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## Executive Summary:

# Insurer Growth from Accretive Reinsurance Materialized

Insurers have embraced growth opportunities by more fully accessing accretive reinsurance, as private insurers have utilized the lower risk transfer margins to actively reduce government participation in catastrophe exposed regions. We anticipate even greater reinsurance-supported growth to materialize for insurers exploiting immediate demands for new classes of underlying insurance risks.

June and July 2015 catastrophe reinsurance program renewals include many U.S. hurricane exposed insurers, most Australia and New Zealand exposed insurers, many Asia ex-Japan exposed insurers, and a meaningful component of Latin American exposed insurers.

Reinsurance capital reached USD580 billion by the end Q1 2015, an increase of 1 percent over year end 2014, as operating earnings remain stable aided by continued light catastrophe activity. Significant merger activity among reinsurers has not resulted in notable capacity contractions offered by the combined entities.

Total alternative capital was up modestly in Q1 2015 and remains impactful to the overall market for risk transfer, as more traditional reinsurers incorporate into their capital structures and enhance offerings to their primary insurer customers. A record USD1.7 billion of catastrophe bonds were issued in Q1 2015 and another USD 3.0 billion issued in Q2 2015. Investors continue to show broad interest in insurance linked securities, however, asset managers are demonstrating discipline in their capital deployment.

Hedge funds seeking stable underwriting risks to complement sophisticated asset strategies also continue to show broad interest in insurance risk, as evidenced by continued capital inflows. The value proposition offered to insurers of low volatility lines of business such as auto and healthcare, as well as primary risks currently financed through captives, remains high, though we believe risk appetites of these capital providers may broaden over time to support additional deployment.

Overall U.S. demand increased materially for the second consecutive year, with the majority of the increase coming from Florida and other coastal risks. Florida companies have heavily utilized reinsurance capacity to depopulate policies from Citizens Property Insurance Corporation, the Florida government run insurer of last resort. Additional demand increases in Chile, Columbia and Australia / New Zealand placements. Changes to criteria from rating agency A.M. Best may spur additional demand for insurance across lines, but the latest criteria release by A.M. Best is less onerous than previous versions and ample reinsurance capacity exists to meet these needs.

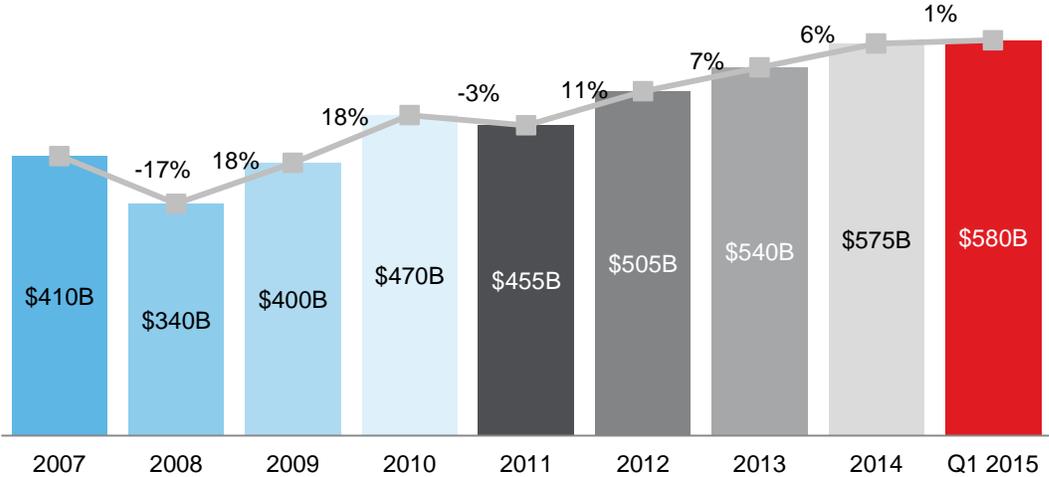
The remainder of 2015 has relatively fewer renewals of major programs, and we expect similar results for these renewals as the supply and demand trends described above continue.

*Note: This reinsurance market outlook report should be read in conjunction with our firm's views on rate on line, capacity and retention changes for each cedent's market. Our professionals are prepared to discuss variations from our market sector outlook that apply to individual programs due to established trading relationships, capacity needs, loss experience, exposure management, data quality, model fitness, expiring margins and other factors that may cause variations from our reinsurance market outlook.*

# Excess Supply Tipping Point to Increased Demand in Peak Hurricane Zone

Reinsurer capital grew by 1 percent since year end 2014, to USD580 billion at March 31, 2015. This compares with a 3 percent increase in Q1 of 2014. There were positive and negative factors behind the overall increase through the quarter. Positive elements were continued growth in the contribution from alternative capital (especially from collateralized reinsurance and sidecars) and from government schemes (principally the Florida Hurricane Catastrophe Fund). Partly offsetting were a contraction in the shareholders' funds of Aon Benfield Aggregate (ABA) companies (partly attributable to the weakening of the euro, which is the reporting currency of several major groups) and a number of catastrophe bond maturities caused a reduction in the amount outstanding at March 31.

