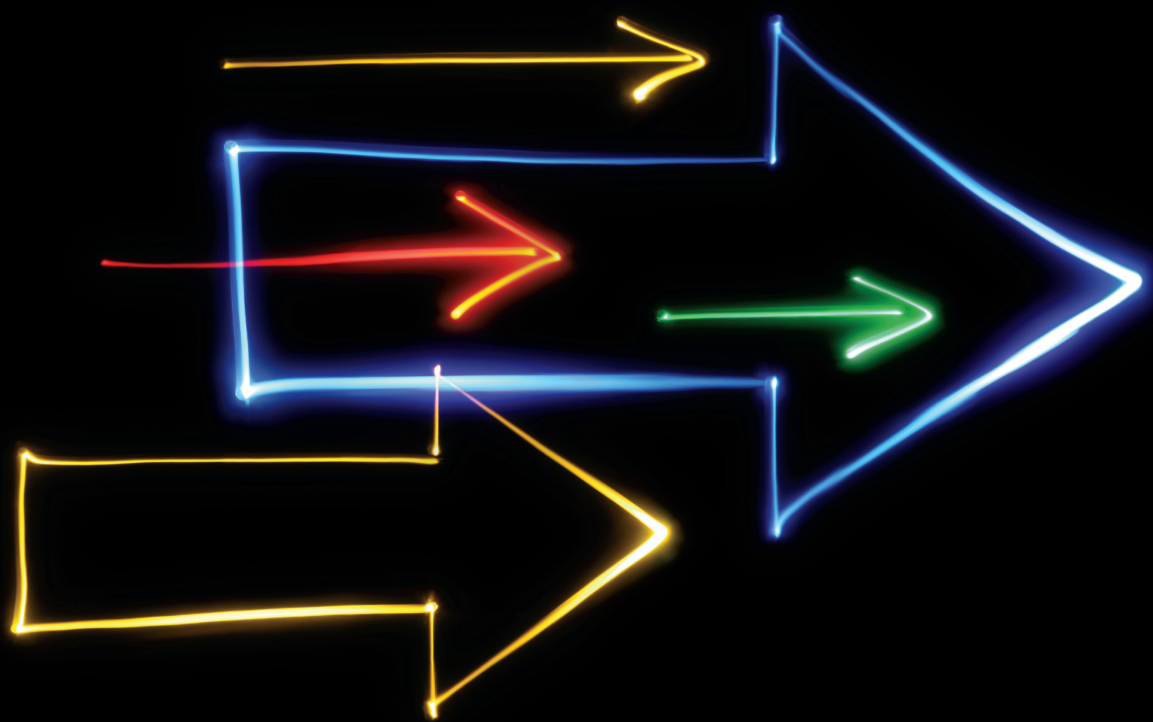
MANAGING EXTREMES Willis Re

1ST VIEW

1 January 2011



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RENEWALS – 1 January 2011

1st View

This thrice yearly publication delivers the very first view on current market conditions to our readers. In addition to real-time Event Reports, our clients receive our daily news brief, *Willis Re Rise ' n shinE*, periodic newsletters, white papers and other reports.

Willis Re

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For over 100 years, Willis Re has proudly served its clients, helping them obtain better value solutions and make better reinsurance decisions. As one of the world's premier global reinsurance brokers, with 40 locations worldwide, Willis Re provides local service with the full backing of an integrated global reinsurance broker.

Keep calm and carry on

As the 2010 underwriting year draws to a close, the reinsurance market is breathing a collective sigh of relief. The full year results are turning out to be much better than initially feared after a very poor 1st quarter. Although the reinsurance market's underwriting results are down compared to the exceptional 2009, taken together with further recoveries in investment returns and continuing strong reserve releases, the industry, as a whole, is currently overcapitalized.

Against this background, it is widely anticipated that many reinsurers will seek to implement more aggressive capital management strategies in the 1st quarter 2011 through share repurchases, dividend payments and other similar techniques. While Merger and Acquisition activity appears to be increasing, the number of completed deals remains modest due to significant execution hurdles.

The global outlook for 2011 is challenging. Strong premium growth in emerging markets is insufficient to offset continuing sluggish premium growth in the mature markets. Despite predictions, the pricing gap in most classes between reinsurance and primary business shows no signs of narrowing. As a result, primary carriers are purchasing less, particularly in casualty lines, and reinsurers are seeing reducing premium volumes.

The price reductions at 1 January 2011 are in line with expectation, and although they are subject to much variation by class and territory (detailed later in this report), they averaged from -5% to -10%. We see no discernible impact on pricing from greatly reduced investment returns, even though new cash can only be invested at half the returns available a few years ago.

