

GUY CARPENTER

Global Reinsurance Outlook

Points of Inflection

Positioning for Change in a Challenging Market



January

2011

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Introduction

Guy Carpenter is pleased to present our 2011 reinsurance market outlook, Points of Inflection.

This is our fourteenth consecutive annual state of the reinsurance market report. The following pages provide important analysis of and insights into the (re)insurance industry, and aim to help Guy Carpenter's clients navigate this challenging market environment. The report also serves as a useful real-time reference guide to the January 2011 renewal results.

Points of Inflection combines the best collective thinking of our global analytical and broking teams located in fifty offices around the globe. It is through Guy Carpenter's integrated, collaborative culture that we are able to deliver these differentiated insights and perspective to our clients.

This year's report contains three key themes: Renewal Rates, Excess Capital and Regulation.

Renewal Rates

Guy Carpenter's proprietary, global Rate on Line Index shows an average drop in rates of 7.5 percent, indicating further softening. The macroeconomic and reinsurance pricing environments remain stubborn, but there may be early signs of catalysts for a firming market. Our examination of these factors – as well as the rest of our 2011 outlook – begins on page 6. Highlights from this year's renewal season can be found in the Executive Summary on page 3, and our comprehensive sector-by-sector review of 2011 reinsurance renewal data starts on page 32.

Excess Capital

As you'll see in our analysis beginning on page 6, Guy Carpenter estimates dedicated reinsurance sector capital to be USD19 billion (11 percent) in excess of historical levels, given risks currently assumed. Cash flow and reserve trends bear watching, as they historically have served as precursors to hardening markets. Our Global Business Intelligence analysis points to marginally negative underwriting cash flow for the U.S. P&C sector while reserve releases continue unabated. We question how much longer favorable development can be expected to prop up calendar year results.

Regulation

The Solvency II regulatory regime has left the station, with a target implementation date of January, 2013. This new capital regime will have a profound impact on the industry far beyond the European jurisdiction; our discussion begins on page 20. Guy Carpenter can provide an array of solutions and advice to (re)insurers worldwide to address a number of issues related to Solvency II, including capital adequacy, risk diversification, enterprise risk management, and identification of strategic opportunities.

Finally, I encourage you to contact me or your local Guy Carpenter representative to provide recommendations on how to make this annual report more relevant to your decision process. We value our client relationships and your comments and feedback are important to us. We welcome your suggestions.

On behalf of all of us at Guy Carpenter, we wish you a prosperous 2011.

Best Regards,



Bill Kennedy, CFA, CEO of Global Analytics and Advisory



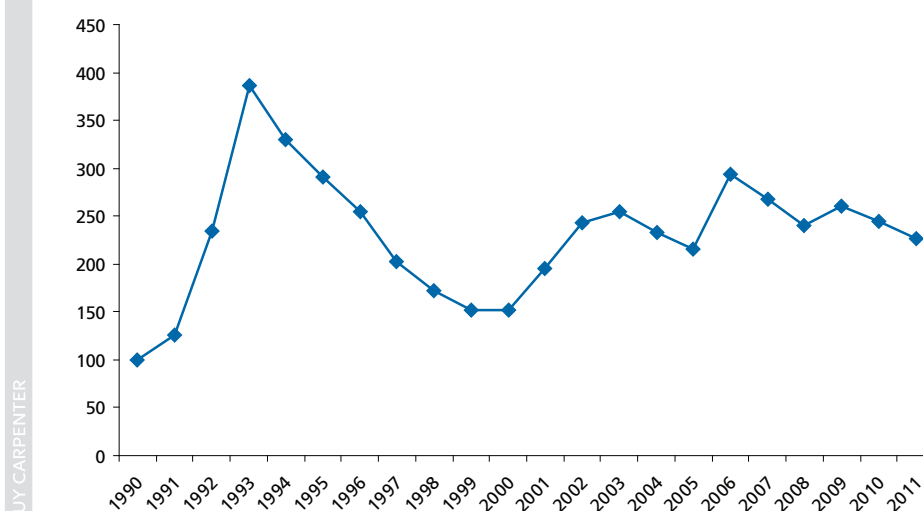
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Executive Summary

2011 Renewal Rates Reflect Continued Softening

Early predictions that January 1, 2011 reinsurance renewal rates were likely to fall have been proven correct. The Guy Carpenter Global Property Catastrophe Rate on Line (ROL) Index lost 7.5 percent – the second consecutive annual decline. Contributing to this move has been a combination of factors, including moderate loss activity and abundant levels of industry surplus.

FIGURE 1: GLOBAL PROPERTY CATASTROPHE ROL INDEX



Source: Guy Carpenter & Company, LLC

The decline in rates on line at January 1, 2011 takes place following a year that began with significant catastrophe activity. Losses in the first half of the year were well above average and included Windstorm Xynthia, the Deepwater Horizon oil rig loss and the Chile earthquake. However, despite the New Zealand earthquake in the second half, the year finished with relatively low insured catastrophe losses — owing in large part to an unexpectedly low-loss hurricane season. Subdued losses, combined with unrealized investment gains, led to record levels of capital, which in turn drove reinsurance pricing lower at the renewal. Structures have not changed significantly: Cedents are buying similar amounts of cover to last year, with purchasing appetite helped by attractive pricing.

As shown in Table 1 on the next page, 2011 renewal rates varied widely by business segment – yet most trended overall flat to negative to their levels last year. The only sectors with a clear upward bias were Marine & Energy and Credit, Bond & Political Risk.

TABLE 1: TYPICAL RATE CHANGES

Business Segment	Price Change
Global Property Catastrophe Reinsurance	Down 6% to 10%
Global Marine & Energy	Up 25% to down 5%
Global Aviation & Aerospace	Up 5% to down 10%
Global Credit, Bond & Political Risk	Up 25% to down 20%
Global Property Retrocession	Flat to down 10%
Global Life/PA Catastrophe	Down 8% to 10%
US Property Catastrophe Reinsurance	Down 6% to 10%
US Casualty Clash	Flat to down 5%
US Workers Compensation Catastrophe	Flat to down 12%
US Directors & Officers	Up 5% to down 5%
US Medical Professional Liability	Flat
US Surety	Flat to down 10%
US Agriculture	Down 10% to 15%

Source: Guy Carpenter & Company, LLC

Outlook 2011: Identifying Forces for Change

While soft market conditions show no immediate signs of reversing, we note an increasing number of latent factors which – alone or in combination – could at some point precipitate a meaningful change in the market’s direction. Depending on loss experience, these factors could begin to coalesce around renewals later in the year.

