STANDARD & POOR'S

Global Reinsurance Highlights

2010 Edition

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SCOR CHARTS ITS COURSE

Profit & Losses 2009 — in € millions

Gross written premiums	6,379
Net earned premiums	5,763
Investment income (gross of expenses)	503
Operating income	372
Net income	370

SCOR is the 5th largest reinsurer in the world, practicing a traditional and cautious business approach combined with conservative financial management. SCOR'S business strategy is based on a triple-engine approach, its engines consisting of SCOR Global P&C, SCOR Global Life and SCOR Global Investments, as well as on strong sectorial and geographical diversification. SCOR provides its clients with cutting-edge technical services throughout the world in order to meet their security expectations.

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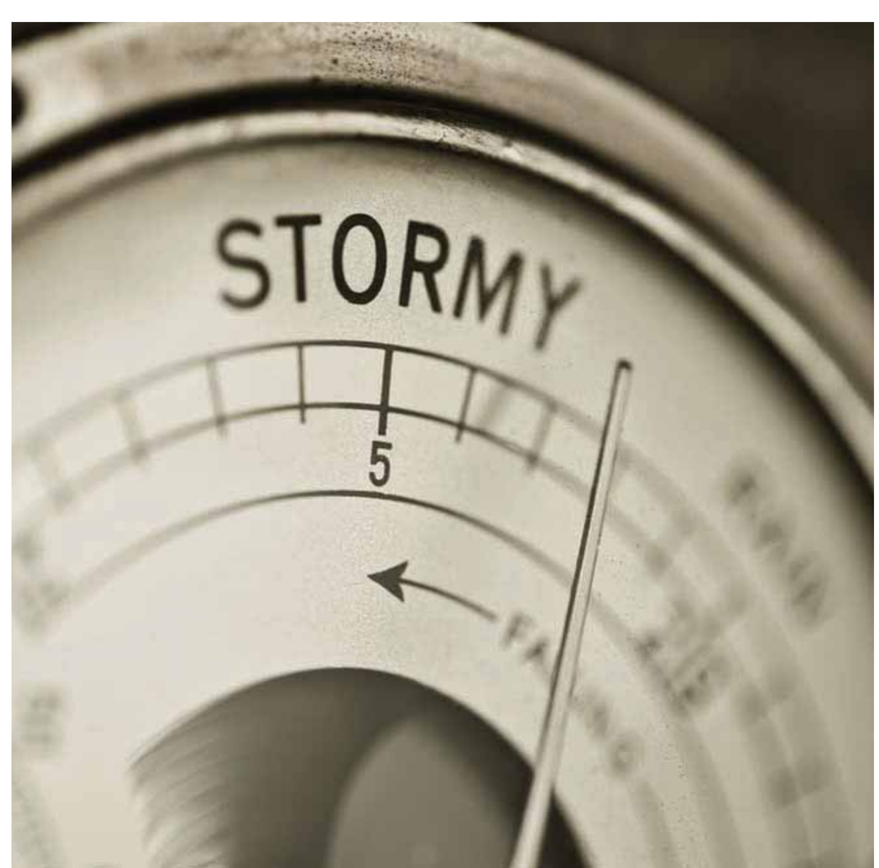

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Published in part by Standard & Poor's, a division of The McGraw-Hill Companies, Inc.
Executive offices: 1221 Avenue of the Americas, New York, NY 10020.
Editorial offices: 55 Water Street, New York, NY 10041.
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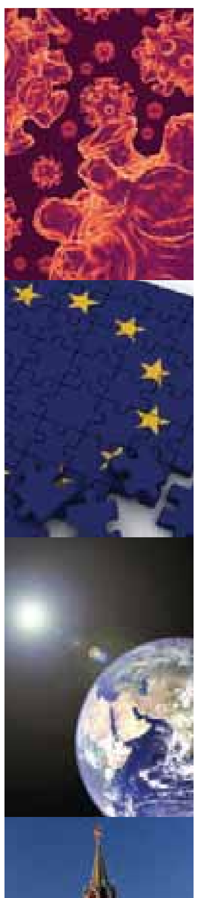

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2010 Edition

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The Panic Has Passed, But The Pain Lingers

By Rob Jones

When we published last year's *Global Reinsurance Highlights*, we noted that reinsurers' balance sheets were recovering their poise after having been severely dented by the impact of credit spread widening on bond portfolios during 2008 and the first quarter of 2009. We believe that recovery is now virtually complete, that many reinsurers' balance sheets are more than restored to levels beyond their 2007 highs, and that share buybacks are back in vogue. However, all is not as rosy as it might appear. Our lead article "2009's Perfect Calm Breeds Stormier Climate For Global Reinsurance In 2010" addresses the industry's latest challenges overall and "The Sluggish Economic Recovery And Emerging Regulatory Changes Are Reshaping the Life Reinsurance Landscape" focuses on the those arising specifically within life reinsurance.

We believe that global reinsurers continue to stand out relative to primary insurers in terms of their enterprise risk management (ERM) capabilities. The fact that the reinsurance sector weathered the financial turmoil better than others was due in no small part to its ERM practices. Nevertheless, we believe there is plenty still to do. "Global Reinsurers Lead The Way in Enterprise Risk Management" analyzes reinsurers' current ERM systems and "Approach To Assessing Insurers' Enterprise Risk Management Refined In Line With With Industry Improvements" includes our plans for recognizing (re)insurers' internal models in our capital adequacy analysis.

Our ERM analysis is closely aligned with Solvency II. "Uncertainty Continues For European Insurers As Solvency II Requirements Remain Undecided" describes the concerns that have emerged over the past year as the likely 2013 implementation date looms. The tentacles of Solvency II are spreading around the world and we believe it is adding a new twist to the domicile choices of reinsurers. "Choosing A Domicile Remains A Hot Topic For Global Reinsurers" explores the issues. "Premium Development And Performance Converge As Integration Of Lloyd's And Bermudian Markets Increases" compares two increasingly intertwined insurance and reinsurance platforms.

The Insurance-Linked Securities (ILS) market has in our view rebounded since the collapse of Lehman Brothers closed the catastrophe bond market to new issuance. However, in "Fall In Traditional Reinsurance Pricing Outpaces Decline In ILS Pricing" we argue that the abundance of traditional reinsurance capacity is making long-term convergence of these markets less likely.

In the first half of 2010, we have seen the highest level of insured catastrophe losses in a decade, including the second-largest earthquake since the early 1900s. "Reinsurers Foot The Bill For Chilean Earthquake Losses" discusses the financial impact.

Our regional articles this year focus on Russia and Asia-Pacific. "Standard & Poor's Sees Evident Weaknesses And Hidden Strengths In The Russian Reinsurance Market" examines the peculiarities of doing insurance and reinsurance business in Russia today. "Asia-Pacific Insurance Finds Recovery Tougher Than Expected As Rates Remain Under Pressure" examines the major primary markets in the Asia-Pacific region and their reinsurance needs.

"Interpreting Insurer Financial Strength Ratings In Light Of Improving Insurer Supervision" answers questions about our ratings that we have been asked in recent years as the modernization of insurer supervision gathers pace.

We think that *Global Reinsurance Highlights* captures the key issues facing reinsurer management. We hope that you enjoy the 2010 edition and would welcome your feedback on possible enhancements for future years. ■

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2009's Perfect Calm Breeds Stormier Climate For Global Reinsurance In 2010

By Mark Coleman, Laline Carvalho and Rob Jones

Catastrophe losses during the first half of 2010 were at a 10-year high, but capacity remained abundant allowing an acceleration of the erosion of underwriting margins. The reinsurance sector is once again facing a test of its resolve, following 2009's perfect calm.

Table 1

Large Losses in H1 2010

Date	Event	Estimated Loss
Jan	Haiti Earthquake[1]	$150m
Feb	Chile Earthquake	$8bn-$12bn
Feb	Winter Stom Xynthia[1]	$3.4bn
Feb	US Winter Storm[2]	$150m-$350m
Mar	Australian Storms[3]	$1.3bn
Apr	Deepwater Horizon[4]	$1.5bn-$3.5bn
May	US Storms[1]	$1.1bn
May	Bangkok Riots[3]	$500m+
May & Jun	European Floods[1]	$280m

1 Source: Munich Re Geo Risks Research, NatCat Service

2 Source: AIR Worldwide

3 Source: Inside FAC

4 Source: Swiss Re

The 2010 earnings outlook for the reinsurance sector stands in stark contrast to the industry's experience in 2009 in Standard & Poor's Ratings Services' view. After the shocks of 2008, the industry rebuilt its capacity and confidence during 2009, supported by a benign property claims and financial climate. By contrast, the first six months of 2010 have seen insured catastrophe losses that have reportedly exceeded $20 billion–equivalent to the losses incurred during the whole of 2009 (see table 1). Standard & Poor's estimates that more than half of the reinsurance sector's annual catastrophe budget has already been eroded before the onset of the U.S. hurricane season, and most weather forecasters predict above-average storm activity in 2010.

We expect earnings in the reinsurance sector to be tested, not only by the amount of losses incurred, but more importantly in our view by some reinsurers' failure to prevent their profit margins from eroding at subsequent renewals. Furthermore, we have observed that persistent low interest rates continue to suppress rate adequacy and are producing returns we consider to be uneconomic in some long-tailed classes of business. We believe that this effect may be compounded if inflation takes hold. In our opinion, favorable frequency trends are unlikely to be sustained indefinitely, especially if policy coverage is widened as the reinsurance market softens, which will act to stem the flow

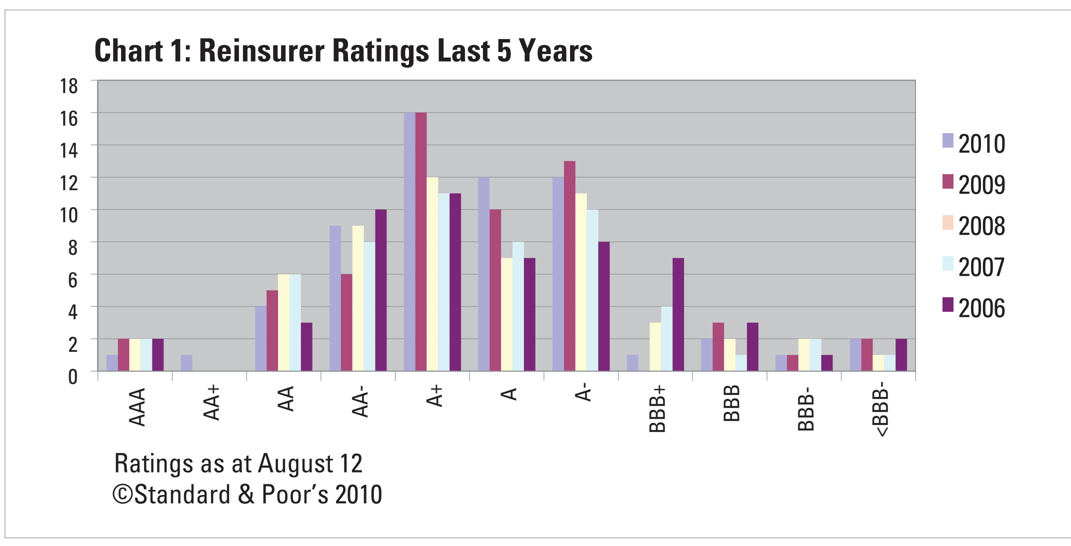
of prior-year reserve releases that have bolstered earnings in recent years.

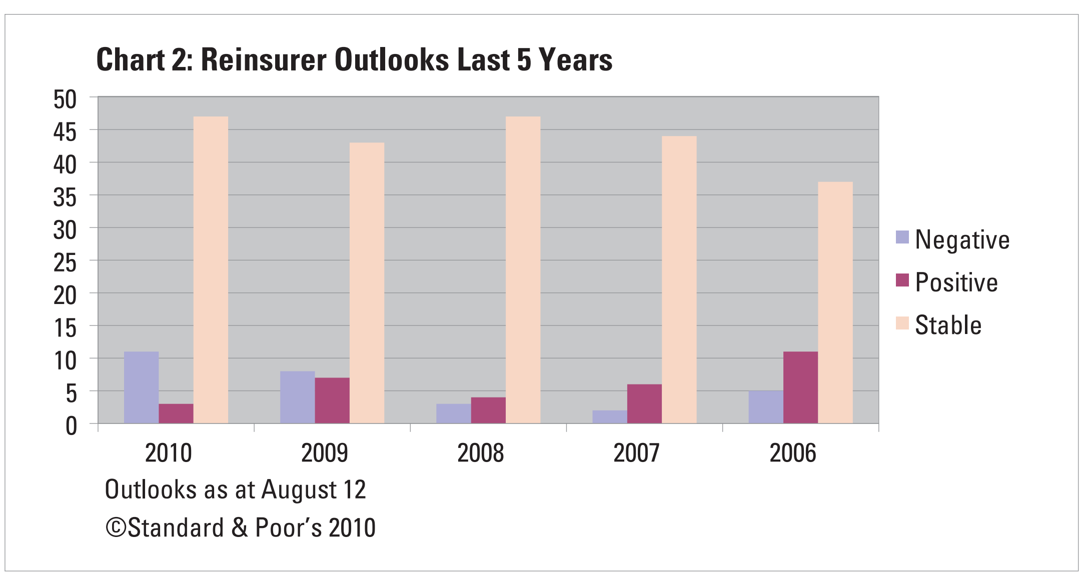
Despite these negative trends, we have retained our stable outlook on the sector because we consider the reinsurance industry's aggregate fundamental balance sheet to be very strong. In addition, 77% of rated reinsurers included in our GRH survey continue to enjoy a stable outlook. Indeed, we have assigned a negative outlook to only 18% of ratings (see Charts 1 and 2), even in the current operating environment. Although we acknowledge that financial strength may come under downward pressure, our stable outlook on the sector reflects our assessment of the following positive factors:

- Capitalization is typically a ratings' strength and in the aggregate is at peak levels;
- Enterprise risk management (ERM) capabilities are high, with reinsurers among the leading practitioners in the industry in our view (see "Global Reinsurers Lead The Way In Enterprise Risk Management");
- Investments are typically focused on high-quality, short-duration, liquid assets;
- Financial flexibility has improved in 2010 in our view;
- For many in the sector, profitability reached record levels during 2009; and
- Profits continue to emerge on prior underwriting years.

These strengths are partially offset by our assessment of the following weaknesses:

- Reinsurance capacity is abundant, but demand is suppressed, which is driving down pricing in our view;
- We have concerns over price adequacy and recent accident-year reserving for casualty reinsurance, although we believe the risk of inflation is deferred for now;
- The high frequency of interim catastrophe losses, softening pricing, and persistent low interest rates make the earnings outlook for 2010 difficult in our view; and





- Some recapitalization risk remains in our view because price-to-book valuations remain low and the hybrid market is dormant.

The EU's Solvency II directive on supervision of insurance represents an emerging issue in our analysis until its details are finalized. That said, we believe that reinsurers may well see an increase in ceded premium as insurers adjust to the new regulations (see "Uncertainty Continues For European Insurers As Solvency II Requirements Remain Undecided").

"Perfect Calm" Produces Record Profits

2009 was characterized by a period of benign loss activity and recovering investment markets that produced record profits for many in the reinsurance sector, in some cases, only 12 months after they had reported record losses. Accident- and calendar-year performance was excellent in 2009 for several reasons:

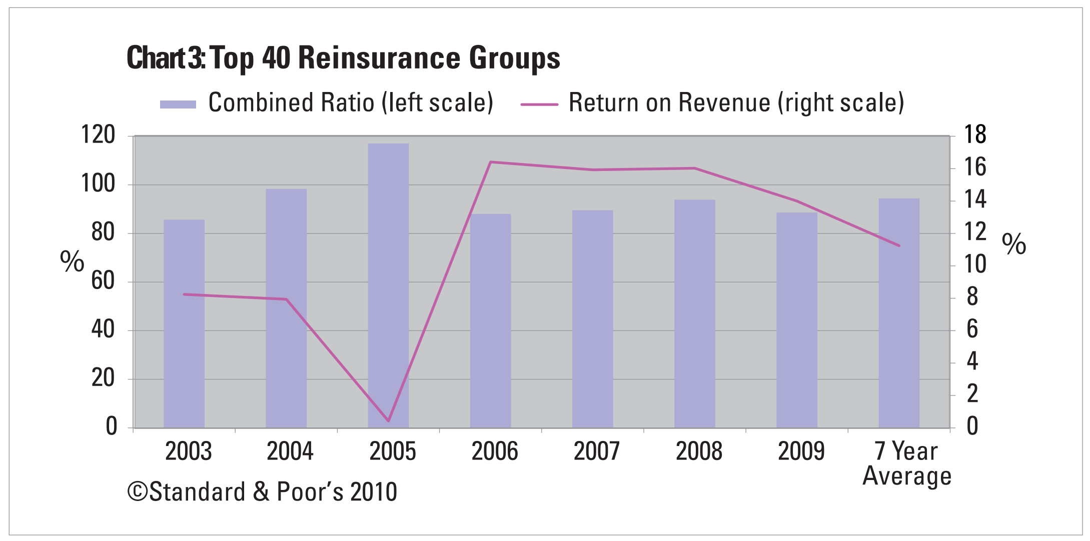
- 2009 was the calmest Atlantic hurricane season in 12 years, resulting in catastrophe losses that were less than a quarter of the long-term averages or expected annual losses reported by Munich Reinsurance Co. (Munich Re; AA-/Stable) and Lloyd's (A+/Stable);
- Claims continued to develop more favorably than the actuarial assumptions used by reinsurers to calculate their reserves, enabling further profit release from prior-underwriting years;
- Risk-adjusted pricing improved in 2009 by around 5% at a portfolio level as the capacity shortage caused by the financial crisis fueled a temporary market hardening;
- Net earned premium increased by 9% during 2009 for the top 40 reinsurance groups as the demand for reinsurance capacity increased; and
- Bond and equity prices rallied, largely reversing the significant write-downs suffered during 2008.

Our analysis of the top 40 reinsurance groups, who we estimate account for more than 90% of global reinsurance premiums between them, shows that the sector produced a return on revenue of 14% and a combined ratio of 88.6% in 2009. This compares to 16.4% and 93.9%, respectively, in 2008, and outperforms the seven-year averages of 94.4% and 11.2% (see chart 3).

The accelerated rate of reserve releases we saw in 2008 held constant in 2009. Based on analysis of 10 of the largest reinsurers both in Bermuda and at Lloyd's, reserve releases made an overall weighted-average positive contribution to the combined ratio of 7%-8%. This figure includes the insurance business underwritten by these businesses. The trend persisted through the first quarter of 2010, with Bermudian reinsurers typically reporting combined ratios with a further eight percentage points of positive reserve development. We expect to see further releases through the remainder of 2010, reinforced by a well-reserved 2009 accident year.

Capital Restored To Cyclical Peak Levels

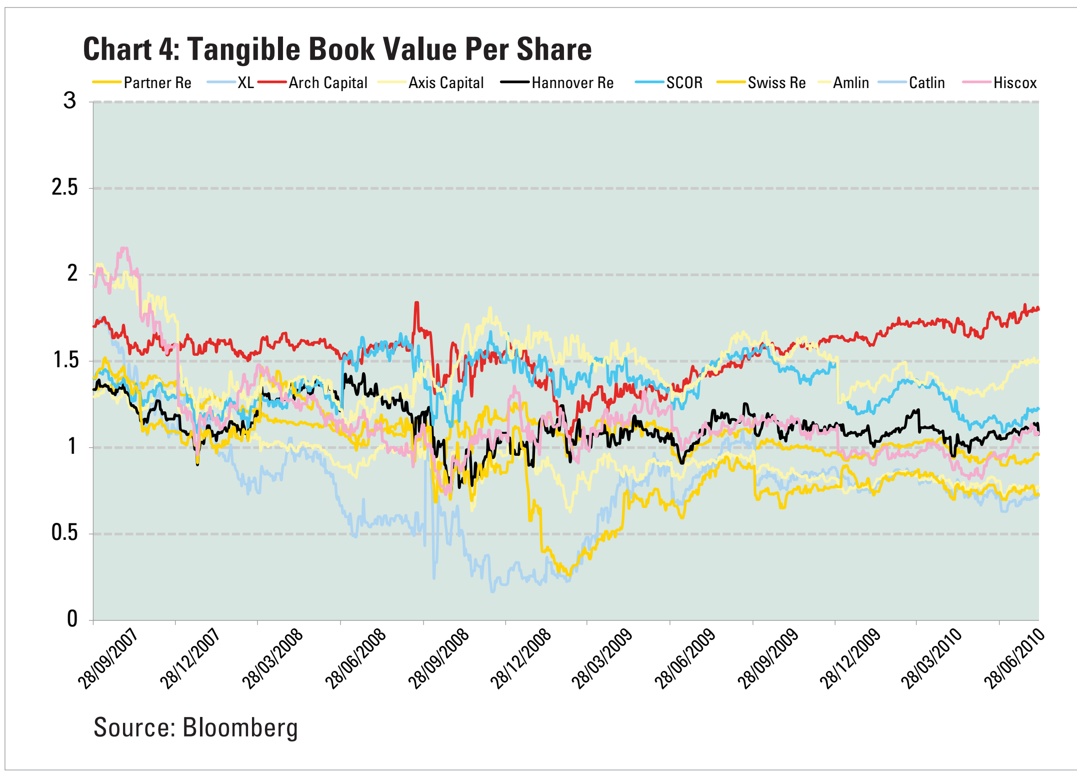
Reinsurance capacity rebounded swiftly in 2009 as strong operating profits, narrowing credit spreads, and the equity market rally helped to restore capital adequacy to "peak of the cycle" levels. Reinsurers were able to more than replenish the 18% erosion in reported shareholder's funds in 2008 (equivalent to $54 billion for the top 40 reinsurance groups) within 12 months, with only limited recourse to investors. Total adjusted shareholders' funds for the top 40 reinsurance groups increased by $63 billion, or 26%, during 2009. It is this fundamental balance-sheet strength, which in our view is partly a reflection of the highly liquid and high investment-grade fixed-income strategies that dominate asset allocations in the sector, which underpins most of our ratings in the sector and our stable outlook. Most reinsurers, particularly those with a high proportion of their capital allocated to underwriting peak catastrophe perils, are operating with risk-adjusted capital at a level at least one notch,

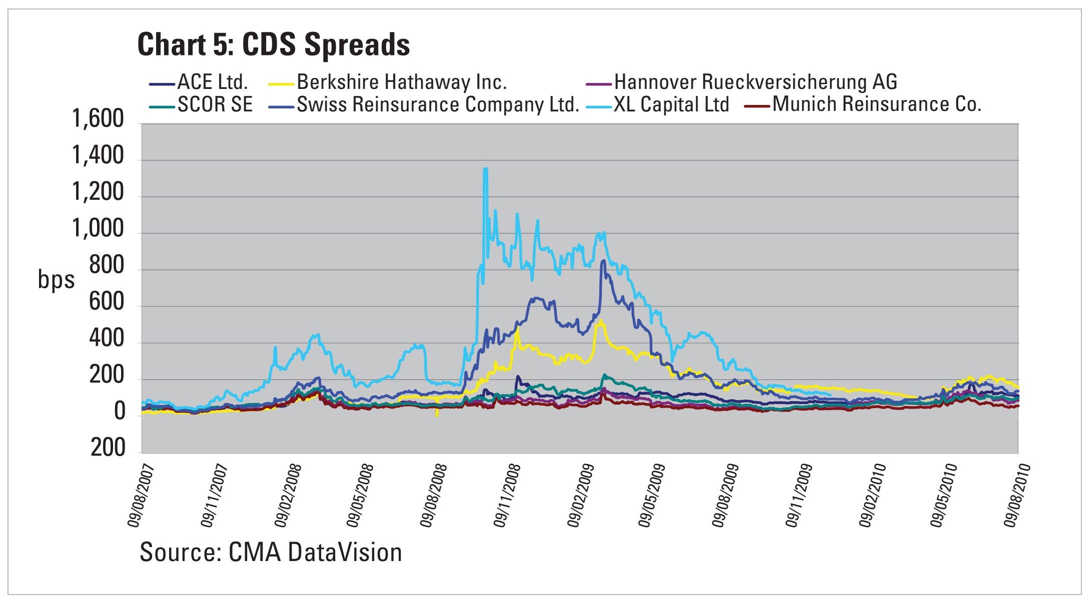


and in many cases more than a full category (i.e., three notches) above the target capital for their rating.

In view of the prevailing market softening, many reinsurers have resumed or announced new share buyback programs. There was a pause following the Chilean earthquake in February, but repurchasing activity restarted in the second quarter of 2010. Because we believe there are currently limited opportunities to grow profitably, we view share buybacks and similar mechanisms for returning capital to investors as indicative of strong financial management. That said, in our analysis we would typically take into account whether the interests of investors and policyholders are appropriately balanced in our view and whether the company remains mindful of the risk and cost of raising new capital after a market-changing event.

On average, the announced buyback activity and special dividends announced in 2010 were equivalent to between 5%-10% of opening book value, which is indicative of pricing trends. The available alternatives to returning capital–writing new business at uneconomic rates, investing unallocated capital in





low yielding or high risk assets, or engaging in cash-based M&A activity–are not very compelling in the current environment in our view. We observe that some financial flexibility has returned to the financial markets, however the sector is trading at around 1.0x to 1.11x (see Chart 4) of tangible book value which for most stocks is below the historical average. Those businesses without a strong track record, franchise, and balance sheet risk possible shareholder dilution if investors are only willing to back them at a steep discount. Although we have seen reinsurer credit default spreads narrow to more normal levels and some senior debt issuance in the first half of 2010, the public hybrid debt market has been largely dormant since 2007 (see Charts 4 and 5).

Strong Capital Adequacy Assumes Reserves Are Adequate

Our view on the strength of capital adequacy is predicated on reserves in the sector being adequate and in many cases, redundant. Despite this, reserving confidence levels are probably lower than they were in 2007. An analysis of the reserve triangles published by Munich Re in 2010 reveals a steady deterioration in treaty-year performance since the market hardening that took place post Katrina. The ultimate loss ratio deteriorated by 10 percentage points between the 2006 and 2009 underwriting years.

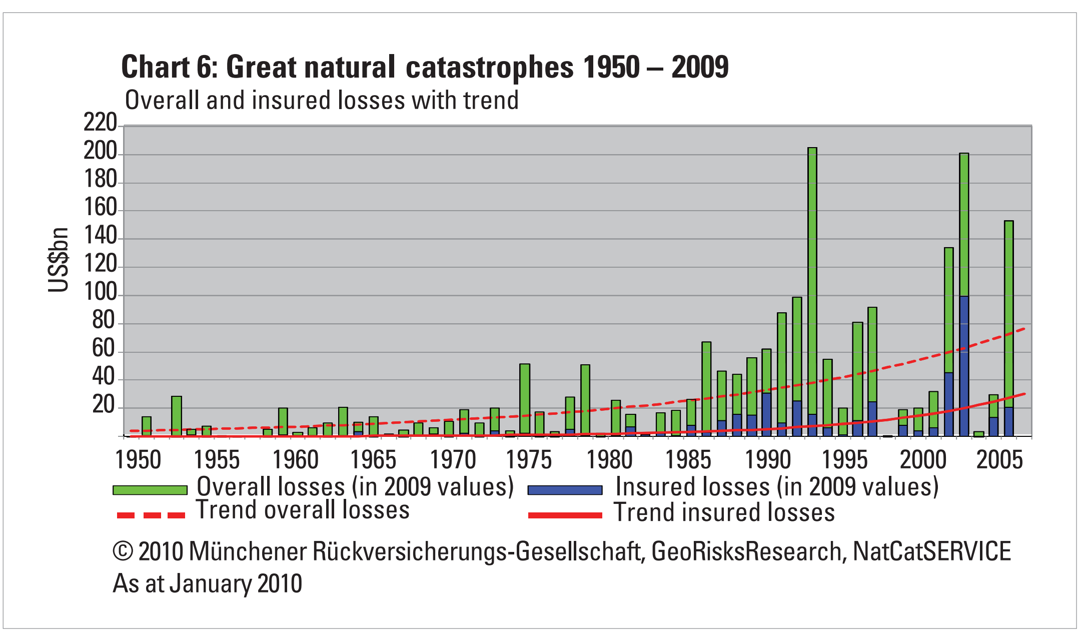
We believe this reflects pricing, rather than claims trends; with the notable exceptions of credit reinsurance and financial institution liability-related losses, claims have generally developed in line with or better than the assumptions embedded in reserves in the sector as a whole. With the exception of treaty-year 2000, each of Munich Re's published underwriting years exhibited positive run-off in 2009, a trend shared by many of its peers.

When we analyzed 10 of the largest companies in Bermuda and 10 of the largest syndicates at Lloyd's, we observed weighted-average reserve releases in 2009 equivalent to 3% and 5% of opening loss provisions, respectively. A lower, but still positive, pattern emerged in the U.S. commercial lines sector during 2008, where excluding $12 billion of reserve strengthening for mortgage and financial guaranty insurance, there was $11 billion of releases from prior-year reserves, equivalent to 2.2% of opening loss reserves. We have been cautioning against the likelihood of a step change in inflation for the last three years. Nevertheless, the global recession has deferred, rather than removed, this risk in our view. Given the slow rate of forecast economic recovery, slack industrial output, and weak job markets, U.S. inflation is expected to remain subdued for the next couple of years. We view this as significant not least because the historical U.S. tort environment and the enactment of new legislation has proved costly for the industry in the past.

We have observed some examples of increased social claims frequency and severity outside the U.S., such as motor business and increased fraudulent claims generally in the U.K., Danish personal lines, and Italian medical malpractice business. In spring 2010, insurance broker Lockton Inc. also noted that claims notifications outside the U.S. had increased in the last 18 months across all of its financial lines products.

Current data suggests to us that the reinsurance industry conservatively reserved for accident years 2002-2006 in their initial years, leading to the reserve releases since. We are less confident that the sector's loss reserves for accident years 2007-2008 are as robust, although 2009 should have enabled reinsurers to book additional margins. Our concerns stem from:

- Changes in ultimate loss reserving picks in recent



years to reflect the industry's more-favorable experience since 2002 (which translates into lower estimated ultimate loss ratios);
- Potentially higher-than-expected losses because of the capital markets fallout and as a result of the global economic slowdown; and
- The prospect of tort reform and the possibility that claims frequency and severity trends may increase at a faster rate than recognized in general inflation and interest rates.

Lockton noted that in the 1980s, US medical professional liability claim frequency spiked in 1985, three years after unemployment reached 10%. This corresponds to the current rate of unemployment, and our expected peak for U.S. unemployment.

Claims activity linked to the global credit crisis appears to have slowed. Advisen Ltd., which provides research and analytical tools for the insurance industry, noted a sharp 39% contraction in new securities lawsuit filings in the U.S. in the first quarter of 2010. A study by Stanford Law School Securities Class Action Clearing House and Cornerstone Research noted a slightly higher reduction in litigation linked to the credit crisis in 2009, and further noted that the number of new class actions overall declined by 24% in 2009 and was 14% below the 10-year average. It attributed the reduction in the number of cases and notifications to the recovery of the financial markets, which it believes has reduced the potential for damages. However, the wave of subprime and related credit crisis claims filed in 2007 and 2008 is still making its way through the U.S. legal system, and the SEC has recently announced new investigations into several Wall Street banks that could prompt new claims, so we believe that considerable uncertainty remains around the ultimate loss.