Many commentators had hoped that the forthcoming changes in insurance regulation in non-U.S. markets would bring new opportunities for reinsurers, but we have seen only limited evidence of this at 1 January. We are unlikely to see more significant change until the 1 January 2012 renewal season in the final run up to Solvency II implementation.

In addition to looming regulatory changes, updated catastrophe models showing dramatic changes in modeled loss outputs are presenting an increasingly common challenge. In particular, the forthcoming RMS Version 11.0 release for U.S. Hurricane, revised to take into account inland losses, is resulting in substantial increases. The greatest changes – for Texas and Mid-Atlantic exposures – undoubtedly have helped reinsurers maintain pricing levels in these areas despite great client pressure for reductions following a second loss-free year.

In the Marine and Energy market, the Deepwater Horizon loss has made an impact, though the ultimate loss to the global reinsurance market remains unclear. Unlike most other classes, pricing for Marine has been flat, although marine accounts which include energy exposures or pure energy accounts are seeing significant rises.

As anticipated, the catastrophe bond market has rebounded in terms of aggregate capacity issued and number of deals executed. As investor demand and understanding increase, the cost gap between catastrophe bonds and traditional reinsurance has narrowed.

The global reinsurance industry faces tough prospects for 2011. Thin investment returns and declining back year releases provide little cover for declining underwriting returns. Consequently, some reinsurers' managers are lowering their guideline returns for 2011. In such an environment, any shock to reinsurers' capital base, either through underwriting losses or other capital events, is likely to result in a sharper reaction from reinsurers than primary companies will find easy to bear.

Peter C. Hearn

Peter C. Hearn
Chief Executive Officer, Willis Re
1 January 2011

Casualty – territory and comments

Australia

- Medical malpractice rate movements are in line with exposure growth
- General casualty renewal saw modest rate decreases

Europe – General / Employers' / Professional Liability

- Reinsurance market harder than expected prior to renewal season
- Rate reductions were still achievable
- Some attempts by reinsurers to re-underwrite long standing market practices such as the structuring of Master Covers and the way they are protected under treaties
- Continued focus on EU Environmental Directive and Financial Institutions
- European clients not taking advantage of newer London market reinsurance capacity
- Impact of lower investment return being used by reinsurers to argue for rate increases

Europe – Motor

- Reinsurance market harder than expected prior to renewal season
- Original market competitive in many territories
- Rate reductions, though, are still achievable under pressure
- Reinsurers remain concerned about bodily injury inflation in major territories
- Some proposals to change the index used in Index Clauses (particularly Germany) but not supported by rest of market
- European clients not taking advantage of newer London market reinsurance capacity

France – General / Employers' / Professional Liability

- General Third Party Liability and Professional Indemnity pricing stable even with lower investment income
- Medical Malpractice price increasing slightly, despite increased capacity
- Pricing for Construction stable. Capacity increases for the high value projects

Germany – General / Employers' / Professional Liability

- Low interest rates are an issue
- On the back of good results, slight softening in mainstream areas

Germany – Motor

- After years of decline, expectation for an increase in original estimated premium incomes
- Low interest rates an issue
- As original premiums increase, trend to stable reinsurance rates

Italy – General / Professional Liability

- Focus on a more disciplined approach, with particularly selective underwriting of Medical Malpractice; some new companies are entering the market on Medical Malpractice due to attractive terms
- On pro rata Medical Malpractice, reinsurers are preferring to support direct companies with strong underwriting expertise and claims management efficiency; new interest from selected players
- For XL programs, slight tension due to increase of bodily injury claims on the basis of new indemnification tables

Italy – Motor

- Market is concerned about new indemnification table for bodily injury losses; original tarifs increasing by 10%/15% year on year, bringing current 2011 expected combined ratio below 100%
- XL program structures basically unchanged; uncertainty about indemnifications and impact of V Directive creating a wide range of pricing
- Existing pro rata treaties generated substantial losses to reinsurers in the last 2 to 3 years and hardening of terms has been seen

Nordic Countries – General / Professional Liability

- Despite passive pre-renewal messages from reinsurers, the reinsurance market was probably harder than expected
- In general a flat renewal
- Newer capacity in the London market yet to be fully utilized, existing reinsurer relationships remain strong

United Kingdom – Motor

- Layers in excess of £5 million are the main area of concern for reinsurers primarily due to increase in bodily injury claims and issues related to periodical payment orders (PPOs)
- The attachment point of a program has a significant bearing on the overall rate movement

United States – General / Professional Liability

- Primary market pricing continues to decline driven by capacity and favorable reported results
- Reinsurance market capacity for all Professional Liability remains stable, with few new entrants and exisiting markets remaining committed to well managed clients
- Plentiful capacity remains available for Errors and Omissions Lines, more limited capacity available for writers of Public Company Directors & Officers Liability
- Ceding companies showing increased appetite to retain risk, predominantly with quota share buyers increasing retention
- Pro rata pricing, terms and conditions remain stable for well managed Clients
- Greater interest in risk excess and systemic clash structures

