Executive Summary – June 1 Renewals Update

The June 1st reinsurance market is dominated by Florida homeowners insurers' renewals. Reinsurance pricing in Florida softened 10 to 15 percent, in line with our previously published predictions. However, uncertainty associated with Florida has meant that the full benefit of the potential reinsurance price reductions that may have otherwise been realized were not realized. Reinsurance pricing for 2010 renewals outside of Florida benefited from the flow of capacity from reinsurers seeking to reduce their exposure to the uncertain Florida residential insurance market.

Most June 1st renewals are reinsurance programs that apply separately to residential business written in the state of Florida. The issues surrounding the Florida homeowners market are many and well documented by Florida's Office of Insurance Regulation (OIR). Reinsurance costs rank high on the OIR's list of significant issues. Private insurers must "compete" with Florida's publicly owned insurer, Citizens Property Insurance Corporation (Citizens), and they continue to have difficulty recovering reinsurance costs owing to legislative caps and unrealistically low primary rates. Rate recovery has been especially challenging, and in some unfortunate cases has proven unsustainable, with several insurers insolvent or are near insolvency.

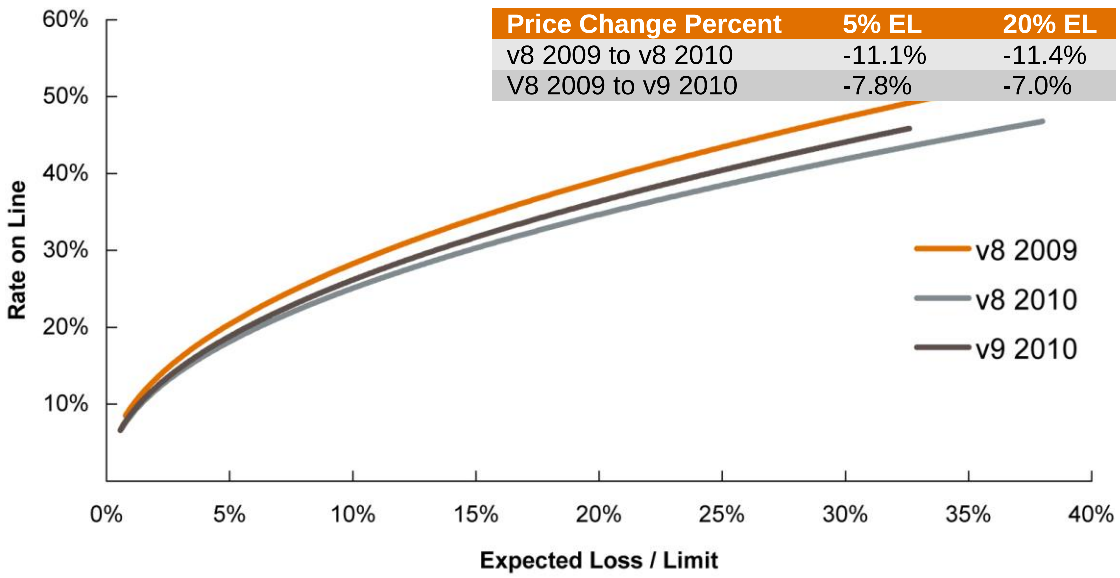
The backdrop for these Florida focused renewals included (a) a 2010 legislative season that offered very little hope for residential insurance market recovery or ability of insurers to realize recently approved rate increases while competing with Citizens, (b) a reinsurance market carefully selecting cedents that are most likely to survive even a hurricane free 2010, (c) an OIR that was appropriately focused on maintaining market continuity while, at the same time, possibly lowering the requirements for reinsurance programs, (d) the principal rating agency for residential property insurers better articulating its rating process and requirements, and signaling the need for some insurers to acquire more reinsurance protection, and (e) the small but downward revision of frequency estimates of Florida hurricanes by the catastrophe modeling firms.

The net effect of this backdrop was to continue the significant feeling of uncertainty about how or when the Florida residential market will make the transition to one that maintains the availability of insurance from private carriers for Florida residents. Despite a strong reinsurance market recovery from the financial crisis, the Florida residential insurance market is one of the few areas, given the backdrop described above, that reinsurers believe became more rather than less risky in 2009 and the first half of 2010.