As always, a major catastrophic event of sufficient size could reverse the direction of rates. We estimate that a USD50 billion insured loss event would stem the decline of property catastrophe reinsurance rates for at least one year in the current, capital rich environment. At USD100 billion, we believe “outlier” reinsurance entity failures could occur, while a USD150 billion insured loss event would create a decided and sustained market turn.

Reserves also bear watching. As reserve releases continue unabated, we question whether the sector has entered the ‘cheating phase’ and how much longer favorable development can be expected to prop up calendar year results.

US P&C sector underwriting cash flow has also turned marginally negative, and we note that the last hard market was accompanied by significant underwriting cash flow shortfalls.

Finally, persistent low sector valuations could themselves prove to be a catalyst for change by precipitating industry consolidation in the form of share repurchases and increasing the potential for mergers and acquisitions (M&A) – both of which could serve ultimately to restrict the supply of reinsurance capital.

It is not clear which of these factors will emerge to affect the direction of the industry, in what combination or when. But there are enough potential catalysts to serve as a potent reminder that the status quo in the industry is not permanent.

Industry Grapples with Regulatory Changes

While the direction of the reinsurance industry in 2011 is uncertain, it is very clear that regulatory issues will be high on the agenda of virtually every participant. At the top of the list is Solvency II, which is set to be implemented in 2013. While nominally European in scope, it is sure to have a significant impact on the entire global industry for years to come.

We note that Solvency II is not only a change in risk management practices but also in management information systems – with a substantial burden resulting from documentation, transparency and disclosure requirements. As a result, the resource costs associated with Solvency II's implementation are putting significant pressure on companies at a time when market conditions and underwriting results are less than optimal. Smaller companies and niche players will be most at risk, and it is crucial that these companies take the right steps now to optimize their performance under the new regime.

Other issues we expect to loom large among reinsurers and the insurance industry in the year ahead include a potentially busy hurricane season and a continued focus on developing and obtaining terrorism risk transfer mechanisms. With regard to hurricane risk, Colorado State University is calling for an above-average hurricane season for the sixth year in a row with 17 named storms, nine hurricanes and five major hurricanes predicted.

In all, we expect 2011 to be a challenging year both in terms of the underwriting environment and underlying macroeconomic issues. But it is also likely to be a year of opportunity, particularly if we see catalysts emerge that begin to change market fundamentals. In any case, firms armed with the best insight, tools and analysis will be those most prepared to position themselves for the inevitable changes to come.

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2011 Outlook

Preparing for an Inflection Point

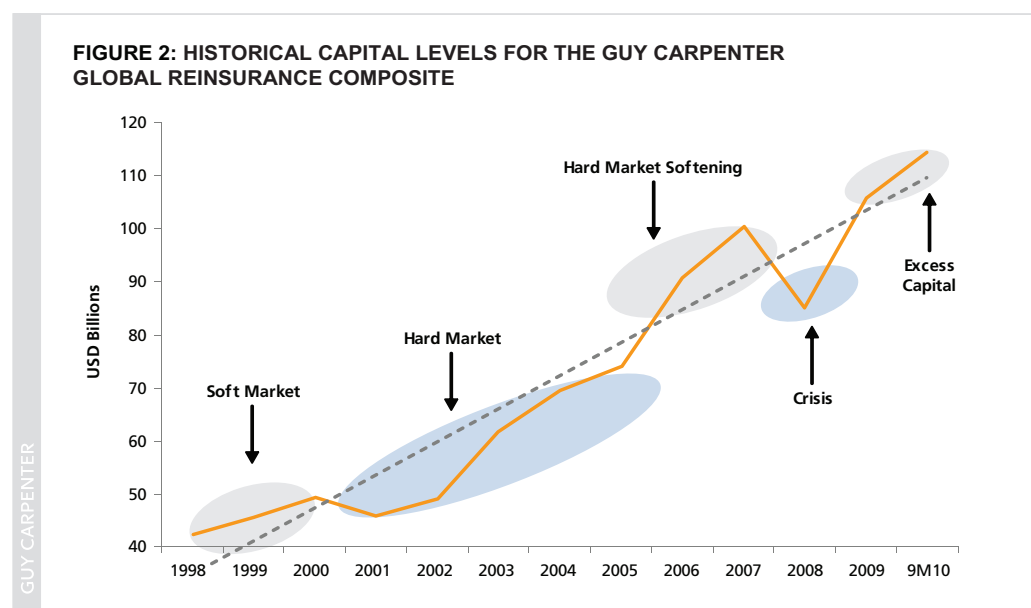
The macroeconomic environment as we enter 2011 is a challenging one for the reinsurance industry. A combination of low yields, high levels of sector capital and lower rates-on-line has led to a climate of persistent low valuations and stubbornly suppressed forward earnings rates. In addition, there is no clear catalyst on the horizon. Until we see a meaningful change in one of these underlying factors, the forecast is for more of the same.

Below we examine the economic factors that have brought about the current softening market as well as the forces that could serve as catalysts for an eventual change.

Sector Excess Capital: The Primary Driver of Lower Rates

The decrease in the Guy Carpenter Global Property Catastrophe Reinsurance Rate on Line Index has been driven by a range of factors, including loss activity and buyer appetite as well as general macroeconomics. While these constitute significant dynamics, perhaps the most important pricing driver is simply the large amount of global reinsurance capital. The Guy Carpenter Global Business Intelligence team estimates dedicated reinsurance sector capital¹ to be USD19 billion (11 percent) in excess of historical levels given risks currently assumed, with a defensible range of between USD14 billion (8 percent) and USD26 billion (15 percent).