Global – General / Employers' Liability

- General and Employers Liability are renewing either unchanged or with small concessions from reinsurers
- Occasionally large programs with very strong track records have seen larger reductions
- Reinsurer awareness of systemic exposures is increasing
- The Reinsurer appetite for General Liability remains strong

Global – Professional Indemnity

- Plentiful supply of capacity for writers of both Global Professional Liability and Global Management Liability
- Reinsurers expressing some concern over final impact of recession-related claims in major territories, especially for Financial Institutions' Professional Liability Lines
- Reinsurers continuing to support well-managed companies that are perceived to be managing the cycle, with stable pricing and capacity
- Buyers' appetite / ability to retain additional risk somewhat tempered by challenging primary market conditions
- Increased focus by both cedants and reinsurers on the impact of sector / event risk, e.g., U.K. mortgage fraud, Madoff-related litigation
- Reinsurers are recognizing "trading balances," on individual programs and are rewarding established clients who have positive balances with consistent pricing methodology and only moderate price increases

Rates

Casualty rates			
TERRITORY	Pro rata commission	XL – No loss emergence % change	XL – with loss emergence % change
Australia	N/A	0% to -10%	0% to +5%
Europe – General / Employers' / Professional Liability	0%	0% to -10%	0% to -5%
France	0%	0% to +5%	+10 to +15%
Germany – Motor	0%	0%	0%
Germany – General / Employers' / Professional Liability	0%	0% to -5%	N/A
Italy – General / Employers' / Professional Liability	0%	-5%	+5%
Italy – Motor	-5%	0%	+10%
Nordic Countries	0%	0% to -7.5%	0% to -5%
South Africa – General / Employers' / Professional Liability	0%	+5%	+10% to +15%
Spain – Motor	N/A	-5%	N/A
United Kingdom – Motor	0%	0% to -5%	+10% to +15%
United States – General / Employers' / Professional Liability	0% to +2%	0% to -9%	0% to +5%

Specialties – line of business & comments

Aerospace – Global

- Aviation XL pricing subject to circa -5% to -10% reduction on programs unaffected by losses and stable exposure profiles
- Proportional treaty market resisting pressures from clients for higher deductions
- Underlying market affected by abnormal amount of Hull-related loss activity
- Dulles Jet Centre loss largest General Aviation loss to affect that market and mainstream core General programs at circa USD 240M, at present.
- Upswing in U.S. General Aviation risk excess pricing anticipated in 2011
- Aviation industry loss warranty pricing 0% to -5%
- Overall proportional capacity for XL programs is at a level which is surplus to demand

Engineering – Global

- Mid-size Construction losses have not had a material impact on reinsurance pricing
- Proportional treaty terms have seen selective increases in both treaty capacity and ceding commission
- New technically-resourced capacity is entering the Engineering and Construction reinsurance market
- Reinsurers looking to maintain their support of global clients
- Reinsurers fear of losing renewable income overriding "pricing concerns"
- 2010 Willis Engineering Rating Index (WERI) forecasting no sign of improvement in underlying rating levels for 2011

Healthcare – United States

- Frequency of loss levels remain historically low and severity trend still manageable
- While due to lower aggregate losses, prices have been continually falling for the last few years, 2010 witnessed a slowing or flattening of these decreases
- Loss reserve releases continue to ensure that calendar year results remain, on the whole, profitable
- It is highly likely that reserve releases will continue into 2011 and beyond, thus further supressing rate increases
- Perhaps the biggest challenge for Medical Professional Liability practitioners and insurers alike is trying to understand and predict the final shape of the healthcare reforms and to prepare their businesses for them

Marine

- Traditional placement of Marine and Energy combined covers as compared to pure Marine covers is resulting in two totally different approaches
- Marine-only covers still benefitting from excess capacity, and with no sign of movement in original Hull and Cargo rates leading to a further widening in reinsurance and primary rating levels, buyers have managed to hold reinsurance rates flat
- Number of small losses on Marine and Cargo accounts during 2010 have largely fallen into buyers' net retentions with insufficient impact to reinsurance programs to move rates
- Following the Deepwater Horizon loss, the Offshore Energy market is seeing large primary rate increases which are feeding through to unchanged pro rata commissions and large increases in XL rates even of loss-free programs
- Capacity for Offshore Energy very tight on a global basis, not just in the Gulf of Mexico as in previous years
- No sign of any new reinsurance capacity entering the market or any significant changes to terms and conditions on cover
- Buyers have kept their retentions largely unchanged, with a few exceptions on Energy-related accounts where reinsurers have been able to force some retention increases
- Sudden Oil Spill Consortium of Munich Re, Willis Re, Aon Benfield and Guy Carpenter has been developed in response to the issues arising from the Deepwater Horizon loss