Pricing Slides, Despite Earthquakes In 2010

As 2009 developed without any major catastrophe losses, and credit and liquidity concerns eased in the financial markets, the market's hopes that the financial crisis would trigger a prolonged hardening in reinsurance pricing vanished. By year-end, pricing (and with it capital adequacy) was generally more or less where it had been 24 months earlier, although rates varied significantly, depending on the class of business underwritten and its sensitivity to economic activity. Rates started to drop slightly at the 2010 January renewals, and the reduction has accelerated since, with the July renewals for catastrophe business reportedly down 10%-12% on a risk-adjusted basis. As a consequence, we saw more business underwritten in the January 2010 renewals in anticipation of a progressive weakening of pricing, in direct contrast to the prior year.

Because we had seen the aggregate level of redundant capital within the reinsurance industry, the lower demand from cedants, and the dogged historical cyclical behavior of the industry, we were not surprised by recent renewal trends, despite the level of catastrophe activity in the first quarter of 2010. We do, however, question the current rate adequacy in some lines of business, particularly casualty business, where pricing has been under pressure since mid-2004. We have concerns regarding reinsurers' ability to compensate both for the current low interest rates and the prospect of rising inflation in the mid-term as the economic recovery gathers pace. From the evidence we have seen, some of this business is being underwritten below the technical rate necessary to meet the cost of capital.

Record Catastrophe Activity In The First Six Months, With More Storms Predicted

Natural and man-made catastrophes have dominated the landscape in the first half of 2010. Munich Re estimates insured losses of $22billion from the catalogue of weather events–including the Chilean earthquake, the U.S. winter storms, Windstorm Xynthia in Europe, hail in and around Melbourne, and widespread flooding in several territories. This is the highest level of first-half losses seen during the last decade, and more than double the average. We believe this estimate could yet be revised upward, since the magnitude of devastation in Chile, which was the second most expensive earthquake and the largest catastrophe loss outside of the U.S. on record, has delayed and complicated the loss-adjusting process. Current industry loss estimates have been reported at between $8 billion and $12 billion.

The environmental damage caused by the Deepwater Horizon rig explosion and subsequent oil spill threatens to overshadow Exxon Valdez, the previous worst disaster. We expect the insured loss to represent a smaller percentage of the very substantial economic damage because BP PLC (A/Watch Neg/A-1), the 65% owner of the affected well, is liable–along with its joint venture partners–for the clean-up costs and is self-insured. Even more than in Chile, the complexity of the loss makes claim estimates uncertain because of the multitude of liability coverages and litigants involved. The proposed changes to the Oil Pollution Act of 1990, which could raise the current liability cap for economic damages to $10 billion or higher from $75 million currently further complicate the matter. The proposed changes may be applied retroactively.

The (re)insurance industry's loss estimate of between $1.0 billion and $3.5 billion is manageable in our view, at less than 4% of the overall 2009 combined ratio. That said, the aggregate 2010 catastrophe losses are mounting and are estimated to have consumed more than half of the annual catastrophe budget (and, in some cases, 80% of the budget), before the U.S. hurricane season even began.

Warm ocean temperatures have drawn comparisons to 2005 and the U.S. National Oceanic and Atmospheric Administration has predicted an active hurricane season for the Atlantic Basin. Chart 6, from Munich Re, adds further weight to the scien-

tifically observed trends of rising or at least elevated levels of natural catastrophes since the 1980s. Two further trends are worth noting: research by modeling firm EQECAT Inc. and the Free University of Berlin (based on climate change simulations) predicts almost a trebling in the frequency of extreme storms with a damage potential of more than €10 billion, and an increase in the clustering of multiple storms within a single year. Clearly the reinsurance industry's ability to monitor its peak exposures and stay within its risk appetite as the impact of climate change is better understood will have a strong influence on ratings going forward (See Chart 6 on previous page).

Regulation Is An Increasing Influence On Capital And Competitive Advantage

In a financial climate where systemic risk has proved to be damaging, we believe the reinsurance industry presents a good template for controlling and spreading risk effectively. The Geneva Association acknowledged this in their March 2010 report, noting that while the industry is exposed to this type of risk, generated elsewhere in the financial system, it found little evidence of insurance generating or amplifying systemic risk outside areas such as financial guarantees. An extreme tail risk, such as a northeast U.S. windstorm with an occurrence probability of less than 0.2%, might test this assertion, but we broadly agree with the position put forward. The (re)insurance industry has nevertheless failed to escape the far-reaching implications of global financial reform.

The pace of regulatory change has accelerated in response to the financial crisis and appears to be high if not top of the agenda in most reinsurers' strategic planning. Solvency II, the Neal Bill, the Dodd-Frank financial reform bill, and the creation of an Office of National Insurance (ONI) within the U.S. Treasury, and a reorganization of financial regulation in the U.K. is increasingly determining reinsurers' capital, tax, and operating structures and, as a consequence, where they are domiciled, to ensure that they remain competitive. Much of the legislative change has yet to be finalized or enacted, but we have already seen some changes in domiciles and the creation of new operating platforms in Europe as (re)insurers anticipate impending changes. More in-depth analysis of the implications of changing regulation can be found in "Choosing A Domicile Remains A Hot Topic For Global Reinsurers."

Time To Put The Brakes On?

The reinsurance industry continues to weather the financial downturn remarkably well in our view, but we consider that this position of relative strength creates its own problems. After a temporary reprieve, the reinsurance sector is confronted with many of the same issues it had before the financial crisis caused a capacity shortage. Capital is once again abundant and the industry has responded by re-entering a negative phase of the cycle. Disciplined capital management is key to regulating pricing, but how much capital is too much when confidence in the financial markets is still relatively weak?

Interest rates are likely to persist at low levels in the short term in our view, and we consider that the improved financial position of the insurance industry is likely to compress demand for reinsurance and operating margins as primary rates and terms weaken at an accelerated pace, as evidenced in U.S. commercial lines in the second quarter of 2010.

Unless a large loss event occurs, we believe that pricing will continue to soften or, for classes of business that are already below technical rates, remain flat until the economic recovery gathers pace and we enter an inflationary environment that would bring new risks. It is worth noting that it required a hit to capital of more than $50 billion in 2008 to increase prices by a little more than 5% in 2009, or about $15 billion in additional premium income.

Were it not for the fundamental balance-sheet strength of the sector, our outlook would almost certainly be aligned with the downward pressures stemming from the operating and wider environments. Should underwriting cash flows and profitability turn negative under these pressures, we would expect to see more negative rating actions as financial strength weakens. ■

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STANDARD & POOR'S

The Sluggish Economic Recovery And Emerging Regulatory Changes Are Reshaping The Life Reinsurance Landscape

By Robert A Hafner and Miroslav Petkov

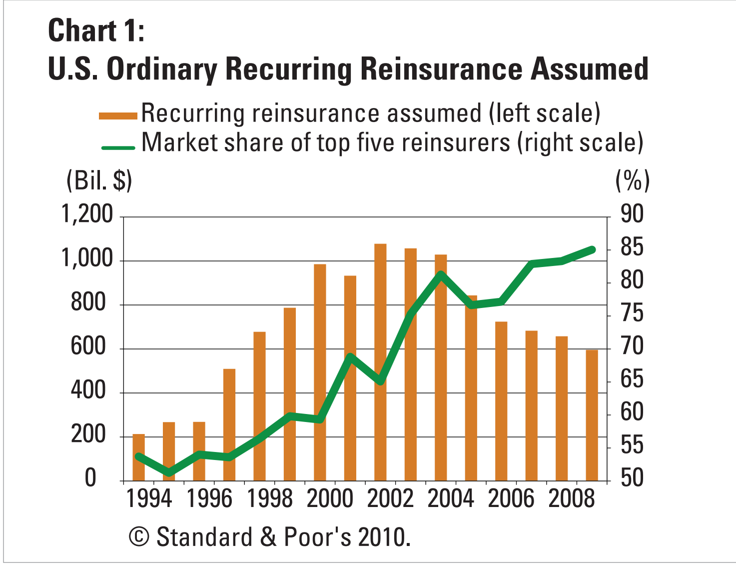
Life reinsurers weathered the global economic downturn relatively well. In fact, most of these companies are emerging from the recession with, in our opinion, strong balance sheets, strong operating performance, and capital that supports their risk profiles and the ratings. But the industry isn't without its challenges.

The sluggish economic recovery in life reinsurers' key markets is requiring them to deploy their limited capital resources cautiously. In addition, the uncertain implications of emerging accounting and solvency standards around the globe for both direct companies and life reinsurers is keeping the industry from venturing too far from familiar, traditional risks. The market dynamics that reduced direct insurance sales also eroded life reinsurers' pricing power slightly, contrary to our expectation last year that their pricing power could improve and meaningfully expand available opportunities.

We now believe it is likely that life reinsurers' pricing power on traditional risks will not change substantially—favorably or unfavorably—during the next year. However, these same circumstances reinforce our long-held belief that life reinsurers will likely expand into new markets and new products to maintain growth opportunities as the global economy stabilizes. Both life insurers and reinsurers were under-prepared to cope with the effects on their variable annuity exposures from an equity market decline as severe as actually occurred because the possibility of such an event was not considered sufficiently plausible. Reinsurers fared better than direct writers because reinsurers accepted relatively limited amounts of VA risk. As the industry moves in other new nontraditional directions, we believe that the more successful players will learn from their missteps in taking on nontraditional variable annuity risks and exercise appropriately high levels of prudence and caution.

Solvency II Could Change The Face Of European Life Reinsurance

Standard & Poor's Ratings Services believes that a key factor that will affect the life reinsurance market in the medium term is the growing aspiration of insurers to optimize their risk/return profile and manage their balance sheet based solely on economic principles. The industry's preparation for the implementation in 2013 of the new regulatory framework in Europe—Solvency II, which is based on economic principles—is accelerating this effort. Other domiciles, such as Switzerland and Bermuda, are also seeking to have equivalent regimes.



Historically, many reinsurance transactions were primarily motivated by improving regulatory balance sheets. However, we believe that the economic impact will increasingly become the dominant consideration in decisions to purchase reinsurance. The change in emphasis from regulatory capital relief to purer economic considerations could reduce the level of mortality risk reinsurance that life insurers purchase. Pure economic considerations might also lead direct insurers to retain more of their mortality risk exposure to diversify their risk profile and optimize their risk-adjusted earnings.

The extent to which economic value considerations will influence reinsurance transactions will depend on the role of risk management in the decision making of the insurers and on their risk-management capabilities. Insurers with stronger risk-management capabilities are more likely to have their internal model approved for regulatory solvency purposes under Solvency II. We believe that the types of reinsurance structures insurers will consider will depend on whether regulatory capital will be determined based on the standard formula or internal models. When designing their reinsurance programs, insurers using their internal model should consistently be able to take into account both the economic benefit of reinsurance and the regulatory capital benefit. However, if the standard formula calibration is not appropriate for the insurer's risk profile, insurers using the standard formula that aim to optimize regulatory capital could purchase suboptimal reinsurance on economic grounds.

We believe the introduction of Solvency II could result in significant consolidation in the European insurance market. This would affect the dynamics of the life reinsurance market, as the larger insurers will have more capacity to retain risks. This could reduce the overall reinsurance demand and put pressure on life reinsurance margins. However, in the short term, there should be increased demand for reinsurance, as it is likely to be one of the main options available to insurers that need to improve capital positions under Solvency II. This will likely boost reinsurance business opportunities, and many reinsurers have already set up special teams to exploit these opportunities.

The Economic Downturn Accelerated The Erosion Of Recurring Reinsurance Volumes In U.S. Markets

The decline in life reinsurance cessions in the largest life reinsurance market globally—the U.S.—continued in 2009. According to the most recent Society of Actuaries study, recurring ordinary reinsurance assumed declined 9.4% in 2009 compared with a 3.7% decline in 2008 and a 34% decline over the previous three years. Recurring assumed business of $596 billion (insurance in force) in 2009 was 45% below the peak of $1.08 trillion in 2002. Initially, the decline occurred primarily because reinsurers raised their prices from very low levels in the early part of the decade, and primary insurers' improved capitalization enabled them to increase retention levels. The lower direct sales levels of primary insurers during the economic downturn accelerated the trend of lower new recurring reinsurance volumes in 2009.

The need to fund XXX redundant reserves was a major contributor to the peak cession volumes in 2002. We believe that life cession volumes in the U.S. could begin to rise again slowly. However, we don't think it will approach the 2002 peak for many years because the less-liquid capital markets and resultant high cost of financing XXX and AXXX redundant reserves has motivated direct insurers to increasingly revise products to generate lower levels of redundant reserves. This moderates the need for capital funding and cession volumes.

Standard & Poor's believes the scarcity of capital for both cedants and reinsurers could increase the pricing power of reinsurers for both recurring business and one-off portfolio transactions. However, life reinsurers will need to manage scarce capital resources and ensure they are able to cover their mainstay regular premium business before deploying significant amounts of capital for block transactions. The lower cession volumes during the recession have instead resulted in more competition among reinsurers for available business and softer pricing in some cases. But past underpricing that led to the need to harden prices significantly in 2004 remains a key concern for life reinsurers, which are generally holding the line on pricing. In addition, investment credit losses and increased capital required under our asset stress criteria limit the amount of excess deployable capital available to U.S.-based reinsurers for capital-intensive transactions while maintaining appropriate capital for the ratings.

The Concentrated Market Is Gradually Reshaping Itself

The life reinsurance sector remains highly concentrated, with Swiss Reinsurance Co. Ltd. (Swiss Re; A+/

Stable/A-1) and Munich Reinsurance Co. (AA-/Stable/--) writing more than half of the global life reinsurance premiums. RGA Reinsurance Co. (RGA; AA-/Stable/--) stands out as the most significant of the few remaining life-only reinsurers. RGA is the only noncomposite reinsurance group with a meaningful and expanding international footprint and consistently holds a top-three new business market share in the U.S. and Canada. The market share for the leading life reinsurers typically hovers at about 20%-25%, and we believe it is probably not sustainable much above 25% for any one company.

With the acquisition of Scottish Re Group Ltd.'s ING-related business and other portfolio transactions, the composite reinsurer Hannover Rueckversicherung AG (Hannover; AA-/Stable/--) increased its U.S. ordinary reinsurance in force more than six fold between 2007 and 2009, improving its market rank to fourth from 11th. Hannover ranked a more distant sixth by recurring ordinary reinsurance in 2009, with less than 30% of the new business of Generali USA Life Reassurance Co. (A/Stable/--), which ranked fifth. In our opinion, the increased mortality data and other resources Hannover acquired position it well to quickly become a force in the U.S. and global life reinsurance markets, where cedants desire a broader panel of high-quality life reinsurers to diversify counterparty exposure and increase competition.

Although in our view Hannover has substantial competitive advantages, the group lacks an extensive facultative underwriting capability. This has proven to be a critical competitive advantage for the established market leaders. Consequently, we believe that the life reinsurers most at risk of losing market share to the ascendant Hannover are the less-established, second-tier life reinsurers that also have not developed this critical offering and lack Hannover's greater financial strength.

In 2009, just five reinsurers controlled 85% of new recurring ordinary life reinsurance business in the U.S. In June 2010, AEGON N.V. (A-/Negative/A-2) announced it is seeking to sell its U.S. reinsurance unit, Transamerica Re, which ranked third at year-end 2009 in terms of both in-force and recurring ordinary insurance assumed. It remains to be seen whether the proposed sale leads to consolidation, brings scale to an aspiring competitor, or provides diversification for another insurer. Other market developments during the past year include the sale of XL Re Life America, XL Capital's small U.S. life reinsurance venture, to SCOR SE (A/Stable/--) and RGA's 2010 acquisition of ING's North American group life, accident, and health reinsurance business. This transaction diversified RGA's capabilities and offerings into a segment where it previously had no presence in the U.S. and only a small presence in Canada.

Expansion Beyond Core Markets Is On Hold For Now

We expect that the lower reinsurance cession rates and slow long-term growth of the dominant but mature mortality markets (primarily the U.S. and U.K.) will increasingly cause life reinsurers to seek out nontraditional risks and expand into less-saturated markets to sustain growth. But for now, the need to manage capital resources carefully has slowed this expansion. The growth opportunities in traditional mortality risks will not likely rebound significantly as the economic turmoil subsides.

In addition to the mortality and retirement savings segments, the life reinsurance sector is more actively supporting long-term care, critical illness, longevity, and health care risks. As the proportion of retirees increases in populations in the developed markets, we believe that these segments will provide a significant growth opportunity for the sector. After life reinsurers learned a painfully hard lesson from the recent bear equity market—closing treaties to new business and refusing to accept new nontraditional equity-linked minimum guarantee exposures on variable-annuity (VA) products—we do not expect them to renew their interest in this segment any time soon.

As the poor results from VA minimum guarantee reinsurance demonstrate, these nontraditional areas of emerging interest for life reinsurers are less well understood and less predictable than are their traditional mortality risks. If strong risk management and astute risk selection do not offset the increased uncertainty, the change in risk profile could erode the life reinsurance sector's financial profile.

High Collateral Funding Costs Are Accelerating Product Changes

Uncertain markets and scarce capital resources have kept collateral funding costs high and securitization activity very low in the U.S. for new funding arrangements for redundant XXX reserves on term insurance and redundant AXXX reserves on universal life insurance with secondary guarantees. Insurers and reinsurers had increasingly relied on long-term letters of credit (LOCs) to fund collateral needs. For a time, the market shock and economic turmoil of the past two years shut down collateral financing through securitization and LOCs. This forced primary insurers to warehouse their excess reserves, which existing capital resources had to fund. To conserve capital, reinsurers have increased their pricing for reinsuring redundant reserves and reduced its availability. These circumstances have forced direct insurers to accelerate product development changes to limit the emergence of redundant reserves on new issues and conserve capital.

Complete regulatory relief from redundant reserves, which the industry widely considers to be uneconomic, is still distant. However, U.S. regulators are taking a renewed interest in comprehensively developing more economic reserve standards because of the increasing need to allocate capital to true economic risks. We believe a revival of the securitization and LOC collateral funding markets will be necessary if life reinsurers are to fully resume their role of

intermediating securitization of redundant reserves in the U.S. Eventually, though, we believe the regulatory reserve standards must evolve to reduce the inefficiency of redundant reserves. Maintaining inefficient reserve requirements could put U.S. insurers at a distinct economic disadvantage relative to European insurers following the introduction of Solvency II, which is based on economic principles.

Extreme Mortality Risk Lives On

The Emergency Committee of the World Health Organization (WHO) determined that as of August 10, 2010, the pandemic outbreak of H1N1/09 influenza (more commonly known as swine flu) has largely run its course and entered the post-pandemic period. The WHO expects the H1N1/09 virus to behave like a seasonal influenza virus and continue to circulate for some years to come. During the pandemic, which was identified in April 2009, the H1N1/09 virus spread to nearly every corner of the globe and resulted in more than 18,000 deaths. The impact on insured lives was negligible because of a strong and coordinated international response. However, life insurers, reinsurers, and their regulators remain alert to the potential of extreme mortality from unexpected sources, including viruses known to mutate rapidly, and they are taking precautions to guard the financial stability of the industry if the worst were to happen.

An example of active regulatory interest in the potential impact of extreme mortality is the Canadian regulator, The Office of the Superintendent of Financial Institutions (OSFI). OSFI annually asks its domestic life insurers to run stress tests to better understand their resilience under various circumstances. This year, OSFI is requiring scenarios that test each company's ability to withstand a major pandemic, among other events. The results of these tests are confidential, but if a company does poorly, OSFI could require it to hold additional capital to improve its ability to withstand the particular stresses. Solvency II will likely employ similar approaches.

Insurer and reinsurer mortality exposure is significant. In the U.K., the gross sums at risk (that is, the amount insurers would pay, in excess of reserves held, in the event of a mortality claim) exceeds £2.1 trillion, according to U.K. Financial Services Authority statutory returns. Approximately half of the U.K. exposure is reinsured (net sums at risk exceed £1.1 trillion). In the U.S., gross sums at risk exceed $18 trillion, with more than 40% of the exposures reinsured.

Other than reinsurance, insurers' options for managing mortality risk include the issuance of annuity contracts (to imperfectly hedge mortality exposure across the whole insurance portfolio) and the issuance of mortality catastrophe bonds (MCBs). MCBs are a relatively new tool that allows insurers with large mortality exposure to transfer the risk of higher-than-expected mortality experience on part of the insured portfolio to the capital market. Both insurers and reinsurers have issued MCBs to protect themselves from extreme mortality risk (generally, pandemic risk), but to an extent, MCBs also protect these issuers from terrorism events and significant adverse changes in mortality trends. Recent issuance of MCBs has been limited, but both SCOR and Swiss Re have issued mortality bonds in the past year to moderate their exposure to extreme mortality risk. Standard & Poor's expects that pandemic risks and heightened regulatory concerns about insurer financial strength will likely spur further MCB issuance as insurers and reinsurers seek to actively manage their risks.

Reinsurers Are Cautious On Older-Age Mortality

Estimating insured mortality for lives older than 70 remains problematic compared with estimates of mortality for younger ages, which are based on vast historical data. Because of the increasing proportion of older insured lives in developed markets materially increases the importance of accurately estimating older-age mortality for both primary and life reinsurers.

The shape of the mortality curve at older ages is less stable than at younger ages. Studies of U.S. experience suggest that the older-age mortality curve might be steepening, which would result in earlier claims than expected and reduced profitability on life insurance and reinsurance. Until sufficient volumes of data allow the industry to observe and predict mortality trends with greater certainty, life reinsurers will likely continue to evaluate these risks cautiously.

The emergence of at-issue and post-issue investor-owned life insurance (IOLI) has intensified the uncertainty regarding older-age mortality. Such policies involve older insured lives, usually with high sums insured. IOLI investments appeal to investors seeking higher returns uncorrelated with other investments. But the investment is predicated on a belief that the investor knows something bad about the insured life that the insurer does not. Investors profit when they correctly estimate earlier mortality by collecting death benefits earlier than the insurers assumed in their pricing. Insurers that do not accurately factor this into their pricing could see accelerated insured mortality claims erode their profitability. Life settlement activity dropped in 2009 because investors became concerned over longer life expectancy projections than were previously assumed in pricing the investments and the scarcity of capital during the recession.

The Longevity Market Continues To Develop

We believe that corporations and pension schemes remain keen to reduce longevity risk, though it is uncertain whether it is reinsurers, capital markets, or specialist vehicles that have the most appetite for longevity risk. Although we expect activity in this segment to increase as the global economic recovery finds firmer footing, there is not enough capital in the life insurance segment to support all of the potential longevity business available. It's not clear whether the

capital markets will prefer to provide capital directly to life reinsurers or if the life reinsurance industry will act more as expert intermediaries to longevity-linked securitizations. The balance between these outcomes will only become apparent as the longevity trading markets develop.

Much of the activity in the longevity market is occurring in Europe, with the U.K. in particular leading the market development, but mainly with regards to longevity exposure of pension funds. According to Lane Clark & Peacock, in 2009, there were £3.7 billion of pension buy-outs and buy-ins and £3.8 billion of longevity swaps. But this is a very small fraction of the potential size of the longevity market. Lane Clark & Peacock also estimates that there is more than £1 trillion of private-sector defined benefit liabilities in the U.K. This does not include immediate and deferred annuities on insurance-company balance sheets.

In the beginning of 2010, major insurers, reinsurers, and investment banks active in longevity risks established the Life and Longevity Market Assoc. (LLMA) in London. Its main goal is to promote a liquid traded market in longevity and mortality-related risk. The LLMA aims to support the establishment of consistent standards, methodologies, and benchmarks to help develop the longevity risk market.

U.S. individual longevity exposure is relatively low, but we expect that it will grow materially given the demographic trends and continuing shift of responsibility for retirement funding from corporations to individuals. The dynamics of the U.S. longevity market are much less developed than in the U.K. because the broad mandate there to annuitize a proportion of each individual's retirement funds provides a broad base of exposure with less potential for anti-selection than in the U.S. market. Corporate and municipal pension plans in the U.S. have considerable longevity exposures, but underfunding inhibits a robust longevity market from emerging quickly. Standard & Poor's believes that life insurers and reinsurers will play a significant role in developing these markets—both by assuming longevity exposures and as intermediaries in the securitization of longevity risks.

As Life Reinsurers' Financial Strength Steadies, They Are Deploying Capital Carefully

Contracting cession rates limit the long-term growth prospects of the life reinsurance sector while more reinsurers are jockeying for market share. We believe that after the global economy stabilizes, reinsurers are increasingly likely to resume pursuing newer, less-well-understood, and potentially more volatile products to sustain long-term growth and profitability. The sector benefited by being reluctant to provide extensive reinsurance for variable annuity equity-linked minimum guarantees. This limited the impact from the equity market decline and raised awareness of reinsurers assuming nontraditional nonmortality risks. Because nontraditional risks are likely to become more prominent within life reinsurance portfolios, we believe the industry will increasingly need to deploy capital carefully.

During the past year, the insurance industry and society in general were largely successful in moderating the impact of the H1N1/09 and H5N1 pandemic threats. But we believe the risk of extreme mortality in the industry's foundational business persists and should continue to be taken seriously. While known disease threats persist, climate change could unpredictably accelerate the rate at which pathogens mutate, attain virulence, and spread globally. These are strong reasons for the industry to remain vigilant on these traditional risks and continue to develop MCB and other risk-control and -transfer mechanisms.

The risks of extreme mortality events complicate the insurance industry's efforts to build a critical mass of older-age mortality data and rely on it because pathogen-caused extreme mortality events will likely affect the very young and the very old most severely.

We believe life insurance-linked securitization transactions continue to have a wide potential scope. As the capital markets thaw, we anticipate that life reinsurers will have an important role in this market. Reinsurers will likely continue to issue insurance-linked securities and intermediate capital-management solutions for cedants because reinsurers' specialized and broad knowledge of the life insurance and longevity markets will facilitate issuance. ■

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Global Reinsurers Lead The Way In Enterprise Risk Management

By Hiltrud Besgen, Laura Santori and Rob Jones

The global financial crisis has revealed a number of weaknesses in the enterprise risk management (ERM) of several insurance companies. Standard & Poor's Ratings Services sees the ERM framework as an important tool for insurers to identify, measure, and manage risk; crucial elements to preserve their financial strength.

Since we introduced our ERM criteria in 2005, we have observed that global reinsurers and groups with reinsurance as a key component (subsequently referred to together as reinsurers) generally have more-advanced ERM capabilities than pure primary insurance writers. ERM is of high importance to our rating assessment of global reinsurers because of the complexity and volatility of the reinsurance business.

Among the insurance companies we rate across the world, reinsurers dominate our "excellent" and "strong" ERM assessments. We distinguish "excellent" ERM programs from "strong" ones mainly if we see a much longer track record of efficient, well-entrenched, and highly advanced ERM practices in the everyday processes and culture of the company.

We have seen further evidence of ERM's value for reinsurers in 2010. In our view, many reinsurers have adhered to prudent investment policies, and there were only moderate rate declines in the 2010 renewal season. We believe this reflects, to some extent, the impact of advanced ERM frameworks, which, in our view, have heightened risk awareness, owing to better risk-measuring techniques and risk-selection practices among global reinsurers.

However, we forecast lower earnings for global reinsurers this year because of major catastrophe losses in the first half of 2010, owing to events like the earthquake in Chile and the oil rig explosion in the Gulf of Mexico. Moreover, we believe that the weak global economy, a decline in available business, and lower premium rates are likely to dampen reinsurers' profitability over the next few years.

Against this backdrop, we regard it as crucial for reinsurers to maintain their commitment to effective ERM practices and to continuously update their risk-management frameworks in order to preserve their financial strength. We see that reinsurers are generally continually developing their risk-management culture, technical risk controls, and modeling capabilities. Reinsurers have also made progress in developing strategic risk management. However, in light of the still uncertain capital-market environment, we believe they have to further enhance investment risk controls because they are typically large institutional investors.

We believe that reinsurers, in particular, those whose ERM we score as "excellent", "strong", and to a lesser extent "adequate with a positive trend", are well placed to manage additional regulatory requirements under various regimes. In our view, the changing regulatory environment and increasingly risky operating conditions could even offer reinsurers with highly advanced ERM capabilities new business opportunities.

ERM Has Shown Its Value

ERM capabilities have continued to show their efficacy this year. The 2010 renewal season saw only moderate rate declines and many reinsurers kept to what we regard as prudent investment policies. This reflects, in our opinion, the impact of advanced ERM frameworks, which have enhanced risk awareness through better tools for risk measurement and selection across the global reinsurance sector. We have observed a reduced willingness to provide reinsurance capacity at inadequate rates, with some players scaling back their business and reducing their peak exposures to mitigate risk.

The industry suffered several major catastrophe losses in the first half of this year, including the earthquake in Chile and the oil rig explosion in the Gulf of Mexico. If reinsurers' ERM practices were to slacken off, the risks for their financial profiles could mount, hampering their results for the next two to three years. Premium rates could fall below a level that is commensurate with the risk.

Nevertheless, we regard recent decisions by some reinsurers as an indication that strategic risk management has gained importance in the industry. In our view, some of them may have chosen to return excess capital to shareholders through share buybacks or special dividends because they believe the prospects for profitable growth to be limited in a difficult economic environment.

"Excellent" Or "Strong" ERM: What Makes The Difference?

Whether we classify an ERM program as "excellent" or "strong" depends on our assessment of the company's risk-management culture, strategic risk-management processes, and emerging-risk management, according to our criteria (see table 1).

We believe it could take longer for large highly complex groups with wide-ranging business and geographic segments to fully and deeply ingrain a consistent groupwide ERM program and culture than for less complex groups with a more focused business model.

We currently regard the ERM programs of the Endurance Group, Partner Re, and Renaissance Re as "excellent". All three groups differentiate themselves from reinsurers that we consider to have "strong" ERM capabilities through their well-seasoned and sophisticated ERM practices, in our view. We have seen the efficacy of their ERM through resilient earnings and capital profiles under diverse and testing market conditions. We believe that these companies' long-standing commitment to ERM is an important factor in their superior performance over the cycle, despite their strong focus on writing highly volatile natural catastrophe risks across the world. Between 2005 and 2009, they recorded average non-life returns on revenue of about 22%, non-life net combined ratios of about 87%, and returns on equity of about 14%. This is despite extraordinary hurricane losses in 2005 and the financial market and economic crisis of 2008.

Reinsurers Top Our Assessments Of Insurance Companies' ERM Programs

Among the 339 insurance groups we rate across the world, reinsurers figure prominently in the "excellent" and "strong" categories (see chart 1). (For more information see "Enterprise Risk Management Con-

Table 1

Enterprise Risk Management Score Features

Classification	Definition
Excellent	Insurer has, in our opinion, extremely strong capabilities to consistently identify, measure, and manage risk exposures and losses within the company's predetermined tolerance guidelines. Risk control processes are leading edge, applied consistently, and executed effectively. The company continues to develop its risk control processes to integrate new technologies and adapt to the changing environment. There is consistent evidence of the enterprise's practice of optimizing risk-adjusted returns, resulting in an overall stronger financial strength than peers. Risk and risk management heavily influence the insurer's corporate decision-making.
Strong	Insurer has, in our opinion, strong capabilities to consistently identify, measure, and manage risk exposures and losses within the enterprise's predetermined tolerance guidelines. A strong ERM insurer is somewhat more likely to experience unexpected losses that are outside of its tolerance level than an excellent ERM insurer. There is clear evidence of the enterprise's practice of optimizing risk-adjusted returns, though it is not as well developed as those of an excellent ERM insurer. Risk and risk management are important considerations in the insurer's corporate decision-making.
Adequate with positive trend	Further along the ERM capability continuum are those companies that have a strong assessment for risk management culture and the near-term potential for strong strategic risk management in addition to having all of the characteristics of companies assessed as adequate with strong risk controls. It is our expectation that a strong assessment of ERM is possible for these companies within 24 months.
Adequate with strong risk controls	These companies generally operate with traditional and largely silo-based risk management practices. They have strong or excellent risk controls for all material risks but, in our opinion, have not developed an holistic view of their risks through a fully developed economic capital model or other tools. Strong risk controls are a key component to maintaining results within tolerance. Therefore, a company in this category will have demonstrated not only the ability to identify and measure its key risks, but in addition, strong mitigants and controls have been put into place, which enable the company to manage its risk within stated tolerances at a very high level of confidence.
Adequate	Insurer has, in our opinion, capabilities to identify, measure, and manage most major risk exposures and losses, but the process has not been comprehensively extended to all significant risks facing the enterprise. Insurer loss/risk tolerance guidelines are less developed. Execution of its existing risk management programs is sufficient, albeit less comprehensive, than are strong and excellent ERM practices. Unexpected losses are more likely to occur, especially in areas beyond the scope of the existing ERM practices. Risk and risk management are often important considerations in the insurer's corporate decision-making.
Weak	Insurer has, in our opinion, limited capabilities to consistently identify, measure, and manage risk exposures across the company and, thereby, limit losses. Execution of its risk management program is sporadic, and losses cannot be expected to be limited in accordance with a set of predetermined risk/loss tolerance guidelines. Risk and risk management are sometimes considered in the insurer's corporate decision-making. Business managers have yet to adopt a risk management framework, are satisfying regulatory minimums without regularly applying risk management to their business decisions, or have very recently adopted a risk management system that has yet to be tested.

tinues To Show Its Value For North American And Bermudan Insurers," published on Feb. 1, 2010, and "Insurers In EMEA See The Value Of Enterprise Risk Management," published on May 5, 2010).