Price and Capacity Reductions

As part of the upgrade to RMS v9 last spring, changes in the medium-term event set resulted in a reduction in frequency for Florida hurricane events. On a constant model basis, Florida reinsurance placements saw average price reductions of approximately 10 to 15 percent, with greater variation based on reinsurers' view of credit quality for specific cedents. Examples at specific expected loss levels in Figure 1 suggest a decrease of approximately 11.1 percent on a constant model basis at a 5.0 percent expected loss to limit level, compared with a 7.8 percent reduction when incorporating the model change.

Figure 1: June 1 Florida Reinsurance Pricing



Source: Aon Benfield

Beyond model change, reinsurers continue to focus on the reasonableness of secondary modifiers put forth in primary portfolios. They are increasingly giving credit for these factors where insurance companies are able to adequately represent that the modifiers actually match the characteristics of the risk insured.

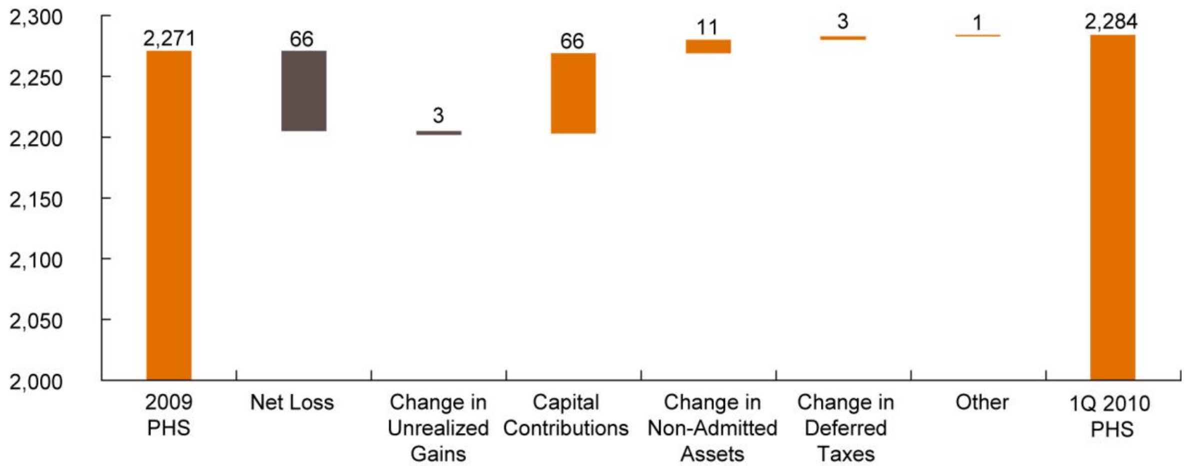
Reductions in Florida private insurer portfolios and relaxed requirements announced by the OIR regarding reinsurance purchases have resulted in a net decrease in reinsurance capacity purchased. Even with the reduction in limit available through the Florida Hurricane Catastrophe Fund (FHCF) Temporary Increase in Coverage Limits (TICL), we estimate that demand for private market limit is down approximately five percent year over year.

Demotech Pushing Insurers to Retain Less Risk

In March 2010, Demotech released a discussion paper entitled “Guidance on Financial Stability Ratings and Catastrophe Reinsurance Program Reporting for Florida Property Insurers”, which provided key benchmarks for various financial metrics. With respect to catastrophe reinsurance, Demotech stated a target pre-tax net retention to surplus of at most 15 percent, which led many companies to evaluate options to reduce retentions below historical norms and their limited apportionment company (LAC) coverage, which attaches at 30 percent of prior year-end surplus for eligible companies. While not all companies have structured their programs to achieve a net retention to surplus of 15 percent, retentions have been pushed lower compared to last year due to poor 2009 results and Demotech’s lower risk tolerance.

The following chart summarizes the capital change for Florida insurance companies for Q1 2010, highlighting the reduction in net loss and significant capital contributions in order to maintain policyholder surplus (PHS) similar to year-end 2009 levels.

Figure 2: Florida Insurer Change in Capital (Q4 2009 vs. Q1 2010)



Source: SNL

As part of the paper, Demotech also standardized a data call for a company's catastrophe exposure analysis that specifically requested modeled results under three methods:

1. model assumptions used for reinsurance purchase decision,
2. historical (long-term) basis with "switches" on (e.g., loss amplification / demand surge), and
3. near-term basis with "switches" on.