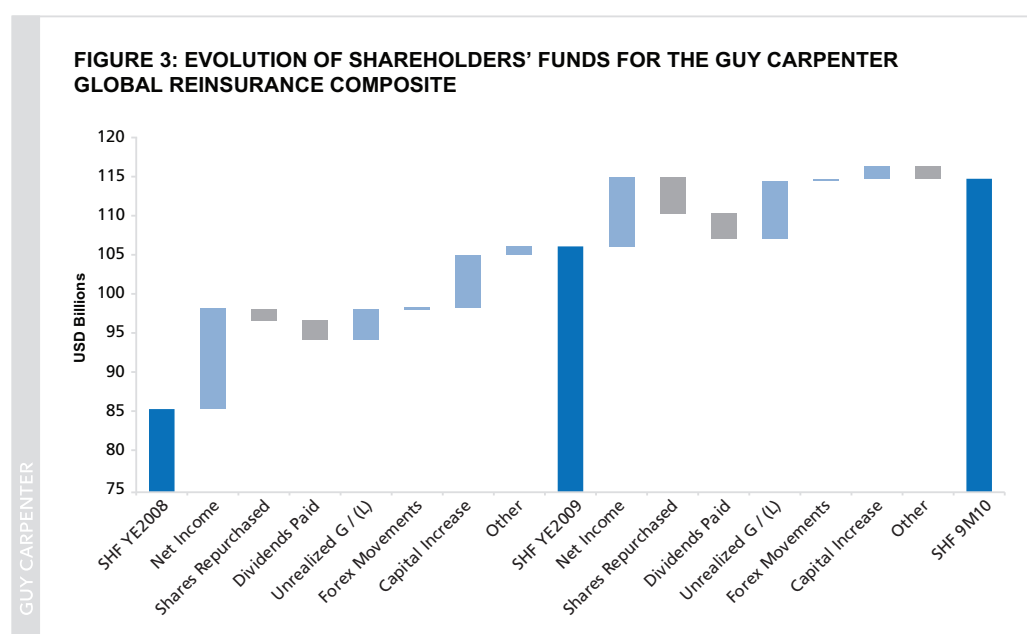
Figure 2 below shows the historical capital levels for the Guy Carpenter Global Reinsurance Composite from 1998. As is evident, the equity of the composite has grown significantly over the period. From a pricing perspective, when capital levels are above trend, reinsurance rates on line come under pressure. By contrast, rates tend to rise during low-capital years. This year, with capital levels in the sector relatively high, it should be no surprise that rate on line has moved 7.5 percent lower.



Source: Guy Carpenter & Company, LLC

¹ Dedicated reinsurance capital is different than reinsurance capacity, or the total capital of insurance carriers who write reinsurance.

Capital growth in the reinsurance sector has been so strong over the last two years that even significant share buybacks and dividends have not been able to negate the increase. Figure 3 drills down into the factors of capital change since the end of 2008, a time when the global financial crisis was nearing its peak and when capital levels were at or near period lows. As Figure 3 shows, the most important drivers of capital development have been strong net income and unrealized investment gains. Composite shareholders' funds have grown from USD85.2 billion to USD114.7 billion, or roughly 35 percent, over the period. This has been in spite of large share buybacks and dividends totaling nearly USD12 billion and heavy first-half underwriting losses in 2010. It is notable that in 2010 specifically, nearly all net income earned by reinsurance companies in the composite was returned to shareholders in the form of share buybacks and dividends. Still, capital levels have grown rapidly and pricing pressure has become more acute.

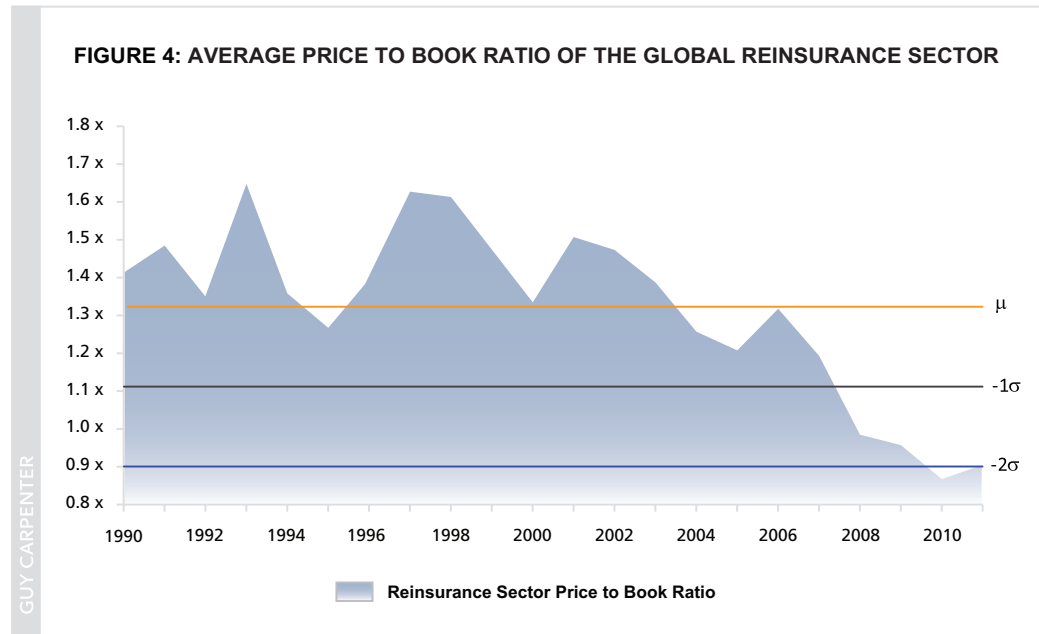


Source: Guy Carpenter & Company, LLC

The Low Valuation Trap

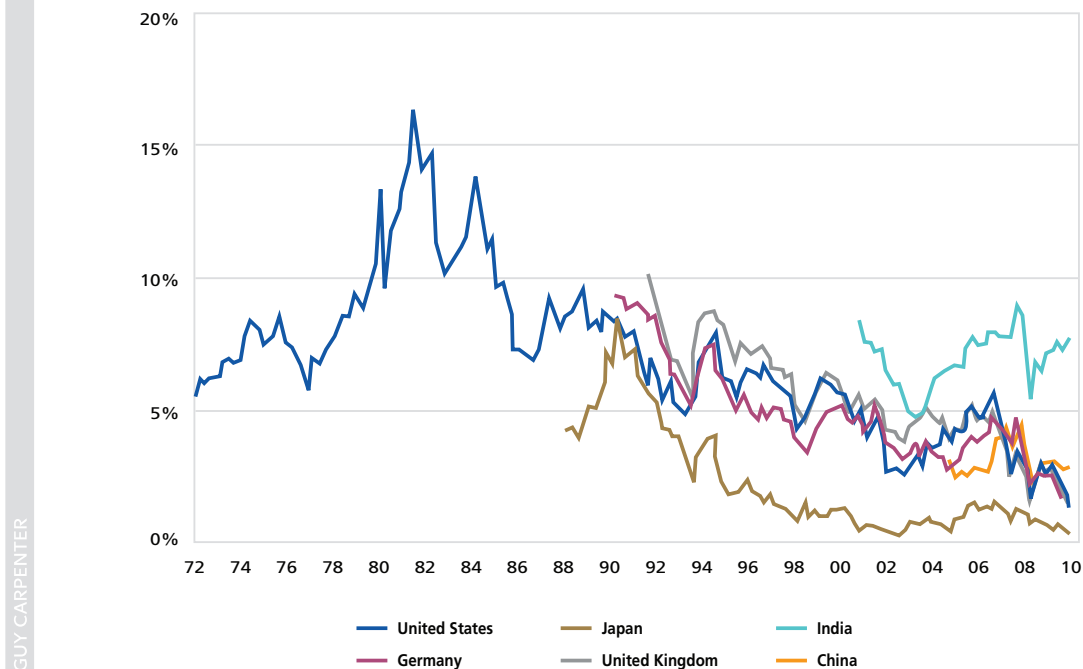
Another effect of the sector's growing capital position has been a marked decline in reinsurers' valuations. The price to book ratio of the Guy Carpenter Global Reinsurance Composite is near twenty-year lows, or over two standard deviations below the long-term mean, at 0.91x. These low valuations have significant implications for reinsurance company managements with regard to company strategy and capital budgeting. They are also important considerations for financial flexibility and the potential for sector consolidation. Figure 4 plots the price to book ratio of the