Medical Excess – United States

- Healthcare reform has increased demand for higher limits of cover with the removal of insurance maximums and caps
- Higher limits without maximums and caps in turn have sparked a new supply of capacity providing unlimited excess protection
- The advent of 3 or 4 new markets in this sector has increased competition
- Renewal rates barely keeping track with Medical inflationary trends

Non-Marine – Retrocession

- Catastrophe Retro has proved difficult again due to the disconnect between clients' expectations and what markets are charging; continuing trend towards combined territorial covers rather than the pillared approach
- Catastrophe on direct and facultative buyers tending to retain more / buy less as original exposures are reducing due to rate inadequacy leading to buyers reducing their overall portfolios
- Risk retro still a relatively small market, but it has increased slowly due to the fact that generally natural perils are still excluded; pricing is becoming more competitive
- Coverage of natural catastrophe on direct and facultative risk portfolios difficult
- Pro rata retro treaties remain mainly consistent in terms and conditions

Personal Accident / Life Catastrophe – United States

- Multiple new entrants into the Accident / Life catastrophe market during 2010
- No catastrophe events of any magnitude to report
- Rates under significant pressure as a result of excess capacity

Political Risk – Global

- Majority of buyers increasing their risk and country limits
- Buyers looking to tap into the increased capacity, by purchasing more pro rata, rather than XL programs for this year to manage their fixed costs more effectively
- Increased reinsurance capacity available from both existing and new reinsurers, but leading capacity still relatively limited
- With notable redundancy in clients' original loss reserves / advices from 2007 and 2008 years of account, clients' expectations were for reductions in overall reinsurance spends – with improved terms in respect of commissions & profit commission provisions on proportional protections
- Reinsurers are acknowledging improvements although they believe increased terms are slightly premature, but as newer and cheaper capacity is now available, limited improvements in terms are being secured from incumbent reinsurers

Surety – United States

- Industry loss ratios remain near all-time lows, despite weakened construction market fundamentals and broad economic malaise
- A decline in exposures coupled with continued solid underwriting performance contributed to further market softening
- In addition to the overall softening, the market demonstrated a willingness to support broader coverage terms
- Overall market capacity remains stable and adequate to meet market demand with new market capacity continuing to explore expansion into the class

Trade Credit – Global

- Several new markets entering for 2011, so capacity increased
- Many programs over-subscribed
- Still a shortage of potential leading / quoting reinsurers
- 2010/2011 underwriting years likely to produce record margins for reinsurers
- Still no large claims; XLs mostly clean for many years

Rates

Specialty rates

TERRITORY	Pro rata commission	Risk loss free % change	Risk loss hit % change	Catastrophe loss free % change	Catastrophe loss hit % change
Aerospace – Global	0% to +2%	-5% to -10%	0%	0% to -5%	N/A
Engineering – Global	+0.5% to +2%	-10% to -15%	0% to +5%	-10% to -15%	N/A
Marine	0%	0%	0% to +20%	0%	0% to 20%
Marine including Energy	0%	+20%	+30% to +50%	+20%	+30% to +50%
Medical Excess – U.S.	N/A	0% to +15%	+15% to +30%	N/A	N/A
Non-Marine Retro	0%	-5% to -10%	0% to +5%	-2.5% to -5%	0% to +5%
Personal Accident / Life Catastrophe – U.S.	N/A	-5% to -15%	N/A	N/A	N/A
Trade Credit – Global	+2% to +5%	-10% to -20%	N/A	N/A	N/A

Property – territory and comments

International

- There have been significant overall catastrophe claims activity for International (excluding U.S.) Property portfolios, particularly from Chile, New Zealand, Haiti, Northern Europe and Australia
- Pricing adjustment per territory or program dependent on level of local loss activity
- Wider overall pricing for International Property business not affected by local / regional loss activity
- Continued plentiful capacity for all territories with excess capital deployed and new reinsurance and retrocession capacity being set up
- Risk-adjusted pricing is largely -5% to -10% with more significant reductions for smaller programs in non-peak territories

Asia

- Risk-adjusted reductions comfortably in the double-digit zone on XLs, but with minimal payback on loss-hit programs / treaties. Pace of reduction appeared to quicken as season progressed; Tier 1 reinsurers at the forefront of competitive pricing
- Capacity supply substantially greater than demand but exposure growth (China and others) is narrowing the gap; anticipate gradual move towards equilibrium as the cycle asserts itself
- Notable arrival of the first Bermudians in Singapore alongside the growing Lloyd's presence (22 syndicates); Singapore market inwards international income grew 33% in 2010
- Gradual introduction of risk-based capital regimes throughout the region (at varying pace) expected to shift focus on benefits of reinsurance from profit and loss protection and capacity-generation to capital and balance sheet implications
- Exponential increase in analytics demand (catastrophe and financial modeling) observable throughout the region