Based upon preliminary data call filings provided to Demotech in April 2010, many companies have subsequently reevaluated the amount of catastrophe limit they planned to purchase based upon feedback from Demotech. Specifically, companies that did not consider loss amplification / demand surge into their exposure analysis and the appropriate amount of catastrophe limit were scrutinized by Demotech and many increased the amount of limit they purchased.

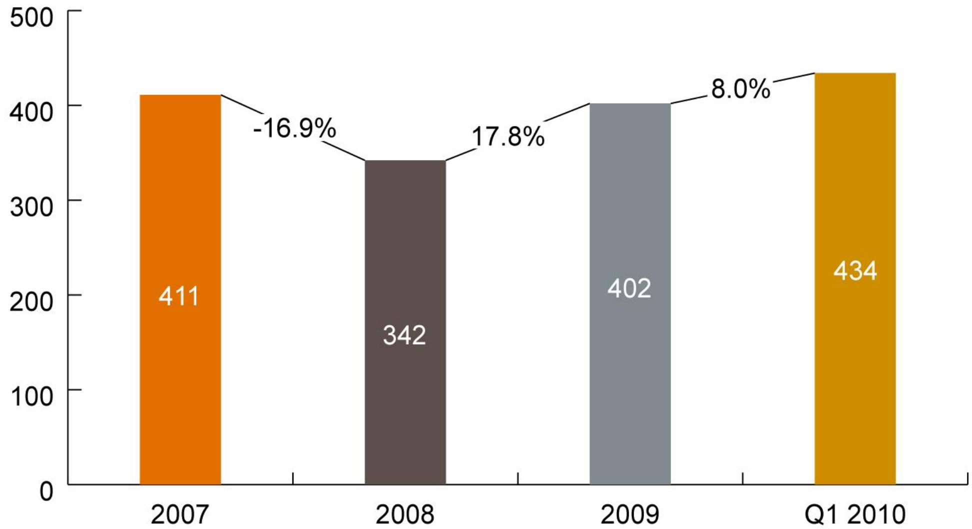
Reinsurance Cost Reductions May Bring Ratios Back in Line for 2010

In 2009, the median net combined ratio for a composite of 62 Florida homeowner-focused companies was 110 percent, despite no catastrophe events. Results were challenged by inadequate rate and elevated reinsurance costs, along with generous mitigation credits and the influence of public adjusters reopening old claims. While the legislative process tried unsuccessfully to address mitigation credits and public adjusters, recent rate increases coupled with more favorable reinsurance pricing will have the most immediate impact on improving 2010 combined ratios. Notwithstanding potential catastrophe losses, most companies should show a trend of consistently improving combined ratios on a quarterly basis as rate increases obtained in late 2009 and early 2010 earn through their financials and new reinsurance programs with lower prices commence on June 1. As a result, we estimate the median (pre-catastrophe) combined ratio for calendar year 2010 may improve by as much as 8 points, while the underlying treaty year (June 1, 2010 – May 31, 2011) combined ratio may be reduced by up to another 5 points.

Reinsurer Capital Surpasses Pre-Crisis Levels

Reinsurer capital rose eight percent in Q1 2010 despite Q1 catastrophe loss activity, and capital remains ample to cover the upcoming 2010 hurricane season. Although we might have predicted a higher level of share repurchase in Q1 2010, many companies elected to forgo this option. With continued pressure on reinsurance rates, it remains to be seen whether reinsurer share repurchase will pick up in Q3.

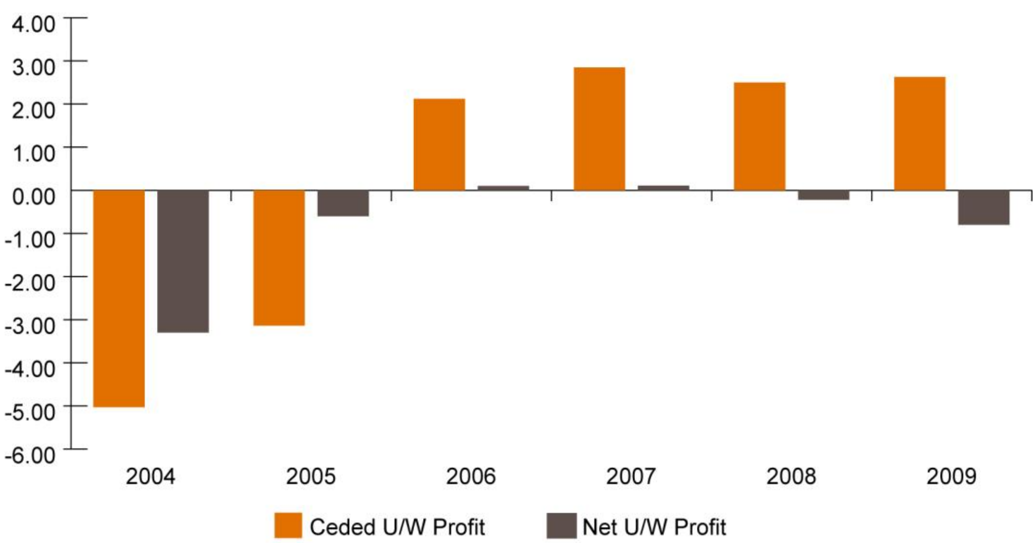
Figure 3: Reinsurer Capital – Q1 2010 ($ billions)



