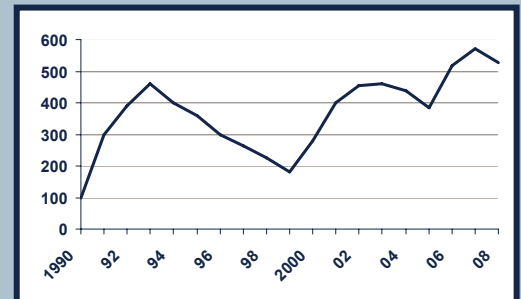
Colombia



USA



Retro



With the brunt of the Atlantic hurricane season yet to arrive, the potential for further / sizeable losses looms and reinsurer 2008 profits are anything but assured.

Property Rates & Capital Markets

Property	Pro Rata Commissions	Risk – Loss Free % Change	Risk – Loss Hit % Change	Cat – Loss Free % Change	Cat – Loss Hit % Change
Australia	Flat	Flat to -5%	Burning Cost +5 to 10%	-5 to -10%	Flat
Caribbean	1.25%	-10%	+10%	-10%	NA
Middle East	+2.50%	-20%	Flat	-15%	Flat
Mexico	Flat	-5%	+10 to +20%	-20%	+10%
South America – Chile	Flat	-5%	+10% to +20%	-10%	NA
South America – Columbia	Flat to -5%	-5%	+10% to +20%	-7.5%	NA
South America – Peru	NA	-5%	+10% to +20%	NA	+5%
US Business – London	+1%	-5% to -10%	+10% to +20%	-10% to -20%	Flat to +5%
US Business – Bermuda	Flat	-15%	Flat	-10% to -20%	NA
US – Florida Business	+1% to +3%	-10% to -15%	NA	-10% to -20%	NA

Capital Markets Prospects in a Softening Reinsurance Environment

Today the recapitalization of the insurance sector appears to be complete. Many (re)insurers say they have too much capital (possibly chasing dwindling returns) and share buybacks proliferate. This environment could be seen as inauspicious for products such as insurance-linked securities (ILS), which have mostly been focused upon surplus relief or relative capital efficiency. If these market conditions, do insurance-linked securities have a role to play?

As might be expected, ILS activity has slowed. Catastrophe bond maturations in 2008 exceed new issue by \$700 million and significant sidecar closures have already been announced with shrinkages in ceded income in all the survivors.

There are, however, positive signs as investors seem to be influenced more by conditions in the reinsurance market than by the relative value of the ILS asset class. This has produced improved flexibility in terms of the coverage that can be obtained:

- Indemnity based cover has become commonplace for all types of sponsor
- Aggregate covers have become commonplace for all types of sponsor
- Pricing has reduced across the board for both peak and non-peak exposures

This flexibility has expanded the universe of opportunity in the ILS sector. ILS have become mainstream capital management / risk transfer tools and there is a consequent widespread trend towards the inclusion of ILS alternatives into the analysis of capital structure for (re)insurance companies.

As would be expected, the crisis in the broad financial markets has had a bearing on the ILS sector. Some investors have shifted the focus of their attention to opportunities in the credit markets that are perceived to be of greater attraction. While new capital has continued to enter the marketplace, in the shape of new start-up Funds as well as feeding the more established investors, there is clear evidence that the flow of capital into the sector has slowed.

Some investors have shifted their focus from the ILS sector to opportunities in the credit markets that are perceived to be more attractive.



