Willis Re – 1st View

Settling or sinking?

With a very profitable 2007 now all but assured, the last 24 months represent a period of exceptional profitability for the reinsurance industry. Nevertheless, despite many statements about the importance of cycle management, the industry is showing signs of reverting to its historic pattern of feast or famine.

As reinsurers are finding themselves squeezed between their primary clients, who continue to experience ever-softer conditions, and their own very strong recent results, the 1st January 2008 renewals were characterized by competition. While nearly all sectors are showing signs of softening, the intensity of this competition varies by class, line, and region. Certain segments, such as Marine, are demonstrating only modest softening, while others, such as US Property, are posting more precipitous declines.

It is also interesting to note that meaningful disparities have developed between the major reinsurance hubs. For example, Bermuda has taken a more aggressive posture than London on Property business for many regions, including the United States. Not surprisingly, when combined with the ongoing gap between insurance and reinsurance pricing trends, this lack of consistency across markets and classes has fostered a "late" renewal season as insurers try to reconcile reinsurer offerings with their own financial objectives.

Clearly, a level of uncertainty is also prevalent in the larger financial marketplace, as the sub-prime crisis has dominated recent headlines. Nevertheless, issues in the credit markets have not produced any meaningful impact on the 1st January renewals. Reinsurer impairment from the sub-prime debacle appears limited, and although losses are ultimately anticipated in specialty segments, such as Directors and Officers Liability, conventional classes appear to remain well insulated from exposure. Equally, the downturn in the wider credit markets has in no way dampened capital market appetite for insurance risk, as US$1.4 billion of catastrophe bonds were issued in the last three months. In total, public cat bond transactions amounted to US$6.4 billion in 2007, and this activity sits on top of continued and robust appetite for private placement transactions.

As the general activity in the ILS marketplace continues, insurers and reinsurers alike are also devoting increasing attention to management of their own capital structures. With recent record profits juxtaposed against a declining rate environment, stock buy-backs by quoted companies are commonplace, a number of sidecars have been allowed to lapse, and some Lloyd's Syndicates are reducing their stamp capacities for 2008. Willis Re partners with our clients to provide integrated advice and execution that fully contemplates the interplay of capital market and traditional options, balancing capital and risk in order to maximize the value of their firms.

In step with our effort to provide industry leading advice and insight, I am pleased to present Willis Re's most recent edition of *1st View*. Enclosed you will find detailed analyses from our business segment experts that will provide you with a greater perspective on recent market trends. I hope that you find this commentary to be helpful, and in closing, I would like to wish you the very best for a safe and profitable 2008.

Peter Hearn, CEO, Willis Re

Renewals – 01.01.2008

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Will another Feast or Famine pattern be precipitated by 24 months of historic profits?

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Class Review

Aerospace

- Reduction in capacity available for Pro Rata covers due to continuing rate reductions on original business.
- Claims to date in 2007 already in excess of US$1.5 billion versus worldwide premium of US$ 1.45 billion.
- Rate reductions on Excess of Loss business of 5.0 to 7.5% on an 'as before' renewal which is less than many anticipated.

Casualty (United States)

- Despite more competition and rate reductions on their business, many large primary insurers are still increasing risk-exposed retentions by dropping reinsurance layers or entire programs.
- Some reinsurers are reducing shares or coming off business, rather than continuing on programs impacted by insurance market conditions and reduced reinsurance rates.
- Rate reductions of 10 to15% for Casualty covers with favorable loss experience and no sign of emerging loss development.

Casualty (United States) – Professional Lines

- D&O Despite a spike in claims frequency and continued rate reductions, most sectors remain profitable. The reinsurance market remains stable with minor improvements in terms for treaties with demonstrated profitability over last four years.
- E&O Rates continue to decline 10 to 20% depending on class and size of risks. Reinsurance capacity is abundant as most treaties remain profitable.
- Many reinsurers will only write Quota Share treaties. Excess of Loss available only for the largest of treaties with very limited number of supporting reinsurers.

