

Insurance Market Update



Overview

In the wake of devastating, geographically diverse natural catastrophes, insurers and reinsurers worldwide have undertaken a comprehensive review of their loss exposures, risk aggregations and adequacy of rates.

The scope and severity of seasonal Australian floods; winter storms and flooding in the U.S.; the February 22 earthquake near Christchurch, New Zealand; and the devastating March 11 earthquake, tsunami and nuclear disaster in Japan have also impelled organisations to reexamine and reassess supply chain vulnerability to such events and the efficacy of their risk management programmes. In addition, the recent tornadoes that affected Midwestern and Southern U.S. states are likely to result in yet-to-be-determined but “significant” insured losses.

Table 1: Significant Natural Catastrophes in Q1 2011

Date	Event	Region/Country	Insured Loss (USD million)
Dec 2010–Jan 2011	Floods	Australia	3,100
31 Jan–3 Feb	Winter storm	United States	450
2–6 Feb	Winter storm	United States	320
2 Feb	Cyclone Yasi	Australia	870
22 Feb	Earthquake	New Zealand	10,000
11 Mar	Earthquake	Japan	12,000 to 34,000

Source: Swiss Re, Munich Re, Insurance Council of Australia, EQECAT, AIR Worldwide, RMS

The catastrophe risk modelling companies Risk Management Solutions (RMS), AIR, and EQECAT estimate insured losses from the Japan disaster to be between \$12.5 billion to \$34 billion, potentially making it the most expensive earthquake for insurers in over 20 years (see Table 2). Including downstream business interruption across a variety of industry sectors, ultimate physical and economic losses could reach or exceed \$300 billion.

Table 2: Five Most Expensive Earthquakes for Insurers between January 1990 and March 2011 (excluding Tohoku Japan on March 11)

Country	Region	Year	Magnitude	Insured Loss (USD million)
United States	Northridge	1994	6.6	20,600
New Zealand	Christchurch	2011	6.3	10,000
Chile	Offshore Maule	2010	8.8	8,000
New Zealand	Darfield	2010	7.0	4,500
Japan	Kobe	1995	6.9	3,500

Source: Swiss Re, Munich Re, USGS



With the exception of specific loss-affected risks, Marsh’s experience, as of April 1, is that there has not been an upward movement in rates.

For many insurers and reinsurers, 2011 budgets for catastrophe losses have already been substantially eroded, if not exceeded. Indeed, Q1 2011 will be a more expensive first quarter for catastrophe losses than any other over the last decade (see Table 3). The total loss figure is also likely to surpass that of Q1 1994, the year of the Northridge earthquake.

These events have all taken place before the official June 1 start of the Atlantic hurricane season, which is predicted to be more active than average. This year, RMS has introduced the 11th revision of its hurricane model (RMS 11), noting that “wind risk has generally increased for all [U.S.] hurricane states on an industry-wide basis.”

Even as these developments portend upward movement in rates for risks subject to natural catastrophe losses, overall marketplace capacity remains plentiful. Insureds with catastrophe exposures, especially those situated in regions affected by recent events, may expect to see some immediate re-pricing (see “Short-Term Market Changes”). In regions and for classes of business not affected by recent losses, property rate reductions may still be generally achievable, though more difficult to obtain.

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As ever in the context of macro developments, each organization’s unique risk attributes, in addition to the structure and quality of its marketplace submission, will be prime determinants of potential capacity and the ultimate cost of risk transfer that can be secured.

Table 3: World Natural Catastrophes—First Quarters, 2001–2010 (US\$ millions)

First Quarter	Number of Events	Original values		In 2010 dollars	
		Overall Losses	Insured Losses ¹	Overall Losses	Insured Losses ¹
2001	172	11,180	1,731	13,573	2,101
2002	147	5,826	1,589	6,962	1,899
2003	139	6,104	2,899	7,132	3,388
2004	159	5,023	2,099	5,717	2,389
2005	171	14,833	5,564	16,330	6,125
2006	179	13,128	4,820	14,000	5,141
2007	301	21,212	8,598	21,979	8,909
2008	194	32,389	8,515	32,314	8,496
2009	178	14,333	7,229	14,333	7,229
2010	210	34,746	9,545	34,746	9,545

Source: Munich Re, NatCatSERVICE

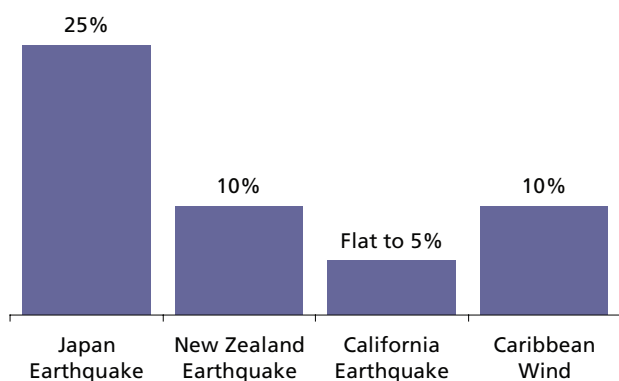
¹ Based on property losses including, if applicable, agricultural, offshore, marine, aviation and National Flood Insurance Program losses in the United States and may differ from data shown elsewhere.

Short-Term Market Changes

Property rate reductions may still be generally achievable, though more difficult to obtain. Insurers, particularly those in the Asia Pacific region, have been examining the implications of recent catastrophes for rate adequacy and long-term profitability.

In loss-affected sectors, certain natural catastrophe rate changes can be expected:

- Japan earthquake: increase of up to 25 percent
- New Zealand earthquake: increase of up to 10 percent
- California earthquake: flat to 5 percent increase
- Caribbean wind: increase of up to 10 percent



Insurers are carefully examining how tsunami risk is treated in policy wordings. Many policies classify tsunamis as part of flood risk, whereby it carries a lower deductible than earthquakes. After the events in Japan, we see pressure from some insurers to move tsunamis into the definition of earthquake, especially in the London market.

