

## **Willis Limited**

The Willis Building  
51 Lime Street  
London, EC3M 7DQ  
United Kingdom  
Tel: +44 (0)20 3124 6000  
Fax: +44 (0)20 3124 8223

**[www.willis.com](http://www.willis.com)**

© Copyright 2010 Willis Limited. All rights reserved. No part of this document may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, whether electronic, mechanical, photocopying, recording, or otherwise, without the written permission of Willis Limited.

Some information contained in this document may be compiled from third party sources we consider to be reliable. However, we do not guarantee and are not responsible for the accuracy of such. The views expressed in this document are not necessarily those of the Willis Group. Willis Limited accepts no responsibility for the content or quality of any third party websites or publications to which we refer.

This paper and all of the information material, data and contents contained herein are for general informational purposes only, are not presented for purposes of reliance, and do not constitute legal advice, tax advice, investment advice or any other form of professional advice. This document is for general discussion and/or guidance only, is not intended to be relied upon, and action based on or in connection with anything contained herein should not be taken without first obtaining specific advice from a suitably qualified professional.

Willis Limited, Registered number: 181116 England and Wales.  
Registered address: 51 Lime Street, London, EC3M 7DQ.  
A Lloyd's Broker. Authorised and regulated by the Financial Services Authority.

The background image shows a multi-story brick building that has been severely damaged, likely by a disaster. The ground in the foreground is covered in rubble, including twisted metal and debris. A street sign with the word "STOP" is visible in the distance. The scene is lit by streetlights, creating a somber and desolate atmosphere.

Willis

# INTERNATIONAL PROPERTY AND CASUALTY MARKET UPDATE

**GLOBAL MARKETS**

**FEBRUARY 2011**

## SUMMARY

As 2010 closed without a market transforming US windstorm or earthquake, some property markets were resigned to the view that the industry was destined for a drawn-out period of weakening profits as excess capacity, rising loss activity and low interest rates chipped away at earnings.

Flooding in Australia and Brazil provided property insurers with a glimmer of hope that while recent international catastrophe activity may not stimulate a wholesale change in the market, it could shorten the cycle and harden terms in loss affected regions and industries.

Catastrophes losses will eventually filter through to (re)insurers' earnings and in the short-term, could allow markets most affected a moment to push back on rate reductions while they assess the extent of loss and determine how wide the effects are felt. However, with markets reporting solid financial results and with little evidence that underlying liability claim trends are changing, it will take more than recent international losses to trigger a meaningful reduction in capacity. This, the complexities of adjusting the Australian floods, and the time-lag that it introduces before the true claims costs hit home will probably mean that underwriters will have to wait before their hope becomes reality.



**Clyde Bernstein**  
Sales Director



**David Thomas**  
Executive Director

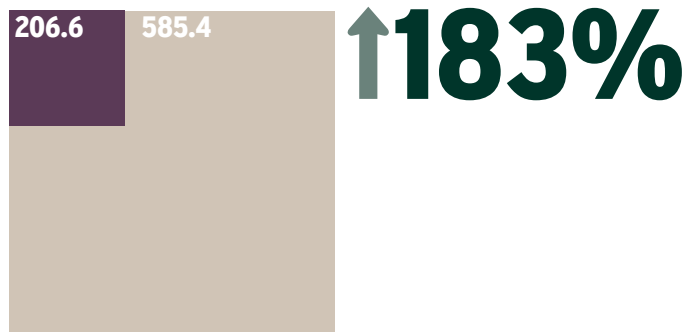
## FINANCIAL PERFORMANCE

At the time of writing, some global (re)insurers have yet to release their 2010 earnings. A consolidated report will be produced in the next few weeks when a full set of financial results are published. It is anticipated however, that in general the 2010 results will prove quite acceptable following a year in which insured loss activity increased by 50%.

While investment portfolios faced periodic bouts of capital market movement, insurers will report reduced impairments on their investment portfolio, reversing some of the investment losses that were characteristic during the financial crisis. Investment returns will offset the impact from an active year of international catastrophe where events such as the New Zealand and Chile earthquakes forced markets' loss ratios higher and pushed the catastrophe component of combined loss ratios above many markets' normal tolerance. In Ace's case for example, total pre-tax catastrophe losses including reinstatement premiums, increased from USD 136 million in 2009 to USD 401 million last year and yet they still reported a 21% increase in operating income. Preliminary estimates at Munich RE shows their 2010 combined ratio of 96% contained 11 percentage points for natural catastrophe, compared to 1.4 percentage points the year before.