Australia

- Market flat on risk-adjusted basis, excluding loss affected layers
- There is an ongoing review of other perils within modeling (e.g., bushfire and hail)
- A strong appetite remains for Australian programs, especially from Singapore-based reinsurance markets
- Christchurch (Darfield) Earthquake continues to increase in expected loss cost (approximately NZD 5B+) and will affect 2011 renewals

China

- Primary companies in China continue to pursue their growth strategy and some are facing capital pressure resulting in strong demand for reinsurance. Capacity plentiful as reinsurers drawn to growth in premium volume and diversification benefit of the China market
- Pro rata treaties comfortably placed at unchanged commission levels as 2009 and 2010 results have substantially improved over earlier years
- Many primary insurers sought to increase their maximum treaty retention and/or number of lines as a means of increasing their capacity
- Capacity remained plentiful on risk and catastrophe XL on Chinese Property and Engineering business leading to risk-adjusted rate reductions

Philippines

- Disproportionately (high) increase in natural perils aggregates versus income
- Market agreement on implementation of tariff rates for natural perils should lead to a better level of rate adequacy going forward

Carribean

- Hurricane Tomas losses in Eastern Caribbean largely restricted to St. Lucia; pricing outside of that market not affected
- Pro rata commissions edged up on back of good results
- Catastrophe capacity plentiful despite potential clash with U.S.

Europe

- Multi-territory peak zone zone catastrophe XL prices down 5% to 7.5% risk-adjusted despite worst International catastrophe losses for a generation
- Abundant capacity available with most programs completed earlier this year with no major market issues
- Much lower modeled results from AIR v12 for residential portfolios and cross country correlations have not been taken into account

Central & Eastern Europe

- No shortage of capacity offered in Central & Eastern Europe
- Since Central & Eastern Europe still considered as a diversifing territory, it remains attractive to the markets
- 2010 year saw an extreme frequency of medium-size catastrophe losses
- Upward pressure on capacity purchasing due to Solvency II future requirements
- The capacity of the regional Property Risk XLs increased; less facultative purchased

France

- Property catastrophe price reduction risk-adjusted from 5% to 8%
- Entry of additional players with significant capacity
- Per Risk: very much linked to the individual companies results; important appetite for this type of cover this year

Germany

- Few changes as many programs renewed with unaltered structures
- Buyers will await results of QIS5 studies and are likely to review their programs for 2012
- An organized softening of the reinsurance rates with more than sufficient catastrophe capacity available
- Reinsurers seem to be prepared to accept increases in exposures in selected areas
- Trend for reduction of proportional treaties

Italy

- Companies are moving from standalone fire and motor own damage covers to combined Property covers against background of Solvency II; key focus on aggregate covers for excess of frequency to stabilize performance
- Plenty of catastrophe capacity available and strong competition
- Exposures for biggest programs substantially increased
- Reinsurance budget is an issue and retentions increased
- Buyers nonetheless sought to protect net retentions through sub-layers and/or aggregate covers
- Risk is still very competitive, but less appealing to reinsurers than catastrophe, especially for London and Bermuda markets

Nordic Countries

- Losses from an unprecedented Scandinavian winter and heavy rain in August affected insurers' balance sheets, but less so their reinsurance programs
- Loss-free catastrophe business enjoyed moderate risk-adjusted price reductions
- Small increases in catastrophe capacity, continuing discussions with reinsurers regarding the non-correlation of Scandinavia
- Some improvements in wordings (Hours Clause, Terrorism, Costs)
- Increasing capacity for risk excess of loss and consequential price softening
- Capacity tighter for proportional treaties and reinsurers more resilient to requests for improved commissions

Turkey

- Pro rata placements renewed smoothly; new capacity available
- Risk-adjusted rate reduction achieved on catastrophe XLs but growing signs of concern particularly in London market over pricing for second tier catastrophe territories following Chile and New Zealand earthquake losses

United Kingdom

- Prices continue to soften
- Capacity remains plentiful and there were several new entrants particularly in the Lloyd's market
- Retentions and limits purchased were broadly stable. There was some increased appetite for the purchase of aggregate XL covers

Latin America

- Overall, there is a growing amount of capacity available for Latin American excess of loss business as reinsurers attempt to obtain more non-correlated business at acceptable modeled margins
- Despite the Chile loss, capacity has far outstripped demand which has held price increases to modest levels
- Primary level competition is partly fuelled by competitive facultative rates and the ability of multinational groups to buy catastrophe cover at wholesale prices with regional discounts
- Proportional placements without event limits are becoming more difficult to achieve