**Exhibit 1: Change in global reinsurer capital**



Source: Individual company reports, Aon Benfield Analytics

## Peak zone reinsurance demand increases

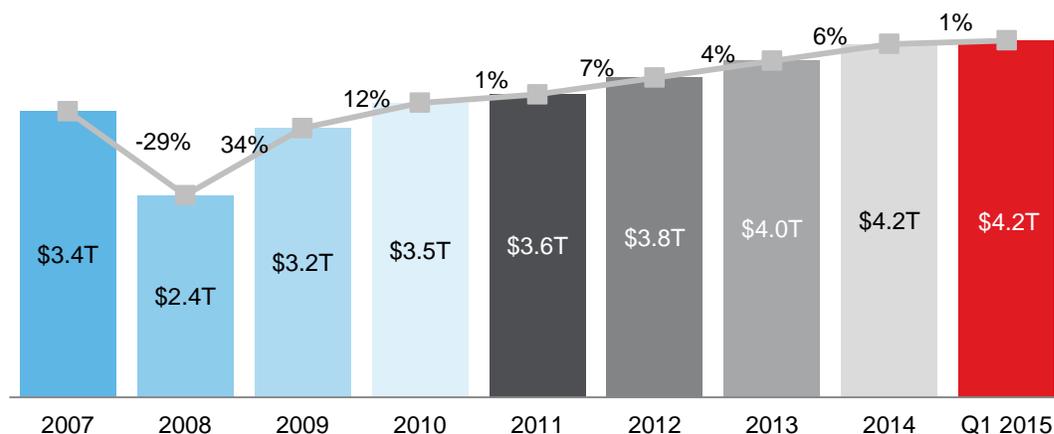
While many established market insurers secured similar capacity year over year, new purchases by Florida Citizens and the FHCF alone increased the reinsurance market demand for 2015. Florida Citizens has been a consistent purchaser of reinsurance since 2011, with total outstanding private market capacity increasing again for the 2015 wind season to approximately USD4 billion. At the same time, exposures to the entity have continued to decline as depopulation of the portfolio continues reducing the 100 year PML by more than half since 2011.

The FHCF elected to secure its first private market coverage for this hurricane season since its inception in 1994. As discussed in the May Advisory Council meeting, the FHCF secured USD1 billion of reinsurance excess of the majority of the cash fund balance at USD12.5 billion. With this purchase, the FHCF is now fully liquid for the 2015 hurricane season up to the potential capacity of USD17 billion.

## Insurer capital increases marginally in Q1 2015

Global insurer capital increased 1 percent since year end 2014. While the North American and EMEA composite changed minimally, the APAC region saw increases in capital in both Japan and China.

**Exhibit 2: Change in global insurer capital**

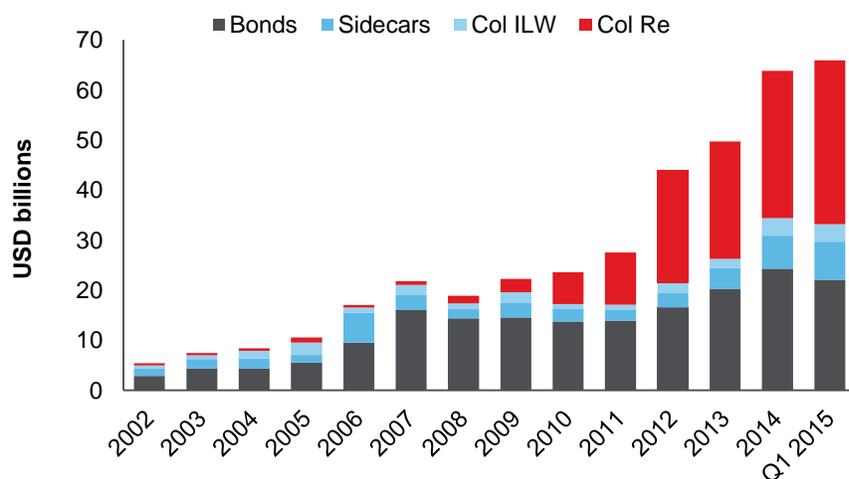


Source: Aon Benfield Analytics

## Alternative capital growth continues as expected

Alternative capital continued to increase for Q1 2015 to a total of USD66 billion, an increase of more than 3 percent since year end 2014. Catastrophe bonds decreased slightly to USD22.1 billion, while sidecars increased USD1 billion to USD7.6 billion and collateralized reinsurance continued to climb gaining USD3 billion in Q1 2015 ending the period at USD32.7 billion.