Markets continued to subsidise their operating results with reserve releases. According to SNF Financials' study of 76% of the US Property and Casualty industry, favourable reserve development in the first nine months of 2010 represented USD 10.1 billion.

**XL** **NET INCOME (USD MILLIONS)** **PERCENTAGE CHANGE**  
2009 | 2010



**COMBINED LOSS RATIO** **POINTS CHANGE**  
2009 | 2010



Source: Company Press Releases

	NET INCOME (USD MILLIONS) 2009   2010	PERCENTAGE CHANGE	COMBINED LOSS RATIO 2009   2010		POINTS CHANGE
AXIS	461.01   819.84	↑79%	79.3%	88.7%	↓9.4
SWISS Re	496   863	↑74%	88.3%	93.9%	↓5.6
ALTERRA PARTNERS <sup>1</sup>	246.2   302.3	↑23%	88.1%	85.7%	↑2.4
ACE	2,549   3,108	↑22%	88.3%	90.2%	↓1.9
CHUBB	2,183   2,174	↓0.5%	86%	89.3%	↓3.3
ARCH	851.1   816.7	↓4%	88.1%	92.5%	↓4.4
MUNICH RE <sup>2</sup>	2,560   2,430	↓5%	95.3%	100.5%	↓5.2
TRAVELERS	3,622   3,216	↓11%	89.2%	93.2%	↓4.0
ZURICH <sup>3</sup>	3,963   3,434	↓13%	96.8%	97.9%	↓1.1
EVEREST Re	806.98   610.75	↓24%	89.1%	102.8%	↓13.7
PARTNER Re	1,537   852.6	↓43%	81.8%	95%	↓13.2

<sup>1</sup> Includes the results of Harbour Point Ltd from May 12, 2010 <sup>2</sup> Preliminary Financial Results in EUR <sup>3</sup> Combined ratio for General Insurance

## CASUALTY

Insurance buyers still have the upper hand in a liability market that remains competitive and profitable. While the energy and utility sector has produced some significant loss events over the last twelve months, there is currently no tangible impact on market sentiment.

Competition for liability business in local markets is intense, particularly in Asia, where significant premium reductions are available for risks that fit local market retentions or authority. This dynamic is often driven by the local operations of global insurers. As London-based insurers expand their reach to capture indigenous business, differences in competitive behaviour can be exploited using programme design and marketing strategies to secure the best terms. While central underwriting control is expected to be maintained for heavier exposures, it is anticipated that local markets will begin to target a wider range of sectors and draw business away from global underwriting centres.

The Deepwater Horizon loss in the Gulf of Mexico is impacting offshore energy markets where rates have risen in response. Any effect on the wider market will be indirect. In time, there may be consequences on rating if insurers' overall loss ratios are impacted significantly. However outside this sector insurers continue to target premium growth in an environment where there is no shortage of good quality capacity. At the same time, economic conditions mean that insurance buyers remain intent on reducing premium spend, resulting in a price-focused competitive market. While some underwriters are trying to resist rate reductions and raise prices, their hand is not strong given the overall capacity position.

Inflation has become a primary concern for markets in recent months. Rising energy, commodity and food prices will test governments' resolve to use monetary policy to dampen inflation without jeopardising economic growth. Casualty insurers will be conscious that inflation can lead to higher claims costs. For life insurers in particular, rising interest rates reduce the value of return guarantees and can have a negative effect on demand. At this juncture, while claims inflation runs ahead of general inflation and claims awareness is increasing across the developing world, there is limited evidence that underlying liability claims trends are changing. Analysts feel that the current rating environment does not necessarily allow for premium increases and will pay careful attention to how rising prices influence future claims costs.

The long-tail nature of liability exposure raises the question of whether insurers' reserves will prove adequate once individual years have run off. Future reserve adjustments without the historical level of investment returns to cushion results could pose a threat to the industry.

## REINSURANCE

For several years, it has been accepted that reinsurers have maintained greater pricing discipline than their direct clients. Reinsurance terms did however soften at the January 1st renewal as ample supply, low volatility in insurers' declining earnings and budget pressures from reduced insurance pricing, limited reinsurance demand. Reductions varied depending on class of business and territory but on average were between 5% and 10%. One exception was marine business with energy or Gulf of Mexico exposures where prices rose significantly.

