Reinsurance Market Outlook

April 1, 2009 Update

Catastrophe reinsurance renewal pricing at April 1 is in line with the global expectations we published in January. Japan dominates the April 1 renewals and yen strengthening resulted in tightened capacity and hardening in the reinsurance market. We expect continued hardening for property catastrophe renewals in June and July where Florida risk is dominant. Important decisions on Florida capacity await conclusions from that state's legislature. June and July reinsurance renewals outside the U.S. are not expected to be meaningfully impacted by decreases in reinsurer capacity.

The continuation of the global credit and liquidity crisis into the first quarter has led to increased interest in capital relief transactions globally.

Supply and Demand Update

Reinsurer capital was reduced by 14 percent in calendar year 2008, based on a representative sample of published full year 2008 financial statements for global reinsurers. We had previously estimated the decline in reinsurer capital at 15 to 20 percent for 2008. The continued asset-related challenges in the first quarter make that estimate a reasonable supply side guide. Currency fluctuations continue to influence capacity more than usual as the strength of the Japanese yen effectively reduced supply in the market during the critical renewal period.

The decline in capital has been significantly worse for insurers than reinsurers. Global insurers saw significant declines in capital ranging from 25 to 30 percent during 2008. In most cases, the impact on capital from Hurricanes Ike and Gustav was small compared to realized and unrealized investment losses, on the order of one thirteenth of investment losses.

These significant declines in insurer capital are driving increased interest in capital relief transactions in the form of quota share, surplus share, property catastrophe occurrence and aggregate as well as adverse loss reserve development reinsurance contracts. Insurers are not yet considering material reductions in per account, per person or per risk retentions. Global insurance markets remain competitive and insurers continue to find it challenging to pay more for reinsurance when the original insurance rates are not rising at a commensurate rate.

Incremental information analyzed since the release of our January 5, 2009 report tells us that demand continues to exceed supply for key aggregate zones like the U.S. east coast (reinsurer's peak risk). Other significant aggregate zones such as Europe and Japan continue to be attractive to reinsurers and supply matches or exceeds current demand in these regions. Shortfalls in capacity are still occurring in property catastrophe retrocession programs as well as in trade credit/bond programs. Announced consolidations in Japan and certain property and casualty insurer separations from bancassurance models in Europe may require larger per program catastrophe capacity from reinsurers and these insurers may require programs that are larger than they have placed historically.

Florida's Impact on Private Market Demand Remains Uncertain

The U.S. east coast is the peak reinsurance aggregate zone. Florida is the center of the highest aggregation of this east coast risk and one of the greatest influences of demand comes from the level of reinsurance risk subsidization from the State of Florida. The state, through its controlled fund called the Florida Hurricane Catastrophe Fund (FHCF), provides approximately $29 billion of projected capacity that would otherwise be required from the private reinsurance market. The FHCF has recently estimated that due to the uncertainty caused by the global credit and liquidity crisis, it may have difficulty financing approximately $18.5 billion of its projected capacity. The State's legislature is currently in session and it is possible that new legislation could be passed that would reduce the size of the potential $18.5 billion shortfall. The legislature may also seek to phase out some of the current projected capacity over multiple years rather than letting a tranche of $12 billion sunset after the 2009 hurricane season.

These potential legislative changes in Florida may slightly increase the demand for private reinsurance for the 2009 hurricane season. The phasing out, over years, of the $12 billion top layer of the FHCF may soften a potential material increase in demand for the 2010 hurricane season and beyond.

Global Market Dynamics for April Renewals

Despite the worsening economic environment, the reinsurance market has generally continued to function in an orderly fashion throughout the first quarter of 2009. Pricing has generally remained firm. As we predicted, areas where reinsurers have higher accumulations, for example the U.S., Europe and Japan, have tended to see firmer pricing than geographies with lower accumulations. However, local factors matter at a class, country and even insurer level. Comments on specific regions are as follows.

Property Catastrophe

Japan: The Japanese April 1 renewal was affected by the strength of the yen against the U.S. dollar, euro and, particularly, the British pound. The pound has fallen by nearly 30 percent against the yen in the year to April 1, 2009. During the peak of renewal negotiations the pound was lower still, even reaching 120 yen to the pound in late January compared to an April 1, 2008 rate of more than 200 yen. This tightened capacity and contributed to prices firming by between 5 and 10 percent for both wind and earthquake covers. Proportional capacity remains adequate although commission rates vary due to portfolio specific factors.