Casualty (International) – General & Employers Liability

- Increasing appetite of mainstream market along with enthusiasm from newer markets to engage in this business.
- Willingness to entertain price concessions on business considered "marginal" only a year ago.
- Somewhat limited interest in purchases of Catastrophe / Clash covers – buyers generally underestimate risk and sellers generally overpricing.

Casualty (International) – Motor

- Retention levels remain stable while pricing remains attractive. France appears to be the exception (5 to 10% increases) to the 5 to 10% decreases in rates seen elsewhere.
- In Spain, retention levels have remained stable due to uncertainty over future award levels and increased limits of indemnity.
- Social Inflation now becoming a focus in Germany, after being widely discussed in UK and France for many years.

Insurers try to reconcile reinsurance offerings with their own financial objectives.

Class Review

Casualty (International) – Professional Lines

- The market is showing a broader appetite than a year ago with improved openness to tailor-made structures.
- Reinsurers of these lines are generally more cautious than with GL / EL / Motor.
- Increasing interest in variations in structure for Professional Lines (each insured / common cause / etc).

Engineering

- Increase in reinsurers' appetite for this class – both XOL and Pro Rata.
- Increase in capacity being sought by insurers to maintain market status and influence.
- Treaty conditions showing minimal change, as concerns for market cycle counterbalance reinsurer's favorable results.

Healthcare (United States)

- Insurance base rates (depending on territory) decreasing – sometimes as much as 25% – due to reductions in what now seem to have been pessimistic prior loss picks and resultant expectations of portfolio loss performance.
- ECO/XPL is seen as a growing area of exposure and risk. More Cat / Clash cover is being purchased, but the ready supply of capital is holding rates steady.
- Clients are still tending to purchase Excess covers and Aggregate Stop Loss, with little activity in pro rata covers.

Life, Accident & Health

- Medical Excess market competitive, Employer Stop Loss market currently not generating required margin of return for reinsurers but this has yet to result in reinsurer rate action.
- Group Life rates generally remaining stable. Pockets of increased competition applying rating pressure.
- Accident Risk and Cat rates remain competitive. Cat rates down 15 to 35% subject to amount of capacity required.
- Continued pressure on rates as more markets look to participate on per person covers. Aggregate and Event Caps continue to broaden. Cats remain generally loss free for the sixth consecutive year. Buyers looking at lower retentions and higher limits.

Marine (United States)

- Further reserve increases from Hurricanes Katrina and Rita are affecting renewals. However, while pricing in prior quarters was flat, rate reductions have begun to appear in the 4th quarter
- Rate reductions on Risk XL covers with good records, and some amelioration in pricing of Cat / Clash covers.

Certain segments, such as Marine, are demonstrating only modest softening.

Class Review

Marine (International)

- Clients were expecting greater value and broader terms but reinsurers mostly held firm. Pricing remains steady on Large International exposed accounts, especially where there are Energy GOM exposures, but is falling by 15 to 20% on small indigenous accounts.
- Commissions and Aggregate Limits are increasing on Pro Rata business.

Non-Marine Retrocession

- Cat Retro rates relatively stable, reductions of 5% to 10% since January 2007 renewals. Expect 10% off in 2008.
- Industry Loss Warranty covers under significant pricing pressure, reductions of 15% to 30% since January 2007 due to pressure from availability of Ultimate Net Loss covers.
- The increase in World-wide capacity anticipated by many did not materialize.

Political Risk

- Increasing interest in the class from new reinsurers seeking diversification.
- XL programs renewed at stable rates.
- Increased capacity generally available.

Surety (United States)

- Favorable primary market conditions continue to exert meaningful downward pressure on reinsurance rates. Indications of limited market pull back in response to price reductions. No material change in treaty coverages.
- Cedents are purchasing additional reinsurance capacity to address exposures on growing portfolios.
- New capital interested in supporting selective underserved surety market niches.

Trade Credit

- US sub-prime losses and subsequent financial market credit crunch have yet to impact insurers' portfolios. Only one reinsurer directly impacted – indirect effects still uncertain.
- XL programs renewed at stable or slightly decreased rates.
- Significant reduction in QS ceded premium and further move from sliding scale to fixed commissions with some increases.