Insurers have reemphasised their requirements for comprehensive underwriting data that can be modeled to generate reliable forecasts. For example, insurers will look for clients to thoroughly substantiate their contingent business interruption (CBI) exposures.

Many insurers are pushing for reduced sub-limits and increased deductibles for CBI cover and catastrophe exposures.

Key EMEA market trends:

- **Property risks:** The effect of the recent natural catastrophe events and claims on the insurance market is not yet confirmed. The increased events are clear, but as there remains capacity in the market and new entrants continue to enter, the laws of supply and demand will go some way to combatting the pressures from increased claims. The further softening may halt - we see some insurers putting a freeze on long-term contracts or further discounts - but the signs of hardening are not yet apparent. The impact of the Japan events continues to be focussed on supply chain interruptions. However, as the supplier extension clause in many property damage/business interruption policies covers first tier suppliers only, there are nuclear exclusions and some interruptions are not as a direct consequence of damage, the actual losses are likely to exceed insured losses under traditional policies.
- **Casualty risks:** Recent events have not impacted pricing or capacity. Rate reductions are still achievable across a range of classes.
- **Financial institutions:** With a significant drop in new D&O claims activities, financial institutions have achieved D&O rate reductions of up to 15%, especially for Side A DIC coverage. Crime and professional indemnity policies have seen further pricing reductions with improved terms and conditions, despite many outstanding claims/losses and renewed market competition.
- **Commercial D&O:** The market for commercial risks continues to be extremely competitive. Economic recovery and the general state of the stock market is having a positive impact on rates helped by the abundance of capacity. Primary D&O premiums were down 5% to 10% while excess D&O premiums were down 10% to 15% on average. Policy terms and conditions continue to improve.
- **Other casualty classes:** Employment practices liability, fiduciary liability, crime and fidelity, and professional liability all experienced slight reductions over Q1, despite rising claims frequency—though not severity—in several specific classes.

Capacity Issues

Market capacity may be reduced in certain loss-affected categories of risk. In Japan itself, the local insurance market is expected to take a major capital hit. This is due to the low level of reinsurance purchased by many carriers, with many existing programs often having high retention levels.

In addition to its potential for changes in rates, reduced capacity for U.S. property risk is also likely to be one of the side effects of the introduction of the new RMS 11 model, as carriers seek to reduce exposure by rationing or decreasing capacity. Insurers have expressed concern that the new model will mean significant changes to assessment of their portfolios. Insureds with high levels of catastrophe exposure, or that purchase high levels of catastrophe limits, may see a reduction in the availability of capacity as insurers address accumulation issues.

Among insurers' concerns are their aggregations in areas that were not previously considered to have high catastrophe exposures, such as Mid-Atlantic States and inland counties in traditional windstorm-affected states.

Market Fundamentals

While the majority of global property insurers posted profits in 2010, the underlying foundation does not appear strong enough to support continuation of a softening market cycle.

By the beginning of 2011, market rates had dropped to well below pre-Hurricane Katrina levels due to intense competition and an abundance of capacity. Investment returns have improved, but there is continuing volatility in the global financial markets.

Given recent losses, future reinsurance catastrophe losses this year are more likely to be capital rather than earnings events. The profitability shown by insurers in 2010 was supported by favorable development in reserves—and most analysts do not expect to see a repeat in 2011. The confluence of these factors has the potential to impair the capital positions of reinsurers directly, which would, in turn, impact pricing for both catastrophe cover and other lines of business.

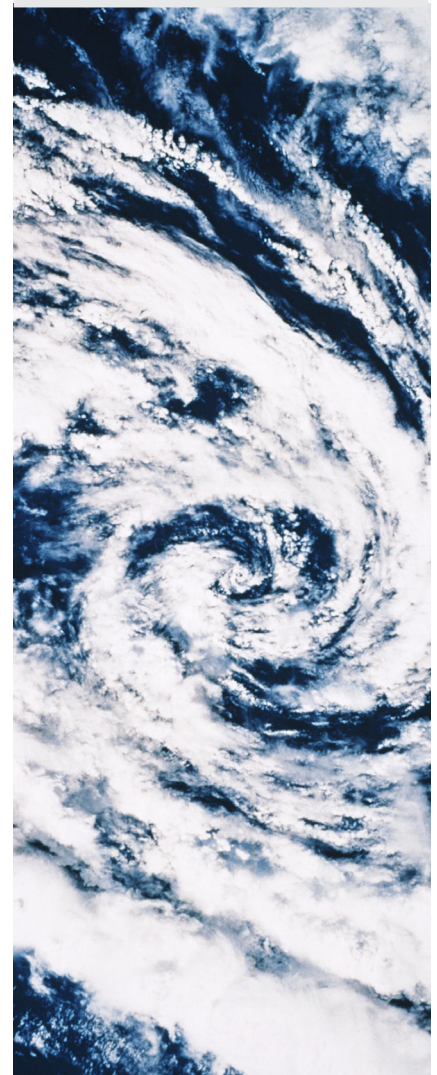
In Europe, carriers face the additional task of meeting enhanced requirements of the impending Solvency II regime. This will add additional pressure on surplus requirements and focus on aggregation of capital and pricing adequacy in the coming year.

Despite the unprecedented level of losses so early in the year, there continues to be ample capacity in the market, especially for new business. Insureds that are able to achieve the best results are the ones that are most able to demonstrate their ongoing commitment to proactive risk management. The quality and extent of information provided to insurers is key in creating a strong negotiating position and establishing the correct perception of the risk.

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