In North America and Bermuda, three of the five companies with an "excellent" ERM score and seven of the 19 companies with a "strong" score are reinsurers. In Europe, the Middle East, and Africa (EMEA), reinsurers represent 7 of the 25 companies with "strong" ERM assessments. We cite ERM practices as playing an important role in reinsurers' business profiles in our main outlook article "2009's Perfect Calm Breeds Stormier Climate For Global Reinsurance In 2010", published on Jan. 26, 2010.

In 2009, we published our analysis of global reinsurers' ERM (see "Raising The ERM Bar: Tighter Practices For Tougher Times," published on Sept. 18, 2009). Since then, the proportion of strong and excellent ERM assessments has climbed to 36% of the total from 31% (see table 2). Nevertheless, we now consider only three of 41 reinsurers, instead of four in our 2009 report, to have excellent ERM capabilities.

The quality of ERM sets reinsurers apart from their peers

We have revised our ERM assessments for some reinsurers over the past year, in line with our view of their performance and ERM frameworks during the recent financial crisis (see table 3). We lowered the ERM score in cases where we saw ERM deficiencies and the insurer or reinsurer had experienced higher losses than peers that were also unexpected and outside internal risk-tolerance limits.

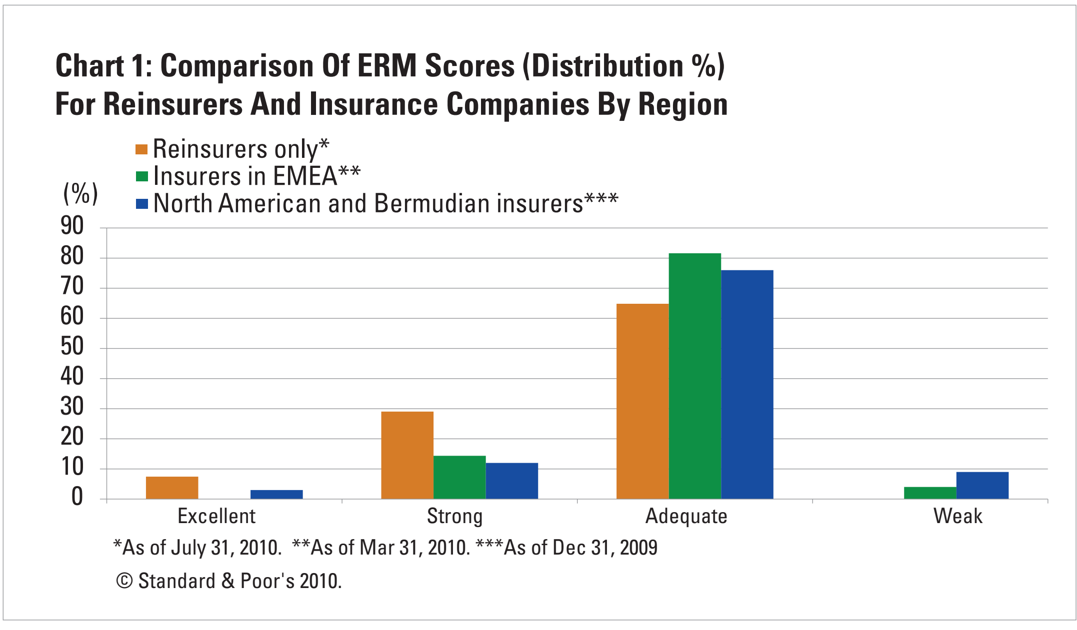
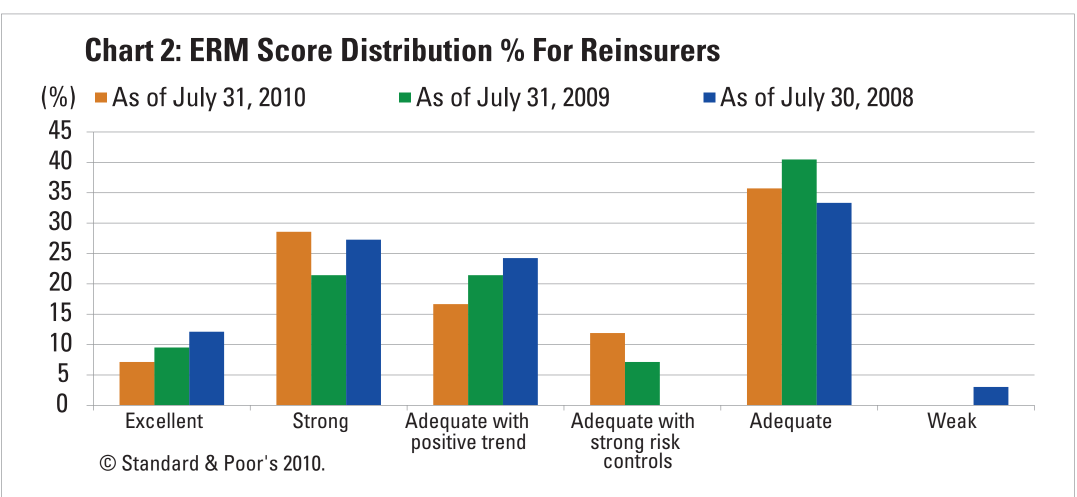


Table 2

ERM Score Distribution For Reinsurers (2008-2010)

	July 2010		July 2009		July 2008	
ERM score	Number of reinsurers	Percentage of total (%)	Number of reinsurers	Percentage of total (%)	Number of reinsurers	Percentage of total (%)
Excellent	3	7	4	10	4	12
Strong	12	29	9	21	9	27
Adequate with positive trend	7	17	9	21	8	24
Adequate with strong risk controls	5	13	3	7	0	0
Adequate	14	34	17	41	11	34
Weak	0	0	0	0	1	3
Total	**41**	**100**	**42**	**100**	**33**	**100**



In the case of Manulife Financial Corp., we revised our assessment of its ERM practices to "strong" from "excellent". We believe that the main reason for Manulife's underperformance was management's aggressive tolerance for equity-linked exposures while assuming the likelihood of sharply lower equity markets occurring in the near term was remote notwithstanding historical precedence. We believe that management accurately understood the financial consequences of such a potential market event. However, management accepted growing variable annuity equity-linked exposures without establishing risk controls in time to moderate the financial consequences should that contingency be realized. Before the 2008 bear equity market emerged, Manulife's equity risk controls were limited primarily to reinsurance of some pre-2004 equity-linked liabilities. This resulted in equity risk controls that were neither leading edge nor applied consistently even though the technologies to implement effective controls were available and extensively utilized by peers. Management relied on capital strength to withstand levels of equity volatility thought to be credible and was inadequately pre-

pared for more extreme contingencies. We believe a more advanced risk-appetite framework could have resulted in a more timely establishment of equity risk controls to limit the impact of less probable events. Assessing an insurers risk-appetite framework is an important component or our ERM assessment and earlier this year we refined our criteria performing this assessment.

Notably, the number of reinsurers we regard as having "strong" ERM programs increased to 12 from 9 (see table 2). We raised the ERM score to "strong" for those reinsurers we considered to have shown effective ERM during the financial crisis because their financial profiles stayed strong and earnings volatility low. We placed the Platinum group, which we published this year for the first time, in the "strong" category. In addition, we raised our assessment of Catlin Group's and SCOR SE's ERM to "strong" from "adequate with a positive trend". Moving out of the "strong" category was Berkshire Hathaway's reinsurance operations, which we now assess as "adequate with strong risk controls" because each subsidiary manages risk largely independently, and there is as yet no holistic approach.

Regional reinsurers, mainly from the Middle East, dominate the "adequate" category. Reinsurers from this region typically have less complex business models, narrower risk profiles with very limited exposure to long-tail risk or natural catastrophes, and high capitalizations relative to their risk exposures. Consequently, we think a sophisticated ERM system is less crucial for these companies to maintain their financial strength. We observe, however, that some reinsures in the Middle East are increasing their risk exposures by investing excess capital in riskier asset classes, such as equity and real estate. This could result in a need to further develop their ERM capabilities in the short term.

A small number of reinsurers migrated from the

Table 3

Reinsurance ERM Assessments And Ratings*

As of July 31, 2010

Reinsurer	ERM score	Insurer financial strength rating
Endurance Specialty Holdings Ltd.	Excellent	A
PartnerRe Ltd.	Excellent	AA-
RenaissanceRe Holdings Ltd.	Excellent	AA-
ACE Tempest Reinsurance Ltd.	Strong	A+
Arch Capital Group Ltd.	Strong	A+
Aspen Insurance Holdings Ltd.	Strong	A
AXIS Capital Holdings Ltd.	Strong	A+
Catlin Group Ltd.	Strong	A
Hannover Rueckversicherung AG	Strong	AA-
Manulife Financial Corp.	Strong	AA+
Munich Reinsurance Co.	Strong	AA-
Platinum Underwriters Holdings Ltd.	Strong	A
QBE Insurance Group Ltd.	Strong	A+
SCOR SE	Strong	A
Swiss Reinsurance Company Ltd.	Strong	A+
Allied World Assurance Co. Holdings Ltd.	Adequate with positive trend	A-
Amlin PLC	Adequate with positive trend	A
Deutsche Rueckversicherung AG	Adequate with positive trend	A+
Korean Reinsurance Co.	Adequate with positive trend	A-
Montpelier Re Holdings Ltd.	Adequate with positive trend	A-

lower adequate categories to higher ERM scores over the past year (see table 4). This indicates, in our view, that companies with less advanced ERM capabilities may find it difficult to catch up with the state-of-the-art practices of the industry. We therefore believe that the gap between companies with what we see as only basic ERM practices and those with more sophisticated and continually developing programs could widen in the future, with a corresponding impact on their competitive and financial strength.

Continual Enhancements Of Major ERM Components

Our ERM score represents a holistic view, taking into account the strength and efficiency of major ERM components, such as the risk-management culture, controls for investment, underwriting, and reserving risks, as well as the management of emerging and strategic risks (see chart 3).

Focus on risk-management culture and technical risk controls

We observe that reinsurers generally continue to enhance components of their ERM practices. Of the 41 reinsurers we rate worldwide, we assess about 63% to have either an "excellent" or "strong" risk-management culture as of July 31, 2010, up from 60% in 2009.

In our opinion, the increase in the number of reinsurers we classify as having "excellent" or "strong" risk management culture since 2009 shows that the majority of reinsurers have implemented a consistent risk-appetite framework and effective risk-management policies and processes. We believe that the three reinsurers with an "excellent" score for risk management culture have demonstrated a culture of controlled risk-taking that is comprehensively and deeply ingrained across all levels of their operations. In our opinion, this should place them in a relatively better position than peers with lower ERM scores to minimize or prevent losses outside of their defined risk tolerances.

Table 3 continued

Toa Reinsurance Co.	Adequate with positive trend	A+
XL Capital Group	Adequate with positive trend	A
Everest Reinsurance Co.	Adequate with strong risk controls	A+
General Reinsurance Group	Adequate with strong risk controls	AA+
Lancashire Insurance Co. Ltd.	Adequate with strong risk controls	A-
Transatlantic Holdings Inc.	Adequate with strong risk controls	A+
White Mountains Re Group Ltd.	Adequate with strong risk controls	A-
Arab Union Reinsurance Co.	Adequate	BB+
BEST RE	Adequate	BBB+
Caisse Centrale de Reassurance	Adequate	AAA
Kuwait Reinsurance Co. K.S.C.	Adequate	BBB
Lloyd's	Adequate	A+
Nacional de Reaseguros S.A.	Adequate	A+
Odyssey Re Group Ltd.	Adequate	A-
Reinsurance Group of America Inc.	Adequate	AA-
Saudi Re for Cooperative Reinsurance Co.	Adequate	BBB+
Societe Centrale de Reassurance	Adequate	BBB+
Taiping Reinsurance Co. Ltd.	Adequate	A-
Takaful Re Ltd.	Adequate	BBB
Thai Reinsurance Public Co. Ltd.	Adequate	A-
Trust International Insurance & Reinsurance Co. B.S.C.(c)	Adequate	BBB+

*ERM scores and ratings refer to the core operating (re)insurance entities of the groups listed.

Table 4

ERM Score Migration

		2010 Score					
		Excellent	Strong	Adequate with positive trend	Adequate with strong risk controls	Adequate	Weak
2009 Score	Excellent	3	1	0	0	0	0
	Strong	0	8	0	1	0	0
	Adequate with positive trend	0	2	5	1	0	0
	Adequate with strong risk controls	0	0	2	1	0	0
	Adequate	0	0	0	1	13	0
	Weak	0	0	0	0	0	0

We consider the underwriting, catastrophe and reserving risk controls of more than half of the rated reinsurers to be "excellent" or "strong". This reflects our view that their business models focus on taking and managing insurance risk rather than on managing investment risks.

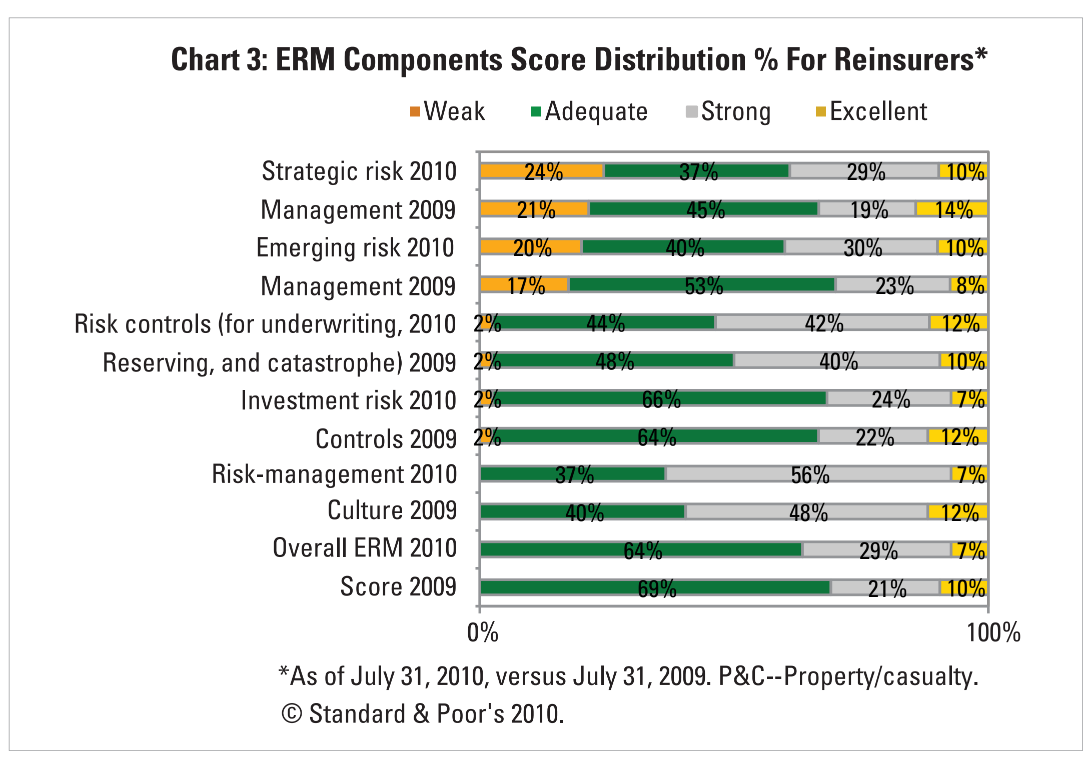
Furthermore, we believe continuous enhancements of modeling techniques for insurance risk, including stress testing, have heightened reinsurers' understanding and awareness of this risk and fuel further development of instruments and processes.

Investment Risk Controls Are Not As Advanced

We continue to see investment-risk controls as less developed within the industry, with only 31% of the players having an "excellent" or "strong" score. Although many companies appear to have maintained conservative investment strategies and show a low appetite for investment risks, we believe that in an uncertain capital market, sophisticated and effective investment risk controls are highly important. They help (re)insurers, which are typically large institutional investors, to keep potential losses within their risk limits while at the same time optimizing returns even in a difficult capital market environment.

Strategic and emerging-risk management are gaining importance

An increasing number of reinsurers are realizing the value of strategic risk management, in our view. They have improved their capabilities, including the consideration



*As of July 31, 2010, versus July 31, 2009. P&C--Property/casualty.

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of risk- and return-oriented targets and the performance metrics in their strategic decision-making processes and management compensation programs. We now assign "excellent" or "strong" strategic risk-management capabilities to 39% of the reinsurers we rate, up from 33% in 2009. We see the recent decisions of some insurers to return excess capital to shareholders as an indication of the rising importance of strategic risk management.

We also observe continuous progress in the industry regarding the setup of effective emerging-risk management to identify, evaluate, and monitor potential risks that could arise from changes in the political, legal, market, or physical environment. The proportion of reinsurers with "strong" or "excellent" scores in emerging risk management increased to 40% from 30%.

ERM Level III Will Soon Augment Our Analysis

In our view, a credible economic-capital model (ECM) and a strong ERM program are fundamental to an insurance company's management and decision-making processes. We have proposed a refinement of our criteria for analyzing ECMs as a third dimension in our ERM analysis (the "ERM Level III" review).

ERM Level III reviews will soon be part of our rating analysis of all insurers and reinsurers. We believe that ECM reviews are likely to yield significant additional insight about the companies' ERM capabilities, including how they quantify risks, the interdependencies within their risk profiles, and a clearer picture of their capital needs.

We have proposed a set of specific criteria for our ECM analysis and published a request for comment encouraging all market participants to respond to our proposal (see "A New Level Of Enterprise Risk Management Analysis: Methodology For Assessing Insurers' Economic Capital Models," published on May 19, 2010). We do not generally expect to make significant rating changes if we adopt the criteria as proposed. Because of the importance our ERM criteria place on the economic quantification of risks, we presently expect only insurers with credible ECMs to achieve an ERM score of "excellent".

Reinsurers Could Benefit From Regulatory Changes

We believe that reinsurers, in particular, those whose ERM we score as "excellent", "strong", and to a lesser extent "adequate with a positive trend", are well prepared to manage additional regulatory requirements under various regimes, such as Solvency II in the EU, the Individual Capital Adequacy Standards in the U.K., Switzerland's solvency test, and the Bermuda Monetary Authority's regulatory practices. The latter partly derive from the desire to achieve equivalence with the EU's Solvency II guidelines.

In our view, reinsurers with advanced ERM capabilities are in a relatively good position to receive approval to use their own internal models to define regulatory capital. This, we believe, should allow them to optimize their capitalization levels to suit their specific risk profiles. The European and Bermudian reinsurers with an "adequate" ERM score could find it difficult to meet the demanding requirements for internal model certification. They may be forced to use the standard regulatory formula to determine the level of capitalization, with the consequence that they have to hold and service more capital than their risk exposures may warrant, which could reduce their competitiveness.

Overall, we believe that reinsurers of high credit quality, specifically, those we regard as having "strong" or "excellent" ERM practices, will gain from the new regulatory environment. They are likely to benefit from a higher demand for reinsurance protection as insurance companies placing business with them (cedants) seek relief from capital requirements under Solvency II. Additional business opportunities could also arise for reinsurers if they can use their sophisticated ERM capabilities to design and offer cedants new, Solvency-II-compatible reinsurance arrangements and insurance-linked security solutions.

ERM Is Crucial In An Adverse Operating Environment

We believe that the weak global economy, combined with a decline of insurable exposures and a continued softening of premium rates, is likely to put pressure on the profitability of reinsurers over the next few years. From this standpoint, we regard it as critical that reinsurers, to maintain their financial strength, continuously reinforce their commitment to effective ERM practices by regularly updating their risk-appetite frameworks and sticking to a risk- and return-oriented underwriting and investment strategy. Management's ongoing commitment to ERM is, in our view, fundamental to keeping potential losses within a reinsurer's defined risk tolerance, while at the same time maximizing the returns from risk, particularly in an adverse operating environment.

We believe that reinsurers with consistently strong ERM practices could generate competitive advantages from multiple perspectives. They are likely to benefit from additional placements from primary insurers that are increasingly seeking greater credit quality when placing their reinsurance programs. Furthermore, ERM could serve as a business enabler if reinsurers exploit their advanced understanding of risk and their sophisticated emerging-risk management capabilities to create new business opportunities and design products to provide protection in an increasingly risky environment. ■

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Approach To Assessing Insurers' Enterprise Risk Management Refined In Line With Industry Improvements

By Laura Santori and Rob Jones

Standard & Poor's Ratings Services believes that all insurers and reinsurers need to keep developing their risk management frameworks to ensure they benefit from the latest techniques and can manage their evolving risk profiles. Reinsurers, as the first to implement full enterprise risk management (ERM) frameworks, have likely had most experience in adapting their frameworks to suit their changing needs and economic conditions.

In the five years since we first evaluated ERM, we have enhanced our approach several times. In recent months, we have published two important articles on our criteria. First, we have refined our criteria for assessing insurers' risk appetite frameworks. Second, we have solicited industry responses to our proposals for assessing insurers' economic capital models (ECMs).

Risk Appetites Have Become More Explicit

In our opinion, the financial crisis exposed a number of weaknesses in insurers' risk appetite frameworks. Some insurers were quite active in acquiring risks that we doubt whether they fully understood; therefore, they were unable to manage these risks within their stated risk tolerances. In response, we have refined our approach to assessing an insurer's risk appetite framework (see "Refined Methodology For Assessing An Insurer's Risk Appetite", published on March 30, 2010).

The article summarizes the features of risk appetite frameworks that we deem to be more and less favorable in our analysis. Some of the features deemed to be more favorable in our analysis of ERM frameworks include:

- Buy-in and use of the risk appetite framework by the board of directors, subsidiaries, and business units. We look for evidence that these stakeholders were involved in establishing the risk appetite tolerances and actively reference the risk appetite in setting risk tolerances, risk limits, risk policies, governance structure, and compensation structures.
- Regular reporting of risk profile and risk appetite, both internally and externally, to help stakeholders find insurers that share their views on risk.

Chart 1
The ERM Level III Review In The Rating Context

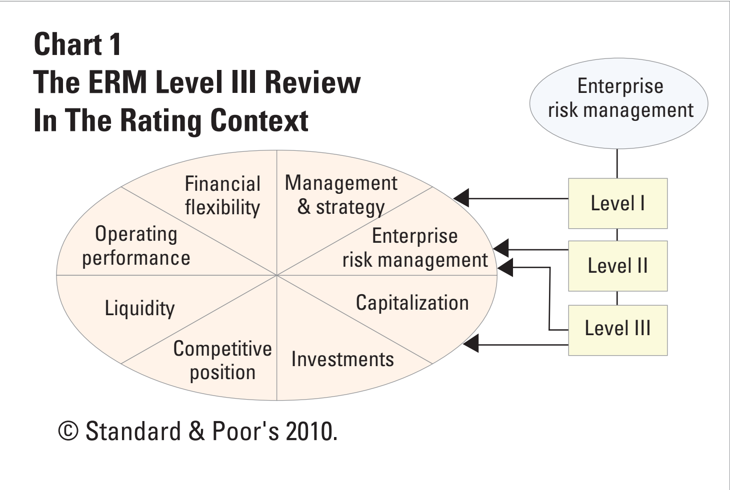

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Table 1

Application Of The M-Factor When An Insurer Calculates Lower Total Target Resources Than Standard & Poor's	
	($)
Standard & Poor's target capital*	100
Standard & Poor's TTR*	900
Insurer's TTR¶ (based on its ECM)	700
Application of 10% M-factor as per ECM review	
POST M-factor TTR [($700x10%) + ($900x90%)] = $880	880
Post M-factor target capital§	80
Reduction in target capital§	20
Maximum allowed reduction in target capital§ (equivalent to one rating category)	10
Post review target capital§	90
Post review TTR§	890

*Based on Standard & Poor's risk-based capital model. ¶Based on the insurer's economic capital model (ECM). §Standard & Poor's calculations. TTR--Total target resources. © Standard & Poor's 2010.

- Articulation of risk preferences--qualitative risk appetite statements--that set out the underlying principles for risk selection and prejudice for and against specific risks based on the insurer's competencies. We view the process of articulating these preferences as fundamental, helping to inform a (re)insurer's strategic risk positioning in terms of the economies, markets, products, and customers to which they seek exposure. We view risk preferences more favorably where these link to the insurer's goals and competences.
- Articulation of risk tolerances that constrain risk exposure across multiple risk measures, with multiple trigger points. We view risk tolerances more favorably where they are explicitly linked to the (re) insurer's key risk measures.
- Articulation of risk limits that serve to constrain risk-taking activities at an operational level, with multiple trigger points and the ability to reconcile the risk limits with the risk tolerances. We view the articulation of risk limits more favorably where these can be clearly reconciled with the (re)insurer's risk tolerances.

Economic Capital Models Are Increasingly Relied Upon For Decision-Making

In May 2010, we published a request for comment on a proposed change to our criteria (see "A New Level Of Enterprise Risk Management Analysis: Methodology For Assessing Insurers' Economic Capital Models", published May 19, 2010). We plan to review insurers' economic capital models (ECMs), which we believe would further our understanding of their quantitative risk management capabilities and capital needs.

Developing economic capital models

Reinsurers were particularly quick to see the advantages of ECMs, and over the past few years, many insurers have also developed ECMs as a means of assessing their risk-based capital (RBC) requirements. These developments reflect the growing recognition of the benefit that can be derived from a detailed capital assessment tailored to an insurer's risk profile, and the introduction of the new Solvency II regulations in Europe.

Because ECMs have a significant role in both strategic risk management and determining capital levels for insurers, we plan to review ECMs for all rated (re) insurers.

Adding a third level to our ERM review process

ERM forms one of the eight rating factors Standard & Poor's considers as part of its ratings analysis for insurers. When analyzing the ERM framework for an insurer we view as having less-diverse or less-complex risks, we typically conduct an ERM level I review. If we view the insurer as having more-diverse and more-complex risks, and where we see that it has implemented a more extensive ERM program, we conduct an ERM level II review. The proposed assessment of (re)insurers' ECMs would be added as an ERM level III review (see chart 1).

If an insurer has an ECM, we will decide whether to review it based on how it is used, and the extent and availability of supporting documentation. We anticipate reviewing an ECM only where the model output supports the insurer in making its major strategic and operational decisions, and the ERM assessment as a whole is at least "strong."

We anticipate ERM level III reviews will focus on

seven categories: methodology, assumptions, data, process and execution, governance, results, and testing and validation. For each of the categories, we plan to classify the credibility of an insurer's approach into "basic," "good," or "superior." We would then combine the results to arrive at a numerical "M-factor," which would be our assessment of the credibility of the ECM. We expect the M-factor to be particularly relevant in our capital adequacy analysis.

Because of the weight our ERM criteria places on quantitative risk management, we presently expect only insurers with higher M-factors will achieve an overall ERM score of "excellent."

Capital adequacy analysis

We believe that an ERM level III review would provide a more-comprehensive analysis of insurers' capital needs than could be obtained by referencing Standard & Poor's RBC model alone. Therefore, we expect to reference our analysis of both an insurer's ECM and our RBC model in our analysis of an insurer's capital adequacy.

To this end, we would review the insurer's economic capital assessments on a basis consistent with our RBC model. We then propose to blend an insurer's economic capital assessment with the results from our RBC model. The weight given to the insurer's own economic capital assessments and the results from our RBC model will reflect our view on the credibility of insurer's economic capital assessments. The M-factor will be used as the weighting.

We will typically constrain the change in target capital from that calculated by our RBC model for a given confidence level, so that it does not exceed one rating category. Table 1 shows an example for an insurer whose model has calculated lower target capital than our RBC model.

Initially, we expect to assign relatively low M-factors. However, as we complete more ERM level III reviews and observe how the models stand up to future stress, we may increase M-factors.

The request for comment details the features of ECMs that we are likely to deem more and less favorable in our analysis, and how our assessment of these features will affect an insurer's M-factor, ERM score, and rating.

The deadline for comments on the proposed criteria was Aug. 9, 2010. We are reviewing the comments and expect to publish our response later in the year. ■

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Fall In Traditional Reinsurance Pricing Outpaces Decline In ILS Pricing, Further Reducing The Possibility That The Markets Might Converge

By Dennis Sugrue and David Harrison

The insurance-linked securities (ILS) market appears to be regaining its confidence following the effective closure it experienced between late 2008 and mid-2009.

In Standard & Poor's Ratings Services' observations, transparency in the market has increased and collateral structures have been enhanced over the past few years reducing exposure to counterparty risk. These improvements could result in a wider investor base, thus making ILS issuance a more attractive option for insurers seeking catastrophe coverage. Despite this, we observe that trends in both the reinsurance and ILS markets have served to shift pricing competitiveness for insurers in favor of the traditional reinsurance market.

The ILS market has seen a significant contraction in its issuer and investor bases over the past two years. Generalist hedge funds and money managers have retrenched to more-traditional investments, and catastrophe reinsurance is now priced to attract many of the cedants who might have considered issuing ILS.

We believe that unless a major catastrophic event occurs, reinsurance pricing is likely to soften further. Since the relative attractiveness to issuers of insurance-linked securities (ILS) as a medium to transfer insurance risk has traditionally been linked to reinsurance pricing, this is likely to dampen ILS issuance. We do not expect levels of issuance to return to those experienced in 2006 and 2007 over the next 12-24 months.

Issuance has increased by almost $1 billion more in the first half of 2010 than it did in the same period in 2009. That said, in our opinion, the majority of issuances for the year may have already occurred. The market may therefore struggle to meet our expectation of around $4 billion of issuance in 2010, unless there is a major catastrophe event to encourage cedants to transfer risk and raise capital.