Capital Markets

Looking ahead, we see continued utilisation of the ILS markets, although maybe not at the heady pace of 2007. Drivers will include:

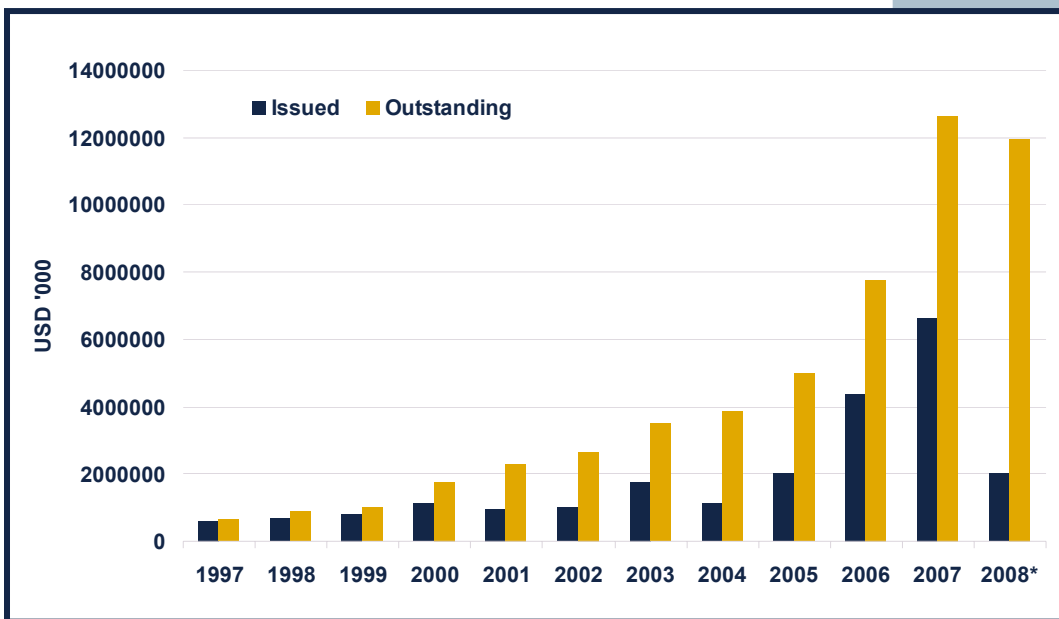
- An increasing focus on credit quality as traditional market conditions deteriorate.
- A shortage of traditional capacity for pockets of peak natural catastrophe perils.
- An increasing supply of Florida wind risk into the open markets.
- The growth of a market in natural catastrophe derivatives.
- The development of new instruments and structures, such as contingent capital products, that can assist long-term capital planning.

It is to be expected that the ILS market will develop and fluctuate with the reinsurance market – a useful and natural maturing of the products. As the market increasingly understands the distinct benefits and advantages of ILS products, a less cyclical outcome is probable.

As the market increasingly understands the benefits and advantages of ILS products, a less cyclical outcome is probable.

Figure 1: Cat Bond Issuance and Outstanding Volume

P&C Securitizations Volumes Issued and Outstanding (as at 16 June 2008)



