

# PROPERTY

## AN OLD CYCLE IN AN UNFAMILIAR WORLD

The forces that are hardening the Property insurance market are not exactly secret:

- 2008 Property losses totaling \$52.5 billion
- The world financial crisis
- The hardening treaty reinsurance market

Also not unexpected: After two years of steady pricing declines, the results for most Q1 renewals can be described as flat. Of course, there are exceptions, especially when adverse loss experience or a high degree of natural catastrophe exposure is thrown into the mix. In these situations, we are seeing increases and, in some instances, the increases are as high as 20%. Given how soft the market has been, we should not be surprised to see the market pendulum swing fully the other way.

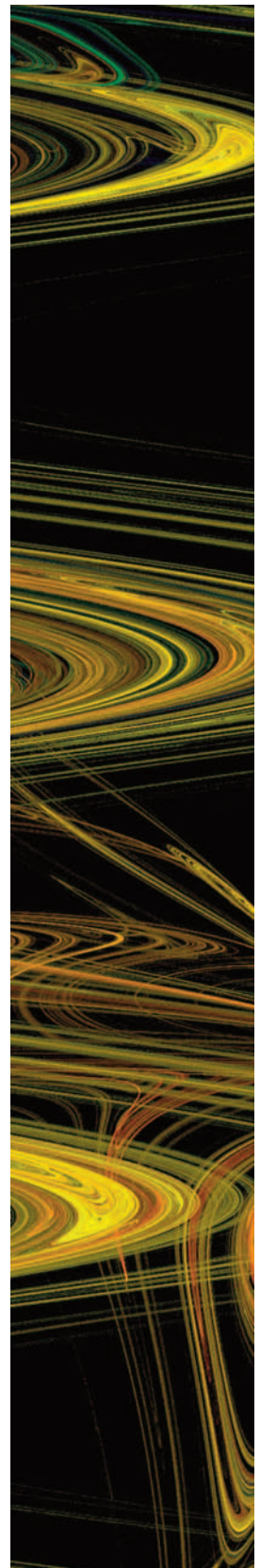
In Q2 of 2009, we expect the market will shift and 5-10% increases will be the norm. Less attractive risks will continue to see higher increases – in the 20-25% range.

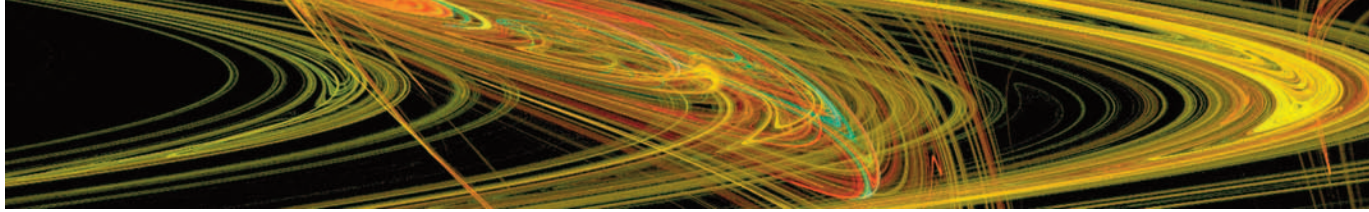
Looking back, we see a classic version of the insurance cycle. Following the market losses of 2005, most notably those caused by Hurricane Katrina, the insurance market hardened dramatically in 2006. Then natural catastrophe loss experience was very quiet in 2006 and 2007; the market softened, with insurers giving back much of the increases they collected in 2005. The investment markets had recovered from the bursting of the tech bubble and insurance capital was in ample supply.

### UNFAMILIAR GROUND

What about the future? Will the cycle stay true to form? On one hand, that seems to be happening. On the other, the world faces conditions most of us have never faced and probably never contemplated. Since fall of 2008, we witnessed the financial turmoil at AIG and the impact of the financial crisis on the world economy, and already we may be on the cusp of a situation that breaks the mold.

One attribute of a typical hard market is that the potential for rising returns attracts new capacity. In 2009, we are not so fortunate. Capital has not flowed into the market in the way of new insurers or existing insurers increasing their capacity. As a result, insurance capacity is on the decline and there are few alternatives when existing providers adopt a conservative stance on renewal.





No one is quite sure when capital fluidity will return. The same can be said of economic activity in general. In the typical hardening market, demand for insurance stays fairly steady or grows in incremental fashion with the economy. Again, we are not so fortunate. The outcome? No one knows. No one knows how a familiar cycle will behave in a suddenly unfamiliar world.