Workers' Compensation (United States)

- Shrinking primary premiums, resulting from double digit loss cost reductions in many states, are putting pressure on reinsurers' margins.
- Although frequency has declined significantly, severity is still rising - especially on single person medical claims impacting reinsurance layers.
- Reinsurers looking to diversify their portfolios have migrated to supporting catastrophe programs rather than working layers.

… issues in the credit markets have not produced any meaningful impact on the 1st January renewals.

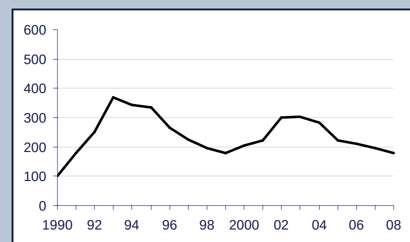
Structure Comments

Property	
AUSTRALIA	
Risk	– No changes in terms or conditions.
Cat	– Ceding companies are awaiting the outcome of APRAS' review of reinsurance recoverables with non-regulated reinsurers, and this may impact marketing strategies in the future.
EUROPE	
Risk	– Strong downward pressures on pricing. Increasing flexibility on coverage issues.
Cat	– Similar strong downward pressures on pricing. Increasing flexibility on coverage issues. An average of 10% more coverage being bought due to lower market prices.
Pro rata	– Event & Limit cessions expanded as more capacity available. Increase in Ceding Commissions.
LATIN AMERICA	
Risk	– Prices Stable to -5% on comparable loss free programs in 2007.
Cat	– -5% to -15% depending on country, recent loss history and whether or not part of multinational cover.
Pro rata	– Cedents, by and large, successfully resisting attempts by reinsurers to stiffen terms and conditions. In some cases, minimum EQ rates down by 10-15% due to large depression in original market rates.
MIDDLE EAST / ASIA	
Risk	– Rate reductions of 15% or more on loss free covers, limited adjustments even on 'loss hit' covers.
Cat	– Rate reductions of 10-15% standard. Limited increase in Client retentions.
Pro rata	– Marginal expansion in capacity. Commission and placement terms essentially same as expiring.
NON-MARINE RETROCESSION	
Risk	– Very few buyers due to lack of transparency of exposures – markets tend to price high to counter this.
Cat	– UNL pricing down, but markets more willing to give multi-territory cover than at January, 2007.
Pro rata	– Still relatively scarce for retro, other than for specific / niche areas.
UNITED KINGDOM	
Risk	– Significant market appetite remains for Risk XL which is putting downwards pressure on rates.
Cat	– Strong market appetite remains for UK cat. Lower layers hit by the summer 2007 floods are paying increases, but overall program are flat. Reinsureds are showing increased interest in aggregate protections.
Pro rata	– Commission changes possible where experience has changed. No strong pressure to further restrict event limits following the 2007 floods
UNITED STATES	
Risk	– More capacity available in this sector, with Bermuda reinsurers seeking to increase market share.
Cat	– Market softening accelerated with a late renewal season. Some new top layers are being bought with savings from the underlying program. A major pricing variance has opened up between small placements and those for clients seeking $100M+ of limit.
Pro rata	– Reinsurers are fighting hard to avoid major commission increases as a reflection of the continuing decline in original market rates.

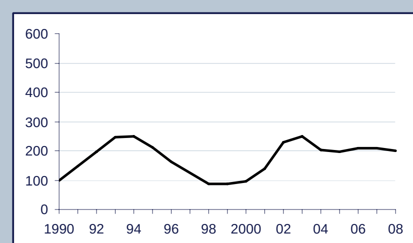
Property Catastrophe Pricing Trends

The charts below display Estimated Year-to Year Property Catastrophe Rate Movement.