reinsurance sector from 1990 to the present day. The drop-off in the last decade has coincided with higher loss activity, falling interest rates, increased capital requirements and lackluster equity global valuations generally.

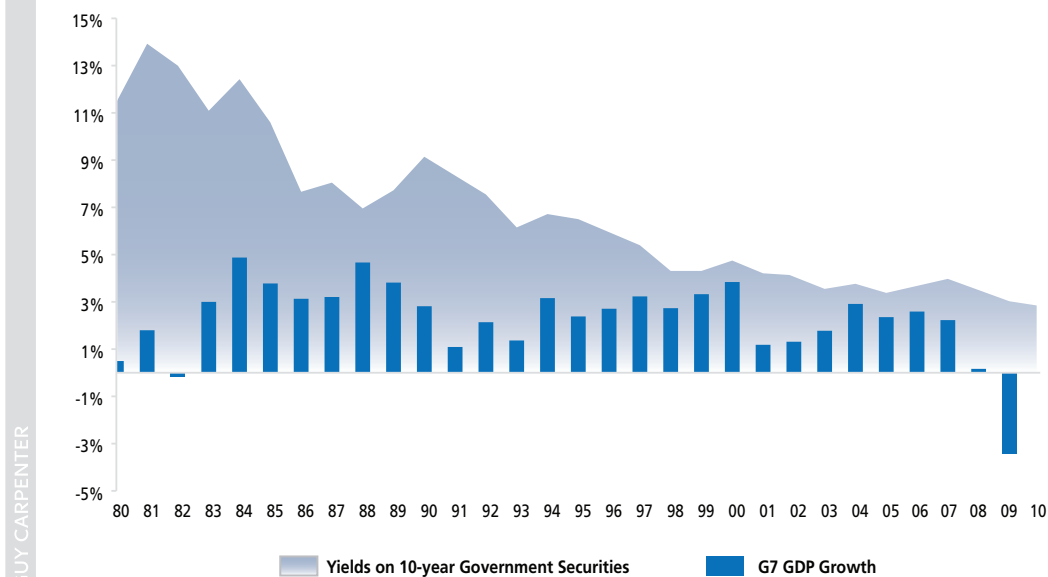


Diminished investor sentiment and valuations have been influenced by a conservative forward sector outlook, driven in turn by low investment yields, top line pricing pressure and “new normal” economic growth forecasts. Investment yields are of particular relevance to reinsurers as the majority of carriers’ earnings have historically emanated from net investment income as opposed to underwriting or net realized gains. Yields on “safe” securities (i.e. large Western economies’ and Japan’s government bonds) are at or near thirty-year lows. This means the old model of writing to a 103 percent combined ratio over the cycle with a leverage ratio of net technical reserves to capital of 3 to 3.5x no longer produces returns on equity commensurate with investor expectations, thereby driving valuations lower.

Figure 5 shows government bond yields over thirty years. Viewed in this context, it is remarkable just how low returns on “safe” investments for insurance companies have become. In addition, Figure 6 shows falling yields on ten-year government securities for the G7 economies superimposed over twenty years of GDP growth trends. Negative economic growth experienced in 2009 continues to affect premium levels and pricing. Together, lackluster premium growth and falling yields have exacerbated the unfavorable valuation situation.