Colombia

- Generally pricing is flat or slightly down where loss free
- The November rains and floods have hit the bottom end of selected programs
- Increasing appetite for some stand-alone Terrorism programs

Venezuela

- Pricing at 1 January flat to small increases due to competitive pricing in 2010 and to some recent small-scale flood losses in November / December
- Capacity for Venezuelan catastrophe XL business outstrips demand due to the 100% devaluation of the Venezuelan Bolivar in 2010

Middle East

- Capacity still coming into an already oversaturated market
- Despite the lack of sizeable retentions, still no clear commitment from reinsurers to have them increased
- Expansion of regional groups likely to lead to increased Mergers and Acquisitons in the area
- Lack of awareness of the potential catastrophe exposure in the region still of major concern to the reinsurers

Algeria

- Pricing reduction on a risk-adjusted basis for XLs, but underlying growth helped to maintain premium volume
- Major structural change in market with Compagnie Centrale de Réassurance's compulsory cession increasing to 50%

Morocco

- On pro rata business, renewal has been as expiry regarding terms and conditions
- On XLs there were risk-adjusted decreases of -5% to -10%

South Africa

- Flat catastrophe pricing if little movement in aggregates
- Small movement upwards on risk XLs based on upward profile movement

United States – Nationwide

- Plenty of reinsurer capacity at the right price for large nationwide programs, while demand is mostly flat to slightly down
- Some markets attempting to incorporate RMS anticipated model changes into pricing
- London generally more flexible than Bermuda due to lower reliance on models

United States – Regional

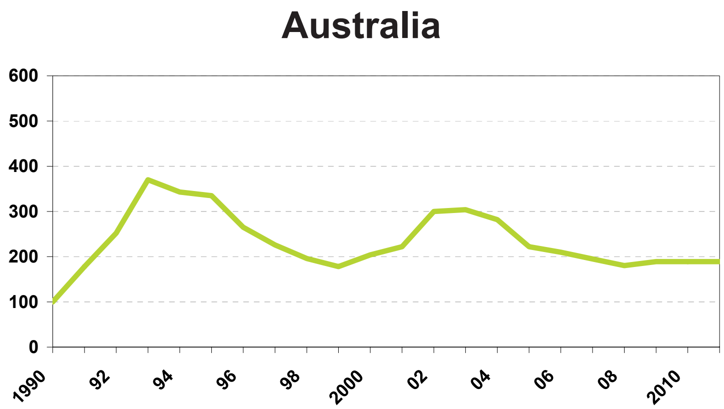
- Regional carriers buying more limit in anticipation of model changes
- Reinsurers quoted high but willing to agree to firm order terms at lower rates compared to nationwide accounts
- Some reinsurers are willing to decline business if they expect a significant increase in modeled losses and do not get the associated increase in pricing