For now, we must be content to understand what brought the Property market to where it is today.

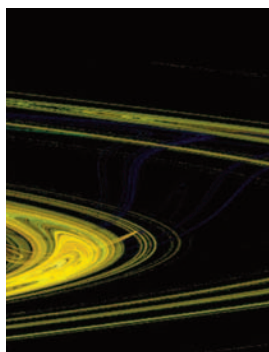
## PROPERTY INSURANCE LOSSES

In 2008, natural catastrophe losses totaled \$44.7 billion, with Hurricanes Ike (\$20 billion) and Gustav (\$4 billion) leading the way. Prior to hurricane season, Property insurers were already experiencing an unusually high run of man-made losses, which totaled \$7.8 billion for the year.

NATURAL CATASTROPHE LOSS (2008)				
RANKING	INSURED LOSSES (USD)	DATE (START)	EVENT	COUNTRY
1	20B	09/06/08	Hurricane Ike, winds up to 195 km/h; floods	U.S., Caribbean
2	4B	08/26/08	Hurricane Gustav, winds up to 240 km/h; floods	U.S., Caribbean
3	1.325B	05/22/08	Tornadoes, rainfall, hail	U.S.
4	1.321B	02/29/08	Winter Storm Emma	Germany, Austria, Czech Republic, et al

MANMADE LOSSES (2008)				
RANKING	INSURED LOSSES (USD)	DATE (START)	EVENT	COUNTRY
1	1.670B	06/03/08	Explosion and fire at gas processing plant	Australia
2	800M	02/18/08	Explosion of gas pipeline	U.S.
3	500M+	06/01/08	Fire at Universal Studios	U.S.
4	400M+	01/05/08	Gas Explosion at steel plant	U.S.
5	323M	02/07/08	Explosion at sugar refinery	U.S.

Source: Swiss Re Sigma Study, March 2009



## THE FINANCIAL CRISIS

The current recession gained momentum in the U.S. in the fourth quarter of 2008 and quickly spread to the larger economies of the world. In 2009, the entire world is sharing a similar pain, whether in the U.K., continental Europe or the Middle East (including Dubai) and the Far East.

Any expectations that investment income would counteract the insurance industry's combined loss ratio (losses + expenses) are gone. The surplus in the P&C industry decreased by \$42 billion, or 8%, through the first nine months of 2008 due to the decline in the investment market.

### U.S. P&C COMPOSITE FINANCIAL RESULTS FOR 2008 (\$ BILLIONS)

	1ST HALF 2007 ACTUAL		1ST HALF 2008 ACTUAL		Q3 2008 FORECAST	
NET EARNED PREMIUM	\$217.8		\$217.7		\$108.8	
NON-CAT P&C LOSSES	\$137.5	63.1%	\$142.1	65.3%	\$71.8	66.0%
NON-CAT FG AND PMI LOSSES	\$1.8	0.8%	\$10.0	4.6%	\$5.1	4.7%
CAT LOSSES	\$3.6	1.7%	\$10.3	4.7%	\$20.0	18.4%
EXPENSES	\$59.8	26.8%	\$60.2	27.1%	\$30.2	27.3%
P/H DIVIDENDS	\$0.6	0.3%	\$0.7	0.3%	\$0.3	0.3%
UNDERWRITING INCOME	\$14.5	92.7%	\$(5.6)	102.0%	\$(18.5)	116.6%
INVESTMENT INCOME	\$26.2		\$25.8		\$12.9	
REALIZED CAPITAL GAINS	\$4.1		\$(1.1)		\$(1.0)	
INVESTMENT INCOME	\$30.3		\$24.7		\$11.9	
OTHER INCOME	\$(1.5)		\$0.2		----	
PRETAX INCOME	\$43.3		\$19.3		\$(6.6)	
FEDERAL TAXES	\$10.7		\$5.4		\$(1.9)	
AFIT INCOME	\$32.6		\$13.9		\$(4.8)	
UNREALIZED CAPITAL GAINS	\$(6.3)		\$(18.5)		\$(19.0)	
S/H DIVIDENDS	\$(11.8)		\$(11.9)		\$(6.0)	
CAPITAL RAISING			\$3.9		\$1.0	
OTHER CHARGES			\$(0.3)		----	
NET ADDITIONS TO SURPLUS			\$(12.9)		\$(28.8)	
ENDING SURPLUS	\$517.9 *		\$505.0 (2.5%)		\$476.2 (8.0%)	

\* Year-end figure

Source: Insurance Information Institute

Note: Figures may not add due to rounding.