**Exhibit 3: Bond and collateralized market development**



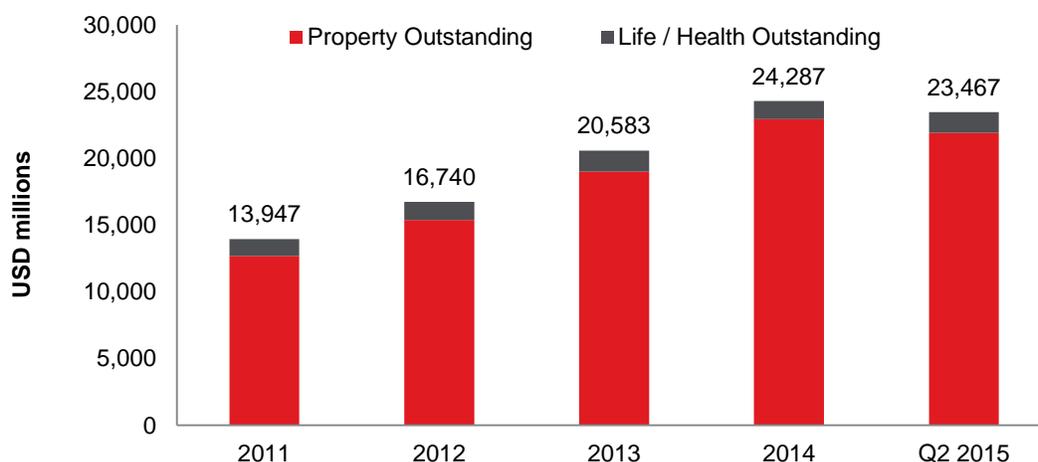
Source: Aon Securities Inc.

## Second Quarter 2015 Catastrophe Bond Update

The second quarter of 2015 saw USD2.96 billion of catastrophe bond issuance through ten transactions. The quarter followed the most active first quarter to date, with issuance for the first half of the 2015 calendar year reaching USD4.66 billion—a 21 percent decrease over the same period in the record prior year.

Outstanding catastrophe bonds increased 6 percent over the second quarter as the market continued to build back to its peak established at year end 2014, following maturities in the first quarter of 2015 totalling USD3.87 billion. Total catastrophe bonds on risk stood at USD23.47 billion as of June 30, 2015.

### Exhibit 4: Outstanding catastrophe bond volume



Source: Aon Securities Inc.

With the second quarter of 2015 came the inaugural issuance from new entrant UnipolSai Assicurazioni S.p.A (UnipolSai). The UnipolSai transaction, Azzurro Re I Limited, provides coverage for Europe earthquake and is the first catastrophe bond to do so with an indemnity trigger.

Ahead of the 2015 Atlantic Hurricane Season eight sponsors returned to the market in the second quarter to issue catastrophe bonds that include the peril of U.S. hurricane. Six of the transactions provide regional cover across territories including Florida, Louisiana, Texas, Massachusetts, and the Northeast. American International Group, Inc. (AIG) and United Services Automobile Association (both top five sponsors of catastrophe bonds based on current outstanding notional volume), secured coverage inclusive of the majority of the U.S. Atlantic coast. Of note, the Compass Re II Ltd. transaction from AIG utilizes a unique parametric index trigger based on reported maximum sustained wind speed and radius of windstorms crossing the boundary points of the covered area over a six month term. This is the first parametric U.S. wind transaction since 2005 and delivers relative cost savings versus AIG's indemnity 2014 Tradewynd Re Ltd. North America multi-peril transaction.

On the life and health side, AXA Global Life's France, Japan, and U.S. extreme mortality transaction Benu Capital Limited brings total life and health catastrophe bond issuance in 2015 to the highest level for a single calendar year since 2007. This is AXA's first extreme mortality catastrophe bond since 2006 and joins its outstanding Calypso Capital II Limited Europe wind transaction issued in 2013 for AXA Global P&C. The trigger is a mortality index weighted by age and gender over a five year term.