ILS Suffers By Comparison With Reinsurance In The Current Pricing Environment

Here, we will try to provide some insight into how in our observations an issuer might weigh the costs and the benefits of acquiring catastrophe coverage by either issuing a bond or purchasing traditional reinsurance. Despite the relative strength of the ILS mar-

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Table 1

Fundamental Factors Influencing Reinsurance and ILS Cycles

Transaction	Series/ Class	Sponsor	Size (Mil. $)	Term (years)	Peril	
Foundation Re III Ltd.	A	Hartford Fire Ins Co	180	3	US hurricane	
Successor X Ltd 2010-1	CN3	Swiss Reinsurance Co.	45	4	US hurricane / Europe windstorm	
Merna Re II Ltd.	A	State Farm Fire & Casualty	350	3	US earthquake	
Ibis Re II	A	Assuarant	90	4	US hurricane	
Ibis Re II	B	Assuarant	60	4	US hurricane	
Johnston Re	A	NCJUA/IUA	200	3	US hurricane	
Johnston Re	B	NCJUA/IUA	105	3	US hurricane	
Lodestone Re	A	Chartis	175	3	US hurricane / US earthquake	
Lodestone Re	B	Chartis	250	3	US hurricane / US earthquake	
Caelus Re II	A	Nationwide	185	3	US hurricane / US earthquake	
Res Re 2010	1	USAA	163	3	US hurricane/US earthquake/other	
Res Re 2010	2	USAA	73	3	US hurricane/US earthquake/other	
Res Re 2010	3	USAA	53	3	US hurricane/US earthquake/other	
Blue Fin Ltd Series 3	A	Allianz	90	3	US hurricane / US earthquake	
Blue Fin Ltd Series 3	B	Allianz	60	3	US hurricane / US earthquake	
Vita IV Ltd Series III	E	Swiss Reinsurance Co.	50	4	Mortality	
Shore Re	A	MPIUA	96	3	US hurricane	

MMF = Money market fund. AIR = AIR Worldwide Corp. RMS = Risk Management Solutions Inc.
IBRD = International Bank for Reconstruction and Development. ILW = Industry loss warranty.

ket, factors within the ILS market and outside it have tended to favor the use of reinsurance to transfer risk. We believe the main internal constraints to greater growth this year has been the concentration of both issuers and investors. The global recession has led to widespread reappraisal of strategic priorities. Many investors have retrenched, turning to more-traditional asset classes. For issuers, the softening reinsurance market has outpaced the tightening of spreads in the ILS market, challenging the economics of the capital market route.

We have also observed an interesting and contrasting dynamic in the reinsurance and ILS markets. In reinsurance, reinsurers are tending to diversify by product line and geography, potentially reducing the price of traditional reinsurance. Conversely in ILS, we find concentration is increasing as the market attracts a higher proportion of specialist investors from within the insurance industry. This investor concentration could potentially push issuance costs up for insurers.

Market Fundamentals For The Reinsurance And ILS Markets

We have observed several marked differences between the market fundamentals for the reinsurance and ILS markets that affect the relative attractiveness of each for issuers over time.

Structural Differences Make It Difficult To Compare Pricing Across The Competing Markets

Many find it difficult to directly compare the components of pricing a traditional reinsurance contract versus the costs of issuing a catastrophe bond (cat bond). While the indemnity style cat bond comes close, we think it remains difficult to design a cat bond whose risk profile matches that of a typical reinsurance contract. It is therefore difficult, in our view, to directly compare the expected losses for the two. Cat bonds typically have multiyear terms, which can increase their cost compared with the typical one-year reinsurance contract. However, bonds usually do not have

Expected Loss	Trigger type	# of events to trigger	Yield	Spread (bps)	Rating	Modelling Agency	Collateral	Occurrence/ Aggregate
3.81%	ILW	1	MMF	575	BB+	RMS	MMF	Per Occurence
0.86%	ILW	2	MMF	975	B-	EQECAT	MMF	Per Occurence
0.43%	Indemnity	1	MMF	365	BB+	RMS	MMF	Per Occurence
1.36%	ILW	1	MMF	620	BB	RMS	MMF	Per Occurence
2.75%	ILW	1	MMF	925	B+	RMS	MMF	Per Occurence
1.05%	Indemnity	1	MMF	625	BB-	AIR	MMF	Per Occurence
1.07%	Indemnity	1	MMF	650	BB-	AIR	MMF	Per Occurence
0.98%	ILW	1	MMF	625	BB+	RMS	MMF	Per Occurence
1.68%	ILW	1	MMF	825	BB	RMS	MMF	Per Occurence
1.07%	Indemnity	1	MMF	650	BB+	AIR	MMF	Per Occurence
0.87%	Indemnity	1	MMF	660	BB	AIR	MMF	Per Occurence
1.81%	Indemnity	1	MMF	890	B+	AIR	MMF	Per Occurence
3.81%	Indemnity	1	MMF	1,300	B+	AIR	MMF	Per Occurence
4.62%	Modelled loss	1	MMF	1,400	B-	AIR	MMF	Per Occurence
1.50%	Modelled loss	1	MMF	925	BB	AIR	MMF	Aggregate
0.46%	Modelled loss	1	6-month LIBOR	525	BB+	RMS	IBRD Notes	Per Occurence
1.47%	Indemnity	1	MMF	700	BB	AIR	MMF	Per Occurence

Res Re 2010 = Residential Reinsurance. 2010 Ltd. NCJUA/IUA = North Carolina
MPIUA = Massecchussetts. USAA = United States Assurance Association.

reinstatement provisions, which are an additional expense commonly seen in reinsurance contracts.

Basis risk in cat bonds is very different from a traditional reinsurance contract, we believe. A typical reinsurance structure is designed so that basis risk is almost nonexistent; the cedant is covered for the losses they incur. In all non-indemnity triggered bonds seen by us, issuers incur basis risk. This, we think, stems from possible differences between industry or index losses and the cedant's actual loss, uncertainty regarding reporting agencies' data, and other such factors. Even in indemnity deals, in which the investor incurs most basis risk, this risk may still exist for an issuer because their actual losses may differ from the modeled losses (due to model uncertainty or exposure data uncertainty and timing mismatch).

Cedants incur counterparty credit risk when they enter into reinsurance contracts, but can try to almost eliminate this risk in cat bonds, which are usually fully collateralized. That said, the demise of Lehman Brothers demonstrates, in our view, that it is not possible to completely remove counterparty risk. Some of the key developments in ILS over the past 18 months have focused on mitigating this risk.

Factors That Affected Pricing in the Past

While prices for both cat bonds and reinsurance contracts are subject to swings in the insurance cycle, we observe that cat bonds are also typically susceptible to swings in the wider securities markets, especially corporate bond prices. Nevertheless, we have observed some common principles that in the past seem to have driven movements in prices for both ILS and reinsurance.

Reinsurance Contract:

Price = Expected Loss + Underwriting expenses + Profit Margin

ILS Issuance:

Price = Expected Loss + Fees + Value of portfolio effect + Investor spread

When deciding whether to buy reinsurance or issue a cat bond, companies seem to be able to assess the expected loss and most expenses/fees associated with each option fairly easily. However, the profit margin and the value of portfolio effect plus investor spread variables are more heavily influenced by external factors and therefore seem to have had a stronger impact on pricing fluctuations in the past.

Elements covered by profit margins in reinsurance pricing

The "profit margin" charged by a reinsurer in our observations typically contains market factors such as systematic or market risk, the requirement for reinstatement premiums, and frictional costs (which include taxes and agency or regulatory costs).

We have seen that certain characteristics of the reinsurer can also cause fluctuations in the profit margin they charge; such as the size of the capital base, the spread of risks in the portfolios, and the contribution of each risk to the negative skew of the return distribution. We have also seen that firms that hold lower capital levels, or face higher costs for external funds, may be forced to charge more to provide coverage because of the high level of capital allocated to the volatile catastrophe business. Similarly, a reinsurance company that primarily writes business exposed to catastrophes will have more highly correlated risks in its portfolio, requiring a higher capital allocation. We would assume it will charge higher rates to provide coverage. Cedants, for their part, may be willing to pay higher premiums to higher-rated reinsurers.

Elements covered by the "value of the portfolio effect" and the "investor spread" in cat bond pricing

The "value of the portfolio effect" and the "investor spread" are considered to be the main variable components of the cost of issuing a cat bond. The value of the portfolio effect is essentially the amount of capital relief an issuer receives as a result of putting the bond in place, and can be related to the components we discussed for the reinsurance profit margin.

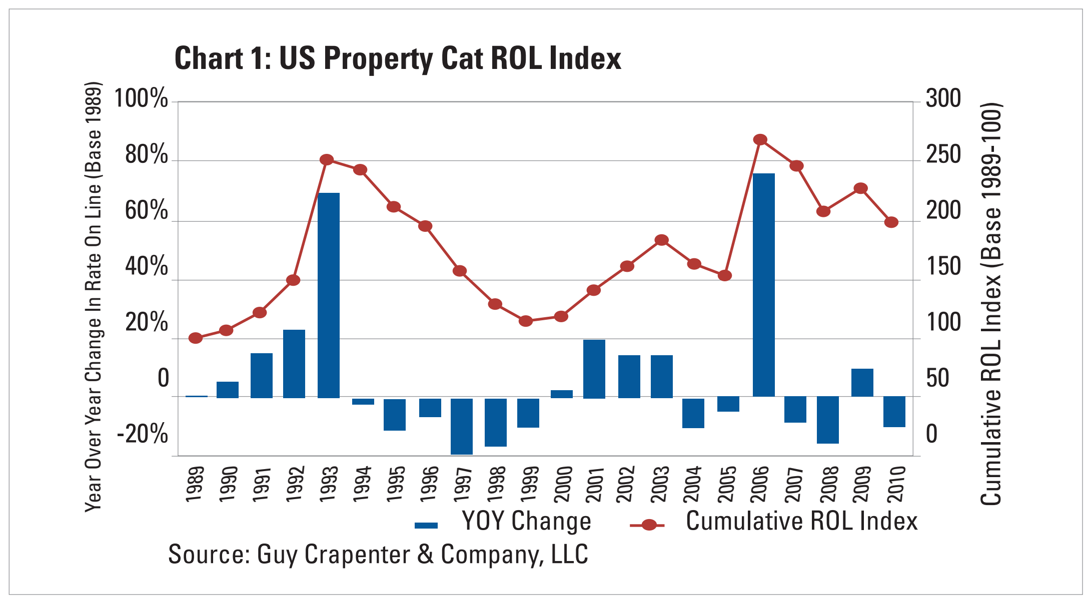
The additional spread paid to investors typically will fluctuate based on wider capital market conditions, such as spread and return levels for other asset classes, the depth of the investor base and the asset portfolios they currently hold, the concentration of perils and risk of attachment levels, concerns around collateral, transparency from issuers, and investors' level of understanding of the products being offered.

Trends That Could Affect Pricing

Reinsurance pricing is likely to remain soft

Some market participants expected Hurricane Ike, which occurred in late 2008, to herald a major increase in reinsurance rates. But although prices spiked in early 2009, they did not peak as highly as expected in subsequent renewals. While we still believe that property catastrophe prices are adequate, pricing levels in catastrophe reinsurance have been declining since the January 2010 renewals, potentially impacting reinsurers' profitability. The most recent July renewals saw rates decline in regions not affected by catastrophes around the globe. Brokers estimate that U.S. property catastrophe rates were down by 10%-25% in July.

Levels of capital in the traditional reinsurance market are at peak levels. Reinsurers replenished their capital quickly in 2009, following a double hit at year-end 2008 from Hurricane Ike and substantial mark-to-market losses in the wake of the financial crisis. We have seen signs that some market participants now believe that the bar has been raised regarding the minimum level of capital that must be held to compete globally in the reinsurance arena. We have noted that capital levels are above historical norms, and companies have not been returning as much through



repurchases or special dividends in recent years. In our view, this elevated capital base translates to an excess in capacity, which is driving down pricing.

We have also observed a trend toward diversification and expansion in the reinsurance market. We see that increased diversification has widened the spread of risks within most companies' books of business, and so diminished the need to increase pricing to allow for correlated risks.

For example, Bermuda has historically been known for its property catastrophe specialist companies, many of which were launched during 2001 and 2005, in response to major catastrophic events. In recent years, we have seen many of these companies diversify their risk profiles, either within short-tail lines, or by expanding into longer-tail casualty risks. In the wider reinsurance market, companies have begun to diversify their portfolios by spreading geographically. Bermudian companies have landed onshore in the U.S., have entered the London market, and are exploring continental Europe. Lloyd's participants have opened Bermudian operations, and have also gone onshore in the U.S. and Europe. Meanwhile, the large European players have lately placed increasing emphasis on their global life and U.S. non-life books. We have also seen reinsurers on both sides of the Atlantic make forays into Latin America, Asia, and the Middle East.

Tax is one of the frictional costs that influence the profit margin. Momentum has been building in the U.S. for the government to levy taxes on premiums ceded from U.S.-based (re)insurers to offshore affiliates. While there is debate as to how much impact this might have on the U.S. reinsurance market--one estimate puts the reduction in reinsurance capacity available to U.S. cedants at around 20%--we believe it is reasonable to believe that any significant reduction in capacity would drive prices for reinsurance up across all lines.

Most of the current trends in the traditional market place catastrophe pricing under significant downward pressure, in our view. The 2010 storm season has been predicted to be a busy one, but unless a major storm hits a heavily insured area, these trends indicate to us a continued decline in rates over the medium term.

Cat bonds spreads are narrowing

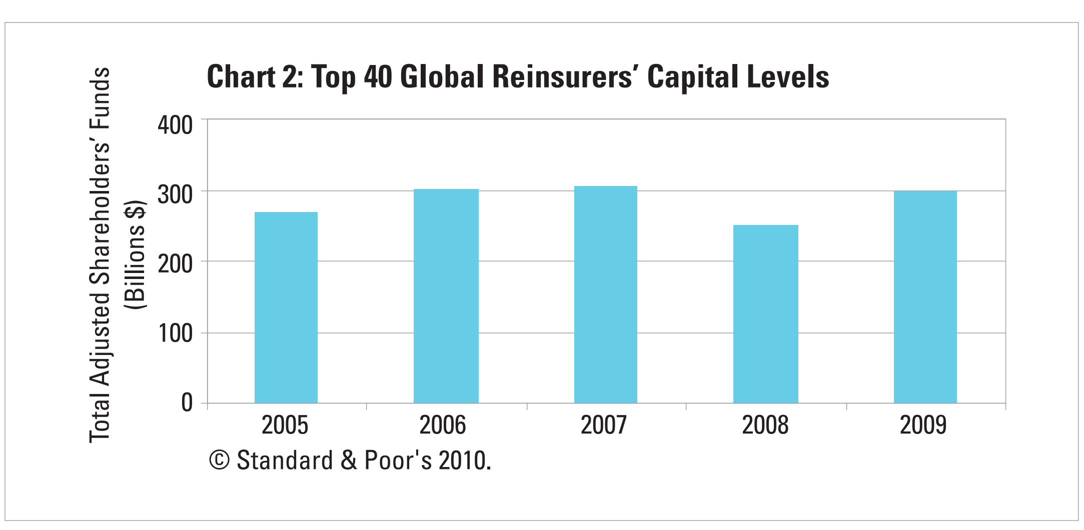
Prices of ILS at issuance, measured as the spread paid to investors in relation to the probability of a first-dollar loss (the attachment probability), have fallen in 2010. They reached their peak in 2009, when the failure of Lehman Brothers caused the ILS market to freeze. Issuances so far this year are broadly in line with initial pricing for the period after Hurricane Katrina and before Lehman Brothers (late 2005 to 2008).

As in 2009, most of the ILS bonds we have rated in the first half of 2010 were exposed to U.S. perils. Of 11 non-life deals rated by Standard & Poor's through July 2010, 10 contained at least some U.S. hurricane exposure. The remaining one, Merna Re II, was a U.S. earthquake bond. As demonstrated by the higher y-intercept for the 2010 line in chart 3, investors in 2010 seem to be requiring an increased spread on the more-remote risks, i.e., those less likely to occur. We believe that this is because the market is becoming saturated with these transactions. Conversely, spreads for bonds with lower attachment points are narrower than those issued after Hurricane Katrina (indicated by the flatter slope of the 2010 line). Note that the relatively small number of data points for 2010 means that any outliers will have more impact on the line.

Cat Bonds: Now And Then

In 2007, when the capital markets were at their peak, the investor base for cat bonds was much more diversified than it is today. Goldman Sachs estimates that in 2007, over half of investors were generalists such as hedge funds or money managers. Today, over 75% are estimated to be specialists such as catastrophe funds, reinsurance companies, or non-life insurance carriers (source: "Cat Bond Investors; A Moving Feast" in Trading Risk, July-August 2010).

The increased demand from these new investors caused a substantial narrowing in spreads in 2007. If



the investor base in the ILS market expands, as many market participants expect it to, we would expect the increased demand to renew the downward pressure on spreads, which would increase the market's competitiveness compared with reinsurance.

Some of the deals issued in 2010 have had some difficulty in meeting their target funding levels. In our opinion, this indicates that investor interest could be waning. One of the perceived benefits of cat bonds to investors is their lack of correlation with other investments in portfolios. If Goldman Sachs' estimate of the proportion of specialists within the current investor base is accurate, we question the portfolio diversification benefit available to these investors. Specialists likely have substantial exposure to insurance risk on both sides of their balance sheets. We believe that a diminished diversification benefit would result in ILS being less attractive to investors. This could spur an increased demand for spread, which in turn would make issuance a more costly option for coverage for insurers.

The broader capital markets also are a factor in investment decisions. The spread between investment-grade corporate bonds and treasuries has diminished in recent months, signaling that investors could be more receptive to relatively lower returns when moving into riskier asset classes. More broadly, tightening spreads in the traditional bond markets could be a catalyst for more-mainstream investors to return to the higher-yield ILS market.

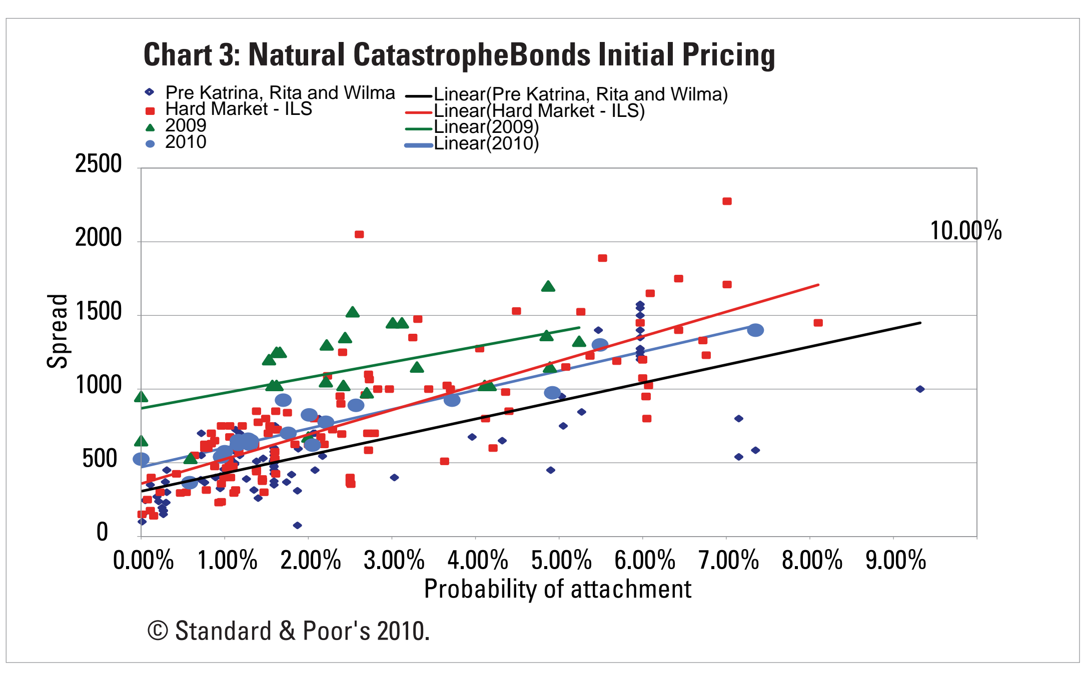
Trading Risk reported in May 2010 that fees for ILS issuance have been declining in recent years and are currently at or below 1%, down from highs of around 2% in the late 1990s. While this bodes well for issuers, we think it is important to consider the opportunity costs to infrequent market participants. Large, regular sponsors such as United States Automobile Assoc., Swiss Reinsurance Company Ltd., SCOR SE, and others who have placed bonds in the market, benefit from dedicated ILS resource, economies of scale, and familiarity with the process of issuance, reducing the opportunity cost of issuance. For smaller (re)insurers, we would expect the decision to issue a cat bond to go through a detailed review by a team normally dedicated to buying reinsurance. Any decision would likely have to be taken further up the chain of command, possibly to the CEO, for approval. This process diverts management's time and resources. Purchasing traditional reinsurance is much more familiar, and therefore faster.

In addition, the Securities and Exchange Commission's (SEC) recently amended Rule 17g-5 under the Securities Exchange Act of 1934 requires issuers, sponsors, and underwriters of "structured finance" securities to create a password-protected Web site on which to post all the information they have provided to a rating agency hired to rate the securities, and to make such information available to other rating agencies. We understand that a typical ILS would generally be considered structured finance transactions within the meaning of Rule 17g-5. The rule took effect from June 2, 2010, although a temporary exemption was granted to certain non-U.S. transactions until Dec. 1, 2010. We expect that setting up the required Web site would be another obstacle for infrequent or potential issuers of ILS.

As with reinsurance, the cost involved with issuing ILS are falling. That said, higher frictional costs are preventing ILS pricing from declining more quickly than reinsurance pricing.

Cedants May Not Choose ILS After The Next Major Event

Cedants will have several choices if they need capital after a major event. Products such as sidecars and



contingent capital facilities could eat into ILS' share of the spoils next time a major event shocks the reinsurance market.

Sidecars are special-purpose reinsurers established to provide underwriting capacity to a specific reinsurer. Following Hurricane Katrina, sidecars successfully provided quick and easy capital relief for reinsurers, while giving investors very attractive returns as well as an easy way out of the market when the term was up. Should another major catastrophe occur, we think it is reasonable to believe that capital will enter again through this medium.

Contingent capital facilities create a funded pool of capital that is available to the "beneficiary" in the event of significant losses. Reinsurers have shown renewed interest in funding contingent capital facilities as a cheaper alternative to ILS for quick access to capital following an event.

These products could also further impede ILS' ability to converge with the traditional market. We continue to be of the view that for there to be a possibility for long-term convergence between the ILS and traditional reinsurance markets, pricing levels for traditional reinsurance and ILS would need to become more closely aligned and both the investor and issuer bases would need to expand greatly.

Over the medium term, in the absence of a major catastrophe event, we expect reinsurance pricing to decline faster than ILS pricing, thus increasing the gap between the two. The trends we have observed in the first half of 2010 do not lead us to predict any expansion in the concentrated investor base, nor do we anticipate that more issuers will overcome the barriers that deter new entrants from joining the ILS arena. ■

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Top 40 Global Reinsurance Groups

Top 40 Global Reinsurance Groups Ranked By Net Reinsurance Premiums Written

		Footnote		Net Reinsurance Premium Written (Mil. $)	
Ranking	**Company**		**Country**	**2009**	**2008**
1	Munich Reinsurance Co.		Germany	33,704.6	29,076.8
2	Swiss Reinsurance Co.	1	Switzerland	22,896.7	24,296.0
3	Hannover Rueckversicherung AG		Germany	13,639.0	10,196.3
4	Berkshire Hathaway Re	2	U.S.	12,362.0	12,123.0
5	Lloyd's	3	U.K.	9,733.5	6,701.9
6	SCOR SE		France	8,314.7	7,499.6
7	Reinsurance Group of America, Inc.		U.S.	5,725.2	5,349.3
8	Transatlantic Holdings Inc.		U.S.	3,986.1	4,108.1
9	PartnerRe Ltd.	4	Bermuda	3,948.7	3,989.4
10	Everest Reinsurance Co.		Bermuda	3,929.8	3,505.2
11	Korean Reinsurance Co.		Korea	2,493.8	2,226.9
12	Tokio Marine Group	5	Japan	2,242.6	2,778.3
13	Transamerica Re (AEGON)		U.S.	2,013.7	1,928.3
14	Mapfre Re		Spain	2,006.8	1,683.7
15	XL Re Ltd		Bermuda	2,003.2	2,402.6
16	General Ins. Corp. of India		India	1,950.2	1,430.1
17	Odyssey Re		U.S.	1,893.8	2,030.8
18	AXIS Capital Holdings Ltd.	2	Bermuda	1,791.4	1,533.0
19	QBE Insurance Group Ltd.		Australia	1,721.0	1,279.8
20	Caisse Centrale de Reassurance		France	1,715.5	1,653.3
21	Toa Re Co. Ltd.		Japan	1,560.9	1,639.7
22	Sompo Japan Insurance Inc.		Japan	1,513.5	1,660.9
23	Mitsui Sumitomo Insurance Co. Ltd.		Japan	1,483.0	1,704.9
24	White Mountains Re Group Ltd.		Bermuda	1,445.5	1,607.2
25	ACE Tempest Reinsurance Ltd.		Bermuda	1,403.0	1,265.5
26	Validus Holdings Ltd	6	Bermuda	1,388.4	1,238.3
27	R+V Versicherung AG		Germany	1,214.5	882.0
28	Aspen Insurance Holdings Ltd.		Bermuda	1,116.7	1,114.4
29	Arch Capital Group Ltd.		U.S.	1,058.8	1,148.1
30	Maiden Re		U.S.	1,030.4	727.4
31	Catlin Group Ltd.	7	Bermuda	992.7	756.0
32	Deutsche Rueckversicherung AG		Germany	953.0	987.9
33	IRB-Brasil Resseguros S.A.		Brazil	915.3	652.0
34	Amlin Group		U.K.	914.0	620.1
35	Platinum Underwriters Holdings, Ltd.		Bermuda	897.8	1,037.6
36	Endurance Specialty Holdings Ltd.	5	Bermuda	865.7	1,051.6
37	RenaissanceRe Holdings Ltd.		Bermuda	839.0	871.9
38	Flagstone Reinsurance Ltd.		Bermuda	792.5	694.7
39	NIPPONKOA Insurance Co. Ltd.	5	Japan	669.7	748.4
40	Montpelier Re Holdings Ltd.		Bermuda	602.2	541.2
	Total			**159,728.9**	**146,742.2**

Footnotes
1 Excluding non traditional and legacy business the combined ratios would have been 88.3% and 97.9%, respectively
2 Adjusted Shareholders' Funds are for the group as a whole, including both its direct and reinsurance operations
3 Net Premium Written, pretax operating income and the combined ratio relate to reinsurance business only; all other items include direct business. The data presented is based on the published pro forma accounts for the Market, which represents an aggregation of all syndicates participating at Lloyd's. As such, some premium included for Lloyd's may also be included by other groups that consolidate their Lloyd's operations
4 The group acquired Paris Re on October 2, 2009. The data presented includes the operations of Paris Re from the date of the acquisition
5 Net Reinsurance Premium Written and Combined Ratio relate to reinsurance business only; all other items include direct business
6 On July 8, 2009, Validus Holdings Ltd acquired IPC Holdings Ltd. The data presented includes the operations of IPC Re from the date of the acquisition
7 Pre tax operating income does not include net investment income. Adjusted Shareholders' Funds are for the group as a whole, including both its direct and reinsurance business.

Pretax Operating Income (Mil. $)		Combined Ratio (%)		Total Adjusted Shareholders' Funds (Mil. $)		ROR (%)	
2009	2008	2009	2008	2009	2008	2009	2008
6,064.4	6,304.4	95.7	99.7	30,372.1	28,235.4	13.8	16.7
1,280.6	8,152.6	93.2	99.3	26,151.7	20,266.1	4.2	25.6
1,217.9	428.3	97.3	95.5	8,113.5	6,636.6	8.3	4.0
N.A.	N.A.	93.4	85.1	64,146.0	50,795.0	N.A.	N.A.
1,983.0	1,062.2	78.4	83.8	28,929.8	20,523.9	16.5	13.4
560.4	834.4	99.6	99.8	5,581.4	4,806.2	6.2	9.9
644.2	605.2	N.M.	N.M.	3,867.9	2,616.8	9.2	9.6
656.8	428.5	93.5	98.6	4,034.4	3,198.2	14.6	9.5
1,191.7	593.2	81.8	94.2	7,645.7	4,199.1	25.2	13.1
863.4	612.2	89.6	95.6	6,101.7	4,960.4	19.5	14.4
90.3	62.2	94.8	103.5	984.2	791.6	3.5	2.6
1,598.2	770.3	N.A.	N.A.	20,775.7	15,882.5	N.A.	N.A.
285.0	-529.0	N.M.	N.M.	N.A.	N.A.	N.A.	N.A.
227.9	208.0	93.5	95.4	1,281.0	1,047.0	11.4	11.9
N.A.	N.A.	82.1	89.1	N.A.	N.A.	N.A.	N.A.
286.7	350.0	109.7	103.0	2,029.4	1,501.1	13.8	19.9
307.0	135.2	96.7	101.2	3,555.2	2,827.7	13.7	5.8
N.A.	N.A.	73.1	92.1	5,500.2	4,461.0	N.A.	N.A.
470.7	165.7	82.1	95.9	1,451.3	1,038.2	25.1	12.1
1,004.6	1,131.8	56.3	44.4	5,592.9	4,794.1	50.3	60.1
233.4	265.9	93.1	91.2	3,052.2	2,701.7	13.9	15.4
352.2	-289.6	N.A.	N.A.	15,411.4	12,096.2	12.8	-9.4
N.A.	N.A.	N.A.	N.A.	18,506.3	15,793.1	N.A.	N.A.
462.8	-267.0	86.6	101.8	2,056.5	2,156.8	24.9	-17.6
832.1	623.9	59.3	75.8	N.A.	N.A.	49.3	36.0
529.5	185.8	72.0	96.7	4,031.1	1,938.7	33.7	13.3
335.7	349.7	99.4	98.9	5,455.8	4,959.3	21.6	28.5
574.3	248.5	58.6	86.1	3,305.4	2,779.2	40.6	20.7
648.6	632.3	73.7	85.3	3,794.0	3,010.3	42.7	39.6
62.1	56.4	95.9	94.8	891.6	509.8	6.3	13.4
102.0	42.3	62.7	73.7	3,278.0	2,469.2	8.0	5.3
48.8	55.6	99.7	95.3	828.3	684.4	4.7	5.1
307.7	214.9	88.9	106.0	1,149.6	798.7	27.1	22.4
575.5	178.2	41.4	68.3	2,537.5	1,759.9	61.1	24.8
323.5	212.8	80.0	94.1	2,077.7	1,809.4	29.3	16.4
509.3	560.4	75.9	93.5	2,787.3	2,512.3	46.5	38.9
N.A.	N.A.	15.4	69.0	3,190.8	2,382.7	N.A.	N.A.
229.8	110.8	74.7	89.4	1,211.0	986.0	26.7	24.4
192.8	245.2	N.A.	N.A.	7,306.5	6,411.6	39.4	37.6
270.8	93.1	62.2	91.0	1,728.5	1,357.6	41.4	15.1
25,323.6	**24,834.5**	**88.6**	**93.9**	**308,713.5**	**245,697.7**	**14.0**	**16.4**

Net reinsurance premiums written = gross reinsurance premiums written less reinsurance premiums ceded; relate to a group's reinsurance business only, unless where separately indicated
Pretax operating income = underwriting profit (or loss) + net investment income + other income. Net realized and unrealized investment gains/losses are excluded from this item
Combined Ratio = (net losses incurred + net underwriting expenses)/net premium earned
Total adjusted shareholders' funds = capital + shareholders' reserves (including claims-equalization reserve and any excess or deficiency of market value of investments over the balance sheet value).
ROR = pretax operating income/total revenue. (Total revenue = net premiums earned + net investment income + other income.)
N.A.—Not available.
N.M.—Not meaningful.

Global Reinsurers By Country

To bring you the 2010 edition of Global Reinsurance Highlights, Standard & Poor's Ratings Services sought data on around 150 reinsurance organizations from over 40 countries. As in previous years, the data is based on survey responses from reinsurance organizations worldwide.