Despite reductions in reinsurance costs, some direct property markets concluded that the rating pressure on their portfolio and a more measured reinsurance market, meant they could no longer continue writing business in the same way. Several Lloyd's syndicates have taken to managing their Caribbean and Mexican catastrophe risks differently by re-positioning reinsurance spend around regional zones or selected islands. This has reduced their exposure in these areas and avoided 'clash' with their southeast US windstorm aggregate. In the case of Mexico, it has led to a reduction of capacity and some rate increases for scheduled business.

Casualty reinsurance terms at the end of 2010 provided little indication of any change in market sentiment and renewed either flat or in some cases with reductions. As a result, there is not expected to be a further significant reduction of direct market pricing.

The Insurance Linked Securities market recovered from a period of retrenchment after the financial crisis, raising USD 4.8 billion in 2010, the third highest level on record. As terms in the broader reinsurance markets soften, the capital markets are gradually providing sponsors with viable risk transfer alternatives at increasingly competitive terms.

# TERRITORIAL SPOTLIGHT



## AUSTRALIA

The Flooding that first occurred in Queensland in early December 2010 covered a vast swathe of land affecting initially, rural towns and communities. Since December, flooding has spread to more populated areas with Brisbane, Northern New South Wales and Northern Victoria all affected.

Unlike many insurers in the country, where the peril of flood is either excluded or only available on a more specific basis, Suncorp has a large market penetration in Queensland and includes flood in its residential policies.

The process of adjusting claims from the Australian floods will be complex and drawn-out. Issues over causation and whether the floods were attributable to inundation of water, triggered by flood waters exceeding the normal course of the river system, or caused by flash flooding will undergo exhaustive review and interpretation. Additionally, with flooding occurring from early December through January 2011, the date of loss(es) will be a major discussion point. The issue over the number of events is an important factor in the adjustment process as it will influence the number(s) of retentions for insured's and insurers, reinsurance recoveries and limits of indemnity.

It is believed that the minerals industry generates between AUD 900 million and AUD 1 billion of loyalty revenue for the State of Queensland and therefore, has enormous economic and political capital in the country. Following the floods, mining companies invoked Force Majeure allowing them a legal let-out to suspend their sales obligations or defer their responsibilities until a future agreed time without penalty. This raises interesting issues about the principle of indemnity and from a business interruption perspective what, if any loss has been sustained. In conjunction with this is the immediate increase in the spot market price for sea-borne metallurgical coal, where prices have risen substantially from around USD 200 before the floods. Unlike the flooding in 2008, on this occasion, some of the major global producers of metallurgical coal including Brazil and South Africa have themselves suffered weather related interruptions further constraining the supply of coal to the market. These issues, believed to be attributable to the La Niña phenomena could push spot prices even higher over coming weeks.

In the personal lines space, Federal and State officers have suggested that insurers should be "kind" in the treatment of flood affected victims. While political interference is not unusual in circumstances like these, insurers will be acutely aware that any goodwill settlement will not necessarily be replicated by reinsurers who traditionally exclude "ex-gratia" payments.



# CLAIMS

2010 was the sixth most loss intensive catastrophe years since 1980 with a total of 950 natural catastrophes recorded. This was markedly above the 785 average for the last ten years. According to Swiss Re, overall losses amounted to around USD 130 billion, of which approximately USD 37 billion were insured.

## TOP 10 INSURED LOSS EVENTS 2010

Date	Event Type	Location	Number of Deaths	Economic Loss Estimate (USD Bn)	Insured Loss Estimate (USD Bn)
27 Feb 2010	Earthquake	Chile	521	30	8
27/28 Feb 2010	European Storm Xynthia	France, Portugal, Belgium, Germany	64	6.1	3.1
4 Sept 2010	Earthquake	New Zealand	0	3.81	3.05
12-26 May 2010	Severe Weather	Midwest, Northeast, Tennessee, USA	0	2.75	2
30 Apr-3 May 2010	Severe Weather	Mississippi Valley, Tennessee Valley, Southeast, USA	32	3	1.5
22 Mar 2010	Severe Weather	Western Australia	0	1.25	1.06
6 Mar 2010	Severe Weather	Victoria	0	1.25	1.02
12-16 Mar 2010	Flooding	Northeast, Mid-Atlantic, USA	11	1.5	1
5-9 May 2010	Flooding	France, Spain	27	1	0.87
5-6 Oct 2010	Severe Weather	Arizona	0	1.25	0.75

Source: Munich RE

While 2010 was largely characterised by the devastation brought about by the Chile and New Zealand earthquakes, it was the 33rd consecutive year of above average global temperatures and the warmest year since records on global temperatures began being recorded. Russia had its grain production cut by millions of tonnes following its worst drought for decades, forcing the government to control the export of grain and lift wheat prices to a two-year high.