## Exhibit 5: Second quarter 2015 catastrophe bond issuance

Beneficiary	Issuer	Series	Class	Size (millions)	Covered Perils	Trigger	Rating	Expected Loss <sup>1</sup>	Interest Spread
<b>Second Quarter</b>									
Heritage Property & Casualty Insurance Company	Citrus Re Ltd.	Series 2015-1	Class A	\$150.0	FL HU (Initially)	Indemnity	Not rated	1.41%	4.75%
			Class B	\$97.5				2.79%	6.00%
			Class C	\$30.0				5.64%	9.00%
Louisiana Citizens Property Insurance Corporation	Pelican III Re Ltd.	Series 2015-1	Class A	\$100.0	LA HU	Indemnity	Not rated	3.51%	6.00%
AXA Global Life	Benu Capital Limited	N/A	Class A	€135.0 <sup>2</sup>	FR JP US Mortality	Parametric Index	BB+ sf (Fitch)	0.64%	2.55%
			Class B	€150.0 <sup>2</sup>			BB sf (Fitch)	1.33%	3.35%
Massachusetts Property Insurance Underwriting Association	Cranberry Re Ltd.	Series 2015-1	Class A	\$300.0	MA HU, ST, WS	Indemnity	B sf (S&P)	1.38%	3.80%
Citizens Property Insurance Corporation	Everglades Re Ltd.	Series 2015-1	Class A	\$300.0	FL HU	Indemnity	BB sf (S&P)	1.55%	5.15%
Texas Windstorm Insurance Association	Alamo Re Ltd.	Series 2015-1	Class A	\$300.0	TX HU	Indemnity	B+ sf (Fitch)	2.68%	5.90%
			Class B	\$400.0			BB- sf (Fitch)	1.58%	4.60%
The Travelers Indemnity Company	Long Point Re III Ltd.	Series 2015-1	Class A	\$300.0	NE HU, EQ, ST, WS	Indemnity	BB- sf (Fitch)	1.18%	3.75%
United Services Automobile Association	Residential Reinsurance 2015 Limited	Series 2015-1	Class 10	\$50.0	US HU, EQ, ST, WS, WF, VE, MI	Indemnity	Not rated	7.28%	11.00%
			Class 11	\$100.0				2.50%	6.00%
American International Group, Inc.	Compass Re II Ltd.	Series 2015-1	Class 1	\$300.0	US HU	Parametric Index	B+ sf (Fitch)	Undisclosed	Undisclosed
UnipolSai Assicurazioni S.p.A	Azzurro Re I Limited	N/A	Class A	€200.0 <sup>3</sup>	EU EQ	Indemnity	BB+ sf (Fitch)	0.31%	2.15%
<b>Total Priced During Q2 2015</b>				<b>\$2,962.3</b>					

<sup>1</sup> Expected loss represents initial one-year annualized figures with warm sea surface temperature sensitivity when applicable

<sup>2</sup> Converted at €1 = \$1.0873 as of April 24, 2015

<sup>3</sup> Converted at €1 = \$1.1244 as of June 17, 2015

Source: Aon Securities Inc.

### Legend:

EU – Europe	EQ – Earthquake
FL – Florida	HU – Hurricane
FR – France	ST – Severe Thunderstorm
JP – Japan	MI – Meteorite Impact
LA – Louisiana	VE – Volcanic Eruption
MA – Massachusetts	WF – Wildfire
NE - Northeast	WS – Winter Storm
TX – Texas	
US – United States	