To ensure consistency, we requested that respondents complied with clear guidance on the definition of the financial items required. In addition, Standard & Poor's attempted to verify the veracity of the data submitted with reference to publicly available data sources, insofar as this was possible.

Our ongoing aim in producing this data is to provide market participants with an indication of the ongoing reinsurance capacity available in each market. Hence, we try to exclude intragroup reinsurances as far as possible. Companies that have not been able to exclude intragroup reinsurance are highlighted in the footnotes on page 54-55.

One of the challenges has been to separate reinsurance from primary insurance business, especially when the reinsurance operation is a division within a company and not a distinct operation. While, generally speaking, all the premium data relates to a company's reinsurance

Rating As Of August 24, 2010	Company	Footnotes	Net Reinsurance Premiums Written (Mil. $)		
			2009	2008	Change (%)
Australia					
A+	Swiss Re Life & Health Australia Ltd.		377.4	289.8	30.2
AA-	Munich Reinsurance Co. of Australasia Ltd.		235.8	137.9	71.0
AA-	Hannover Life Re of Australasia Ltd.		184.9	215.7	-14.3
AA+	General Reinsurance Life Australia Ltd.		130.6	95.0	37.4
AA+	General Reinsurance Australia Ltd.	1	67.1	49.1	36.6
	Total:		**995.8**	**787.6**	**26.4**
Bahrain					
BBB+	Trust International Insurance & Reinsurance Co. B.S.C.		141.2	105.5	33.8
A	Hannover ReTakaful		53.8	38.5	39.7
	Total:		**195.0**	**144.0**	**35.4**
Belgium					
A	Secura N.V.		272.3	265.6	2.5
	Total:		**272.3**	**265.6**	**2.5**

premiums written, in some cases the other metrics will also include primary business. These cases can be identified through the footnotes to the tables, although if we believe the metrics provided by the company are not representative of the company's reinsurance operations, we have marked the metric as N.A. (not applicable). For companies that report in currencies other than the U.S. dollar, we have converted the reported data at year-end exchange rates.

Standard & Poor's has endeavored to collect the data underlying each group or entity's combined ratio in order to calculate this metric in a comparable manner. The combined ratios presented in Global Reinsurance Highlights have been calculated as: (net losses incurred + net underwriting expenses)/net premiums earned. The combined ratio of any entity that writes purely life reinsurance has been marked as N.M. (not meaningful), as Standard & Poor's does not consider this to be an accurate measure of a life reinsurer's profitability. For those groups or entities writing both non-life and life reinsurance business, the combined ratio reflects non-life business only.

The main group and country listing for each entity surveyed is representative of that group or company's total reinsurance business written, whether it be life, non-life, or a combination of both. ■

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	Pretax Operating Income (Mil. $)		Combined Ratio (%)		Total Adjusted Shareholders' Funds (Mil. $)			Return on Revenue (%)	
	2009	2008	2009	2008	2009	2008	Change (%)	2009	2008
	107.4	-19.5	N.M.	N.M.	270.1	156.9	72.1	25.7	-5.9
	27.5	-5.7	N.M.	N.M.	144.2	102.1	41.3	10.4	-3.6
	48.7	-5.8	N.M.	N.M.	201.2	132.4	51.9	21.8	-2.1
	16.2	10.9	N.M.	N.M.	75.4	54.6	38.1	11.3	10.3
	134.9	41.3	82.6	43.7	295.7	218.7	35.2	120.8	53.0
	334.5	**21.1**	**82.6**	**43.7**	**986.7**	**664.7**	**48.4**	**28.8**	**2.2**
	12.7	20.1	90.4	80.1	192.3	209.8	-8.3	10.6	20.7
	3.2	1.4	97.5	102.5	58.2	53.8	8.0	6.3	6.0
	15.9	**21.5**	**92.3**	**84.0**	**250.5**	**263.6**	**-5.0**	**9.3**	**17.9**
	54.7	47.4	96.6	98.2	294.0	289.1	1.7	16.8	14.7
	54.7	**47.4**	**96.6**	**98.2**	**294.0**	**289.1**	**1.7**	**16.8**	**14.7**

Global Reinsurers By Country

Rating As Of August 24, 2010	Company	Footnotes	Net Reinsurance Premiums Written (Mil. $)		
			2009	2008	Change (%)
Bermuda					
A+	Everest Reinsurance (Bermuda) Ltd.		1,752.3	1,575.4	11.2
A+	ACE Tempest Reinsurance Ltd.		1,037.8	913.7	13.6
A+	Arch Reinsurance Ltd.		973.1	1,059.6	-8.2
A	Platinum Underwriters Bermuda Ltd.		897.8	1,037.6	-13.5
A	XL Re Ltd.		764.3	826.0	-7.5
A-	Validus Reinsurance Ltd. (Bermuda)	2	672.6	624.8	7.7
A+	AXIS Specialty Ltd.	3	635.8	620.2	2.5
A-	Montpelier Re Ltd.		602.2	541.2	11.3
AA-	Renaissance Reinsurance Ltd.		503.7	530.7	-5.1
AA-	Partner Reinsurance Co. Ltd.		476.1	913.2	-47.9
NR	Hiscox Insurance Co. (Bermuda) Ltd.		474.1	431.0	10.0
NR	IPCRe Ltd.	4	380.8	397.3	-4.2
A	Amlin Bermuda Ltd.		376.2	353.3	6.5
A+	ACE Tempest Life Reinsurance, Ltd.		365.2	351.8	3.8
AA	Tokio Millennium Re Ltd.		360.6	318.3	13.3
A	Catlin Insurance Co. Ltd.	5	355.2	289.5	22.7
A	Aspen Insurance Ltd.		355.0	393.5	-9.8
A+	DaVinci Reinsurance Ltd.		332.1	341.2	-2.7
AA-	Hannover Re Bermuda Ltd.		307.2	271.0	13.3
A-	Lancashire Insurance Co. Ltd.	6	144.0	113.1	27.3
BBB+	International General Insurance Co. Ltd.		93.6	90.2	3.8
AA-	MS Frontier Reinsurance Ltd.		83.4	72.8	14.6
AA	Top Layer Reinsurance Ltd.		28.2	29.5	-4.5
	Total:		**11,971.3**	**12,095.0**	**-1.0**
Brazil					
NR	IRB-Brasil Resseguros S.A.		915.3	652.0	40.4
	Total:		**915.3**	**652.0**	**40.4**
Canada					
NR	Swiss Re Life & Health Canada		685.5	558.7	22.7
AA-	Munich Reinsurance Co. of Canada		179.5	146.3	22.6
A	SCOR Canada Reinsurance Co.		145.1	71.5	103.0
	Total:		**1,010.1**	**776.5**	**30.1**

	Pretax Operating Income (Mil. $)		Combined Ratio (%)		Total Adjusted Shareholders' Funds (Mil. $)			Return on Revenue (%)	
	2009	2008	2009	2008	2009	2008	Change (%)	2009	2008
	482.4	342.0	89.8	82.4	2,722.6	2,222.6	22.5	23.9	21.0
	677.9	518.5	59.3	75.8	N.A.	N.A.	N.A.	53.9	39.2
	570.6	622.7	72.1	83.5	2,734.5	2,046.6	33.6	40.4	41.7
	323.5	212.8	80.0	94.1	2,077.7	1,809.4	14.8	29.3	16.4
	N.A.	N.A.	51.9	76.4	N.A.	N.A.	N.A.	N.A.	N.A.
	456.1	171.0	55.3	89.5	3,764.7	1,779.3	111.6	50.9	22.6
	N.A.	N.A.	36.3	80.2	4,449.4	3,783.8	17.6	N.A.	N.A.
	270.8	93.1	62.2	91.0	1,728.5	1,357.6	27.3	41.4	15.1
	N.A.	N.A.	11.5	68.0	1,600.0	1,600.0	0.0	N.A.	N.A.
	645.1	571.0	18.3	64.2	3,300.2	2,986.2	10.5	80.9	55.0
	254.1	43.1	57.7	76.3	807.9	805.5	0.3	45.5	11.6
	236.9	262.8	22.7	49.6	2,150.3	1,851.5	16.1	74.3	54.6
	274.8	15.9	44.6	84.5	1,580.6	1,389.5	13.8	65.9	4.3
	154.2	105.4	N.M.	N.M.	N.A.	N.A.	N.A.	36.0	25.8
	200.5	126.6	30.2	45.7	1,241.5	1,054.0	17.8	51.9	37.3
	91.0	57.4	61.2	75.8	3,956.3	3,322.1	19.1	20.1	11.4
	287.7	1.4	39.0	99.6	1,755.4	1,197.0	46.6	56.5	0.4
	N.A.	N.A.	28.4	77.1	1,473.7	1,196.9	23.1	N.A.	N.A.
	292.2	181.2	31.8	51.9	1,307.2	1,311.9	-0.4	75.4	60.3
	366.8	134.8	13.6	50.5	1,268.1	1,138.8	11.4	62.1	21.8
	10.3	-2.4	97.3	110.0	171.3	153.3	11.7	9.8	-2.6
	81.6	43.5	25.6	60.6	525.7	439.5	19.6	79.3	49.7
	N.A.	N.A.	22.2	23.9	53.2	50.6	5.1	N.A.	N.A.
	5,676.5	**3,500.8**	**56.0**	**78.5**	**38,668.7**	**31,496.1**	**22.8**	**45.8**	**28.9**
	307.7	214.9	88.9	106.0	1,149.6	798.7	43.9	27.1	22.4
	307.7	**214.9**	**88.9**	**106.0**	**1,149.6**	**798.7**	**43.9**	**27.1**	**22.4**
	60.9	75.5	N.M.	N.M.	355.9	286.2	24.3	29.1	23.3
	38.4	49.2	91.4	83.2	252.9	229.2	10.3	17.6	26.2
	7.1	17.7	104.3	96.0	159.4	156.3	2.0	4.6	20.4
	106.4	**142.3**	**97.1**	**87.3**	**768.2**	**671.8**	**14.4**	**18.3**	**23.8**

Global Reinsurers By Country

Rating As Of August 24, 2010	Company	Footnotes	Net Reinsurance Premiums Written (Mil. $)		
			2009	2008	Change (%)
France					
A	SCOR Global Life SE		1,796.0	1,603.9	12.0
AAA	Caisse Centrale de Reassurance		1,715.5	1,653.3	3.8
A	SCOR SE		1,338.7	1,375.6	-2.7
A	SCOR Global P&C SE		1,016.2	959.8	5.9
	Total:		**5,866.4**	**5,592.7**	**4.9**
Germany					
AA-	Munich Reinsurance Co.		24,591.8	21,954.9	12.0
AA-	Hannover Rueckversicherung AG	7	9,288.1	7,771.8	19.5
AA	Allianz SE	3	4,530.2	4,032.8	12.3
AA-	E+S Rueckversicherung AG	7	2,853.7	2,540.8	12.3
AA+	Koelnische Rueckversicherungs-Gesellschaft AG		2,601.3	2,325.0	11.9
A+	R+V Versicherung AG		1,214.5	882.0	37.7
A+	Deutsche Rueckversicherung AG		529.6	487.0	8.8
A+	DEVK		260.7	133.8	94.9
	Total:		**45,869.9**	**40,128.0**	**14.3**
Hong Kong					
A-	Taiping Reinsurance Co Ltd.		193.4	201.1	-3.8
A	SCOR Reinsurance Company (Asia) Ltd.		79.9	101.2	-21.0
	Total:		**273.3**	**302.3**	**-9.6**
India					
NR	General Ins. Corp. of India		1,950.2	1,430.1	36.4
	Total:		**1,950.2**	**1,430.1**	**36.4**

	Pretax Operating Income (Mil. $)		Combined Ratio (%)		Total Adjusted Shareholders' Funds (Mil. $)			Return on Revenue (%)	
	2009	2008	2009	2008	2009	2008	Change (%)	2009	2008
	17.2	243.8	N.M.	N.M.	948.9	933.1	1.7	0.9	13.2
	1,004.6	1,131.8	56.3	44.4	5,592.9	4,794.1	16.7	50.3	60.1
	680.8	-87.4	101.9	113.0	3,494.4	3,327.7	5.0	32.7	-6.0
	-33.0	45.1	122.0	108.6	2,528.4	1,247.4	102.7	-2.9	4.1
	1,669.7	**1,333.3**	**86.5**	**80.5**	**12,564.5**	**10,302.2**	**22.0**	**23.2**	**21.2**
	2,365.0	2,618.1	98.9	103.1	35,658.9	33,068.7	7.8	8.6	10.1
	764.0	636.0	98.2	87.5	6,376.1	5,774.7	10.4	7.5	7.5
	79.4	-8,758.4	90.0	90.9	85,771.9	84,831.0	1.1	N.M.	N.M.
	216.6	219.1	102.5	94.2	2,078.3	1,980.7	4.9	6.8	7.6
	551.5	488.6	96.7	96.4	2,535.7	3,134.1	-19.1	16.0	18.5
	335.7	349.7	99.4	98.9	5,455.8	4,959.3	10.0	21.6	28.5
	40.2	41.6	96.0	97.6	678.1	605.5	12.0	7.0	7.7
	128.9	235.4	100.8	96.3	1,285.4	1,200.6	7.1	29.8	58.9
	4,481.3	**-4,170.0**	**98.0**	**97.0**	**139,840.3**	**135,554.6**	**3.2**	**9.6**	**-9.9**
	52.8	11.1	92.0	85.4	310.1	254.3	21.9	21.7	5.9
	53.8	7.2	49.1	95.4	121.6	73.3	66.0	52.4	6.7
	106.6	**18.3**	**77.8**	**88.8**	**431.8**	**327.6**	**31.8**	**30.8**	**6.2**
	286.7	350.0	109.7	103.0	2,029.4	1,501.1	35.2	13.8	19.9
	286.7	**350.0**	**109.7**	**103.0**	**2,029.4**	**1,501.1**	**35.2**	**13.8**	**19.9**

Global Reinsurers By Country

Rating As Of August 24, 2010	Company	Footnotes	Net Reinsurance Premiums Written (Mil. $)		
			2009	2008	Change (%)
Ireland					
AA-	Hannover Life Reinsurance (Ireland) Ltd.		1,617.8	610.8	164.9
AA-	Partner Reinsurance Europe Ltd.		1,197.8	825.4	45.1
A+	AXIS Re Ltd.	3	611.5	550.0	11.2
AA-	Hannover Reinsurance (Ireland) Ltd.		570.2	414.1	37.7
A-	Atradius Reinsurance Ltd.		442.5	468.0	-5.5
A	XL Re Europe Ltd.		401.9	670.4	-40.1
A	SCOR Global Life Reinsurance Ireland Ltd.		220.6	157.7	39.9
AA-	Mitsui Sumitomo Reinsurance Ltd.		143.3	167.6	-14.5
A+	QBE Reinsurance (Europe) Ltd.		85.0	99.5	-14.6
AA	Tokio Marine Global Re Ltd.		57.0	83.0	-31.3
	Total:		**5,347.6**	**4,046.4**	**32.2**
Japan					
AA	Tokio Marine & Nichido Fire Insurance Co. Ltd.		2,242.6	2,778.3	-19.3
AA-	Sompo Japan Insurance Inc.		1,555.8	1,706.4	-8.8
AA-	Mitsui Sumitomo Insurance Co. Ltd.	3	1,483.0	1,704.9	-13.0
A+	Toa Reinsurance Co.		1,304.7	1,371.9	-4.9
AA-	NIPPONKOA Insurance Co. Ltd.	6	669.7	748.4	-10.5
AA-	Nissay Dowa General Insurance Co. Ltd.		300.2	343.8	-12.7
A-	Kyoei Fire & Marine Insurance Co.		178.0	176.5	0.8
A+	Nisshin Fire & Marine Insurance Co. Ltd.		147.1	167.6	-12.2
	Total:		**7,880.9**	**8,997.8**	**-12.4**
Kazakhstan					
BB-	Eurasia Insurance Co.		26.1	41.4	-36.9
	Total:		**26.1**	**41.4**	**-36.9**
Korea					
A-	Korean Reinsurance Co.		2,493.8	2,226.9	12.0
	Total:		**2,493.8**	**2,226.9**	**12.0**
Kuwait					
BBB	Kuwait Reinsurance Co. K.S.C.		89.2	61.1	46.0
	Total:		**89.2**	**61.1**	**46.0**

	Pretax Operating Income (Mil. $)		Combined Ratio (%)		Total Adjusted Shareholders' Funds (Mil. $)			Return on Revenue (%)	
	2009	2008	2009	2008	2009	2008	Change (%)	2009	2008
	32.0	40.4	N.M.	N.M.	1,097.2	425.3	158.0	1.8	5.8
	287.7	140.8	78.2	102.2	2,257.3	1,804.2	25.1	20.4	10.5
	N.A.	N.A.	99.9	97.5	555.9	510.4	8.9	N.A.	N.A.
	56.2	66.4	117.3	102.6	642.1	607.1	5.8	9.1	12.8
	-119.1	-65.1	128.3	119.4	393.6	441.9	-10.9	-25.0	-14.8
	N.A.	N.A.	86.2	84.3	N.A.	N.A.	N.A.	N.A.	N.A.
	39.8	10.3	N.M.	N.M.	151.9	111.1	36.8	16.5	5.7
	5.3	-3.3	100.3	106.3	101.0	95.2	6.1	3.2	-2.0
	62.8	54.4	52.7	51.4	288.1	281.7	2.3	57.4	62.2
	11.8	18.0	83.3	80.8	99.7	92.0	8.4	16.1	22.0
	376.5	**261.9**	**96.6**	**98.5**	**5,586.8**	**4,368.8**	**27.9**	**7.8**	**7.5**
	1,598.2	770.3	N.A.	N.A.	20,775.7	15,882.5	30.8	N.A.	N.A.
	394.9	-439.2	N.A.	N.A.	15,572.1	12,294.3	26.7	15.6	-15.2
	N.A.	N.A.	N.A.	N.A.	18,506.3	15,793.1	17.2	N.A.	N.A.
	173.9	211.4	92.5	91.8	2,819.3	2,592.3	8.8	12.8	15.2
	192.8	245.2	N.A.	N.A.	7,306.5	6,411.6	14.0	39.4	37.6
	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
	N.A.	N.A.	N.A.	N.A.	1,072.4	998.9	7.4	0.0	0.0
	69.6	-179.0	N.A.	N.A.	784.9	713.4	10.0	N.A.	N.A.
	2,429.5	**608.7**	**N.A.**	**N.A.**	**66,837.1**	**54,686.1**	**22.2**	**55.5**	**12.3**
	35.5	23.5	79.0	61.6	208.9	176.5	18.3	52.1	45.8
	35.5	**23.5**	**79.0**	**61.6**	**208.9**	**176.5**	**18.3**	**52.1**	**45.8**
	90.3	62.2	94.8	103.5	984.2	791.6	24.3	3.5	2.6
	90.3	**62.2**	**94.8**	**103.5**	**984.2**	**791.6**	**24.3**	**3.5**	**2.6**
	10.8	-15.8	95.5	95.4	125.4	125.4	0.0	12.2	-23.9
	10.8	**-15.8**	**95.5**	**95.4**	**125.4**	**125.4**	**0.0**	**12.2**	**-23.9**

Global Reinsurers By Country

Rating As Of August 24, 2010	Company	Footnotes	Net Reinsurance Premiums Written (Mil. $)		
			2009	2008	Change (%)
Luxembourg					
A+	Swiss Re Europe S.A.		6,175.8	3,822.1	61.6
	Total:		**6,175.8**	**3,822.1**	**61.6**
Nigeria					
A-	African Reinsurance Corp.		294.4	246.1	19.6
	Total:		**294.4**	**246.1**	**19.6**
Poland					
BBB	Polskie Towarzystwo Reasekuracji S.A.		84.9	97.6	-13.0
	Total:		**84.9**	**97.6**	**-13.0**
Russia					
NR	Transsib Re		21.6	25.8	-16.1
NR	Vostochnoye perestrahkovochnoye obshestvo (VPK)		21.4	20.0	6.9
BB-	Unity Re (Russia)		18.4	27.3	-32.5
NR	Munich Re Life E.E.C.A.		14.4	8.1	77.9
	Total:		**75.9**	**81.2**	**-6.5**
Singapore					
A-	Asia Capital Reinsurance Group Pte Ltd.		338.9	338.7	0.1
A	SCOR Reinsurance Asia-Pacific		150.2	139.9	7.4
AA	Tokio Marine Re Takaful		7.6	7.9	-2.7
	Total:		**496.7**	**486.5**	**2.1**
Slovenia					
A-	Pozavarovalnica Sava, d.d.		145.3	133.9	8.5
A	Triglav Re		86.9	88.8	-2.1
	Total:		**232.2**	**222.7**	**4.2**

	Pretax Operating Income (Mil. $)		Combined Ratio (%)		Total Adjusted Shareholders' Funds (Mil. $)			Return on Revenue (%)	
	2009	2008	2009	2008	2009	2008	Change (%)	2009	2008
	1,750.9	941.1	61.5	85.1	2,701.1	1,604.8	68.3	49.4	46.6
	1,750.9	**941.1**	**61.5**	**85.1**	**2,701.1**	**1,604.8**	**68.3**	**49.4**	**46.6**
	46.9	26.7	88.3	93.4	277.9	221.5	25.5	24.7	10.6
	46.9	**26.7**	**88.3**	**93.4**	**277.9**	**221.5**	**25.5**	**24.7**	**10.6**
	1.7	-5.4	98.1	105.7	63.6	39.0	63.2	1.6	-6.0
	1.7	**-5.4**	**98.1**	**105.7**	**63.6**	**39.0**	**63.2**	**1.6**	**-6.0**
	1.7	-0.3	76.5	88.5	10.6	9.6	10.6	7.3	-1.3
	0.4	0.1	99.2	100.6	7.3	6.9	4.9	2.0	0.7
	3.0	8.9	81.9	66.3	19.4	18.1	7.5	13.7	40.8
	1.2	-0.9	N.M.	N.M.	12.6	11.6	8.9	8.1	-12.7
	6.3	**7.7**	**86.1**	**83.3**	**49.9**	**46.2**	**8.1**	**7.7**	**10.6**
	20.1	-14.2	86.0	95.9	611.8	548.8	11.5	5.4	-5.4
	-6.9	-9.7	93.5	122.0	104.3	80.0	30.4	-4.4	-6.4
	1.3	0.7	N.M.	N.M.	17.9	16.4	8.9	16.2	9.2
	14.5	**-23.2**	**87.8**	**102.3**	**734.0**	**645.2**	**13.8**	**2.7**	**-5.5**
	-10.9	-9.8	107.4	106.4	215.0	216.6	-0.8	-8.1	-7.8
	8.0	3.9	91.0	95.5	45.0	30.9	45.4	8.7	4.5
	-3.0	**-5.9**	**101.2**	**102.0**	**260.0**	**247.5**	**5.0**	**-1.3**	**-2.8**

Global Reinsurers By Country

Rating As Of August 24, 2010	Company	Footnotes	Net Reinsurance Premiums Written (Mil. $)		
			2009	2008	Change (%)
South Africa					
A+	Munich Reinsurance Co. of Africa Ltd.		249.5	167.3	49.2
AA+	General Reinsurance Africa Ltd.		161.0	116.4	38.3
NR	Swiss Re Life & Health Africa Ltd.		150.5	113.2	33.0
A	Hannover Reinsurance Africa Ltd.		132.0	91.3	44.5
A	Hannover Life Reassurance Africa Ltd.		129.5	84.0	54.3
NR	African Re Corp. (South Africa) Ltd.		56.9	39.9	42.4
NR	Swiss Re Africa Ltd.		39.3	50.2	-21.7
	Total:		**918.8**	**662.4**	**38.7**
Spain					
AA	Mapfre Re, Compania de Reaseguros, S.A.		1,958.1	1,683.9	16.3
A+	Nacional de Reaseguros S.A.		471.6	446.9	5.5
	Total:		**2,429.7**	**2,130.7**	**14.0**
Sweden					
A-	Sirius International Insurance Corp.		956.3	1,052.4	-9.1
A	Sweden Reinsurance Co. Ltd.		169.9	200.3	-15.2
	Total:		**1,126.2**	**1,252.8**	**-10.1**
Switzerland					
A+	Swiss Reinsurance Company Ltd.		5,776.0	8,878.4	-34.9
A	SCOR Switzerland AG		1,851.8	1,949.7	-5.0
AA-	New Reinsurance Co.		1,421.6	1,023.6	38.9
NR	Flagstone Reassurance Suisse SA		641.2	165.9	286.5
A+	DR Swiss, Deutsche Rueckversicherung Schweiz AG		422.4	500.4	-15.6
NR	Glacier Re		384.8	441.8	-12.9
A	XL Re Latin America Ltd.		181.3	207.2	-12.5
A	SCOR Global Life Rueckversicherung Schweiz AG		63.6	103.1	-38.3
A+	European Reinsurance Co. of Zurich	8	-234.3	424.6	-155.2
	Total:		**10,508.3**	**13,694.7**	**-23.3**
Taiwan					
A-	Central Reinsurance Corp.		389.5	422.5	-7.8
	Total:		**389.5**	**422.5**	**-7.8**

	Pretax Operating Income (Mil. $)		Combined Ratio (%)		Total Adjusted Shareholders' Funds (Mil. $)			Return on Revenue (%)	
	2009	2008	2009	2008	2009	2008	Change (%)	2009	2008
	45.6	23.0	78.7	110.1	191.6	148.8	28.7	16.4	12.3
	20.9	24.7	N.M.	N.M.	60.1	57.6	4.4	11.3	18.8
	64.8	38.8	N.M.	N.M.	75.6	74.0	2.2	34.0	26.8
	18.5	17.2	91.3	91.4	86.4	62.8	37.6	12.6	16.8
	17.5	11.4	N.M.	N.M.	42.7	25.8	65.3	12.4	13.1
	7.6	0.8	102.9	110.6	28.8	18.0	60.2	11.5	1.7
	3.8	16.3	119.0	84.9	40.4	37.0	9.1	8.3	25.4
	178.9	**132.2**	**92.9**	**98.4**	**525.5**	**423.9**	**24.0**	**17.0**	**17.4**
	264.3	148.2	93.4	95.6	1,115.7	1,008.2	10.7	13.3	8.8
	40.5	41.8	95.8	94.5	309.9	270.3	14.7	8.4	9.9
	304.7	**190.0**	**93.8**	**95.4**	**1,425.6**	**1,278.5**	**11.5**	**12.4**	**9.1**
	260.7	69.8	82.1	86.7	1,359.4	1,603.7	-15.2	24.0	7.0
	17.4	21.3	N.M.	N.M.	112.5	88.3	27.4	8.7	10.1
	278.1	**91.1**	**82.1**	**86.7**	**1,471.9**	**1,692.0**	**-13.0**	**21.7**	**7.5**
	1,699.4	3,111.6	90.9	91.1	23,851.6	21,416.5	11.4	14.6	13.9
	359.9	265.5	90.2	92.3	2,285.6	1,959.3	16.7	18.6	12.4
	231.4	49.8	89.7	100.6	1,147.7	933.5	22.9	15.0	4.6
	159.2	70.0	60.7	64.2	1,419.8	1,263.9	12.3	27.4	57.5
	-6.0	34.8	106.1	99.0	227.7	211.1	7.9	-1.3	6.3
	68.0	26.0	76.6	99.6	557.0	496.0	12.3	16.3	5.9
	N.A.	N.A.	82.5	117.8	N.A.	N.A.	N.A.	N.A.	N.A.
	13.1	6.8	N.M.	N.M.	59.8	49.2	21.5	33.9	7.0
	711.4	954.0	81.5	89.3	2,144.0	1,409.0	52.2	12.4	23.9
	3,236.3	**4,518.6**	**87.9**	**91.8**	**31,693.3**	**27,738.5**	**14.3**	**14.5**	**14.6**
	61.1	68.9	88.6	87.5	446.3	340.0	31.2	14.1	15.4
	61.1	**68.9**	**88.6**	**87.5**	**446.3**	**340.0**	**31.2**	**14.1**	**15.4**

Global Reinsurers By Country

Rating As Of August 24, 2010	Company	Footnotes	Net Reinsurance Premiums Written (Mil. $)		
			2009	2008	Change (%)
Thailand					
A-	Thai Reinsurance Public Co. Ltd.		106.6	97.8	9.0
	Total:		**106.6**	**97.8**	**9.0**
Turkey					
trAA	Milli Reasurans T.A.S.		502.2	522.3	-3.8
	Total:		**502.2**	**522.3**	**-3.8**
U.K.					
A+	Lloyd's	9	9,733.5	6,701.9	45.2
A	Aspen Insurance U.K. Ltd.		761.7	720.9	5.7
AA	Tokio Marine Global Ltd.		201.3	157.6	27.8
AA-	Hannover Life Reassurance (UK) Ltd.		164.7	116.4	41.5
AA-	Great Lakes Reinsurance (U.K.) PLC		128.6	114.8	12.0
AA+	Faraday Reinsurance Co. Ltd.		110.7	88.6	25.0
AA+	General Reinsurance UK Ltd.		100.7	93.1	8.2
A+	QBE Insurance (Europe) Ltd.		94.8	89.2	6.2
A	SCOR U.K. Co. Ltd.	10	63.9	96.1	-33.5
A	SCOR Insurance UK Ltd.	10	6.8	22.4	-69.5
	Total:		**11,366.6**	**8,200.9**	**38.6**

	Pretax Operating Income (Mil. $)		Combined Ratio (%)		Total Adjusted Shareholders' Funds (Mil. $)			Return on Revenue (%)	
	2009	2008	2009	2008	2009	2008	Change (%)	2009	2008
	16.7	13.7	83.0	87.1	70.4	55.2	27.6	15.3	13.7
	16.7	**13.7**	**83.0**	**87.1**	**70.4**	**55.2**	**27.6**	**15.3**	**13.7**
	74.1	108.5	110.3	103.5	517.3	437.7	18.2	13.0	20.5
	74.1	**108.5**	**110.3**	**103.5**	**517.3**	**437.7**	**18.2**	**13.0**	**20.5**
	1,983.0	1,062.2	78.4	83.8	28,929.8	20,523.9	41.0	16.5	13.4
	304.0	204.1	68.9	79.4	1,412.9	918.3	53.9	33.0	26.3
	43.7	0.5	80.9	93.5	303.9	244.8	24.1	21.7	0.3
	1.9	-15.3	N.M.	N.M.	69.1	74.2	-6.8	1.0	-11.0
	97.3	81.6	59.1	69.2	466.0	430.2	8.3	56.9	58.3
	25.3	50.4	120.2	93.8	297.3	293.1	1.5	16.0	36.3
	53.9	100.1	98.7	42.2	483.8	441.4	9.6	34.0	73.1
	25.5	23.3	88.1	104.1	277.8	271.0	2.5	19.8	17.8
	24.8	0.6	75.8	113.0	123.4	89.4	38.0	27.7	0.7
	0.0	9.7	N.M.	N.M.	154.3	90.4	70.6	N.M.	N.M.
	2,559.4	**1,517.2**	**78.1**	**83.8**	**32,518.4**	**23,376.7**	**39.1**	**18.3**	**15.8**