FIGURE 5: FIVE-YEAR YIELDS TO MATURITY ON GOVERNMENT SECURITIES

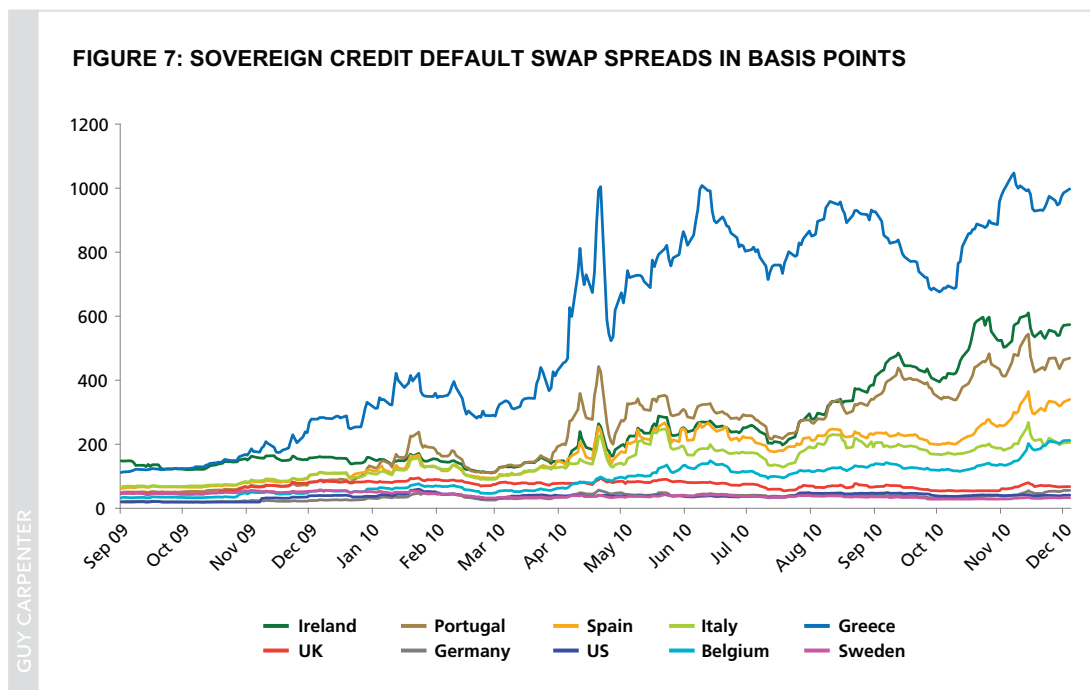
Source: Guy Carpenter, Bloomberg Data

FIGURE 6: TEN-YEAR YIELDS TO MATURITY ON G7 GOVERNMENT SECURITIES SUPERIMPOSED ON G7 GDP GROWTH

Source: Guy Carpenter, Bloomberg Data, International Monetary Fund

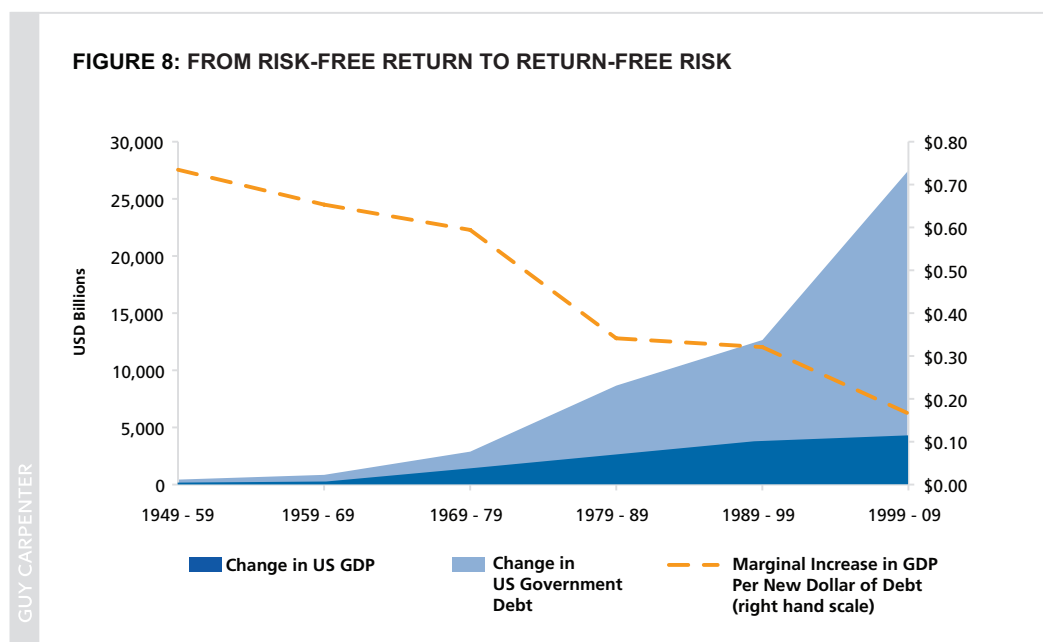
The fact that yields are low on government securities does not guarantee low investment risk. Although rating agencies and regulatory models tend to influence companies to invest in government securities because of their perceived relative safety, these securities could one day prove less safe than they seem at present. This process may have already begun to happen in the Eurozone, where some sovereign debt securities once considered beyond reproach have drawn increased scrutiny – with certain European countries even requiring special loans from the European Union (EU) and the International Monetary Fund (IMF).

Figure 7 shows five-year credit default swap spreads for sovereign securities. Although disclosure regarding reinsurer exposure to European sovereign securities is relatively sparse at present, Guy Carpenter monitors reinsurance counterparties' sovereign debt positions (where possible) as well as reinsurer credit default swap spreads on a daily basis.



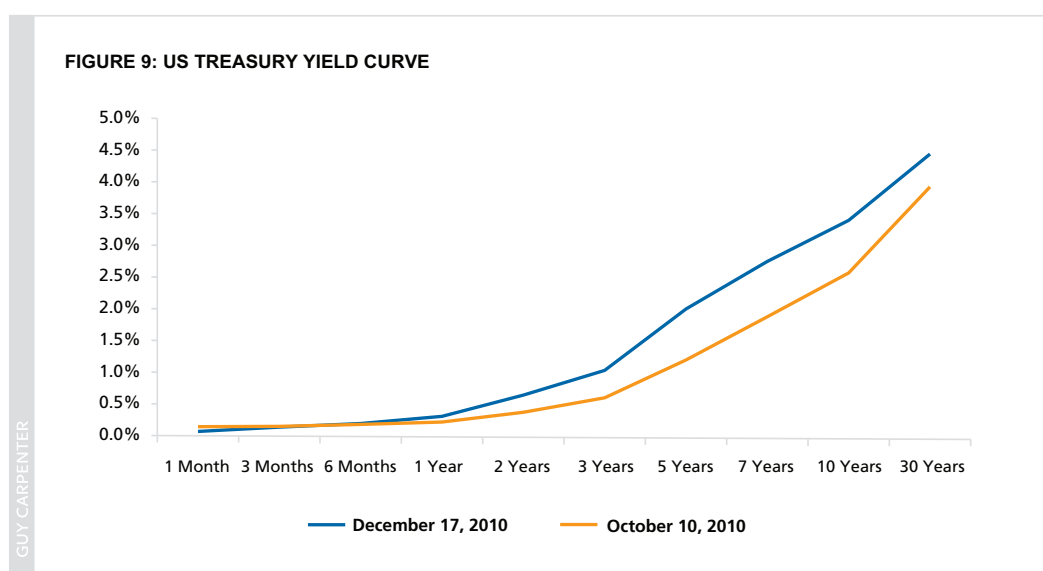
Source: Guy Carpenter, Bloomberg Data

Peripheral European sovereign securities are not the only potential cloud on the investment horizon. Besides the bonds of certain US municipalities, there is a risk that US Treasury securities themselves may come under more intense scrutiny by investors given the large US budget deficit and growing national debt. Figure 8 shows the exponential change in US government debt since the 1950s as well as the relatively moderate increase in GDP. The result is that the marginal increase in GDP per new dollar of US government debt is now only 17 cents in contrast to 70 cents in the early 1950s, begging the question: Is this risk-free return or return-free risk?