## Second quarter 2015 catastrophe bond transaction review

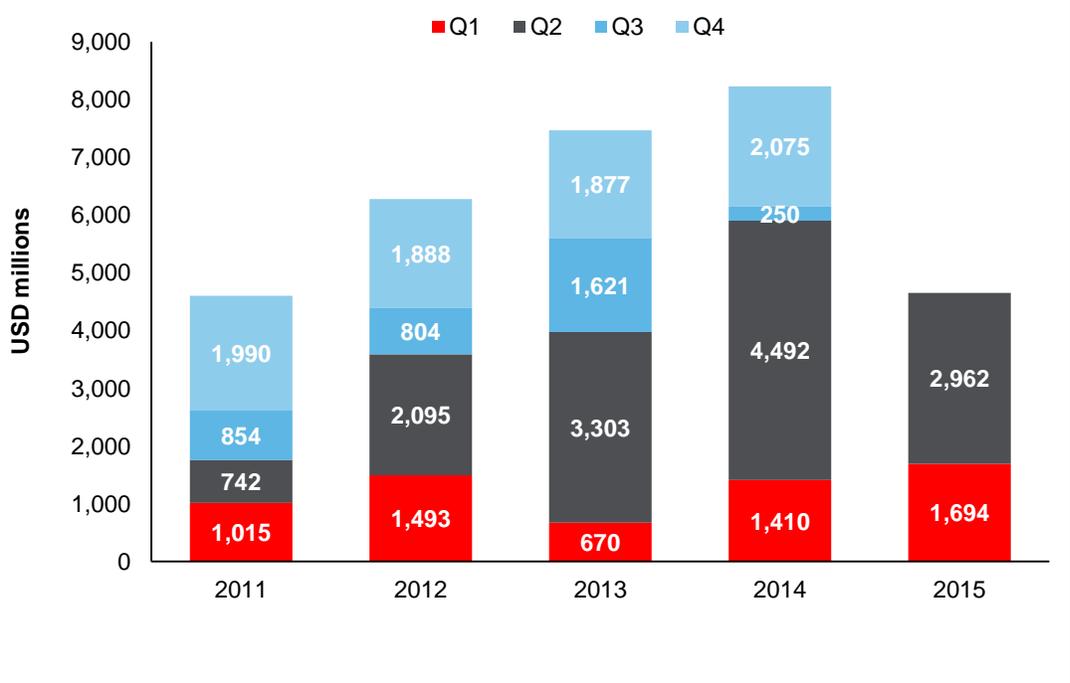
Heritage Property & Casualty Insurance Company (Heritage), was first to return to the catastrophe bond market in the second quarter with its third transaction under its Citrus Re Ltd. program. Again, the transaction covers Florida hurricane risk on an indemnity basis, however, this time with newly introduced Class B and C notes positioned relatively lower in the reinsurance tower to replace part of Heritage's FHCFC reinsurance cover. Overall, Heritage was able to reduce its reliance on the FHCFC and secure coverage at a more competitive cost through use of the alternative market notes capacity.

The Texas Windstorm Insurance Association again returned to the alternative market through ceding reinsurer Hannover Rück SE's retrocession agreement with Alamo Re Ltd. The indemnity trigger annual aggregate Texas hurricane transaction significantly increased in capacity compared to the prior year's transaction, closing at USD700 million in coverage across two classes and represents a 75 percent increase in limit from 2014.

Long Point III Ltd. Series 2015-1 is The Travelers Indemnity Company's fifth catastrophe bond transaction. Unlike the prior transactions, which all covered Northeast tropical cyclone, this is the first to provide multi-peril coverage including, earthquake, severe thunderstorm, and winter storm events in addition to tropical cyclone.

The chart below shows catastrophe bond issuance by quarter since 2011.

**Exhibit 6: Catastrophe bond issuance by quarter**



Source: Aon Securities Inc.

## Rating Agency Update

As A.M. Best's updated BCAR model approaches its targeted release date of late summer, more details are being discussed publicly by A.M. Best. The look and feel of the model will remain unchanged but now will provide results at five confidence levels. The output at the higher confidence levels will give A.M. Best insight into the point at which a company's surplus falls short of required capital.

Many different options were discussed to determine the best way to incorporate catastrophe risk in the new model. Currently, A.M. Best includes the net retention of the greater of a 1 in 100 wind event or a 1 in 250 earthquake event (both on an occurrence basis). They discussed the use of VaR vs. TVaR, occurrence vs. aggregate, and all perils vs. peak peril. A.M. Best commented in March 2015 that they were considering using an aggregate, all-perils TVaR metric that would be consistent with the rest of the model (which was then going to be on a TVaR basis). In May 2015, A.M. Best announced that they plan to use an occurrence, all-perils VaR view of catastrophe risk and they will switch to VaR for the other components of the model for consistency. The return period will vary by confidence interval and higher rated companies (A- or above) are expected to have more tail coverage. The catastrophe risk measure will be moved to the denominator of the BCAR calculation (as opposed to the current practice of subtracting it from surplus), so the capital position (the numerator) is the same for all confidence levels. A.M. Best commented that there will continue to be a catastrophe stress test, but the approach on how a stress test will be incorporated has not been finalized.

### Exhibit 7: Comparison of A.M. Best BCAR catastrophe risk analysis

	Current Approach	Initial Proposed March 2015	Current Proposed May 2015
Peril	Peak Peril	All Perils	All Perils
Return Period	100yr HU/Wind or 250yr EQ	Vary by confidence interval (20yr, 50yr, 100yr, etc.)	Vary by confidence interval (50yr, 100yr, 200yr, etc.)
VaR or TVaR	VaR (loss at a specific return period)	TVaR (avg of losses beyond a return period)	VaR
Agg or Occ	Occurrence	Aggregate	Occurrence
BCAR Impact	Reduction to surplus	Addition to net required capital	Addition to net required capital