Rates

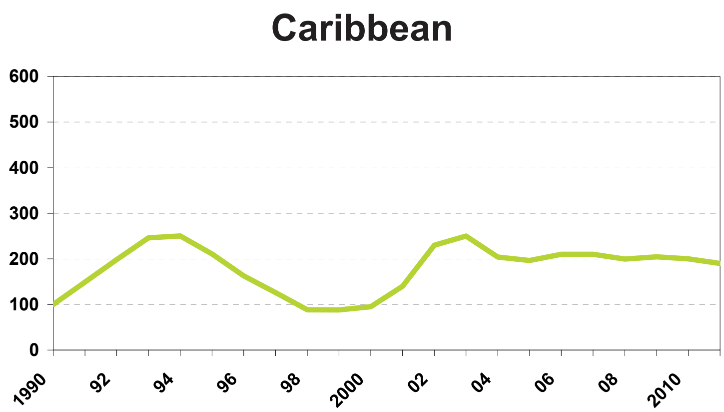
Property rates

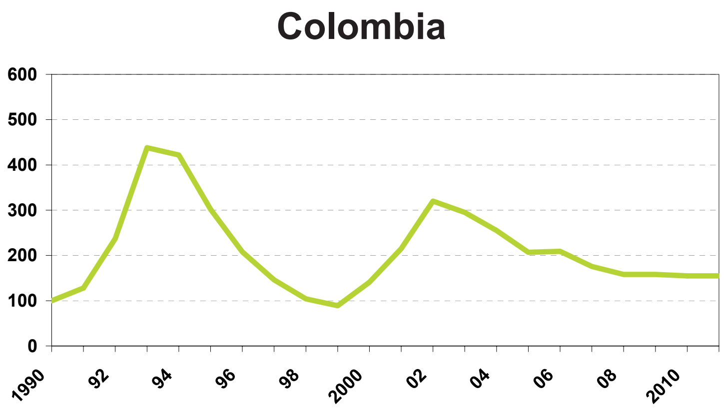
TERRITORY	Pro rata commission	Risk loss free % change	Risk loss hit % change	Catastrophe loss free % change	Catastrophe loss hit % change
Australia	0% (Australia) to -10% (for NZ-affected business)	0%	+10% to +20%	0%	+10% to +20%
Caribbean	+1%	-5%	variable	-5%	+7%
China	0%	-5% to -15%	N/A	-5% to -15%	-5% to -15%
Colombia	0%	0%	+10% to +50%	0%	+3% to +5%
Europe	N/A	-5% to -7.5%	N/A	-5% to -7.5%	N/A
France	N/A	-5% to -10%	0%	-5% to -8%	0% to -2.5%
Germany	0%	0% to -5%	0% to +5%	0% to -5%	-2.5% to +5%
Indonesia	0%	N/A	+5%	-5%	N/A
Italy	0%	-5%	0%	-15%	-10%
Middle East	+2%	-10%	-5%	-15%	0%
Nordic Countries	0%	-5% to -10%	-5% to +10%	-5% to -10%	variable
Philippines	N/A	-20%	0%	-25%	N/A
South Africa	0% to +2%	0%	+10% to +20%	0%	+5% to +10%
Spain	0%	-7.5%	0%	-5%	0%
Taiwan	N/A	-5% to -10%	0% to +30%	-15% to -25%	-10% to -15%
Turkey	0%	N/A	N/A	-5% to -15%	N/A
U.K.	+1% to +2%	-7.5% to -10%	N/A	-5% to -7.5%	N/A
U.S. – Nationwide	N/A	0% to -5%	0%	-5% to -10%	0%
U.S. – Regional Wind	0%	0% to -5%	0% to +5%	-5% to -15%	0% to +10%
Venezuela	0%	0% to +10%	+10% to +55%	0% to +3%	+3% to +8%