Global Reinsurers By Country

Rating As Of August 24, 2010	Company	Footnotes	Net Reinsurance Premiums Written (Mil. $)		
			2009	2008	Change (%)
U.S.					
AA+	National Indemnity Co.		4,253.0	4,468.0	-4.8
A+	Transatlantic Reinsurance Co.		3,410.0	3,488.9	-2.3
A+	Swiss Reinsurance America Corp.		3,331.0	3,050.8	9.2
AA+	Berkshire Hathaway Life Insurance Co. of NE	11	2,338.0	57.4	N.M.
AA-	Munich Reinsurance America, Inc.		2,217.8	2,454.9	-9.7
A-	Odyssey America Reinsurance Corp.		1,660.9	1,702.4	-2.4
A+	Everest Reinsurance Co.		1,646.6	838.8	96.3
A+	Swiss Re Life & Health America Inc.	11	1,336.9	4,605.8	-71.0
A+	Berkley Insurance Co.	12	1,226.0	1,232.3	-0.5
AA+	General Re Corp.		1,198.3	1,150.6	4.1
AA-	Munich American Reassurance Co.		1,073.2	1,278.0	-16.0
AA+	General Re Life Corp.		1,072.8	1,086.1	-1.2
NR	Maiden Re		1,030.4	727.4	41.7
A+	Reassure America Life Insurance Co.		957.2	1,068.7	-10.4
AA-	Partner Reinsurance Co. of U.S.		763.7	760.7	0.4
A+	Axis Reinsurance Company	3	544.0	362.8	50.0
A	XL Reinsurance America Inc.		538.8	613.6	-12.2
A	SCOR Reinsurance Co.		522.9	388.0	34.8
A	SCOR GLOBAL LIFE US RE Ins Co.		499.1	132.5	276.7
A-	White Mountains Re America		489.1	554.9	-11.9
AA-	Hannover Life Reassurance Co. of America		403.0	788.3	-48.9
A+	QBE Reinsurance Corp.		397.6	209.4	89.9
A+	Toa Reinsurance Co. of America (The)		235.3	244.3	-3.7
A+	Putnam Reinsurance Co.		179.5	183.6	-2.2
A+	Arch Reinsurance Co.		79.3	83.5	-5.0
NR	SCOR GLOBAL LIFE US RE Ins. OF TEXAS		27.2	31.2	-12.7
	Total:		**31,431.6**	**31,562.9**	**-0.4**
	Grand Total		**151,296.9**	**141,050.6**	**7.3**

Company notes:
1 Significant increase in pretax operating income in 2009 reflects a commutation enacted during the year
2 On July 8, 2009, Validus Holdings Ltd acquired IPC Holdings Ltd. The data presented includes the operations of IPC Re from the date of the acquisition
3 Adjusted Shareholders' Funds are for the company as a whole, including both its direct and reinsurance business
4 On July 8, 2009, the company was acquired by Validus Holdings Ltd. The data presented represents the operations of IPC Re until the date of the acquisition
5 Pre tax operating income does not include net investment income. Adjusted Shareholders' Funds are for the company as a whole, including both its direct and reinsurance business
6 Net Reinsurance Premium Written and Combined Ratio relate to reinsurance business only; all other items include direct business
7 The combined ratio includes direct business
8 Negative net reinsurance premium written reflects a new outward quota share treaty
9 Net Premium Written, pretax operating income and the combined ratio relate to reinsurance business only; all other items include direct business. The data presented is based on the published pro forma accounts for the Market, which represents an aggregation of all syndicates participating at Lloyd's. As such, some premium included for Lloyd's may also be included by other groups that consolidate their Lloyd's operations
10 The operations of Scor Insurance UK were transferred to Scor UK Co Ltd via a Part VII transfer on 30 April 2009

	Pretax Operating Income (Mil. $)		Combined Ratio (%)		Total Adjusted Shareholders' Funds (Mil. $)			Return on Revenue (%)	
	2009	2008	2009	2008	2009	2008	Change (%)	2009	2008
	939.0	317.2	78.9	94.1	38,436.0	27,613.1	39.2	12.9	5.6
	468.0	448.8	92.5	99.2	4,016.1	3,534.1	13.6	12.2	11.4
	485.4	229.0	101.2	108.3	4,805.2	4,153.5	15.7	23.1	9.7
	-1,578.0	-82.2	N.M.	N.M.	1,033.0	810.4	27.5	-60.3	-34.3
	305.1	2.9	101.9	119.3	3,824.6	3,546.6	7.8	10.2	0.1
	325.1	213.0	92.2	97.5	3,512.8	2,951.3	19.0	17.2	11.4
	485.0	292.1	89.0	105.3	2,789.7	2,342.4	19.1	24.3	21.1
	598.2	455.3	N.M.	N.M.	3,039.5	1,788.0	70.0	91.9	14.7
	293.1	296.0	92.2	93.6	2,477.2	2,036.6	21.6	19.3	18.5
	1,340.0	519.4	88.5	107.3	9,909.5	8,936.8	10.9	63.0	39.5
	48.8	-45.8	N.M.	N.M.	609.7	649.2	-6.1	3.8	-3.0
	157.8	41.4	N.M.	N.M.	560.8	466.6	20.2	12.8	3.6
	62.1	56.4	95.9	94.8	891.6	509.8	74.9	6.3	13.4
	293.4	170.9	N.M.	N.M.	647.9	520.4	24.5	30.9	15.2
	166.6	65.2	95.1	107.3	792.6	608.3	30.3	18.2	7.3
	N.A.	N.A.	89.3	104.5	609.2	519.7	17.2	N.A.	N.A.
	N.A.	N.A.	94.6	91.8	N.A.	N.A.	N.A.	N.A.	N.A.
	63.3	11.8	91.7	107.3	551.8	503.6	9.6	12.8	3.3
	-40.9	27.8	N.M.	N.M.	126.2	162.9	-22.6	-7.3	14.1
	239.1	-325.5	93.3	126.9	918.1	760.0	20.8	33.7	-71.1
	4.2	-4.7	N.M.	N.M.	140.8	128.1	9.9	1.4	-0.7
	19.9	12.1	97.4	108.1	580.5	538.8	7.7	5.2	7.1
	48.1	79.2	100.9	90.3	516.7	434.5	18.9	16.3	24.7
	36.8	24.5	92.5	99.2	203.5	165.9	22.7	18.0	11.8
	20.9	8.6	92.3	107.9	1,059.5	963.7	9.9	21.3	8.3
	-11.2	-5.3	N.M.	N.M.	19.9	41.5	-52.0	-34.5	-12.8
	4,769.9	**2,808.2**	**91.7**	**101.5**	**82,072.3**	**64,685.8**	**26.9**	**13.5**	**8.9**
	29,279.0	**12,809.3**	**88.3**	**93.6**	**425,553.3**	**364,850.4**	**16.6**	**16.5**	**13.4**

11 Significant change in NPW for 2009 reflects a reserve transfer arising from a co-insurance agreement between Swiss Re Life & Heath America and Berkshire Hathaway Life Insurance Co. of NE
12 Data presented includes intra group reinsurances

Net reinsurance premiums written = gross reinsurance premiums written less reinsurance premiums ceded; relate to a company's reinsurance business only, unless where separately indicated
Pretax operating income = underwriting profit (or loss) + net investment income + other income. Net realized and unrealized investment gains/losses are excluded from this item
Combined Ratio = (net losses incurred + net underwriting expenses)/net premium earned
Total adjusted shareholders' funds = capital + shareholders' reserves (including claims-equalization reserve and any excess or deficiency of market value of investments over the balance sheet value)
ROR = pretax operating income/total revenue (Total revenue = net premiums earned + net investment income + other income)
N.A.—Not available
N.M.—Not meaningful

Choosing A Domicile Remains A Hot Topic For Global Reinsurers

By Laline Carvalho, Damien Magarelli and Rob Jones

For global reinsurance companies, the choice of domicile–which can have significant regulatory and tax implications–has always been paramount. While the U.S. remains an important market, Europe and Bermuda continue to vie for the top spot among reinsurers that are launching their businesses or considering a change of address.

From the mid-to-late 1990s through 2007, Bermuda was the location of choice for reinsurers that were setting up new businesses. Start-up activity on the island was particularly strong in 2001 to 2002 following the Sept. 11, 2001, terrorist attacks, as well as in 2005 to 2006 after Hurricanes Katrina, Rita, and Wilma. Demand for reinsurance increased substantially during those times, and Bermuda–which offered relatively quick regulatory approval to begin operations, favorable tax laws, and proximity to the U.S.–proved an attractive place for reinsurance companies.

However, the number of reinsurers (many of which offer a combination of insurance and reinsurance products) that are moving to establish their business in Europe has risen over the past few years. Europe historically has been home to some of the largest and most well-established reinsurers in the world. And though Bermuda had gained prominence as a domicile of choice, we are now seeing a significant shift back toward Europe. Europe accounted for 60% of global net reinsurance premiums written in 2009, and five of the six largest and longest-standing global reinsurance writers–Hannover Re, Lloyd's, Munich Re, SCOR and Swiss Re–are based in the region. Proposed regulatory and taxation-related changes in different parts of the world are sparking a renewed interest in Europe, particularly Ireland and Switzerland. This is true for new companies, for reinsurers that are changing their countries of domicile, and for large reinsurance groups located elsewhere that are forming new operating subsidiaries.

Despite Its Benefits, Bermuda Has Been Losing Ground

Bermuda offers several advantages to reinsurance companies. In addition to its proximity to the U.S. and favorable tax system, Bermuda's regulatory system generally provides companies with both quick approval to start up their businesses and the ability to rapidly change their policies and prices, which means they can respond quickly to changing market conditions. Of these benefits, we view Bermuda's ability to approve new reinsurance formations in a matter of a few weeks (versus several months in other jurisdictions) as a key advantage. This is valuable for reinsurance capital providers when attempting to take advantage of great-

er demand for reinsurance and better pricing during the months immediately following high catastrophe activity–as we saw in 2001 and 2005.

These factors contributed significantly to Bermuda's becoming one of the most important centers for global reinsurance over the past decade. Bermuda-based reinsurers accounted for about $12 billion (or 8%) of the total $160 billion in global net reinsurance writings in 2009 (see Chart 1). Just a decade earlier, in 1998, Bermuda's contribution to global reinsurance writings was much more modest. Net reinsurance writings in Bermuda totaled about $3 billion, which represented about 4% of total global reinsurance writings of $87 billion during the year. The island has taken a particularly important role in the underwriting of large property/catastrophe programs and other complex, global risks. As a result, most third-party underwriters based in Bermuda, excluding captive (re)insurers (which a parent company or group forms to cover its own assets and risks), consist of global players offering a combination of insurance and reinsurance covers. Many of these companies are fairly large, including XL Capital (with $9.6 billion in GAAP shareholders' equity at year-end 2009), PartnerRe ($7.6 billion), and AXIS ($5.5 billion) (see Table 1).

Despite these benefits, recent regulatory changes in Europe related to the Solvency II Directive and continued concerns with about potential changes in Bermuda's status with regard to U.S. tax legislation have increased the attractiveness of a number of European countries as potential reinsurance domiciles. These include locations such as Ireland, the U.K., Switzerland, the Netherlands, and Luxemburg.

A more sophisticated regulatory system could give Europe an edge

Some reinsurance management teams are starting to look at Europe as potentially offering a more sophisticated regulatory environment based on planned changes in that region related to Solvency II. This is despite the relatively aggressive stance the Bermuda Monetary Authority (BMA) has taken in recent years with regard to its oversight of Bermudian insurers and reinsurers. The BMA has made enhancements, such as the introduction of a risk-based capital adequacy model, to achieve regulatory equivalence with Solvency II. In 2010, the BMA took several measures, including:

- Publishing a proposal for a groupwide supervision framework for (re)insurers domiciled on the island;
- Launching a pilot internal capital model assessment for (re)insurers;
- Proposing that commercial insurers in Bermuda perform assessments of their own risks and solvency requirements; and
- Putting forward new requirements for disclosure and transparency for Bermuda's largest writers.

Table 1

10 Of The Top Bermuda-Based Insurance And Reinsurance Groups

	2009 GAAP shareholders' equity (bil. US$)
XL Capital	9.6
PartnerRe	7.6
AXIS	5.5
Arch	4.3
Validus	4.0
Renaissance Re	3.8
Aspen	3.3
Catlin Group	3.3
Allied World	3.2
Alterra*	3.0

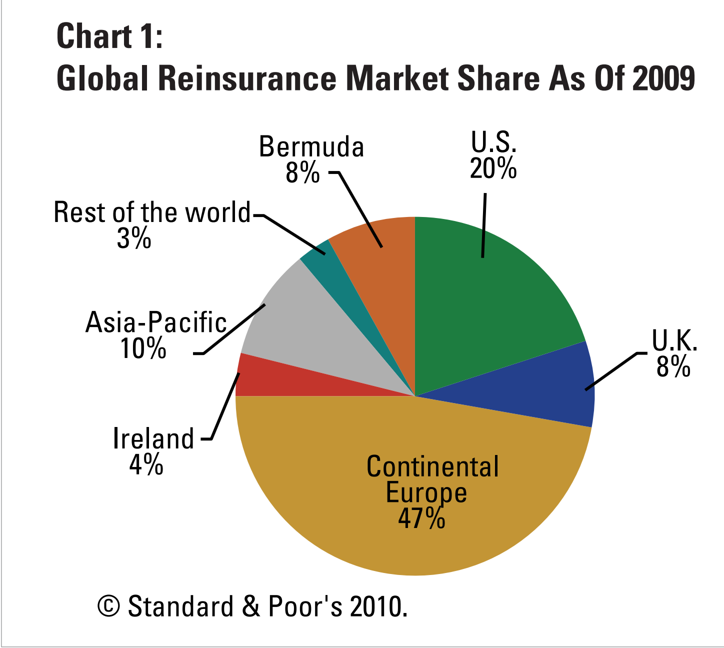
*Figures for Alterra are pro forma accounting for the May 2010 merger of Harbor Point and Max Capital.

Achieving regulatory equivalence with Solvency II is an important objective for the BMA and insurers operating on the island. It would mean that EU supervisors could cede much of their supervisory activities for a Bermuda-based group to the BMA, rather than burden that group's EU subsidiaries with extensive exposure to direct EU supervision. It would also mean any reinsurance that EU (re)insurers cede to Bermudian reinsurers would receive more favorable regulatory treatment in those EU entities' capital requirements.

As a result of advances the BMA has made, the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) has recommended to the European Commission that Bermuda, along with Switzerland, be in the first wave of third-country equivalence assessments under Solvency II. In our opinion, the BMA is somewhat better prepared than several continental European supervisors for Solvency II.

Potential U.S. tax changes could also make Europe a more attractive domicile

One of the key advantages for insurers and reinsurers operating in Bermuda is the island's low taxes, so the prospect of taxation for U.S.-sourced business written either directly by a Bermuda-based subsidiary or indirectly by a U.S.-based operating subsidiary with significant quota-share arrangements back to Bermuda could jeopardize Bermuda's position as the domicile of choice. Changes in U.S. rules regarding taxation of U.S.-sourced business going to Bermuda and other low-tax domiciles in the coming years remain a possibility. And although the full scope of such potential changes remains unclear, many market experts expect



them to be most relevant (if enacted) for Bermuda-domiciled reinsurers with U.S. subsidiaries that quota share a significant proportion of their gross writings to Bermuda.

In contrast to Bermuda, some European countries, such as Switzerland and Ireland, offer reinsurance capital providers relatively stable tax arrangements, including long-held tax treaties with the U.S. Most experts believe that potential changes to U.S. tax legislation are unlikely to affect these tax treaties. Ireland and Switzerland also boast workforces of experienced insurance professionals, lower operating costs relative to Bermuda (particularly in Ireland), and proximity to the European markets.

Ireland And Switzerland Are Emerging As The Most Sought-After European Domiciles

Many of the recent (re)insurance formations in Ireland–which is part of the EU and currently accounts for 4% of total global net reinsurance premium writings–are operating subsidiaries of Bermuda- and U.S.-based insurers and reinsurers that are considering this country as their main operating platform within the EU. In addition, some Bermuda-based companies see Ireland as a potential destination for redomestication of their ultimate holding companies (as several U.K. insurers and reinsurers have already done). A number of Bermudian reinsurers also have transferred direct ownership of their U.S. reinsurance subsidiaries to Irish intermediate holding companies, further distancing their U.S. operations from Bermuda and the possible changes in the U.S. tax treaties. Various Bermuda-based reinsurers have set up intermediate holding companies or insurance and reinsurance operating subsidiaries in Ireland in recent years, including PartnerRe, XL Capital, Everest, Arch, AXIS, Allied World, and Alterra.

Switzerland is also gaining ground as an attractive domicile for (re)insurers. In 2008, ACE moved its ultimate holding company from the Cayman Islands to Switzerland, and Flagstone merged its Swiss and Bermudian operating subsidiaries under one flagship operating subsidiary based in Switzerland. In addition, Catlin and Amlin recently announced their intention to form Swiss operating subsidiaries. Flagstone made its Bermudian subsidiary a branch of the Swiss company, and Catlin is taking similar steps–it is forming a Bermudian branch that its new Swiss subsidiary will own, and the branch will write some of the business that the Bermudian operating company currently underwrites. Amlin intends to redomicile its Bermuda-based operating company to Switzerland and form a Bermudian branch.

This trend among Bermudian (re)insurance groups of forming European flagship companies while maintaining operations and staff in Bermuda (through either wholly owned operating subsidiaries or Bermuda-based branches) has helped to increase companies' regulatory capital flexibility while maintaining Bermuda as a key underwriting center. We believe other Bermuda-based companies could move to do the same in the coming years, although many remain committed to Bermuda as their primary domicile.

Beyond Ireland and Switzerland, other European locations that are sparking interest among insurers and reinsurers include Luxemburg and the Netherlands. Flagstone recently announced that it is moving its ultimate holding company from Bermuda to Luxemburg, and in 2009, Brit Insurance established Brit Insurance Holdings N.V. in the Netherlands as its new ultimate parent company. Previously, the group's parent was in the U.K. U.K.-based Lloyd's of London also continues to attract significant interest as an important operating platform. Over the past five years, most global Bermuda- and U.S.-based reinsurers have either acquired or formed new Lloyd's syndicates, in recognition of Lloyd's significant global outreach through its many country licenses and its reputation as a leading provider of specialty classes of business, as well as the strong credit ratings on Lloyd's. Although the U.K. has been rather less appealing as a holding company domicile, largely because of its tax regime, recent reductions to the headline rate of corporation tax may increase its appeal.

The U.S. Remains An Important Market, But It's Unattractive As A Domicile

While Europe is gaining momentum as an attractive domicile for (re)insurers, the number of U.S.-based reinsurers has dropped significantly since the late 1990s, when the market softened and companies began to leave the business. Most that remain today are subsidiaries of Bermuda- and Europe-based reinsurers or large U.S. financial conglomerates, with the exception of Transatlantic, which is a fully independent U.S.-based reinsurer.

U.S. reinsurers' gross premium writings have also declined over the past 10 years, in step with the continued exit of these companies from the market and an increase in non-U.S.-based companies directly reinsuring U.S.-based risks. Over the past five years alone, the number of U.S. reinsurers reporting to the Reinsurance Association of America (RAA) fell to 19 from 26. And aggregate gross writings dropped to $30.8 billion in 2009 (excluding writings from nontraditional reinsurer National Indemnity Co.), a 16% decline from $36.5 billion in 2005. Aggregate net writings of only $19.7 billion in 2009 suggest a significant 37% retrocession rate, leaving a much smaller proportion of business in the U.S. This high cession rate mostly reflects significant quota-share arrangements between individual U.S. reinsurers and their ultimate parent companies in Bermuda or Europe.

The possible lack of equivalence status under Solvency II is likely another reason reinsurers aren't choosing to domicile their businesses in the U.S. CEIOPS did not recommend that the U.S. be included in the first wave of assessments.

In spite of these trends, however, the overall size of the U.S. reinsurance market hasn't declined when accounting for all U.S. risks reinsured by either domestic or foreign reinsurers. What has changed is the location of the ultimate holding companies and where the business is being reinsured. The U.S. remains one of the most important reinsurance markets in the world, and one that most global reinsurance players want to participate in.

Our Ratings Should Remain Stable Despite Potential Taxation And Domicile Changes

We believe a change in U.S. taxation, if enacted, could lead to a modest increase in the overall tax that Bermudian (re)insurers pay. However, the impact will differ from company to company, and we generally don't view the tax increase in itself as material enough for us to change our ratings on these entities. One of the main reasons for this is that most Bermudian companies have operating subsidiaries all over the world, so they're already subject to local taxation rules.

In addition, because most Bermudian (re)insurance writers are global, a change in the country of domicile is unlikely to have a significant impact on business. Therefore, we don't expect to take any rating actions on holding companies or core operating companies as a result of taxation or domicile changes.

We would, however, consider taking rating actions on some U.S. subsidiaries of Bermuda- and Europe-based insurance and reinsurance groups if their management teams were to significantly reduce existing quota-share and other explicit support arrangements as a result of any potential changes in U.S. taxation. If this were to occur, we likely would analyze the U.S. subsidiaries of each of these groups on a case-by-case basis to determine how any modifications in explicit support arrangements could affect our ratings in accordance with our group rating methodology criteria (see "Group Methodology," published April 22, 2009).

Choosing A Domicile Will Remain A Key Consideration For Reinsurers

We believe that reinsurance capital providers will look for a wider variety of alternative domiciles in the coming years, which should mean a more global reinsurance industry. We also expect that reinsurers will continue to diversify their operations not only geographically, but also by line of business, which will enable them to offer an increasingly comprehensive set of insurance and reinsurance products. Although we believe Bermuda likely will remain a significant hub for reinsurance placements, we expect management teams on the island to continue to weigh the pros and cons of keeping their business in Bermuda as regulatory and taxation trends continue to unfold in different jurisdictions. As a result, we expect choice of domicile to remain a key item on the agenda for many reinsurance management teams, as well as for those planning to enter the market in the coming years. ■

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Uncertainty Continues For European Insurers As Solvency II Requirements Remain Undecided

By Rob Jones and Miroslav Petkov

The fifth quantitative impact study (QIS 5) for Solvency II, the new supervisory framework for the EU insurance and reinsurance industry, commenced in August 2010. QIS 5 participants are to report on their results with several variations. As a result, even though Solvency II is expected to come into effect in 2013, the industry will have no clear idea what the final calibration might be until the end of 2011.

Even after the intervention of the European Commission (EC), which moderated the advice of the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) on capital requirements to be tested under QIS 5, Standard & Poor's Ratings Services observes that European insurers and reinsurers are still viewing Solvency II with some trepidation.

Modified QIS 5 Still Not Capital-Neutral At An Industry Level

In our opinion, based on QIS 5 specifications, Solvency II would not offer the capital neutrality that insurers are lobbying EU policymakers to achieve. We interpret capital neutrality to mean that the aggregate capital held by the EU insurance industry would be unchanged by Solvency II, with some insurers having to raise capital and others able to release it, leaving the distribution of industry capital more closely matched to risk profiles. That lobbying has been only partly successful, leading to the moderation of CEIOPS' advice in the EC requirements for QIS 5. CEIOPS has stated that capital neutrality should not be an objective. The full extent of the potential capital raising implied by QIS 5 should become clearer in the spring of 2011, when CEIOPS publishes the study's results.

On average, we believe that based on the submissions CEIOPS sent the EC, its advice would have resulted in increased capital requirements of approximately 70% (life companies 75%, non-life companies 65%) over the calibration tested in QIS 4. This advice has been substantially moderated by the EC in QIS 5 but, in our opinion, would still result in significant capital raising. Supervisory capital adequacy would be likely to become a much more relevant consideration for determining our ratings on EU insurers. We expect that negative rating actions could also be a likely consequence for Europe's insurers.

While there were calls from some parties to pause the implementation of Solvency II in the wake of the financial crisis, the report to the EC of the high-level group on financial supervision in the EU headed by Jacques de Larosière concluded that Solvency II should be "adopted urgently."

Financial Crisis Encouraged Supervisors To Increase Demands For Capital

The financial crisis had a major influence on CEIOPS' advice. In our opinion, the industry expected that the solvency capital requirements (SCR) based on the standard model for market risk for corporate bonds and equities might increase and that the correlation assumptions between these and certain other risks might also increase as a consequence of the financial crisis. However, we believe that the industry did not anticipate the extent of the changes proposed to these factors, nor did it expect to see changes made in other areas such as non-life premium and loss reserves.

In 2008, based mainly on healthy year-end 2007 balance sheets, CEIOPS concluded that, even based on QIS 4, 11% of Europe's insurers would fail to cover their SCR. As discussed in our article "One In Four Of Europe's Insurers Could Face Major Strategic Decisions Under Solvency II," published on March 12, 2008, we took the view that the impact would have been much higher when the likely level of buffer capital (above the SCR) was taken into consideration.

Even after the EC's intervention, under QIS 5, the impact is likely to be significantly greater than QIS 4, although it is difficult to be precise about the impact given the very recent finalization of QIS 5 requirements. We expect solvency ratios to be volatile under Solvency II and therefore expect most insurers to maintain sufficient buffer to avoid any potential future breach of their SCR.

Internal Model Approval Would Be Critical For Many Insurers

While the final standard model calibration remains uncertain, the incentive to seek approval for the use of internal models for determining SCR is not. We understand that many insurers regard this as critical given the uncertainties about the final calibration of the standard model. However, since the standard model and internal models are both calibrated at a 99.5% of value at risk, we expect some supervisors would take some persuading before approving internal models that produce a dramatically different outcome from the standard model. Furthermore, CEIOPS' advice on approving the use of internal models sets such a demanding standard that, in our opinion, very few insurers in Europe would currently meet the requirements for model documentation and the "use test." We also believe that few European supervisors have adequate resources to consider the likely volume of requests to approve internal models. Given this, we believe there is also a significant risk that differences in interpretation of the requirements may result in inconsistencies in the application of internal model approval standards across Europe in the early years of the directive. Over time, however, we would expect this to improve with greater transparency, oversight, and peer review of supervisors' practices.

Standard & Poor's Has Made Modest Revisions To Its Capital Requirements

From a rating perspective, while we believe that the experience of the past three years (including the financial crisis) added to the historic observations that caused an upward reassessment of capital needs, we do not believe that a material increase in capital requirements is required (see "Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy," published on June 7, 2010).

If QIS 5 were to be the final Solvency II calibration, we would expect the results of our model to have less impact on some rating outcomes going forward. Under Solvency I, the capital Standard & Poor's expects to see at entities rated at a 'BBB' level usually substantially exceeds supervisory capital requirements. Under Solvency II, 'BBB' rating capital requirements may be lower than the SCR (based on the standard model) for many 'BBB' rated entities. Furthermore, several 'A' rated entities, especially those with a risk profile that would be heavily affected by CEOIPS' latest advice, may find that the SCR exceeds the rating capital levels produced by our capital model.

It is important to note that rating agencies and supervisors have different objectives. In "Interpreting Insurer Financial Strength Ratings In Light Of Improving Insurer Supervision," we discuss whether an FSR should be considered a "solvency rating" and other related questions.

Opinions On International Competitiveness Have Reversed

We have observed that opinion regarding the international competitiveness of European insurers under Solvency II has swung dramatically in recent months. Based on the QIS 4 calibration, the U.S. insurance industry was concerned that it would be disadvantaged versus European groups on the international stage. Much of the potential disadvantage resulted from the diversification benefits that European insurers were expected to enjoy. U.S. insurers' fears were partly allayed when group support was removed from the final directive. However, the European industry is now complaining that it would be disadvantaged globally based on QIS 5.

Negative Rating Actions For Europe's Insurers May Be Likely

Capital is a significant component of Standard & Poor's overall rating on an insurer, but not the only one. That said, a final calibration equivalent to QIS 5 might have an adverse effect on other elements of rating analysis, such as competitive position, operating performance, and financial flexibility. Not only could international competitiveness be affected, as mentioned above, but even within Europe, business models may need to be fundamentally re-examined. This could affect product design, matching asset classes, pricing, and distribution (see "Ratings To Reflect Expected Solvency II Impact

On European Insurers' Risk Profiles And Strategic Positioning," May 18, 2010).

A higher cost of capital would also adversely affect operating performance and financial flexibility. Would investors be willing to fund the transition to Solvency II capital needs, and at what price? Given the uniqueness of their business, insurers have consistently found it difficult to communicate with investors regarding risk and return, but it may be about to get a whole lot harder. We would expect these factors to have an adverse impact on our ratings on insurers in Europe.

The Beneficiaries And The Burdened Across The Insurance Industry

Standard & Poor's expects certain groups to benefit from the move to Solvency II, while others are put at a disadvantage. Below, we discuss the effect we believe a calibration like QIS 5 might have on different market participants.

Well-capitalized insurers

Generally, we would expect (re)insurers with a high level of capital adequacy already in place to enjoy a significant competitive advantage. There would be a widespread demand for new capital under Solvency II. It is not clear whether the supply would match that demand for all and, if it did, at what price it would come.

Reinsurers

We also believe that generally reinsurers should do well, especially in the early years of Solvency II. During our assessments of their enterprise risk management (ERM) capabilities we have seen evidence to support our belief that they are relatively well-prepared for Solvency II (see "Global Reinsurers Lead The Way In Enterprise Risk Management"). We expect primary insurers (which, in our opinion, are generally less well prepared than reinsurers) to seek quick and efficient forms of risk mitigation, such as reinsurance, in the short-to-medium term as they look to cushion the initial impact of Solvency II. That said, this demand for reinsurance may not be sustained in the longer term, as primary insurers become more sophisticated. For example, they may obtain approval from their supervisors for their SCR to be based on their internal model; they may access the general capital markets; or, more specifically, they may access the insurance-linked securities (ILS) market. We would expect well-capitalized reinsurers with the capacity to offer additional quota share protection to fare especially well. Quota share reinsurance is favored because it would affect the standard model and internal models, while nonproportional protection would only be at its most effective for insurers with approved internal models.

Large groups

In our opinion, large groups should benefit in terms of capital efficiency, and thus price competitiveness, under Solvency II, although the level of potential benefits is much lower than we had estimated in our earlier commentaries. The absence of group support from the final directive was a major setback to many groups, as is the lower level of diversification benefit in QIS 5. We believe large groups are relatively well prepared for Solvency II. Many of the group are CRO Forum members, all of whom already operate internal models. We would expect these groups to be among the first to have their models reviewed and approved.

Insurance-linked securities

The ILS market would in our view be likely to be given additional impetus by Solvency II since the directive embraces risk mitigation in all its forms. Currently, reinsurers are the main sponsors of ILS transactions. More primary insurers might access the market in the future, particularly as their internal modeling capabilities grow. The ILS market may be given even further impetus in areas where Solvency II risk capital requirements are viewed by capital markets as excessive.

Consultants

Consultants are already prospering from the advice they are providing to insurers in the run-up to implementation. Actuarial services are in particularly heavy demand. Some reinsurers are positioning themselves as Solvency II advisers.

Issuers of hybrid capital

Issuers of hybrid capital are concerned that the standards expected for inclusion as net assets (known as "own funds" under Solvency II) are higher than those reflected in current instruments, especially for inclusion as Tier 1 own funds. We understand that their concern partly relates to the viability of hybrid capital as a future source of capital, but the more-pressing concern is that QIS 5 is silent on the "grandfathering" period for existing hybrids. Standard & Poor's estimates that European insurance groups currently have approximately 80 billion of hybrid capital outstanding. Few of these issues would meet the new standards fully for Tier 1 or Tier 2.

Insurers failing to obtain approval for internal models

Insurers who fail to obtain approval for their internal model would clearly be disadvantaged in our view. Failure to obtain approval would likely result in higher regulatory capital requirements and increased cost of capital. Consequently, insurers may need to change their business strategy, reduce their risk profile, or raise capital. Investors would also view such failure negatively.

Companies whose preparations are not already advanced

Companies whose preparations for Solvency II are not already advanced face significant uncertainty. Such companies may not be aware of all the implications of

Solvency II for their strategy, risk profile, and capital resources, and they may be late in implementing the necessary changes. Also, these insurers may have understated the resource requirements for Solvency II implementation and experience higher implementation costs as they may need to rely more on external resources.