Source: Aon Benfield Analytics, A.M. Best

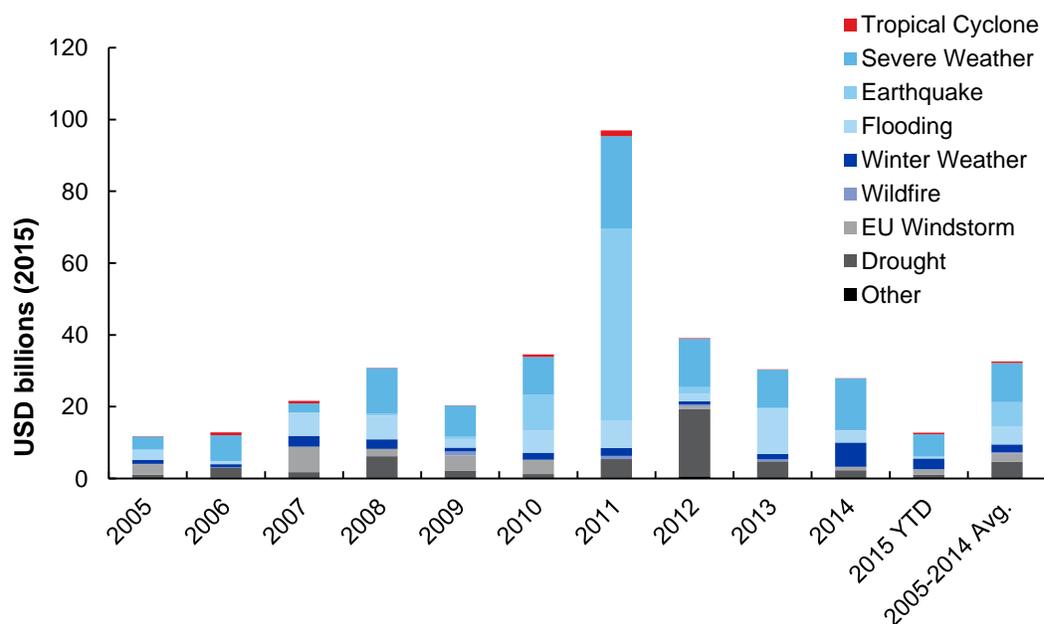
Companies we believe are most at risk from a change to the BCAR model are those with lower current BCAR scores relative to their rating level as there is less room to absorb the impact of more conservative factors, especially at higher confidence intervals. In addition, higher rated companies (A- or above) whose current catastrophe reinsurance program exhausts near the 100-year return period will likely see a material drop in capital adequacy at higher confidence intervals, which will influence A.M. Best's view of their balance sheet strength. We will also be working with our clients that are not currently rated by A.M. Best to understand if the changes to the BCAR model would be an advantageous time to explore a rating.

## Below Average 1H Insured Natural Disaster Losses for Third Straight Year

Despite an eventful six months of 2015, the number of events did not translate into substantial insurance losses for the industry. Overall first-half natural disaster losses were below normal from the recent ten-year average (2005-2014) for the third consecutive year. As of this writing, the roughly USD14 billion in insured losses thus far in 2015 are 58 percent less than the recent average of USD33 billion. Global losses were below average for all major peril types with the exception of winter weather, which was particularly harsh across the central and eastern United States.

The costliest event during the first two quarters of the year was an extended period of very heavy snowfall and bitter cold that impacted as many as 20 states in the U.S. Much of the minimum USD1.8 billion in losses occurred in the Northeast, particularly in Massachusetts. The only other confirmed billion-dollar insured loss event between January and June was an extended period of record rainfall in Texas and Oklahoma, plus widespread convective storm damage during the last ten days of May. Outside of the U.S., the most noteworthy industry loss events were European windstorms across western and northern Europe. Storms Elon and Felix and Niklas combined to cause nearly USD1.4 billion in insured losses.

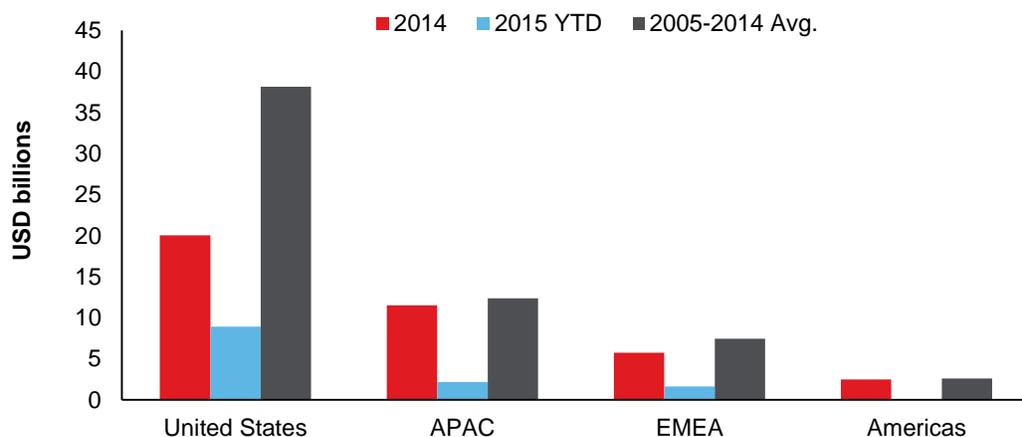
**Exhibit 8: Q1/Q2 Insured losses by year by type (2005-2015)**