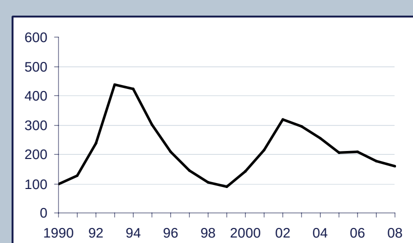
Australia



Caribbean



Colombia



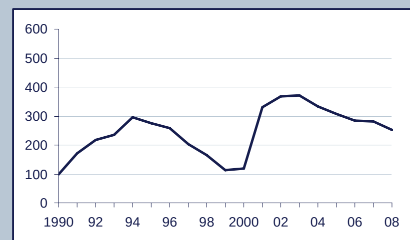
Rates and Territories

Property

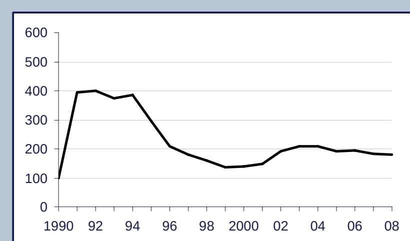
	Pro Rata Commission	Risk Loss Free % Change	Risk Loss Hit % Change	Cat Loss Free % Change	Cat Loss Hit % Change
Australia	FLAT	-5%	+5 to +10%	-5 to -10%	FLAT to +5%
Caribbean	FLAT	-5%	+5%	-5%	N/A
Europe					
Central & Eastern Europe	+1.5 to +3 pts	-10%	FLAT	-10%	FLAT
France	N/A	-10%	FLAT to +5%	-10%	N/A
Germany	FLAT	-5 to -10%	FLAT to +5%	FLAT to -5%	FLAT to +5%
Ireland	FLAT	-5%	+5%	FLAT to -2.5%	N/A
Italy / Southern Europe	+1.5 pts	-15%	-5%	-15%	N/A
Nordic Countries	Varies per Result	-5 to -20%	FLAT to +5%	-7 to -11%	N/A
Spain	FLAT to + 1pt	-10%	FLAT	N/A	N/A
Switzerland	N/A	FLAT	+10%	FLAT	+7.5%
United Kingdom	FLAT	-5%	FLAT	-5%	+5%
Latin America					
Colombia	FLAT	FLAT to -5%	N/A	- 10%	N/A
Venezuela	FLAT	-5%	+5%	-5%	N/A
Middle East / Asia					
Algeria	FLAT	-10%	+5%	-15%	FLAT
China	FLAT	-10%	FLAT to +10%	-10%	FLAT to +10%
Indonesia	FLAT	N/A	FLAT to +5%	FLAT	+10%
Morocco	+2.5 pts	-10%	+5%	-10%	FLAT
Philippines	FLAT	-15%	N/A	-10 to -15%	N/A
Taiwan	FLAT	-12.5%	N/A	-20%	N/A
Turkey	+1.5 to +3 pts	-15%	N/A	-15 to -20%	N/A
Vietnam	FLAT	-10%	+5%	-10%	N/A
Non-Marine Retrocession	N/A	-10%	FLAT	-10%	+2.5%
South Africa	+2 to +4 pts	FLAT	+5 to +10%	-15%	-5%
United States	+1 to +2 pts	-15%	FLAT	-10 to -15%	N/A