Source: Guy Carpenter, Ned Davis Research, The Blackstone Group

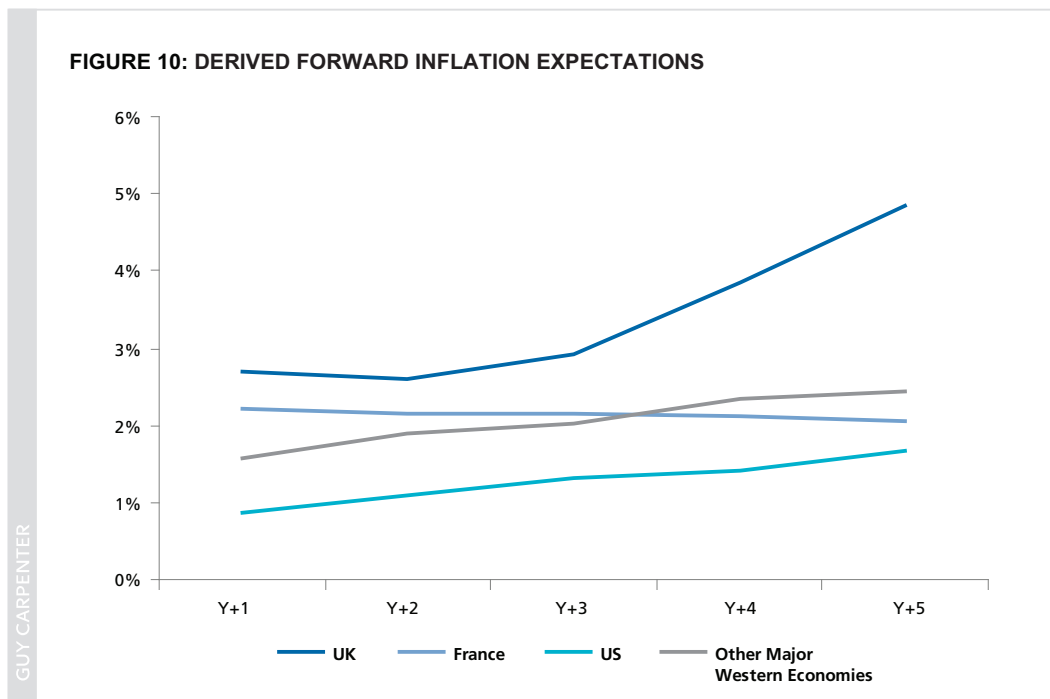
Since the US Federal Reserve undertook its most recent round of quantitative easing in the autumn of 2010, the US Treasury yield curve has shifted outward (Figure 9) implying investors are beginning to demand higher (although still historically low) returns even from the almighty greenback.



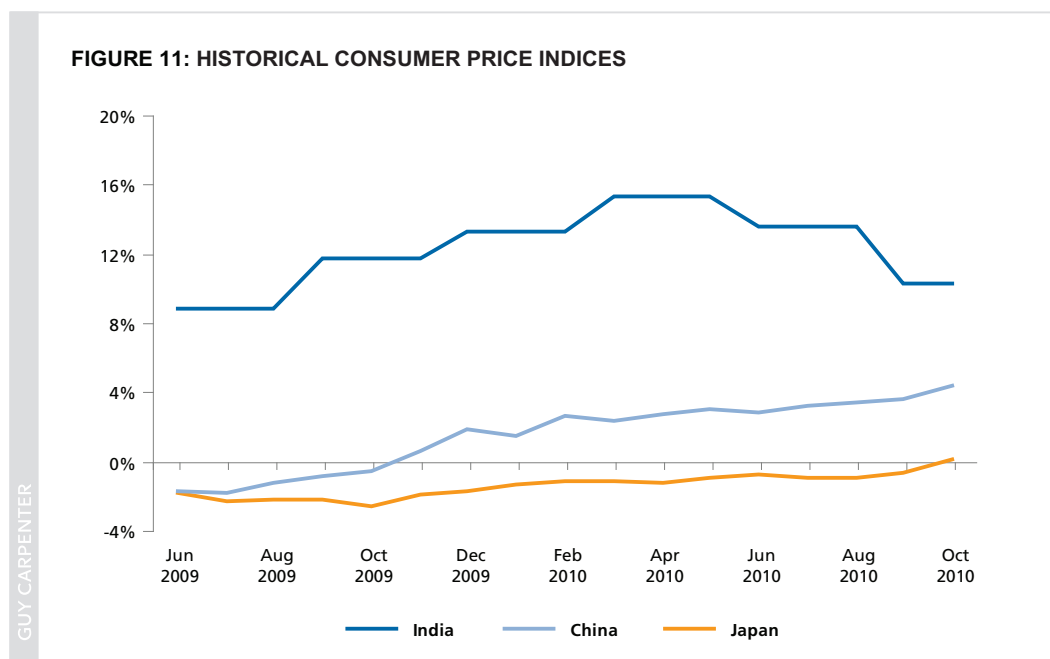
Source: Guy Carpenter, Bloomberg Data

The conclusion to draw both from the shift in the US Treasury yield curve and from the escalating levels of US debt is that even though investment yields are hovering at multi-decade lows, there is still almost certainly risk that is not reflected in those low yields.

Another contributor to the valuation trap is the creeping effect “cheap money” may have in heightening forward rates of inflation in certain key economies. Although Japan and most of the major Western economies have been in a disinflationary environment at least since the onset of the financial crisis, certain regions, such as the UK, India and China, have experienced or begun to experience above-trend rates of inflation. Figure 10 attempts to project rates of inflation for the UK, France, the US and other major Western economies using bond market pricing data. Here, nominal to inflation-linked break-even rates are used as the basis for deriving the forward rate of inflation. This analysis can only be undertaken for countries that offer multiple, liquid, short and medium-term inflation-linked sovereign securities. For China, India and Japan, where the range of available securities is less, Figure 11 shows the respective backward-looking consumer price indices.



Source: Guy Carpenter, Bloomberg Data



The takeaway is that buyers of sovereign inflation-linked securities expect the UK to experience higher rates of inflation than the other major Western economies. Furthermore, rates of inflation, as measured by national consumer price indices, are significantly elevated in places like India and China. Japan remains decidedly disinflationary. This is significant for carriers based in relatively disinflationary regions such as the US or Japan writing medium or long-tail business in relatively inflationary regions such as the UK, China or India. Premiums written today on longer tail lines must not only reflect future claims expectations, but must also allow for a range of inflation expectations depending on the region and line of business.