What is most distressing about these figures is that they do not include the fourth quarter of 2008, when conditions continued to deteriorate. Towers Perrin predicts that the overall decrease in surplus in 2008 could turn out to be near \$80 billion.

## TREATY REINSURANCE MARKET

When natural catastrophe losses declined in 2006 and 2007, the reinsurance market declined in tandem. Insurers were flush and less inclined to seek the protection, and capital, available through reinsurance. When faced with large-scale Property insurance losses and no way to make up the difference in the investment market, reinsurers were forced to take action. Insurers recently renewing their reinsurance treaties found two common results:

- Insurers without loss experience on their 2008 treaty insurance typically saw a 10-15% increase in costs where CAT exposure is involved.
- Insurers with loss experience in 2008 saw increases in the 20-30% range where CAT exposure is involved.

Many insurers were at very high retention levels with respect to their reinsurance treaties before the recent 1/1 renewals. Paying an increase while retaining a large share of the losses is squeezing insurer margins. Even so, access to the capital represented by reinsurance remains an attractive option.

## NEWS BY MARKET REGION

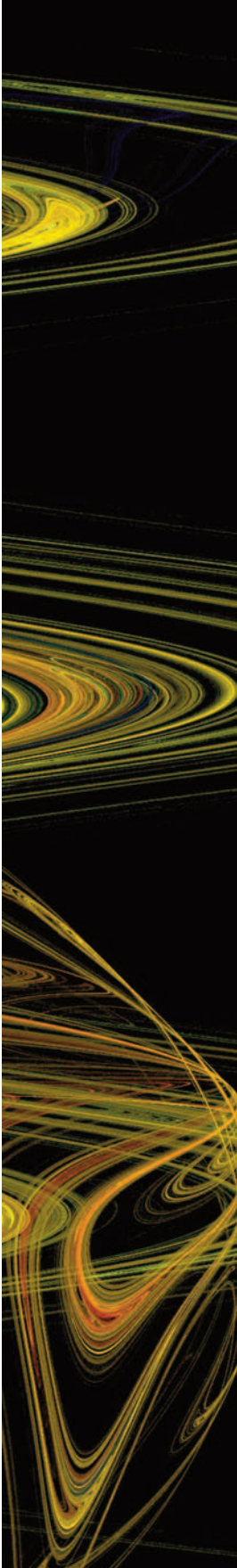
### U.S.

- The AIG situation may be solidifying, following the announcement of the formation of AIU Holdings, which will encompass the company's healthy insurance operations with a surplus of \$26 billion. The industry is waiting for this move to become final.
- Ironshore's U.S. operations, writing at a primary attachment level, are seen as an aggressive presence in the market, though Ironshore's overall capacity has been reduced from \$50 million to \$25 million.
- Hiscox is in the midst of gearing up their U.S. operations and also taking primary positions on some accounts.

### LONDON

#### COMINGS

- Jubilee Syndicate, mostly made up of former St. Paul Travelers syndicate underwriters who left at the end of last year, are recreating the same book they had at Travelers (a small \$5 million line with about \$2 million of Cat capacity).
- WR Berkeley Syndicate, expected to be up and running July 1, will be looking at participating on accounts with a potential \$15 million line, but this has not been finalized.
- Renaissance Re has set up a new syndicate, details on business plan and capacity to be announced.
- Arch opened a syndicate to write Property, focusing on international business.



## GOINGS

- Markel is out of all new Wind, Quake and Mining, but will renew existing Cat.
- Atrium has not stopped writing but is reducing lines dramatically.
- Broadgate and HCC have no Florida wind aggregate at all for onshore U.S. Property.

## BERMUDA

- No major marketplace changes.
- Ironshore has decreased their critical Cat line from \$15 million to \$10 million and their Fire line from \$50 million to \$25 million. They have also increased their minimum deductibles for a number of classes to \$25,000 as they look to move away from very small accounts. They are in the process of putting in place a 30% quota share treaty, which will enable them to write more accounts, and they are also looking to raise additional capital.
- AWAC is still finalizing their R/I treaty for 4/1; in the meantime they are limiting their participations to \$5 million as their net line. They are confident that they will be able to offer \$10 million of capacity as they did last year.
- Max Capital has been purchased by IPC (a Cat reinsurer based in Bermuda). Changes should be minimal, and Max should be able to benefit from IPC's S&P A- rating.

## CONTACT

### David Finnis

National Property Practice Leader  
404 942 5070  
david.finnis@willis.com