Korea: By contrast, the Korean won has fallen considerably against the U.S. dollar over the year and stayed flat to the pound. For Korean catastrophe business, another claim free year, coupled with the increased interest of some smaller regional reinsurers wishing to diversify their portfolios, resulted in mild downwards pricing pressure and reductions of up to 5 percent, despite lead reinsurers initial hopes of price rises. By contrast, risk excess of loss treaty prices stayed firm.

India: In India, the major concern remained the impact of the abolition of the tariff on original pricing and the performance of proportional treaties. This resulted in pressure on original company results with consequential pressure upon proportional capacity and commission rates. While some major reinsurers scaled back their writings, other reinsurers filled the gap; thus, commissions typically fell by only around 5 percentage points from current levels typically in the 35 to 40 percent range. Per risk excess of loss pricing saw small nominal price increases, but growth in exposures more than offset these price increases. This impact was amplified for catastrophe excess of loss business. Aggregates were generally significantly higher often leading to significant premium increases; however, on a risk adjusted basis, rates decreased.

United States: April 1 renewals in the U.S. do not represent a significant portion of the U.S. market. The renewals that did occur saw a continuation of the trends that we identified in our January update. Those with east coast hurricane exposure generally saw increases of between 10 and 25 percent on a risk adjusted basis and capacity continued to tighten. Several programs with later renewal dates entered the markets early to get ahead of the potential supply/demand imbalance anticipated at June and July renewal dates. The continued uncertainty about the FHCF's potential inability to pay (as more fully described above), weighed on the April 1 market and began to incrementally move reinsurance pricing higher than witnessed at January 1, 2009.

Europe/U.K.: Major renewals have tended to be firmer, with prices up by around 5 percent. Capacity has been an issue, particularly at the bottom of programs where uncertainty over potential flood exposures has deterred some reinsurers. Smaller programs have generally been easily placed.

Other Primary Catastrophe

Although generally firmer, local factors such as recent loss experience, underlying business trends, model changes and reinsurers' appetite caused some variation. For example, prices for one non-peak catastrophe program fell by around 30 percent due to a reassessment of underlying aggregates.

Catastrophe Retro

As at January 1, the market is short on capacity and some programs continue to experience shortfalls. Pricing is up by around 20 percent where U.S. exposed. Pure international programs have also seen some increases, particularly at the lower end of programs, with prices up around 10 percent.

Specialty Classes

The trends seen at January 1 continue. For example the trade credit/bond and political risk market remains short on capacity, particularly for new business to the market with some programs experiencing shortfalls. Marine business has been hit by reducing cargo volumes and hull values. This has resulted in premiums perhaps 5 to 10 percent lower, but risk -adjusted pricing is flat to firm. Proportional business has seen some pressure on commission rates, though there are no capacity concerns. The aviation market was flat, despite reinsurers' talk of a slight hardening. Going forward, the size of recent liability awards in the U.S. and elsewhere may well lead to a re-evaluation of pricing as we move into the second half of the year. However, this may be offset by lower passenger traffic and therefore lower exposure and potentially lower frequency.

Expectations for Upcoming June and July Renewals

Our expectation for upcoming June and July 2009 renewals have changed slightly but remain in line with our January 2009 publication (see next page). The complete report issued in January remains available online at aonbenfield.com and is titled Reinsurance Market Outlook.

United States: June and July 2009 Renewals

	ROL CHANGES	CAPACITY CHANGES	RETENTION CHANGES
Personal lines national	+5 to +25%	Stable to -15%	+10 to +15%
Personal lines regional	-5 to +30%	Stable to -10%	+5 to +15%
Standard commercial lines	+5 to +25%	Stable to -10%	+10 to +25%
Complex commercial lines	+10 to +25%	Stable to -15%	+10 to +25%

Rest of World: June and July 2009 Renewals

	ROL CHANGES	CAPACITY CHANGES	RETENTION CHANGES
Europe			
Northern (wind dominating)	Stable to +5%	Stable to -5%	Stable
Southern (quake dominating)	Stable to -5%	Stable	Stable
United Kingdom	Stable to +5%	Stable	Stable
Asia Pacific (excluding Japan)	Stable to -5%	Stable to +10%	Stable
Japan	Stable to +10%	Stable	Stable
Australia / New Zealand	Stable to +10%	Stable	Stable
Canada	Stable to +5%	Stable	Stable
South America	Stable to +5%	Stable	Stable
Mexico	Stable to +5%	Stable	Stable
Caribbean	Stable to +5%	Stable	Stable

Assumptions: No changes in insured catastrophe exposures. No significant catastrophe model changes. No significant catastrophe losses occur before negotiations are completed. Rate of change measured from the expiring June through July, 2008 terms.

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