Potential Catalysts for a Cycle Turn

Given low valuations, low yields, macroeconomic instability, inflationary pressures and lower pricing, it is not unreasonable to argue that the current operating environment is among the most challenging in living memory. The question most frequently posed in the reinsurance sector currently is: What will it take to turn the market? Below we discuss several potential scenarios that could expedite the turn. However, it is most likely that a combination of events will ultimately create the inflection point from which the sector will again enter a hard market.

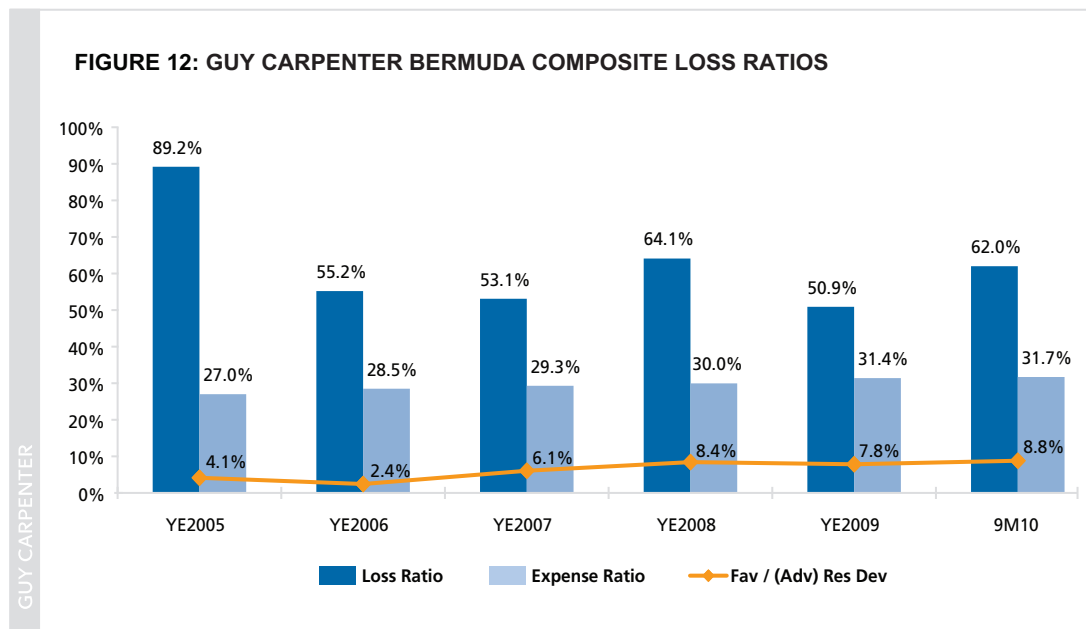
Critical-Mass Loss Event

As mentioned, a USD50 billion industry loss event would be enough to stem the decline of property catastrophe reinsurance rates even in the current, capital rich environment while at USD100 billion, Guy Carpenter believes “outlier” reinsurance entity failures could take place. A USD150 billion event would certainly create a sustained and long-term market turn.

Unexpected events could create even more powerful catalysts for a turn. For example, North Atlantic and Gulf of Mexico wind events have been modeled extensively since 2004 when hurricane frequency became a more prominent industry issue. A large hurricane on the southern coast of the US may therefore already be “priced in” to rates on line to some extent. But a large terror event or a nuclear accident may contain an element of “less-known unknowns,” which could constitute a stronger means for a reversal in pricing.

Sustainability of Reserve Releases

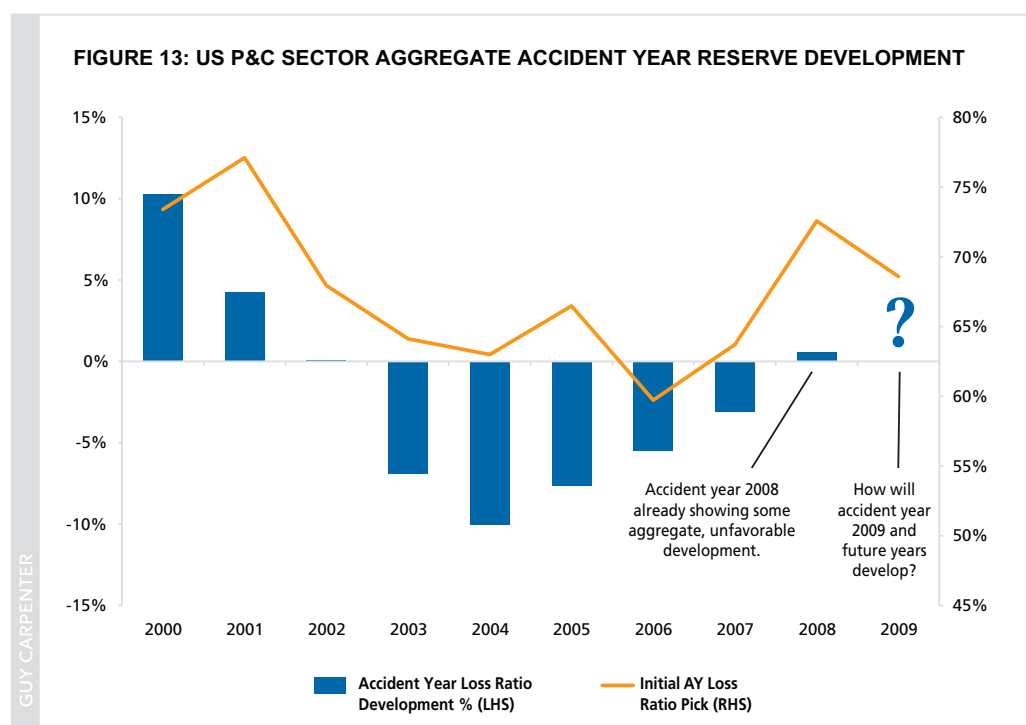
Historically, one of the “big cats” has been sector under-reserving, which served as the backdrop for the last hard market. Over the last four years, reserve releases have featured prominently in the reinsurance sector and have continued to do so up until the third quarter of 2010. Figure 12 shows the contribution to reserve releases on the Guy Carpenter Bermuda Reinsurance Composite combined ratios from 2005. It is notable that the benefit from reserve releases has ticked up in the first nine months of 2010 by one full percentage point, to 8.8 points on the loss ratio. This has occurred during a year when many projected reserve releases would diminish.