Source: Aon Benfield Analytics

The USD14 billion in global insured losses were primarily led by two perils: severe weather (convective thunderstorm) and winter weather. The two combined to comprise 71 percent of the total, with severe thunderstorms topping USD6.0 billion. The U.S. sustained the highest level of insured losses (USD9.0 billion), which represented 64 percent of the globally incurred total. It should be noted that U.S. insured losses in 2015 were 55 percent less than what was sustained in 1H 2014 (USD20 billion) and 61 percent less than what was registered in 1H 2013 (USD23 billion).

## Exhibit 9: 2015 YTD Insured losses compared to recent annual averages by region



Source: Aon Benfield Analytics

Should current trends from the first half of the year continue, there are currently no regions of the world on pace to surpass their ten-year average in 2015. The arrival—and forecast strengthening—of a strong El Niño phase of ENSO (El Niño-Southern Oscillation) should have a modest impact on losses through the rest of the calendar year into early next year as well. See the next section for a more detailed discussion on the upcoming El Niño and its likely impacts on APAC and U.S. tropical cyclone activity.

As always, it is worth reminding that despite the fact that the U.S. is currently below recent loss averages, with the Atlantic Hurricane Season officially underway, it would take just one significant landfalling hurricane event could quickly reverse the trend. As a reminder, the U.S. remains in the midst of a record-setting stretch without a major hurricane landfall (Category 3+). 2005's Hurricane Wilma was the last such event.

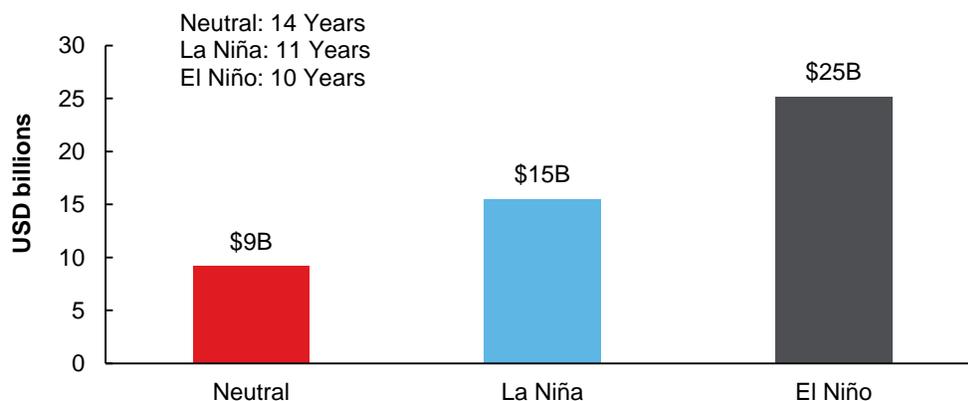
For the most up-to-date global catastrophe loss data for 2014, and other historical loss information, please visit Aon Benfield's Catastrophe Insight website: [www.aonbenfield.com/catastropheinsight](http://www.aonbenfield.com/catastropheinsight)

### Does the arrival of El Niño signify greater tropical cyclone industry losses for APAC?

The number of tropical cyclones does not significantly vary with ENSO phase in the Western Pacific Basin. However, there is usually a shift in storm development location with a higher frequency of storms developing further eastward in the basin. This eastward shift in the development location also translates to an eastward shift in location of landfalls when compared with neutral or La Niña years. Because of this, it is unsurprising that there is a higher amount of incurred insured cyclone losses in APAC—particularly East Asia. Since 1980, APAC has recorded nearly USD25 billion in insured losses during ten El Niño years. This compares to USD15 billion for 11 La Niña years and USD9.0 billion for 14 ENSO-neutral years.

The annual average number of landfalling hurricanes, based on data from 1980 to 2014, in the basin does not appreciably change between ENSO-neutral and El Niño years with 10.9 typhoon landfalls recorded per year. The average number of landfalls does, however, decrease in La Niña years with 8.6 typhoons on average coming ashore in the region annually.