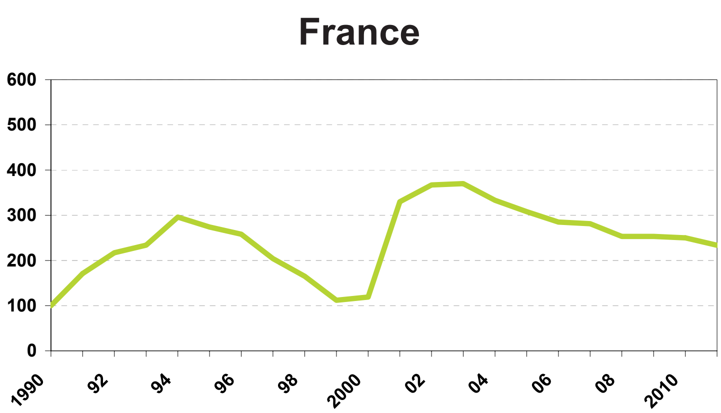
Property catastrophe pricing trends



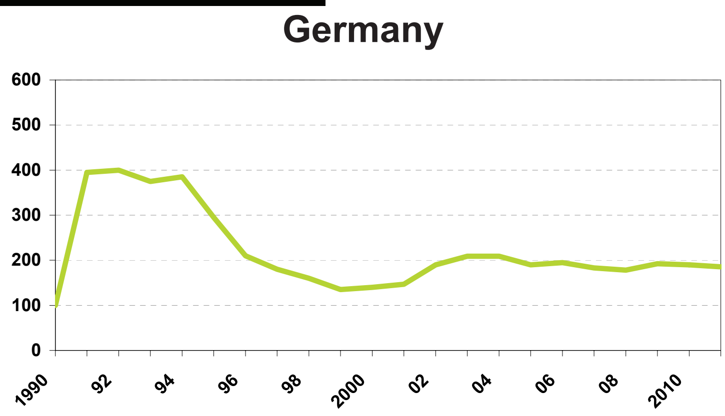
Australia







The charts on this page display Estimated Year-to-Year Property Catastrophe Rate Movement.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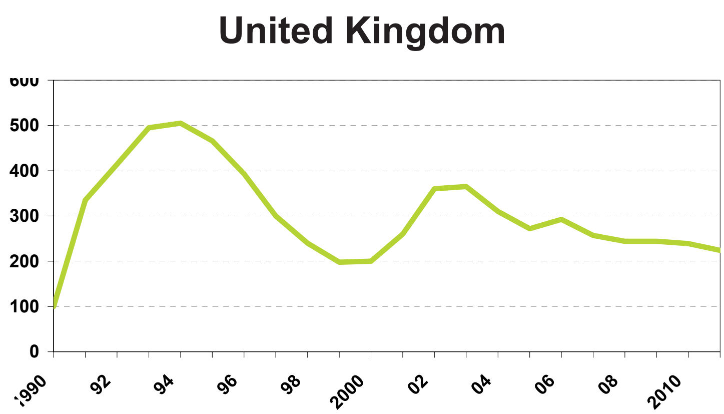
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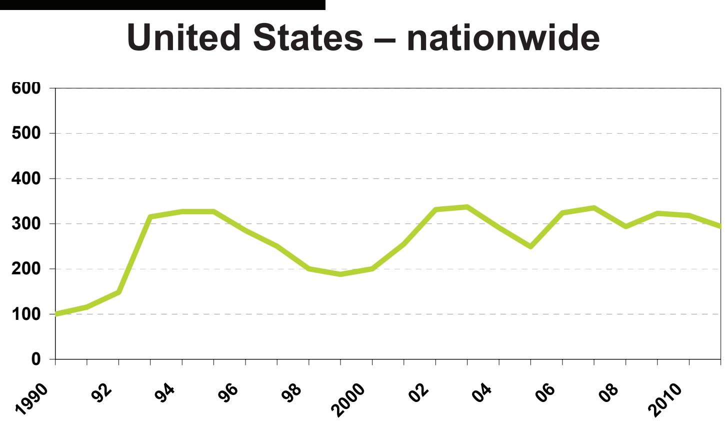
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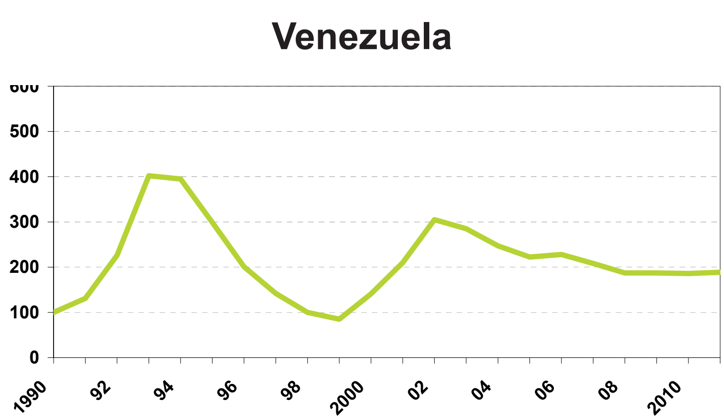
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Capital Markets – territory & comments

- Third and fourth quarter 2010 saw a dramatic increase in new deals coming to market. Investors thrilled with an extensive variety of new transactions offering a wide range of perils, triggers and in some cases relatively high expected loss costs.
- Many new issues upsized during the placement process due to higher than anticipated demand.
- 2010 has seen USD 4.8B of new bond capacity issued compared to USD 3.4B in 2009 and USD 2.7B in 2008. At year end, outstanding natural catastrophe bond amounts total USD 12.2B roughly in line with the 2009 figure of USD 12.3B.
- In the face of strong investor demand, pricing margins have narrowed to a point where the product is competitive in pure pricing terms as compared to traditional reinsurance, not only for U.S. hurricane risk but increasingly for other perils as well. These price drops have occured, notwithstanding the recent and pending catastrophe model changes that affect catastrophe bond pricing more rapidly than traditional reinsurance renewals.

U.S. Workers' Compensation – territory & comments

- On the primary side, 2010 experienced industry-wide decreases in payroll for the first time in memory. Policyholders overestimated their payrolls when their policies incepted in late 2008 to early 2009, resulting in return premium once these policies expired and audits were completed. The negative audit premiums resulted in reduced 2010 cash flow which was further impacted by continuing reduced payroll expectations for the 2010/2011 renewals. This combination of negative audits and reduced 2010 expectations significantly impacted cash flow. Negative audit premiums have significantly diminished in the fourth quarter of 2010.
- On the reinsurance side, pricing on working layers has stabilized. Select reinsurers have taken a more conservative approach, but overall, the market remains relatively unchanged through the January 2011 renewal season.
- The catastrophe reinsurance market remains soft. 2011 represents the beginning of a ninth consecutive year of softening terms. The 2010/2011 pricing for catastrophe capacity was impacted twice. First, exposure is down industrywide due to the declining payrolls. Reinsurers readily recognized the exposure reduction in their pricing. Second, the competitive market conditions have resulted further price reductions.

Rates

U.S. Workers' Compensation rates

TERRITORY	Pro rata commission	XL – no loss emergence % change	XL – with loss emergence % change
United States	0%	0% working layers -5% catastrophe layers	+5% working layers 0% catastrophe layers

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