We believe that even in markets that already have elements of supervision akin to Solvency II, such as the U.K., insurers still have much to do before the implementation date. Among the newer EU member states, the level of preparedness is typically very low, in our opinion.

Monoline and less-diversified businesses

Although diversification benefits have fallen in QIS 5 relative to QIS 4 as a result of the new correlation assumptions, those benefits would still be material in our opinion. Consequently, monoline and less-diversified businesses would likely require much more capital than under Solvency I, relative to their more-diversified competitors. Depending on how their key risks are treated in the standard SCR, they may have strong incentives to apply for internal model approval. Their supervisory capital requirements may well exceed those normally expected of an insurer rated 'BBB' by Standard & Poor's. In such cases, supervisory capital requirements would likely prevail in our rating analysis, with our own model expected to be of limited practical relevance.

Small companies

We believe Solvency II would not favor small companies, in spite of the principle of proportionality applied under the directive. This is mainly due to the demands of Pillar 2, which requires a level of risk management sophistication that may not be feasible for many small companies. Furthermore, smaller companies also tend to be less well diversified, which would compound their problems.

Captive insurers

Captive insurers may also be disadvantaged under Solvency II, in our opinion. The issues of size and diversification affect most captives. Even reinsurance captives outside the EU may find their choice of European fronting insurers limited if the captive domicile does not achieve Solvency II supervisory equivalence, since the fronting insurer may not be able to take credit for recoveries due from the captive reinsurer.

QIS 5 Will Be A Crucial Exercise For The Industry

QIS 5 is due to run between August and November 2010 and will be crucial during the discussions between member states and the European Parliament in 2011. The calibration of the standard formula SCR will not be finalized until the results of QIS 5 are known. ■

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Interpreting Insurer Financial Strength Ratings In Light Of Improving Insurer Supervision

By Rob Jones

Standard & Poor's Ratings Services remains committed to the transparency of its ratings and the criteria used to determine those ratings. This article responds to questions we have recently received regarding our Financial Strength Ratings (FSRs) on insurers, particularly as the modernization of insurer supervision gathers pace. In Europe, Solvency II looms on the horizon. The questions are as follows:

- How does Standard & Poor's define an FSR?
- How are FSRs determined?
- Should an FSR be considered a "solvency rating"?
- Will Solvency II make FSRs obsolete?
- Most insurers have sufficient capital to pay all their known liabilities by some considerable margin. Why aren't they all rated 'AAA'?
- Why doesn't Standard & Poor's assign higher ratings to start-ups?
- What about run-offs?
- How does an insurer default?
- Are FSRs the same as Claims Paying Ability ratings?
- Do FSRs incorporate government support?
- What is the difference between an FSR and a Lloyd's Syndicate Assessment (LSA)?
- What is the difference between an interactive FSR and a public information FSR?

Frequently Asked Questions

How does Standard & Poor's define an FSR?

A Standard & Poor's insurer FSR is a current opinion of the financial security characteristics of an insurance organization with respect to its ability to pay under its insurance policies and contracts in accordance with their terms. The full definition is included in the article, "Standard & Poor's Ratings Definitions," published Feb. 25, 2009, on RatingsDirect. This is also included as an appendix below.

How are FSRs determined?

All of Standard & Poor's entity-based ratings start by arriving at an issuer credit rating (ICR) for each entity. An ICR is a current opinion of an obligor's (the insurer's) overall financial capacity to pay its financial obligations (its creditworthiness). This opinion focuses on the obligor's capacity and willingness to meet its financial commitments as they come due. It does not apply to any specific financial obligation, as it does not take into account the specific provisions of the obligation, its standing in bankruptcy or liquidation, statutory preferences, or the legality and enforceability of the obligation.

The senior most obligation of an insurer in most countries is to its policyholders (which we view as analogous to an "issue" of debt) or at least includes its policyholders. Where this is the case, the FSR is assigned at the same level as the ICR. Senior, subordinated, and deeply subordinated obligations are typically all junior to policyholder obligations and their ratings are therefore "notched off" the FSR/ICR, that is, lower than the FSR/ICR by one or more notches depending on the degree of subordination.

Should an FSR be considered a "solvency rating"?

With the emergence of improving risk-based regimes for insurer supervision (or regulation) around the world, such as Solvency II, we are often asked how our ratings should be compared to a supervisor's opinion on an insurer. We believe they are differentiated, but both are relevant opinions.

Although rating agencies and insurance supervisors may look at similar issues, they have different objectives. Supervisors control access to the market via their authorization processes. Having granted access, supervisors maintain financial supervision over insurers in order to ensure that policyholders are provided a minimum level of capital strength. As far as the outside world is concerned, the supervisor's opinion is a binary one: either the insurer's authorization is maintained or it is withdrawn. Although it rarely becomes information in the public domain, some insurers spend time in "limbo" where the supervisor has concerns that they ask management to address. Once the insurer is authorized, a rating agency may

assign a rating. Standard & Poor's provides opinions that differentiate between authorized insurers in terms of their comparative creditworthiness. Once public, ratings are subject to ongoing surveillance and therefore provide to policyholders, distributors, and others a current, transparent, and globally comparable opinion on the creditworthiness of the rated insurer.

Will Solvency II make FSRs obsolete?

Once Solvency II is implemented, it is possible that policyholders will ultimately draw greater comfort regarding their security as a policyholder from the fact that an insurer is authorized than they do currently under the Solvency I regime. Supervision will almost certainly be more sensitive to risk in the future, in our opinion.

Specifically under Solvency II, policyholders will be able to monitor the extent to which insurers cover their (risk-based) Solvency Capital Requirements (SCR). Standard & Poor's welcomes the added market transparency that this will provide. SCR coverage measures will be important (and a relevant input to our own assessment of insurers capital adequacy). However, they will have several limitations, which include:

- Public SCR coverage will not be real time, that is, it will be a backward looking measure, published some months after the insurer's financial year end. It will also be volatile from year to year. Ratings are current, based on all the public and confidential information available at the time, and an ongoing dialogue with management. Ratings also tend to be relatively stable.
- SCRs use a one-year time horizon. In the case of Solvency II, the SCR is calibrated such that there is a one-in-200 year likelihood on average that an insurer will fail to cover its liabilities with its assets. Our long-term ratings take a longer-term view of financial security (Standard & Poor's does provide short-term FSRs, but they are rarely requested).
- The SCR is a point in time measure of capital adequacy. In our opinion, historic capital adequacy is a poor lead indicator of insurer failure. Capital adequacy is an important quantitative element of our analysis, but it is just one feature of our overall capitalization analysis, which in turn is one of nine categories of analysis. We believe categories such as competitive position, enterprise risk management (ERM), management/corporate strategy, financial flexibility, and operating performance are better leading indicators of long-term financial strength.
- The SCR will be based on a model: the standardized model, the insurer's own internal model, or combinations thereof with all the associated potential limitations of any model.
- Publicly available risk-based capital model results have been a feature of U.S. insurance supervision since the early 1990s. However, the number of our ratings on U.S. insurers has grown substantially rather than shrunk over the period since then.

Ultimately, it is for policyholders and distributors to decide, but we believe that comprehensive analysis of the financial security of insurers will remain important. Ratings are a relevant input to policyholders' own assessments of financial security in our opinion. Standard & Poor's ratings opinions are based on analysis by experienced professionals who evaluate and interpret information received from insurers and other available sources to form a considered opinion. These opinions are primarily intended to provide investors and market participants with information about the relative credit risk of insurers and individual debt issues that we rate.

Most insurers have sufficient capital to pay all their known liabilities by some considerable margin. Why aren't they all rated 'AAA'?

Taking a short-term perspective, most insurers do indeed have sufficient capital to pay all their known liabilities by some considerable margin at this point in time, albeit to varying degrees. However, insurers are dynamic: they are exposed to the full range of life, non-life, market, and operational risk and they acquire new exposures each day. Since capital can be quickly depleted by events, our long-term FSRs recognize this and take a longer-term view of financial security. Among other things, this allows us to evaluate the insurer's ability to replenish capital post event.

The evaluation of an insurer's capital adequacy involves both qualitative and quantitative considerations as warranted to derive a complete picture of an insurer's capital position. Similarly, a broad-based analysis of an insurer's credit quality involves much more than simply looking at its level of capital adequacy. Strength or weakness in other key areas, such as a company's competitive position, management and strategy, investment risk, liquidity risk, operating performance, ERM, and financial flexibility can more than offset relative strength or weakness in capital adequacy. The areas of analysis are interconnected and their importance and influence on a rating will differ depending on company specific circumstances.

Why doesn't Standard & Poor's assign higher ratings to start-ups?

Although most start-up insurers have capital adequacy that could be consistent with 'AAA' ratings since they typically have huge capital with little or no exposure, we rarely rate them higher than the 'BBB' range. While their capital adequacy may be consistent with a 'AAA' rating over the near term, their competitive position (on which their long-term future is to a significant degree dependent) would normally be 'BBB' at best. The overall blended rating outcome would normally be limited to the 'BBB' category since we expect start-ups to meet their near-term obligations, but, in our opinion, they rarely have the competitive position to sustain themselves at the outset. In our experience, start-up companies often change their business plans,

earnings expectations, and financial profile in their first few years of operations. Their earnings can be uncertain, given the competitive challenges, and experience demonstrates that their capital will erode if they are not able to successfully execute their business plan. Over time, start-ups may improve their competitive position resulting in higher ratings.

Start-ups that are rated 'BBB+' or higher are typically those that, in our opinion, have a compelling competitive position at the outset. This may be because the start-up is able to differentiate itself in some way, such as by a unique business line, tied distribution, or geographical affiliation.

What about run-offs?

For similar reasons to those related to start-ups we rarely rate run-offs higher than the 'BBB' range. Capital adequacy may be substantial, but the insurer by definition has no competitive position, and hence no new earnings stream with which to rebuild capital if it becomes depleted. Management teams in run-off often change and investment and claims management may change as a result. Consequently, the ratings on insurers that go into run-off would often be lowered to the 'BBB' category or lower. In practice, FSRs often have little value to the run-off company concerned and tend to be withdrawn.

How does an insurer default?

According to the way that Standard & Poor's records them in its default statistics, insurers have defaulted in a number of ways:

- Its financial security may be so undermined such that the supervisor assumes control of the insurer.
- It may embark on a coercive claims commutation program with its policyholders.
- It may fail to meet policy guarantees, remove bonuses previously declared, or fail to declare bonuses that policyholders reasonably expect based on policy terms or public statements made by the insurer.
- It may fail to meet a senior or subordinated obligation.

Standard & Poor's uses the 'R' rating ('R' is derived from regulatory action) rather than 'D' (default) for its FSRs given the nature of insurance policyholder liabilities and the legal status of insurers in many countries.

Are FSRs the same as Claims Paying Ability ratings?

Yes. We renamed our prior Claims Paying Ability ratings as FSRs in 1997 since we believed the terminology better described the opinion we provide. There were no associated changes to our criteria or processes.

Do FSRs incorporate government support?

Generally, no. Some insurers have been recipients of government support, although in most recent cases this was a consequence of their membership of bancassurance groups or where there was a significant related capital markets subsidiary (AIG). Aegon is the only "pure play" insurer to receive government support. Aegon utilized the support that was made available to all Dutch financial institutions, banks, and insurers. The Netherlands is unique in this respect.

In Aegon's case, the current ratings reflect the support received and the associated obligations; however, they do not anticipate future support. The same is true of all FSRs, except for the limited number of insurers designated government related entities by Standard & Poor's, such as Caisse Centrale de Reassurance (AAA/Stable/--) in France. This differs from our approach to bank ratings, which can anticipate government support more frequently given what we believe to be banks' greater systemic importance.

What is the difference between an FSR and a Lloyd's Syndicate Assessment (LSA)?

LSAs are a distinct nonrating product, which responds to the unique nature of Lloyd's. Lloyd's is a globally respected insurance marketplace where capital providers accept insurance risk on a strictly several basis through syndicates in return for insurance premiums. The financial risks to these capital providers are partially mutualized through the Lloyd's Central Fund, to which all underwriting members contribute. Because of the presence of the Central Fund, and the powers vested in the Council of Lloyd's to manage this fund, Standard & Poor's is analytically comfortable assigning an insurer FSR to the Lloyd's Market (A+/Stable/--).

Generally, Standard & Poor's does not believe that, under the Market's current legal and regulatory structure, FSRs on syndicates are appropriate. This view reflects the fact that syndicates are groupings of one or more capital providers, managed on their behalf by a managing agent, and are not legal entities in themselves. Furthermore, regulatory action is the main arbiter of default with regard to FSRs and, due to the mutualization of Lloyd's through the Central Fund, regulatory action resulting from concerns as to ability to meet claims would be marketwide, not syndicate specific.

With these issues in mind, in order to meet the insurance and capital markets' requests for a more specific view on syndicates, Standard & Poor's offers an opinion on a syndicate's business continuity characteristics in the form of an LSA. LSAs represent our view of the relative dependency of syndicates on Lloyd's infrastructure and the Central Fund, reflecting their ability to offer business continuity to policyholders.

What is the difference between an interactive FSR and a public information FSR?

The two forms of insurer FSR published by Standard & Poor's are "interactive" and "public information"

(‘pi’). Although both types of ratings use the same basic rating scale, to distinguish between the two, a ‘pi’ subscript is used for the latter (for example, ‘Api’). The main distinguishing feature between the two types of rating is the amount and type of information our analysts receive from the company to which a rating is assigned.

Standard & Poor’s interactive ratings indicate that a company has chosen to undergo Standard & Poor’s complete analytical process, involving in-depth meetings with the company’s senior management. For an interactive rating, the insurance company can provide confidential information to refine the analysis. However, Standard & Poor’s does not engage in any consulting or structuring regarding the insurance company’s business.

A ‘pi’ FSR is based on an insurer’s published financial information and other data in the public domain. We may also receive a limited amount of confidential information from the company, which we may rely on. Standard & Poor’s decision to rate a company on a ‘pi’ basis is influenced by market sentiment--if sufficient interest in a rating on any currently unrated entity exists in the markets then we may rate it. ■

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Appendix: Insurer Financial Strength Rating Definitions

A Standard & Poor’s insurer financial strength rating is a current opinion of the financial security characteristics of an insurance organization with respect to its ability to pay under its insurance policies and contracts in accordance with their terms. Insurer financial strength ratings are also assigned to health maintenance organizations and similar health plans with respect to their ability to pay under their policies and contracts in accordance with their terms.

This opinion is not specific to any particular policy or contract, nor does it address the suitability of a particular policy or contract for a specific purpose or purchaser. Furthermore, the opinion does not take into account deductibles, surrender or cancellation penalties, timeliness of payment, nor the likelihood of the use of a defense such as fraud to deny claims. For organizations with cross-border or multinational operations, including those conducted by subsidiaries or branch offices, the ratings do not take into account potential that may exist for foreign exchange restrictions to prevent financial obligations from being met.

Insurer financial strength ratings are based on information furnished by rated organizations or obtained by Standard & Poor’s from other sources it considers reliable. Standard & Poor’s does not perform an audit in connection with any rating and may on occasion rely on unaudited financial information. Ratings may be changed, suspended, or withdrawn as a result of changes in, or unavailability of such information or based on other circumstances.

Insurer financial strength ratings do not refer to an organization’s ability to meet nonpolicy (i.e. debt) obligations. Assignment of ratings to debt issued by insurers or to debt issues that are fully or partially supported by insurance policies, contracts, or guarantees is a separate process from the determination of insurer financial strength ratings, and follows procedures consistent with issue credit rating definitions and practices. Insurer financial strength ratings are not a recommendation to purchase or discontinue any policy or contract issued by an insurer or to buy, hold, or sell any security issued by an insurer. A rating is not a guaranty of an insurer’s financial strength or security.

Asia-Pacific Insurance Finds Recovery Tougher Than Expected As Rates Remain Under Pressure

By Michael Vine, Paul Clarkson, Reina Tanaka and Yumee Oh

The Asia-Pacific region has emerged from the recent global financial market turmoil relatively unscathed and has retained its solid industry and economic prospects. Standard & Poor's Ratings Services considers that the Asia-Pacific non-life and life insurance markets have stable outlooks, but acknowledges that profitability and premium rate growth for the primary and reinsurance sectors has been mixed.

In the first half of 2009, the rate of premium growth for non-life insurers slowed. GDP growth was generally slower and some investment assets were impaired. That said, by the end of 2009, most of the region's governments appear to have successfully revived their economies by applying fiscal stimuli. Narrowing spreads and booming stock markets then helped non-life insurers' earnings and capitalization to recover from the previous year's lows. The life sector also recovered with strengthened balance sheets, easing liability risks, and improved earnings, aided by a rebound in investment markets. As a result, we revised the sector outlook to stable from negative earlier in 2010.

Effect Of The Crisis On Reinsurance Renewals Proved To Be Limited

In 2009, insurers were grappling with investment losses, some catastrophe events, and the effects of a period of softer pricing, especially for statutory and commercial lines of business. As a result, non-life premium prices showed signs of rising, particularly in Australia. Despite this, the January and June 2010 reinsurance renewal seasons proved disappointing for reinsurers. Any increases in 2009 were short-lived, with January 2010 reinsurance renewals discounted.

Despite the soft pricing, earnings and capital generally improved on the back of good premium growth, especially for most of the less-developed markets. Therefore, the rating outlook for the region is stable, and we expect it to remain so. We might consider a negative outlook in 2010 or beyond if we see signs of renewed investment-market volatility, sluggish economic performances that affect top-line growth, and price discounting that could affect future earnings. While our stable outlook anticipates some continued growth and earnings improvement in the region, we might consider a positive outlook (possibly country-specific) with evidence which we consider indicates improved economic and investment market fundamentals, and sustainable improvement in underwriting and operating performance.

Gradual Increase In Economic Activity Is Boosting Premium Growth, But Most Rates Remain Soft

For non-life insurers in the region, premium growth tended to slow through 2009. This particularly affected those countries where vehicle sales declined, because automotives is still by far the largest class of business for most markets. Lower economic activity also generally dampened premium growth. However, economic stimulus from governments has started to increase premium growth from car sales, exports, and infrastructure projects.

Rates in the primary market continued to soften, even in classes and countries where they were already soft. Commercial and liability classes across the region have seen rate reductions, and pricing competition is re-emerging in personal lines. Only primary markets that have been unprofitable because of inadequate pricing or higher claims have continued to see some premium price increases, although in our opinion these have generally been short of that required for a return to what we view as adequate profitability. For example, the Australian market experienced underwriting losses and as a result has seen early premium-price increases, but only in personal lines such as home and motor.

Weather Events Caused Losses In Some Countries

Australian insurance has had a difficult year to date. There were two severe weather events in March 2010, costing the industry an estimated A$2 billion or more across the primary and reinsurance markets. Preliminary June 2010 result releases for Australian market leaders have seen profit downgrades from a mix of reasons, including a downturn in equity markets over 10% in the first half of the year, increased claims following the severe hail and storm events in Melbourne and Perth, and soft premium rates.

Typhoon Melor, the first typhoon to make landfall in Japan since 2007, came ashore in October 2009. The incurred claims totaled more than JPY50 billion, but with only a minority of the event borne by reinsurers, pricing for non-life insurers' 2010 reinsurance renewals was not materially affected. Japanese insurers sought total capacity for their natural catastrophe exposures at a similar level to 2009. In most other lines of business, reinsurance rates declined during the 2010 renewal season. Overall, renewals were smoother and easier for buyers than in previous years, reflecting a generally softer market because of the effects of healthier reinsurer balance sheets.

Elsewhere in the region, China experienced underwriting losses but is now seeing premium rate rises on top of already strong volume growth. Korean non-life insurers' overall loss ratio increased because of weak pricing in auto insurance; the commercial and long-term lines performed adequately in our view. The

non-life sector as a whole recorded more than 10% premium growth on the back of long-tail lines. The reinsurance renewal rate was flat or slightly lower in fiscal 2010 because there has not been a significant catastrophe loss event over the past couple of years.

Earnings Benefit As The 2009 Impairment Losses Are Reversed

In 2010, we believe it is likely that we will see premium growth approaching 20% in the developing markets of China and India, growth of 5% to 10% in the more-developed markets such as Australia and Singapore, and stagnant growth for Japan and Taiwan. We cautiously expect earnings to increase as investment markets improve and credit spreads narrow. Underwriting performance should be at least steady in 2010, with insurance demand from economic stimulus offsetting some reductions in premium rates.

In our opinion, the investment mix within the region is likely to remain conservative, with relatively unsophisticated markets and regulatory restrictions on investing likely to result in little investment in exotic products and structures. The only insurers to suffer from credit-risk and foreign-exchange losses were operating in markets where regulatory restrictions were relaxed for nondomestic investments. However, we regard these losses as having been relatively minor, and consider that they did not overly affect balance-sheet strength.

Much of the impairment suffered by insurers was from fair-value equity investments and widening credit spreads. Capital adequacy remained relatively strong, and supported the financial strength and ratings on companies, despite the impairment. These losses have mostly since been reversed as equities rebounded and spreads narrowed in the second half of 2009, returning capital-adequacy closer to precrisis levels. We consider it is likely that capital levels will remain strong to support growth and ongoing risks, but we believe they may remain somewhat susceptible to any asset bubbles that build up.

Asia-Pacific Offers Reinsurers Diversification In A Market With Room To Grow

Asia-Pacific remains attractive to the reinsurance sector because it offers higher economic growth than other regions. As the region urbanizes and industrializes, the emerging middle class accumulates assets and the demand for insurance grows. In addition, it offers a seasonal and geographic offset to the major catastrophe risks of the northern hemisphere. However, the region is not without its risks, with a range of earthquake and weather-related catastrophe risks. Emerging markets also tend to bring data quality and risk management risks in their wake.

Japan is one of the largest insurance markets in the world, but Toa Reinsurance Co. is the only domestically incorporated reinsurance company that underwrites various lines of business in both local and international markets. While international reinsurers play important roles as capacity providers for catastrophe and other risks, we believe the company will remain the preferred reinsurance provider, especially for non-catastrophe-related risks, backed by its strong historical ties with most domestic primary insurers. The company also plays an important role in Japan's life insurance market, mainly as a facultative reinsurance underwriter.

In Korea, the dominant domestic player is Korean Reinsurance Co., which has maintained a market share of about 65%. We believe it will continue to play a key role in the domestic market by expanding into the property, cooperative, and government insurance markets and developing new products in life reinsurance and long-term lines. That said, we expect foreign reinsurers to maintain their competitive advantage in the life reinsurance sector.

Other Asia-Pacific markets remain dominated by global players. Singapore is fostering new reinsurance capacity, in part through Lloyd's syndicates. The Asian region also attracts local and regional capacity through indigenous reinsurers.

Optimism about 2010 has dissipated in some markets, with rate increases falling short of expectations, and premiums not compensating for the frequency and severity of severe weather events. We believe that there is justified hope for improved returns in 2011, however, as the fundamentals of the region continue to support growth and the economic and investment markets continue to improve. ■

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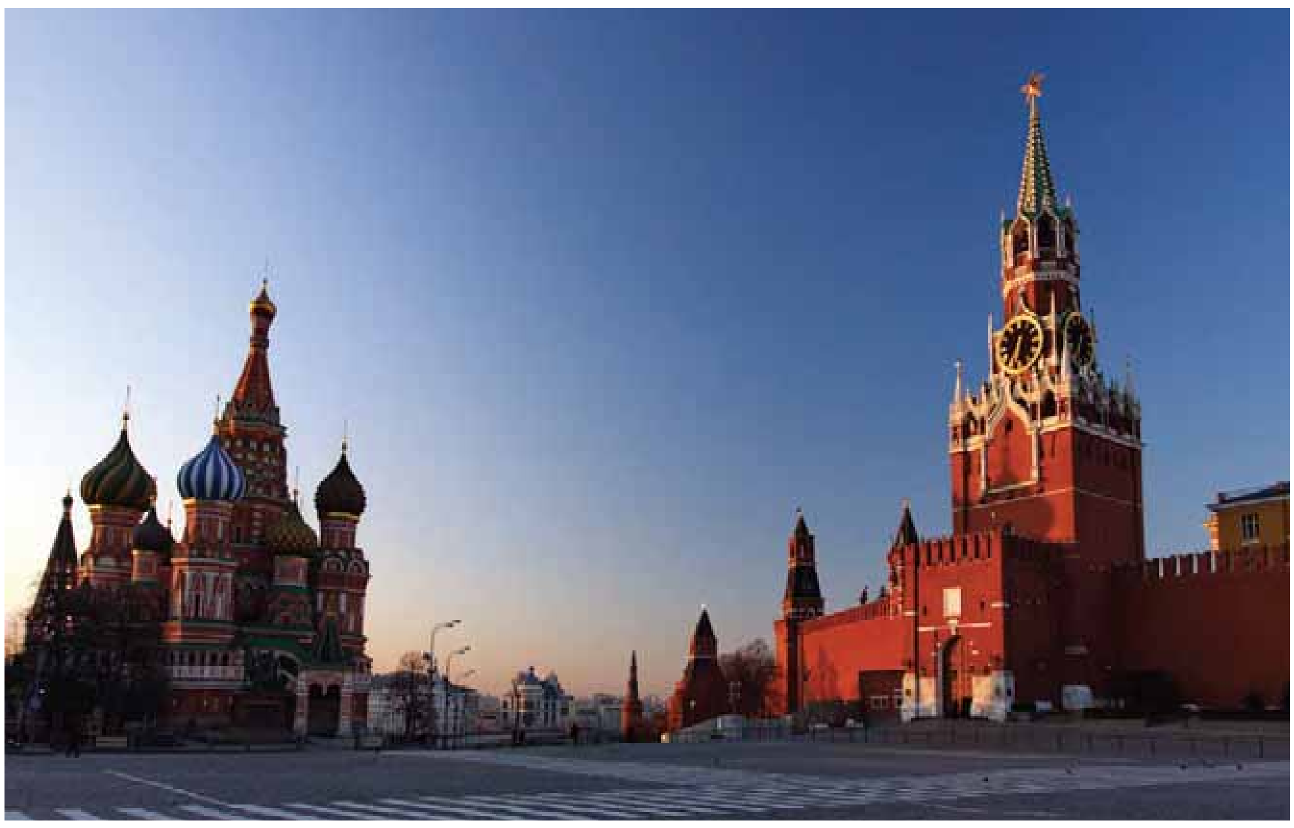

Standard & Poor's Sees Evident Weaknesses And Hidden Strengths In The Russian Reinsurance Market

By Victor Nikolskiy and Ekaterina Tolstova,

The Russian market is impeded by a number of challenges but there are also signs of positive developments.

Russian reinsurers are burdened with the consequences of financial turmoil and high inherent industry risks. But despite generally noted negative issues impacting Russian reinsurance–money laundering and tax optimization schemes, poor transparency, dumping, low capitalization, and entrepreneurial business models–Standard & Poor's Ratings Services believes there are some less-affected, reputable players in this market. Among them we see leaders, with well-known reputations, adequate financial indicators, and significant expertise.

In our observations, the reinsurance market players outside the Russian Federation seem to have a similar view. According to official statistics provided by the Russian regulator, the Federal Insurance Supervisory Authority, the share of inward reinsurance business coming from abroad increased to almost 25% in 2009 from only 5% in 2005.

Reinsurers based in Russia still mainly serve the regional primary market. Their performance is therefore strongly interlinked, in our view. Although certain lines have suffered market softening owing to

economic conditions, the Russian domestic market in our opinion has profitable lines that appeal to Russian reinsurers, and for which primary writers need more reinsurance capacity: motor liability, property and construction, and marine hull. Furthermore, we believe that the Russian primary insurance market has noticeable growth potential, is less exposed to catastrophe risks, and also has a vast geographic diversity.

Weakening Factors Impact The Reinsurance Business In Russia

Money laundering and tax optimazation schemes

Money laundering and tax optimazation schemes are generally considered commonplace in Russian reinsurance and is often described as "scheme business". There are currently 636 multiline companies and 24 specialized reinsurers licensed to practice reinsurance in Russia. We consider only about 60 of them to be professional players in the reinsurance market. We have observed that companies without track records sometimes suddenly appear and land near the top of the list in terms of gross premiums written (GPW). However, these brief appearances are often followed by license withdrawals.

Official statistics show a decrease of GPW in Russia's reinsurance market to Russian ruble (RUB) 43 billion in 2009 compared with RUB54 billion in 2008. The difference in U.S. dollars was even higher, from $2.2 billion in 2008 to $1.4 billion in 2009, because of the depreciation of the ruble against the dollar.

However, we believe that despite the described contraction, the volume of real premiums didn't actually decline at such a pace and may even have slightly increased. In our observation scheme business quite significantly shrank in 2009, mostly because of intervention by the regulator. In 2009, licenses were withdrawn from companies that had written approximately RUB16 billion of GPW ($0.7 billion or about 30% of the market at that time) in 2008.

We understand that premiums on scheme business are often channeled outside Russia. According to statistics provided by the regulator, 24% of all outward reinsurance premiums in the Russian market in 2008 went to companies domiciled in Uruguay or Kyrgyzstan, neither of which has, in our view, a robust reinsurance market. We believe these operations do not bring any protection to reinsurance buyers, but instead most likely represent capital flight.

Poor transparency

In our observations, Russia's accounting system differs from those of most western markets, in particular, in terms of reserving, revenue recognition, valuation of assets and liabilities, impairment testing, consolidation, and disclosure. Consequently, we believe, it might be generally difficult to trust or analyze data–or compare financial data with those of international peers–without additional information or verification (Standard & Poor's does not do any verification or due diligence itself, but relies on audit reports, for example). Moreover, the quality of auditing in some cases is below par, in our view. There are quite a lot of small audit companies that, in our observations, barely check the financial records they sign off on. However, most of the top reinsurers prepare financial statements according to International Financial Reporting Standards (IFRS), and have them audited by internationally recognized auditors, but do not necessarily make them fully available to the public.

To improve transparency, the regulator unveiled an initiative that would see all insurers reporting under IFRS starting from 2011. However, we have observed that a similar initiative for the banking sector, which stipulated that all banks were to begin reporting under IFRS in 2004, has progressed very slowly. Consequently, we have little expectation that all reinsurers will be reporting under IFRS any time soon.

Dumping

Dumping, as in charging premiums that are lower than economically justified, in our observations was rife in the primary insurance market in the beginning of 2009, and reached the reinsurance market later that year. Usually dumping affects proportional reinsurance directly, as this type of reinsurance is tied to pricing of the primary market.

Nevertheless, nonproportional reinsurance dominates the Russian market, but we believe that many Russian reinsurers underwrite for cash flow rather than for premium adequacy. In certain business lines reinsurance tariffs were reduced as much as 30% in 2009. In our opinion such practices undermine market stability because most reinsurers do not possess sufficient capital cushions.

Low capitalization

Low levels of capitalization remain a significant issue for Russian reinsurers, in our view. The average capi-

Table 1

Insurers And Reinsurers In Russia Rated By Standard & Poor's

Company	Rating*
Ingosstrakh Insurance Co.	BBB-/Negative/–
Unity Re	BB-/Positive/–
OJSC Sogaz	BB+/Stable
Moscow Reinsurance Co.	BB/Stable/–
SCOR Perestrakhovaniye	A/Stable/–
Allianz Insurance JSC	BBB-/Negative/–
LEXGARANT Insurance Co. Ltd.	B/Stable/–
*Ratings as of Aug 12, 2010.	

talization level was $15.4 million in 2009. Moreover, excluding multiline (universal) companies brings the average down to $7.7 million–a fraction of the capital held by international reinsurers.

However, amendments to Russian insurance legislation will enter into force from Jan. 1, 2012, requiring minimal registered capital for reinsurance companies to be RUB480 million (approximately $15.5 million). In our view, this will likely reduce the number of active reinsurers and foster transparency and stability in the sector.