Capital Markets

Figure 2: Cat Bond Sponsors by Type

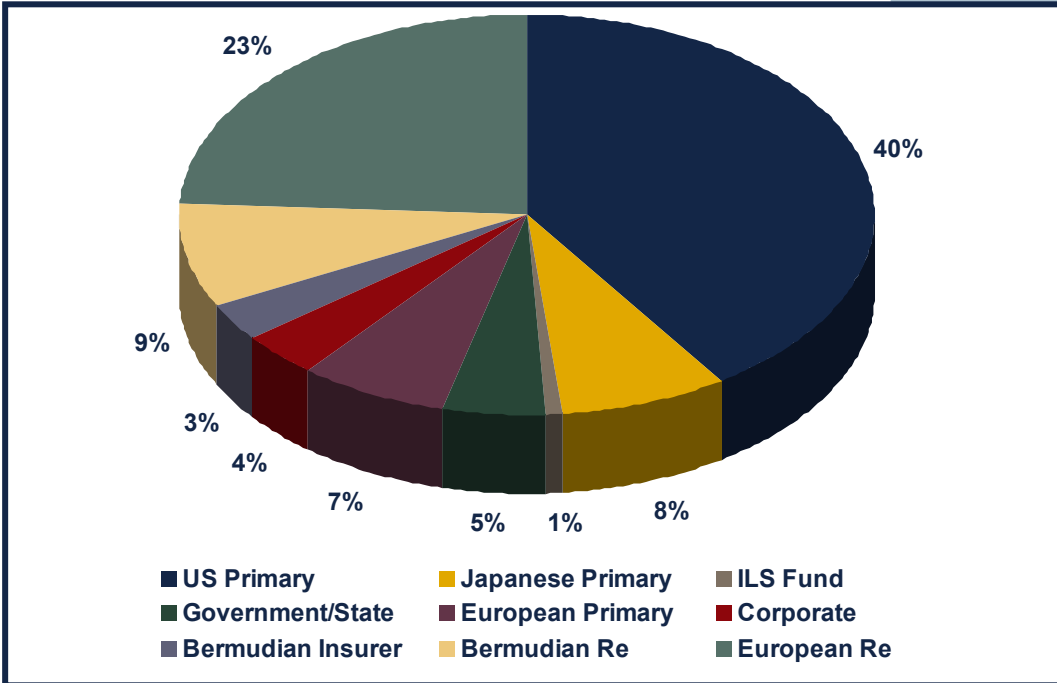
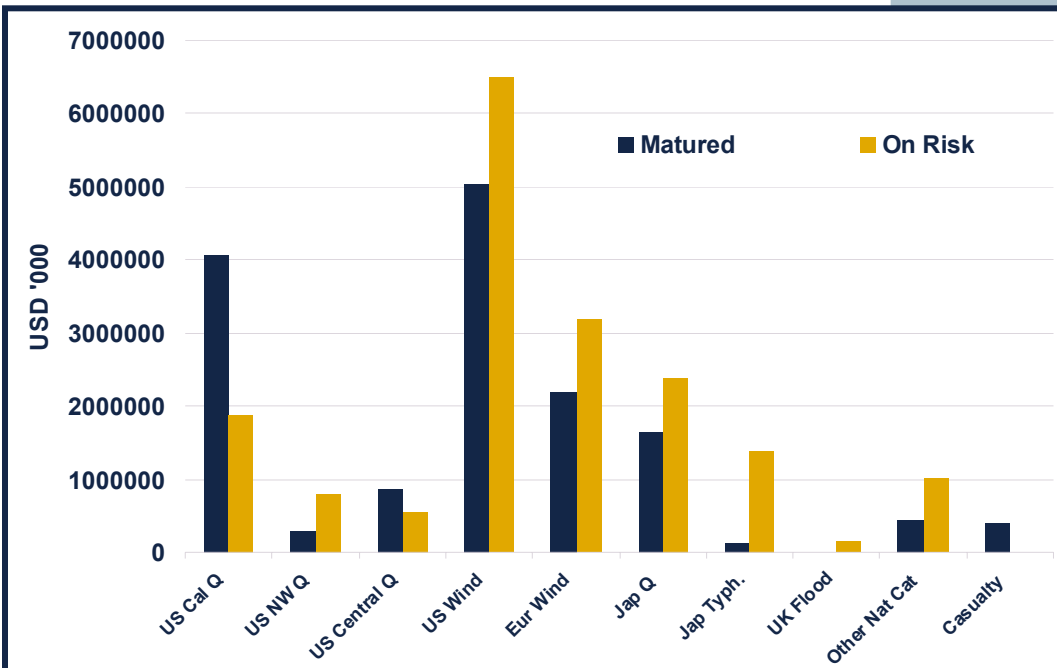


Figure 3: Cat Bond Covered Perils

Volume of on-risk P&C Securitizations by peril (as at 16 June 2008)



For over 100 years Willis Re has proudly served its clients, helping them obtain better value solutions and make better reinsurance decisions. As one of the world's premier global reinsurance brokers, Willis Re employs 1,100 Associates and handles more than USD12 billion in premiums. With 40 locations worldwide, Willis Re provides local service with the full backing of an integrated global reinsurance broker.

This thrice yearly publication delivers the very first view on current market conditions to our readers. In addition to real-time Event Reports, our clients receive daily news briefs, *Willis Re Rise 'n' shinE*, periodic newsletters, white papers and other reports.