### Exhibit 10: Tropical cyclone insured losses in APAC by ENSO phase (1980-2014)



Source: Aon Benfield Analytics

However, the eastward shift in development location does have an impact on landfall location, with Japan and Korea experiencing more typhoon landfalls during El Niño years than during neutral or La Niña years. On average, Japan and Korea experience 3.5 landfalling typhoons during the warm phase of ENSO compared to just 2.0 in La Niña years and 2.8 during ENSO neutral years. Philippines generally experiences less typhoon landfalls during El Niño years (3.9) when compared to ENSO neutral years (4.5). China and Taiwan also experience slightly fewer typhoon landfalls with 3.2 on average during El Niño years and 3.3 during neutral phase years. Similarly, there are fewer typhoon landfalls in the rest of South East Asia in El Niño years (0.2) when compared with neutral years (0.4).

The figure below shows the annual average number of typhoon landfalls from 1980 to 2014 by ENSO phase and by region.

### Exhibit 11: Annual average number of Western Pacific Basin typhoon landfalls (1980-2014)

Basin	Neutral (14 Years)	La Niña (11 Years)	El Niño (10 Years)
<i>Whole Basin</i>	11.0	8.4	10.8
Japan & Korea	2.8	2.0	3.5
China & Taiwan	3.3	2.5	3.2
Philippines	4.5	3.6	3.9
Rest of SE Asia	0.4	0.3	0.2

Source: Aon Benfield Analytics

## A reminder: El Niño and the Atlantic Hurricane Season

During an El Niño phase, suppressed tropical cyclone activity is typically expected in the Atlantic Basin; while enhanced tropical cyclone activity occurs in the Eastern Pacific Basin. The decreased level of activity in the Atlantic Basin is due to increased vertical wind shear and reduced sea surface temperatures in the main development region.

Given the much higher percentage of insurance penetration in the United States, there always remains a heightened level of interest in the Atlantic Hurricane Season. Since 1990, there have been eight separate hurricane seasons which have endured El Niño conditions either throughout an entire season or just partially for select number of months. Despite an expected reduced level of activity in 2015, the ultimate factor that determines a busy season for the insurance industry depends on how many and where storms actually make landfall.

## Forecasters: El Niño expected to cause below average Atlantic storm activity

The three main hurricane season prognosticators (National Oceanic and Atmospheric Administration (NOAA), Colorado State University (CSU) and Tropical Storm Risk (TSR)) have all forecast below normal hurricane activity for the 2015 Atlantic Hurricane Season. Each agency cites the anticipated arrival of a strong El Niño in the Central and Eastern Pacific Ocean which will lead to cooler sea surface temperatures in the main development region of the Atlantic Ocean and above-average wind shear in the upper levels of the atmosphere.

The figure below shows the latest TSR, CSU and NOAA forecasts. The table shows a comparison of each group's climatological average to their forecast for 2015.

**Exhibit 12: 2015 Atlantic Hurricane Season forecast comparisons by agency**

	Named Storms	Hurricanes	Major Hurricanes
<b>TSR (May 2015)</b>			
1950-2014 Average	11	6	3
2015	10	4	1
Difference	-1.0	-2.0	-2.0
<b>CSU (June 2015)</b>			
1981-2010 Median	12.0	6.5	2.0
2015	8	3	1
Difference	-4.0	-3.5	-1.0
<b>NOAA (May 2015)</b>			
1981-2010 Average	12	6	3
2015	6-11	3-6	0-2
Difference	-3.5	-1.5	-2.0

Sources: Tropical Storm Risk (TSR), Colorado State University (CSU), NOAA

## Contact Information

### **Bryon Ehrhart**

Chairman of Aon Benfield Analytics

Chairman of Aon Securities

+1 312 381 5350

[bryon.ehrhart@aonbenfield.com](mailto:bryon.ehrhart@aonbenfield.com)

### **John Moore**

Head of Analytics, International

Aon Benfield Analytics

+44 (0)20 7522 3973

[john.moore@aonbenfield.com](mailto:john.moore@aonbenfield.com)

### **Stephen Mildenhall**

Global Chief Executive Officer of Analytics

Aon Center for Innovation and Analytics, Singapore

+65 6231 6481

[stephen.mildenhall@aon.com](mailto:stephen.mildenhall@aon.com)

### **Tracy Hatlestad**

Managing Director

Aon Center for Innovation and Analytics, Singapore

+65 6512 0244

[tracy.hatlestad@aon.com](mailto:tracy.hatlestad@aon.com)

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