Source: Individual Company Reports, Aon Benfield Research

In addition to increases in capital, reinsurers have experienced positive underwriting results over the last four years in Florida due to minimal reinsured catastrophe events. The chart below compares the accident year experience of insurers and reinsurers since the significant hurricane experience of 2004 and 2005.

Figure 4: Florida Insurer vs. Reinsurer Experience ($ billions)



Source: SNL

Forecasters Predict Above Normal Hurricane Activity

Recent reports from Tropical Storm Risk, Colorado State University and National Oceanic and Atmospheric Administration (NOAA) have all predicted above average activity for the 2010 hurricane season. The most recent report, published by NOAA, estimates there is an 85 percent chance of an above-average hurricane season.

Figure 5: NOAA Hurricane Season Forecast

Forecast Parameter	Average Year	2010 (May 2010)
Named Storms	6-14	14-23
Hurricanes	4-8	8-14
Major Hurricanes	1-3	3-7
Net Tropical Cyclone Activity	100%	155%-270%
Chance for an Above-Average Hurricane Season	33%	85%
Chance for a Near-Average Hurricane Season	33%	15%
Chance for a Below-Average Hurricane Season	33%	5%

Source: NOAA

Insureds in Florida Remain on the Hook for Big Events

Even with the increases in capital for Florida Citizens and the recent announcement by the FHCF that they estimate to be able to fully fund the FHCF TICL layer for the 2010 season, insureds in Florida remain on the hook for a significant portion of the potential loss in that state.

Florida Citizens' estimated 2010 claims-paying capacity is $14 billion, which includes accumulated surplus, pre-event liquidity and coverage from the FHCF's mandatory layer. However, for a 1-in-100 year event, 50 percent of Citizens' losses will still be paid through assessments funded by statewide policyholder surcharges. In any one year, the maximum assessment surcharge that can be imposed on Florida's P&C policyholders for Citizens' deficit is 48 percent of the subject premium (18 percent for regular assessment and 30 percent for emergency assessment). Similarly, the FHCF can issue post-event bonds and levy emergency assessment to pay for its deficits. The FHCF has $9.5 billion in pre-event loss reimbursement capacity but $20 billion in potential obligation for the 2010 season. Any deficit will require an issuance of post-event debt and policyholder surcharges over multiple years. Currently, there is a one percent assessment on subject premiums (all P&C premiums including surplus lines, except premiums from NFIP, WC, and Accident and Health) for FHCF's shortfall from 2005.

These assessment-related subsidies, derived from Citizens and FHCF's statutory funding procedures, may have a negative effect on the efficient functioning of the market and market price signals. Such subsidies exist both across geographic zones and across time.

Property Legislation Vetoed By Governor Crist On Last Day

Property insurance legislation that passed on the last day of the legislative session was vetoed on June 1 by Governor Crist who expressed concern about rate increases for policyholders in Florida despite support for the bill by Commissioner McCarty. As part of this bill not becoming law, Use and File will be law at the end of 2010, significant issues regarding public adjusters will go unaddressed, medical malpractice premiums will become part of the FHCF assessment base for the 2010 hurricane season, and Citizens requirement to reduce boundaries to meet its PML benchmark reduction will become law on December 1, 2010.

Figure 6: Vetoed SB 2044 Highlights

Topic	Summary of Changes
Medical Malpractice FHCF Exemption	• Extends the exemption an additional three years for medical malpractice premiums to be part of the FHCF assessment base (through May 31, 2013).