Property Catastrophe Pricing Trends

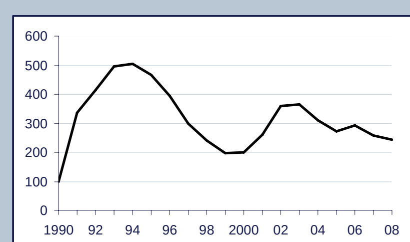
France



Germany



United Kingdom



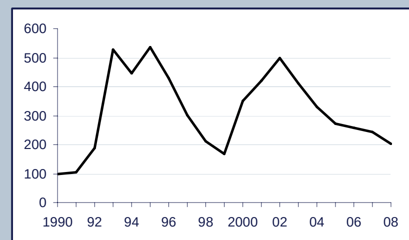
Structure Comments

Casualty

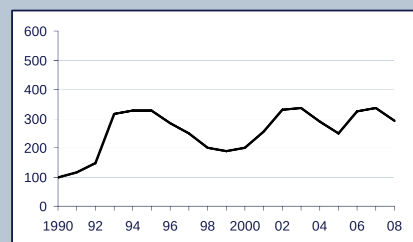
INTERNATIONAL – GENERAL LIABILITY / EMPLOYERS LIABILITY	
Risk	– Substantially unchanged structures.
Cat/Clash	– Still limited purchases.
Pro rata	– Substantially unchanged structures.
INTERNATIONAL – MOTOR	
Risk	– Substantially unchanged structures.
Cat/Clash	— Substantially unchanged structures.
Pro rata	– Increasingly complex ART type structures emerging as buyers adopt more sophisticated capital management strategies.
INTERNATIONAL – PROFESSIONAL LINES	
Risk	– Interest in variations in structure (each insured / common cause / etc).
Cat/Clash	– Interest in variations in structure (each insured / common cause / etc).
Pro rata	– Substantially unchanged structures.
UNITED STATES – CASUALTY	
Risk	– A significant number of larger companies are increasing their net retentions on casualty risk business and in some instances dropping entire layers / programs. These actions appear to be at odds with what is happening in the primary market as these same companies report increased competition and price reductions for their business
Cat/Clash	– Meaningful conventional Casualty Clash coverage for reasonable rates on line remains elusive for most large (nationwide type) carriers. For smaller (regional type) carriers this coverage has shown signs of price softening in line with current reinsurance market trends.
Pro rata	– Pressure to increase ceding commissions (especially on the more profitable portfolios) as cedent's production sources look to increase commissions. This and reduced premiums drive up expense ratios.
UNITED STATES – WORKERS' COMPENSATION	
Risk	– Working layer reinsurers are trying to hold pricing flat but are more willing to offer higher aggregate limits. Higher retentions or co-participations also impacting ceded dollars.
Cat/Clash	– Abundant worldwide capacity has resulted in steady downward trend in rate-on-line pricing with 2008 placements seeing 10-15% ROL reductions as well as more favorable terms such as higher Maximum Any One Life limits.
Pro rata	– Because of profitable primary underwriting results in the last three years, pro rata placements have declined, creating more sellers than buyers.

Property Catastrophe Pricing Trends

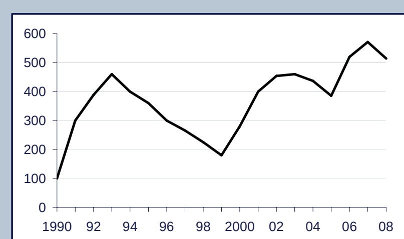
Turkey



United States



Non-Marine Retrocession



Rates and Territories

Casualty

	Pro Rata Commission	XL – NO Evidence of Loss Emergence % Change	XL – WITH Evidence of Loss Emergence % Change
Australia	N/A	FLAT	FLAT to +2.5%
Caribbean	FLAT	FLAT	FLAT
Europe			
Central & Eastern Europe	FLAT	FLAT	FLAT
France	FLAT	-10%	FLAT
Germany	FLAT	FLAT	Experience
Ireland	N/A	FLAT	+5%
Italy / Southern Europe	+ 2 pts	-12.5%	-2.5%
Nordic Countries	FLAT	-5 to -10%	N/A
Spain	FLAT	-10%	FLAT
Switzerland	+ 10%	FLAT to - 5%	FLAT to + 7.5%
United Kingdom	FLAT	FLAT to -5%	+5 to +15%
Middle East / Asia			
Algeria	+2.5 pts	-10%	FLAT
Indonesia	FLAT	-10%	N/A
Morocco	+.5 pts	-10%	FLAT
Philippines	FLAT	-15%	+5%
South Africa	+2 to +4 pts	-10%	FLAT
United States			
Casualty	+1 to +2.5 pts	-10 to -15%	+5 to +10%
US Workers' Comp	FLAT to +2.5 pts	FLAT to – 5%	+5 to +15%

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