In 2009, reportedly only 34% of reinsurers had authorized capital in line with the likely post-2012 minimum level. These companies generate about 50% of total premiums in the market. Smaller companies will likely have to recapitalize, merge, or leave the market.

Entrepreneurial business models

We notice that some Russian reinsurers still follow an entrepreneurial business model, which can be seen in the low capitalization of some market participants. Many small reinsurers treat reinsurance as a secondary activity to their other investing activities and consequently, in our view, such business is not very strongly capitalized.

With less than one-half of total assets in liquid form, we observe that such companies exhibit high investment risk appetites from a global perspective. High levels of accounts receivable on reinsurance premiums and significant investments in Russian banks also may increase credit risk, in our view.

Most reinsurers have limited currency asset liability matching discipline, which, we believe, exposes some of them to risk from significant currency positions. Moreover, currently there is lack of regulatory oversight of currency exposure, in our opinion.

Standard & Poor's Sees Strengths: Growth Potential, Low Exposure To Catastrophe Risks, And Vast Geographic Diversity

Although Russian reinsurers have a very small share in the worldwide market and face significant issues, we believe the local market has certain competitive strengths.

First, although international players have large capacities, we observe their appetite for Russian risk ebbs and flows with the perception of political and industry risk, softening and hardening of the global market, and opportunities elsewhere around the globe. For example, Munich Re significantly reduced its presence in property lines on the Russian market in 2009. In our view this tendency creates uncertainty for reinsurance buyers as to what extent they can rely on international players in the long run.

Second, Russian reinsurers with long and reputable experience in reinsurance markets may be generally characterized by a high level of expertise, local knowledge, client services, a high level of flexibility, and operational effectiveness. We see that they commonly understand the deficiencies of the local market better than outsiders. They also tend to be more flexible and responsive to customer needs than international players, in our view.

Rated Reinsurers Stand Out

The reinsurers on the Russian market that we view as higher quality are well represented among companies rated by Standard & Poor's.

We note that those reinsurance companies, especially the higher-rated reinsurers, generally tend to be characterized by lower exposure to the inherent deficiencies of the Russian reinsurance industry, more transparency, higher-than-market-average liquidity and capitalization, and higher-quality balance sheets with more diversified asset mixes. ■

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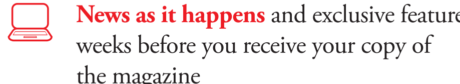

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Premium Development And Performance Converge As Integration Of Lloyd's And Bermudian Markets Increases

By Eoin Naughton and Mark Coleman

Standard & Poor's Ratings Services analyzes the data published in Global Reinsurance Highlights since 2001 with the aim of providing insight into the development of the two markets and their relative performance.

The rapid development of the Bermuda reinsurance market from its beginnings in the mid-1980s has transformed the reinsurance industry. Until the development of Bermuda, Lloyd's was the pre-eminent marketplace for many of the catastrophic covers that are now placed in Bermuda. Lloyd's remains one of the largest providers of reinsurance capacity, with a global market share of 6.4% in 2009, up from 4% in 1997, and continues to attract investors. Both Bermudian and global (re)insurers have started up or acquired agencies and syndicates at Lloyd's in recent years.

This study will focus purely on reinsurance written by the Lloyd's market and reinsurance written by Bermuda-based operating entities after the industry-changing attack on New York's World Trade Center in 2001. As such, in assessing the figures we believe it is important to note that there may be an element of double counting of premiums written through Lloyd's

by syndicates that are ultimately consolidated into Bermudian operating entities. Intragroup reinsurance may also muddy the picture somewhat.

Premium Development: Significant Growth In Both Markets

As recently as 1998, net reinsurance premium written in Bermuda was equivalent to that at Lloyd's, at around $3.5 billion. Since then, both of these reinsurance markets have grown rapidly, with net premiums written (NPW) of $11.9 billion at year-end 2009 in Bermuda--equivalent to a compound growth rate of just over 9% (see chart 1). Over the same period, Lloyd's NPW has grown at a compound rate of 8.6%. To give these figures some context, global reinsurance has seen premium growth of 4.6%, which indicates to us that while Bermuda has shown exceptional growth over the period, it has not grown at the expense of Lloyd's market share. The shape of the relative growth rates also highlights key differences and similarities between Bermuda and Lloyd's. Bermudian reinsurance premiums remained at a similar level to Lloyd's until 2002 when Bermuda was the preferred destination for new capital in the aftermath of the Sept. 11 terrorist attacks, leading to a near-doubling of premium. Bermuda's premium growth was less pronounced relative to that at Lloyd's after the record-breaking 2005 Atlantic hurricane season. Since 2006, Lloyd's growth has accelerated, while Bermuda has seen a reduction in net premium written. We believe this reflected the increasing attractiveness of Lloyd's as a marketplace and the increased interaction between the two markets.

Chart 2 shows Bermuda and Lloyd's respective share of global reinsurance premium. While their combined share may appear relatively low, these two markets are integral in the provision of reinsurance capacity in certain catastrophic and specialist lines. We would expect the shares shown in the chart to look somewhat different if measured by exposure; Lloyd's and Bermuda conduct most of their business on a nonproportional basis, but proportional business still represents a significant share of global reinsurance premiums.

Bermuda's Underwriting Performance Clearly Demonstrates Its Strength

Bermuda's overall operating performance, in particular its underwriting performance, is clearly stronger than Lloyd's. Since 2001, the unweighted average combined ratio for Bermuda has been 87%, 11 percentage points better than that of Lloyd's at 98%. Lloyd's performance is better than that for the global reinsurance market as a whole (two points higher, at 100%).

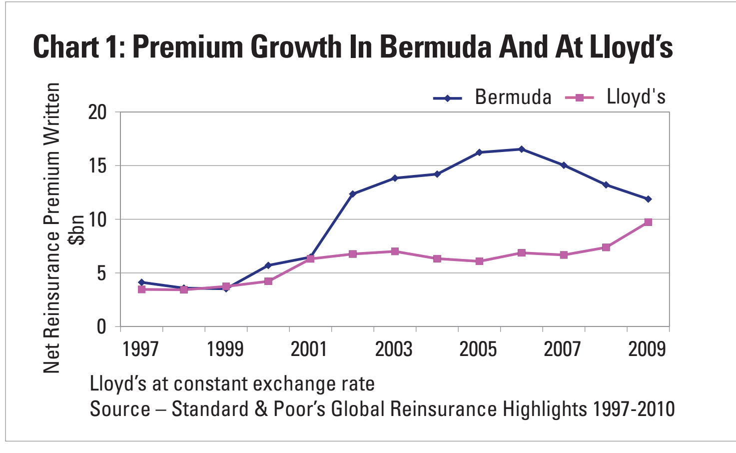
Over the past decade, we have noted that the market has started to view Bermuda as a natural home for catastrophe risks. In our opinion, Lloyd's likely has more per-risk exposures and more geographic diversity. As such, one might expect Bermuda to outperform its global peers, including Lloyd's, in years which are less affected by catastrophes, and to underperform in years which are more affected by catastrophes. Reviewing the data in chart 3, this trend emerges; Bermuda underperformed Lloyd's in 2005, the only year in the period in question which suffered major catastrophic losses. However, the trend is perhaps less evident than might have been expected; Bermuda outperformed Lloyd's in years which had above average, but not very large, catastrophic activity, such as 2004 and 2008; this in part reflects the typically high operating expenses at Lloyd's which will moderate outperformance in less catastrophe affected years.

By contrast, we consider Lloyd's overall performance versus the wider market to be more in line with what we may have expected. In the heavily catastrophe-affected years of 2001 and 2005, Lloyd's underperformed the market as a whole, but it outperformed in other years.

Exposure to different types of risk likely supports improved performance

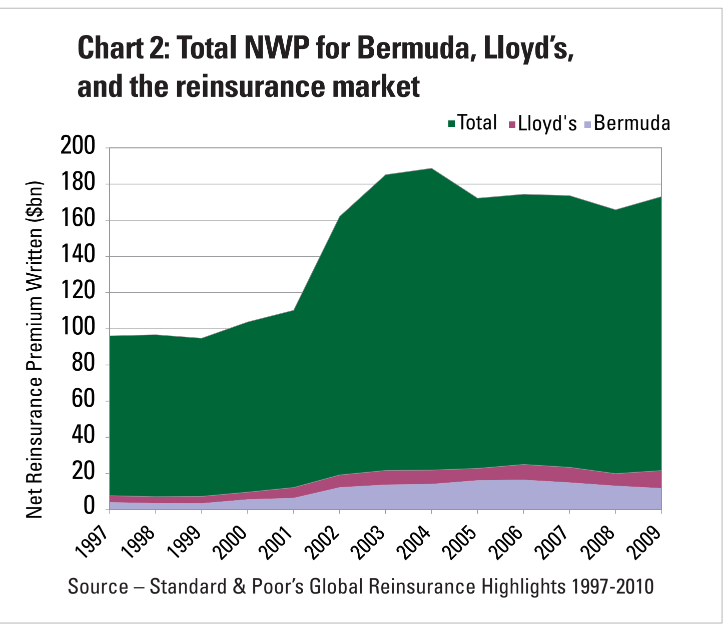
The reasons for Bermuda's apparently superior per-

Chart 1: Premium Growth In Bermuda And At Lloyd's

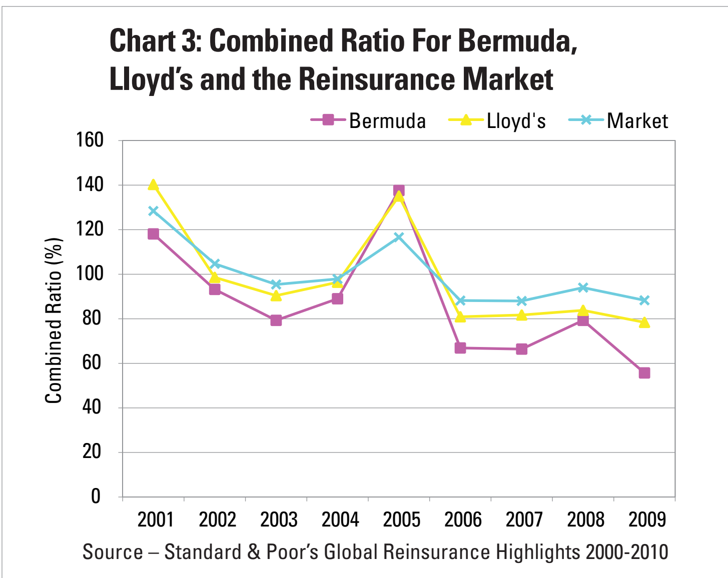


Lloyd's at constant exchange rate
Source – Standard & Poor's Global Reinsurance Highlights 1997-2010

Chart 2: Total NWP for Bermuda, Lloyd's, and the reinsurance market



Source – Standard & Poor's Global Reinsurance Highlights 1997-2010



formance are not immediately obvious in our view, although the type of catastrophic loss is one key factor. Lloyd's has a greater weighting to energy and aviation, where Bermuda has greater exposure to property risks. As a result, Lloyd's suffered outsized losses from Gulf of Mexico hurricanes, particularly those in 2005, and also suffered losses stemming from the Sept. 11 terrorist attacks. In addition, 2005 is the only year in the period in review which suffered a series of large catastrophic losses including the costliest natural disaster ever; we believe it may be possible to conclude that this reflects Bermudian companies' weighting to higher layers in programs that will only attach in very large events.

Comparing relative performance in benign loss years is perhaps more interesting; Lloyd's underperforms, which we believe indicates that it has a greater exposure to attritional loss activity, which suggests greater participation in per-risk covers and lower layers in catastrophe programmes. In addition, in earlier years, we consider that the clean balance sheets of the recently established Bermudian companies shielded them from reserve deficiencies resulting from the soft underwriting market between 1997 and 2001. It is too early to get a clear view of how the large loss events of 2010--in particular the Chilean earthquake and Deepwater Horizon rig loss and related oil spill--will affect the relative performance of the two markets.

Markets Have Become Increasingly Integrated And Performance Has Converged

Standard & Poor's data indicates that the Bermudian market has seen stronger premium growth than Lloyd's in the past decade, while achieving better underwriting performance (based on combined ratios). Companies such as Amlin PLC, Catlin Insurance Co Ltd, and Hardy Underwriting Group PLC, which originated at Lloyd's, have expanded into Bermuda in recent years, reflecting, in our view, the perceived benefits of diversifying operating platforms. Meanwhile, we consider that the steady stream of Bermuda-based businesses that have launched Lloyd's underwriting operations confirms Lloyd's continuing attraction.

We have observed that (re)insurers continue to view Lloyd's as an attractive market to do business in. For some Bermudians, such as ACE Ltd and XL Group Ltd., Lloyd's has been an integral part of their business for a number of years. That said, in the past few years, most of the classes of 2001 and 2005 have either purchased or started their own syndicates; the most recent examples are Allied World Assurance Co Ltd and Arch Capital Group Ltd. Bermudian participation at Lloyd's has increased to such an extent that Bermuda-based players contributed 13% of Lloyd's capital requirements in 2009, up from 5% as recently as 2007 (source – Lloyd's Annual Report). A decade ago, Bermuda contributed a negligible amount of the capital at Lloyd's.

While we believe Bermuda may continue to be the preferred market for large catastrophe treaty risks, particularly for U.S. business, Lloyd's licenses, capital efficiency, product offering and rating give it access to a more-international portfolio and a more-diverse spread of risks. In addition, we consider that the market still views the different platforms as having unique attributes that continue to make them attractive to reinsurers with ambitions to offer a full suite of products by product type and across various territories. ■

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Reinsurers Foot The Bill For Chilean Earthquake Losses

By Taoufik Gharib, Kyle Leung

The earthquake that hit Chile in February 2010 has ramifications for the global reinsurance market and the local Chilean insurance sector.

The powerful earthquake that struck Chile on Feb. 27, 2010, near the city of Concepción was one of the strongest since recordkeeping began in the early 1900s. Measuring 8.8 on the Richter scale, it was 500 times more forceful than the 7.0 earthquake that hit Haiti on Jan. 12, 2010. The Chilean earthquake, which also triggered a tsunami, resulted in a number of injuries and fatalities and caused significant economic losses that could reach $30 billion.

Assessing The Financial Impact

The global reinsurance industry has shouldered a significant portion of the earthquake-related economic losses. As of the close of second-quarter 2010, this event has generated an estimated $8 billion-$12 billion in insured losses, putting a significant dent in many re/insurance companies' annual catastrophe budgets. In fact, in many cases, catastrophe losses have already exhausted more than half of re/insurers' budgets, thereby reducing the built-in cushion for the remainder of the year.

In the first quarter, re/insurance companies' Chilean earthquake industry loss estimates ranged from $2 billion to $10 billion. However, as more information became available, some industry participants revised the industry estimated insured loss upward to $10 billion-$12 billion. Indeed, when Lloyd's of London announced its estimated pretax loss of $1.4 billion on May 26, 2010, it mentioned that its losses were consistent with the upper range of industry loss estimates. Incurred claims reported by reinsurers and insurers outside of the local market (Table 4) have already reached $7 billion.

The loss estimate revisions reflect new information collected following the inspection of buildings and properties since the first quarter. The early loss estimates companies reported varied widely because of, among other things, the preliminary nature of the information available, limited actual loss data, data inade-

quacy, and companies using market share and industry loss information to book their initial losses. In addition, there were a limited number of loss adjustors, low primary insurer retentions, a meaningful amount of facultative insurance coverages, and a lack of historical data regarding how structures in this region respond to an earthquake of this magnitude. Ongoing business interruption losses also have made it difficult to estimate the impact of this event. However, a number of reinsurance contracts have already exhausted their contractual limits and in theory should not develop adversely, which adds some certainty to estimates.

The two largest reinsurers, Munich Re and Swiss Re, reported upward revisions to their Chilean loss estimates fairly early on. Both companies have a global presence, with a significant amount of exposure in South America, including facultative reinsurance coverages. Munich Re increased its loss estimate by 43% ($300 million) to $1.0 billion (after retrocession and before taxes) as of June 8, 2010. Besides being affected by the aforementioned issues, the number of individual losses was also very high, as local insurance companies received more than 190,000 claims notifications at the end of April. Similarly, Swiss Re increased its Chilean earthquake losses by 26% ($130 million) to $630 million as of June 11, 2010. Its new loss estimate also reflects more specific information from clients on actual damage to individual properties and businesses.

On the other hand, in the second quarter, some Bermudian reinsurance companies reaffirmed their first-quarter Chilean loss estimates. The Bermudian companies participate primarily on a treaty excess-of-loss reinsurance basis, which is less dependent on specific information on properties and businesses but still relies on cedents reporting losses in a timely manner. Furthermore, some of these companies recorded a meaningful amount of IBNR reserves in the first quarter.

We believe the accumulated losses from the Chilean earthquake have materially affected the earnings of property/casualty re/insurers worldwide. According to the re/insurance companies that have reported their losses so far, the weighted-average Chilean losses reduced about one-quarter of their reported net incomes as of June 30, 2010. Therefore, we expect that with the exception of a few outliers, these losses will be an earnings event rather than a capital event. As a result, the losses should be contained within the first-half 2010 results. Based on these disclosed losses, we do not anticipate rating changes at this time.

In 2010 dollars, the Chilean earthquake losses could become the re/insurance industry's second costliest earthquake since the beginning of the 20th century,

Table 1

The Top Five Earthquake Insured Losses Since The Early 1900s

		Insured losses (Bil. $)	
Date	Location	In 2010 dollars	At time of occurrence
Jan. 17, 1994	U.S.: Northridge, Calif.	22.4	15.3
Feb. 27, 2010	Chile: Concepción	8.0-12.0	8.0-12.0
Sept. 1, 1923	Japan: Tokyo	7.6	0.6
Jan. 17, 1995	Japan: Kobe	4.3	3.0
Oct. 17, 1989	U.S.: Loma Prieta, Calif.	1.7	1.0

trailing only the 1994 earthquake in Northridge, California. It will also be the largest insured catastrophe in Latin America's history, surpassing Hurricane Wilma, which damaged the Cancun region of Mexico in 2005.

It is worth noting that in aggregate, the Chilean earthquake affected Bermudians re/insurers' earnings more than it did their European and North American counterparts. As of June 30, 2010, these losses reduced net incomes by roughly 42% for the Bermudians compared with about 30% for the Europeans' and about 9% (17% when excluding Berkshire Hathaway Inc.'s figures) for the North Americans. This is not surprising, given that this differential underscores Bermuda's established position as a property catastrophe underwriting hub. In addition, the European and North American re/insurers' business models are more diversified, with a greater geographical spread and more balanced mix of short- and long-tail lines as well as life and nonlife products.

The Risks And Opportunities Of The Chilean Re/Insurance Market

The Chilean insurance market cedes about 90% of its catastrophe risk out of the domestic market and into the global reinsurance industry. As a result, despite the magnitude of the insured losses, the Chilean primary insurance market's operating performance for the first six months of 2010 was strong, with a combined ratio of 91.7%.

Many global reinsurers have written business in Chile to diversify their exposures away from catastrophe-prone hot spots such as the Gulf of Mexico and Florida. These global reinsurers have assumed two-thirds of Chilean business through the treaty market and one-third through the facultative market. Some of the properties and industries affected in Chile included residences (apartments and houses), infrastructure, factories, retail stores, energy facilities, and wineries.

According to the Chilean regulator Superintendencia Valores Y Seguros (SVS), there are about

Table 2

Chilean Primary Insurance Market

		Six months ended June 30, 2010		Year ended Dec. 31, 2009		Year ended Dec. 31, 2008	
Ranking	Company	Direct premiums (Mil. $)	Combined ratio (%)	Direct premiums (Mil. $)	Combined ratio (%)	Direct premiums (Mil. $)	Combined ratio (%)
1	RSA Insurance	140.7	89.7	353.2	95.8	308.7	82.8
2	Penta-Security	139.1	90.4	273.7	93.6	240.3	88.6
3	MAPFRE	127.3	104.1	202.0	96.1	171.8	102.9
4	BCI	105.3	95.9	199.8	90.4	147.7	86.8
5	Aseg. Magallanes	95.4	92.4	168.3	96.7	131.7	92.4
6	Liberty Mutual	94.9	88.1	196.0	80.9	158.1	83.4
7	Cardif	91.7	83.7	183.5	106.8	130.4	95.2
8	Chilena Consolidada	91.1	94.0	185.9	94.6	182.5	85.7
9	Santander	67.9	125.5	122.9	N.A.	69.2	92.7
10	ACE	51.8	129.1	104.4	94.9	90.8	116.0
11	Chartis	50.0	77.0	146.1	103.1	164.6	84.0
12	Consorcio Nacional	26.5	87.1	44.8	88.8	35.4	94.3
13	HDI	15.8	104.4	34.6	100.3	35.4	89.9
14	Renta Nacional	14.7	95.5	33.3	100.5	23.8	97.2
15	Chubb	12.4	65.0	23.3	63.1	22.3	N.A.
	Other companies	6.0	N.A.	5.6	N.A.	1.6	N.A.
	Total market	1,130.5	91.7	2,277.5	94.5	1,914.2	89.9

N.A.—Not available. Source: Superintendencia Valores Y Seguros.

four million residential units in the affected areas, of which one-quarter was insured. The percentage of insured residential properties varies significantly between residential units with a mortgage (about 90%) and those without one (about 10%). The Chilean banks package these mortgage portfolios and let the local primary insurers provide coverage through a bidding process. Ultimately, these primary insurance companies heavily reinsure the risk through the global reinsurance market.

Overall, Chile's very good building standards, which it enforces strictly, somewhat mitigated the property losses. Through June 30, 2010, SVS estimated that out of the 964,060 residential properties that have earthquake insurance in the most affected areas, 176,018 had filed insurance claims. Of those claims, about 73% have been inspected by insurance companies, of which 29% have been paid totaling $245 million. According to a few market participants, the residential risks in Chile have performed reasonably well thus far, unlike the large industrial risks that have been hurt by business interruption losses.

Some industry participants have mentioned that the possibility of another large earthquake hitting the region has diminished in the short term because the seismic pressure has been relieved. Nevertheless, other experts warn that the likelihood of damaging aftershocks will remain high for months and perhaps even years to come. Therefore, many market participants are considering the heightened risk of earthquakes and recalibrating their risk appetite and risk-adjusted pricing accordingly. Their reinsurance costs will soar.

Table 3

Chilean Earthquake Losses By Re/Insurer

Re/Insurers	Financial strength rating on lead operating companies as of Aug. 10, 2010 (unless otherwise stated)	Reported first-quarter Chilean earthquake loss (Mil. $) (1)
Europe		
Lloyd's (2)	A+/Stable	1,400
Munich Reinsurance Co. (3)	AA-/Stable	700
Swiss Reinsurance Company Ltd.	A+/Stable	500
Hannover Rueckversicherung AG	AA-/Stable	226
Zurich Financial Services Ltd.	AA-/Stable	200
Amlin PLC (2) (4)	A/Stable	165
MAPFRE S.A.	AA/Negative	99
SCOR SE (5)	A/Stable	116
Beazley PLC (4)	BBB+/Stable (Holding Company Rating)	75
Brit Insurance Holdings N.V.	NR	69
Flagstone Reinsurance Holdings Ltd.	NR	55
RSA Insurance Group PLC	A/Stable	45
ACE Ltd. (2)	A+/Positive	34
Total Europe		3,684
Bermuda		
Everest Re Group Ltd. (6)	A+/Stable	270
Validus Holdings Ltd.	BBB-/Positive/-- (Holding Company Rating)	293
PartnerRe Ltd. (7)	AA-/Negative	300
XL Group Ltd.	A/Negative	157
Hiscox Ltd. (2) (5)	A/Stable	151
Catlin Group Ltd.	A/Stable	140
White Mountains Insurance Group Ltd. (3)	A-/Stable	110
RenaissanceRe Holdings Ltd. (5)	AA-/Stable	125
continued overleaf		

How The Earthquake Has Affected The Re/Insurance Business

Following this devastating event, reinsurers have increased rates as much as 80% during the July 1, 2010, renewal period on Chilean-specific coverages. Improvements in pricing have only affected the Chilean market and have not spread to other regions. Even with the improvement in pricing for Chile-only coverage, RenaissanceRe commented that it still did not find many opportunities that met its return hurdles. We expect that the next major renewal period on Jan. 1, 2011, will also reflect rate increases for Chile earthquake exposures.

Primary carriers operating in Chile, and subsequently the insureds, will bear the increase in premium rates. As a result, the country's nonlife premium volume could increase in 2010 and 2011. In 2009, Chile's nonlife premiums declined by about 5% in local currency (though they grew 19% in U.S. dollars). The decline stemmed from low premium volume across all lines of business because of the economic downturn. According to Swiss Re Sigma, the Chilean property/casualty insurance market was the sixth-largest market based on premium volume in Latin America and the Caribbean in 2009, with a large percentage of the commercial market insured against earthquake risks. The Chilean insurance market is well developed, with good insurance penetration rate and data quality for the region. According to the same Sigma report, Chile's nonlife premiums accounted for 1.6% of GDP in 2009 and about $164 per capita.

Today, with access to new capital easing relative to the tumultuous second half of 2008 and the first quarter of 2009, when capital markets were frozen, we

	Reported first half Chilean earthquake loss (Mil. $) (1)	Second quarter impact (Mil. $)	Reported net income for the first six months of 2010 (Mil. $)	Reported nonlife combined ratio for the first six months of 2010 (%)
	1,400	-	N.A.	N.A.
	1,000	-300	1,457	106.4
	630	-130	1,203	105.9
	222	4	410	99.5
	200	-	1,679	98.0
	165	-	N.A.	N.A.
	118	-19	688	96.0
	116	-	190	102.8
	75	-	98	89.0
	61	8	102	96.5
	60	-5	34	100.6
	45	-	337	94.8
	34	-	1,432	91.2
	4,126	-442	7,631	N.A.
	306	-36	134	108.5
	293	-	61	105.3
	283	17	271	103.8
	164	-7	338	96.4
	151	-	N.A.	N.A.
	135	5	79	97.5
	130	-20	-25	113.0
	125	-	459	54.0

still view catastrophe risk as a threat to the financial strength of the reinsurance industry. However, most reinsurers, particularly those with a high proportion of their capital allocated to underwriting peak catastrophe perils, are operating with risk-adjusted capital at a level at least one notch—and in many cases more than one full category (three notches)—above the target capital for the respective ratings. In addition, over the past few years, reinsurers have in general enhanced their enterprise risk management, in our view, as Hurricane Katrina heightened the importance of catastrophe risk for the industry.

This is notwithstanding an active Atlantic hurricane season forecast for 2010 according to the U.S. National Oceanic and Atmospheric Administration. As a result, if a market dislocation were to occur, we believe that not all companies would have the same access to additional capital and financial flexibility, as investors would be very selective in their choice of companies in which to invest.

Uncertainty remains regarding the Chilean earthquake insured loss estimates. We expect that

Table 3 continued

Chilean Earthquake Losses By Re/Insurer

Re/Insurers	Financial strength rating on lead operating companies as of Aug. 10, 2010 (unless otherwise stated)	Reported first-quarter Chilean earthquake loss (Mil. $) (1)
AXIS Capital Holdings Ltd.	A+/Stable	100
Platinum Underwriters Holdings Ltd.	A/Stable	84
Aspen Insurance Holdings Ltd.	A/Stable	100
Lancashire Holdings Ltd.	A-/Stable	95
Montpelier Re Holdings Ltd.	A-/Stable	94
Endurance Specialty Holdings Ltd. (5)	A/Stable	65
Allied World Assurance Co. Ltd.	A-/Positive	65
Arch Capital Group Ltd. (5)	A+/Stable	58
Alterra Capital Holdings Ltd. (2) (4) (5)	A-/Stable	50
Argo Group International Holdings Ltd.	A-/Stable	22
Total Bermuda		2,278
U.S. and Canada		
American International Group Inc.	A+/Negative	310
Berkshire Hathaway Inc. (2)	AA+/Stable	222
Fairfax Financial Holdings Ltd.	A-/Stable	137
Transatlantic Holdings Inc.	A+/Stable	105
Travelers Companies Inc. (5)	AA-/Positive	86
Chubb Corp. (2)	AA/Stable	70
HCC Insurance Holdings Inc. (5)	AA/Stable	21
Markel Corp.	BBB/Negative/-- (unsolicited holding company rating)	17
W.R. Berkley Corp. (2)	A+/Stable	8
Total U.S. and Canada		975
Australia		
QBE Insurance Group Ltd. (2)	A+/Stable	78
Total Australia		78
Grand total		**7,015**

For companies with a Lloyd's syndicate, some of the reported losses could be counted twice given that the losses might be included in bo
2010. N.A.—Not available. (1) Losses could include the impact from reinstatement premiums, taxes, lost profit commissions, and noncontr
not reported second-quarter earnings yet, we used the losses as of the first quarter. If first-quarter losses were not disclosed, then we us
We used the high end of the loss range. (5) Losses were primarily from the Chilean earthquake but include other catastrophic events. (6) T
from the Chilean earthquake and European Windstorm Xynthia.

earthquake losses will likely continue to develop as additional claims information flows in. Nevertheless, we believe the accumulated losses from the Chilean earthquake—coupled with the catastrophe losses from European windstorm Xynthia, the U.S. East Coast winter storms, the severe weather in Australia, and the Deepwater Horizon oil rig disaster—could have material unfavorable effects on the earnings of property/casualty re/insurers worldwide. If 2010 turns out to be an active catastrophe year, as the trend indicates, and aggregate losses are in the tens of billions of dollars, the cumulative effects of these losses could erode the capital of a few re/insurers, which could cause us to take rating actions. ■

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Reported first half Chilean earthquake loss (Mil. $) (1)	Second quarter impact (Mil. $)	Reported net income for the first six months of 2010 (Mil. $)	Reported nonlife combined ratio for the first six months of 2010 (%)
124	-24	335	92.1
101	-16	140	84.2
100	-	127	98.4
98	-3	93	77.4
94	-	80	92.7
65	-	114	93.8
65	-	318	93.1
58	-	460	93.4
50	-	140	86.2
26	-4	47	103.8
2,366	-89	3,171	N.A.
310	-	390	102.3
222	-	5,902	N.A.
134	3	615	106.3
125	-20	126	101.8
89	-3	1,317	95.8
70	-	982	92.0
21	-	155	88.0
17	-	64	102.0
8	-	229	94.2
996	-20	9,780	N.A.
78	-	N.A.	N.A.
78	-	N.A.	N.A.
7,566	**-551**	**20,582**	**N.A.**

th the company's and Lloyd's figures. For figures in a foreign currency, we used the exchange rate as of June 30, olling interest. (2) If the company did not comment on any changes to the Chilean loss estimate or if the company has ed the second-quarter losses for the first-quarter value. (3) Reported combined ratio for the reinsurance segment. (4) The first-quarter loss is before taxes, and the second-quarter loss is after taxes. (7) The $17 million reduction was both

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AA
An insurer rated 'AA' has VERY STRONG financial security characteristics, differing only slightly from those rated higher.

A
An insurer rated 'A' has STRONG financial security characteristics, but is somewhat more likely to be affected by adverse business conditions than are insurers with higher ratings.

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BB
An insurer rated 'BB' has MARGINAL financial security characteristics. Positive attributes exist, but adverse business conditions could lead to insufficient ability to meet financial commitments.

B
An insurer rated 'B' has WEAK financial security characteristics. Adverse business conditions will likely impair its ability to meet financial commitments.

CCC
An insurer rated 'CCC' has VERY WEAK financial security characteristics, and is dependent on favorable business conditions to meet financial commitments.

CC
An insurer rated 'CC' has EXTREMELY WEAK financial security characteristics and is likely not to meet some of its financial commitments.

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