Topic	Summary of Changes
Minimum Capital	• Requires any insurer not holding a COA before July 1, 2010 to possess $15M. • Requires any insurer having a COA prior to July 1, 2010 to possess $5M until July 1, 2015, $10M until July 1, 2020 and $15M thereafter.
Affiliates	• Requires insurers who lose more than 15 percent of PHS in any quarter or annual financial statement cumulative for a calendar year to provide additional financial information regarding affiliates. • Also requires these insurers to prepare and submit a risk-based capital plan including conditions that contributed to the reduction in PHS, a proposal for corrective action, financial projections including assumptions and sensitivity around assumptions within 45 days. • Requires insurance companies to notify OIR 30 days in advance of entering arrangements with new affiliate organizations.
Public Adjusters	• Caps compensation at 20 percent for reopened or supplemental claims. • Adds clarification regarding the type of statements that would be considered misleading in public adjuster advertisements including any invitation to submit a claim for damage that is not covered, any invitation to receive monetary incentives to submit a claim, claiming there is “no risk” to the policyholder of submitting a claim, or implying that the public adjuster is affiliated with a government agency. It also identifies specific language to be printed on any written solicitation or advertisement to this effect. • Adds language regarding a public adjusters responsibility to promptly report claims to insurers as well as not restricting an employee or representative of the insurer from communicating directly with the insured and being able to inspect the property. • Adds requirements for public adjuster apprentices for continuing education. • Caps supplemental or reopened claims to three years for windstorm or hurricane events.
File and Use	• Extends File and Use to December 31, 2011 (from 2010).
Rate Filings – Cap and Separate Filings	• Adds ability to make a separate filing for an inflation trend factor for residential property insurance as well as an adjustment for reinsurance cost or financing products used in the replacement of reinsurance. • Eliminates the cap of 3 percent increase on financial products but incorporates a cap of 10 percent for any individual policyholder as a result of all of these factors. • Eliminates prior language regarding not including a load for profit or expenses. • Eliminates the provision that prohibited the insurer from having filed within the past six months or filing in the next six months.
Mitigation in Pricing	• Modifies language to include debits. • Allows insurers to recover lost revenue through an increase in base rates if the aggregate amount of mitigation credits is greater than the reduction in aggregate loss.
Replacement Cost for Dwelling	• Reduces the initial payment for replacement cost of dwelling to the actual cash value of the insured loss, less any applicable deductible, with subsequent payments made as the work is performed to repair the structure. • Includes a one-year cap on claiming replacement cost expenses after actual cash value payment is made to the insured.

Expectations for Upcoming July Renewals

Our outlook for July 2010 renewals remains in line with our forecast at January 1 and April 1, 2010. As mentioned before, despite the reinsurance recoveries paid as a result of the Chile Earthquake and Xynthia windstorm, reinsurer capital remains stable and capacity remains abundant. Our expectation is that renewals in peak zones such as the United States and Europe throughout the remainder of the year will be unaffected by the reinsurance losses incurred during the first quarter of 2010. With major market renewals in the United States throughout the remainder of 2010, we provide our views on how the reinsurance market is likely to continue throughout 2010 renewals.

Figure 7: United States: Property Catastrophe July 2010 Expectations

	ROL CHANGES	CAPACITY CHANGES	RETENTION CHANGES
Personal lines national	-15% to -5%	+5% to +15%	+5% to +15%
Personal lines regional	-15% to -5%	+10% to +20%	+5% to +10%
Florida HO specialists	-10% to -5%	+5% to +10%	-10% to +5%
Standard commercial lines	-15% to -5%	+10% to +15%	+5% to +10%
Complex commercial lines	-20% to -10%	+10% to +15%	Flat to +15%
Assumptions: No changes in insured catastrophe exposures. Rate of change measured from the expiring Spring/Summer 2009 terms. The information provided above assumes no material ceded reinsurance catastrophe event prior to Spring/Summer renewals.			

Source: Aon Benfield Analytics

These expectations represent our views of market trends. Individual client placements are represented by professionals from our firm who understand the unique underwriting processes, class choices, original exposures, data quality, aggregations of catastrophe exposures, loss history, program structure, capacity needs, and security requirements of each client. Our professionals work closely with clients to properly differentiate their individual placements within the dynamic marketplace. Actual rate on line, capacity and retention changes are carefully considered and tailored to each client and can vary materially from the expectations for the broad market set forth above.

Contacts

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About Aon Benfield

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