2010 was the second consecutive year that did not have a land-falling hurricane in the United States and the fifth consecutive year without a major land-falling hurricane. There were 19 named Atlantic storms of which 12 became hurricanes, the third (joint) highest in history. Five hurricanes fell into the top hurricane category (wind speeds over 178 km/h). For the 2011 hurricane season, The Colorado State University predicts the probability of a major hurricane making landfall in the Caribbean as 62 percent against an average for the last century of 42 percent. The prediction for the Atlantic hurricane season is for 17 named storms, 9 hurricanes and 5 major hurricanes (Saffir/Simpson category 3-4-5) with sustained winds of 111 mph or greater.

## RECENT MAJOR SELECTED RISK AND CASUALTY LOSSES

Date	Type of Loss	Occupancy	Location	Estimate (USD)
30 Dec 2010	Explosion	Steel Manufacturing	Netherlands	200,000,000
7 Jan 2010	Pipeline Explosion	Oil Refining	Canada	tba
5 Jan 2010	Fire	Engineering	Netherlands	30,000,000
10 Dec 2010-11 Jan 2011	Flooding	Various Mining	Queensland, Australia	1,612,000,000
	Fire	Retail/Warehousing	France	34,000,000
10 Dec 2010-11 Jan 2011	Fire	Defence/Commercial	Kuwait	30,000,000
	Storm Damage	Port Operator	Brazil	50,000,000
	Storm Damage	Mining	Brazil	200,000,000
20 Apr 2010	Deepwater Horizon	Oil Exploration	Gulf of Mexico	3,000,000,000*
Dec 2010	Fire	Hospitals	South Africa	20,000,000
19 Nov 2010	Boiler Pipe Leakage	Chemicals	Israel	17,000,000

\* Liability Only

Source: Public information. All figures are estimates based on marketplace assumptions.

## SOLVENCY II

Reinsurers that were expecting to experience increased demand for reinsurance as clients sought capital relief under new European regulations acknowledge that, at this moment, demand has not developed as anticipated. It is envisaged however, that the need for aggregate covers and more specialized reinsurance products which reduce earnings volatility will grow as companies aim to optimise the use of their capital under Solvency II.

A recent survey on Solvency II carried out by a consulting firm concluded that the overall cost of Solvency II to the insurance industry could be significantly higher than the €3 billion anticipated by the European Commission in their Impact Assessment summary in 2007. The survey of 115 insurers in 22 countries across Europe found that around 40% are only in the preparatory stages of their Solvency II projects or have yet to launch their exercise.

## RISK MODELLING

Over the next few months, three of the main catastrophe modelling firms will be carrying out major updates to their Atlantic, Caribbean and European windstorm models. Based on past hurricane activity, particularly in the Gulf of Mexico, RMS for example, will release a comprehensive revision of its Atlantic model Version 11 that includes significant changes to its “event set”. This is expected to increase modelled loss estimates. Preliminary reports suggest that this may not have a huge change on US coastal exposures but is likely to affect inland exposures more.

For European tool sets, both AIR and RMS are planning updates to their models that will allow a greater number of European countries to be modelled for earthquake and windstorm while providing greater flexibility for distinguishing risks by age of construction.

## CONTACTS

### **Clyde Bernstein**

#### **Sales Director**

Global Markets International

Tel: +44 (0)20 3124 6338

Mob: +44 (0)7730 563924

[bernsteinc@willis.com](mailto:bernsteinc@willis.com)

### **David Thomas**

#### **Executive Director**

Global Markets International

Tel: +44 (0)20 3124 6774

[thomasda@willis.com](mailto:thomasda@willis.com)

### **Liam McGrory**

#### **Marketing Director**

Global Markets International

Tel: +44 (0)20 3124 7868

[liam.mcgrory@willis.com](mailto:liam.mcgrory@willis.com)

Global Markets is Willis Group's centre of excellence for International Property and Casualty risks supporting the Group's resources and offices worldwide. With over 250 Associates based in London, Singapore, Melbourne, Ipswich and Mumbai, the division incorporates a number of market-leading industry practice groups including Power and Utilities, Renewable Energy, Terrorism, Leisure and Hospitality, Life Sciences and Metals and Mining.