Source: Guy Carpenter & Company, LLC

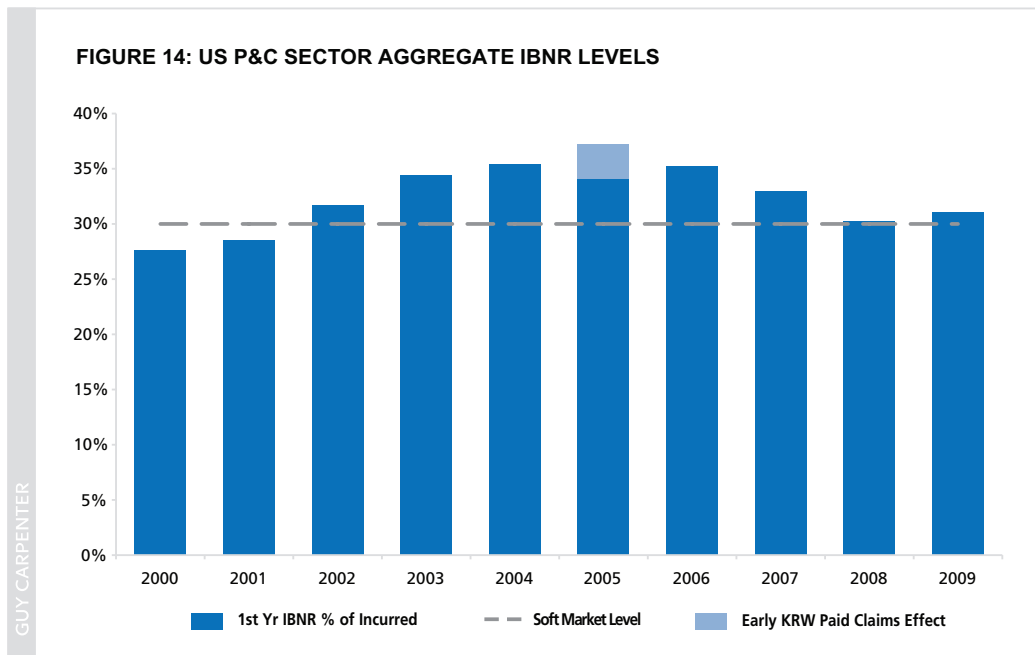
Accident year loss experience is, by contrast, beginning to show signs of lower reserve margins. Figure 13 shows US P&C industry reserve development by accident year since 2000. The reserving cycle is evident in the graph with adverse accident year loss development during the “soft market” years of 2000 and 2001 and favorable development between 2003 and 2007. The orange line in the graph shows the average initial loss ratio pick. The old reserving adage that “good years get better and bad years get worse” appears to be borne out here.

Although more recent accident years are less mature, it is interesting that the trend of favorable development seems to be diminishing rapidly, with unfavorable development already coming through for accident year 2008 (although this included significant adverse development on mortgage indemnity business). The broader question is, of course, when does the sum of development turn unfavorable?



Source: Guy Carpenter, Highline Data

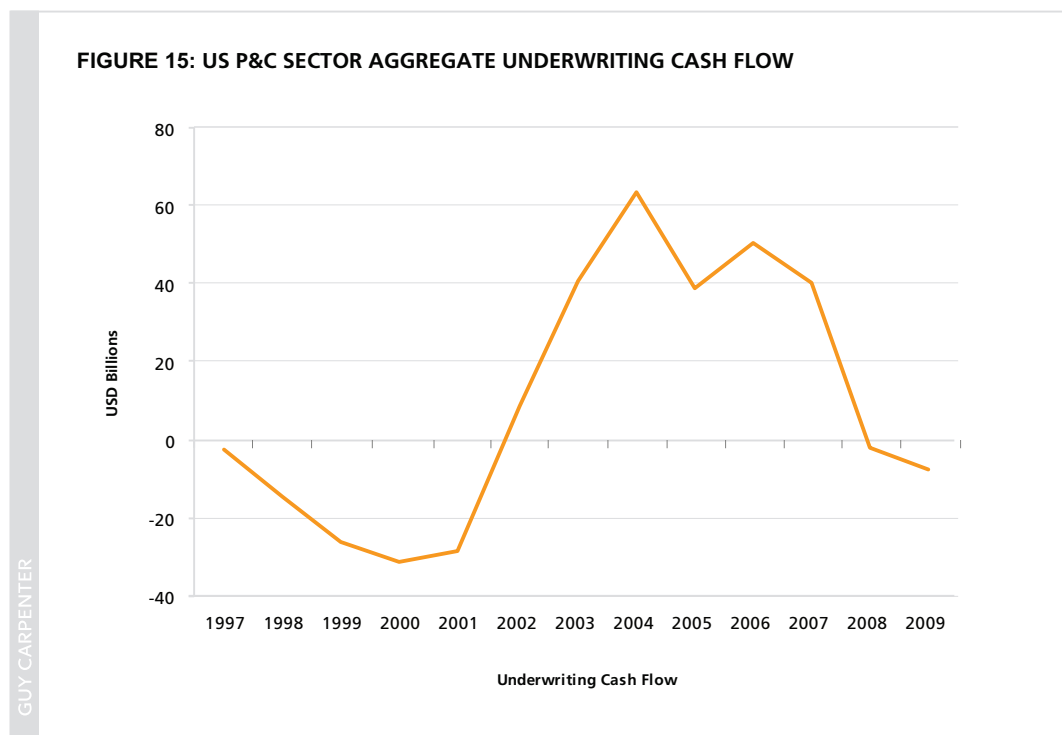
Another clue which could point to a shift in reserving trends may be evident in US P&C industry percentage of first year incurred but not reported (IBNR) figures, which, all else equal, is a measure of reserving conservatism. Here again, in Figure 14, a trend of potentially diminishing conservatism can be seen. It is significant that the industry is, in aggregate, back to levels of around 30 percent – levels previously seen in the last soft market.



Negative Underwriting Cash Flow

While reserving will almost certainly play a role either as a backdrop or as a catalyst in the next cycle turn, another less analyzed industry metric that tends to coincide with pricing cycles is industry underwriting cash flow. Here, too, the indicator is suggesting a change.

Underwriting cash flow measures the difference between checks being received by insurance companies and checks being written. Here, again, US P&C industry data are analyzed as they are most readily available. Figure 15 shows that negative underwriting cash flow is closely correlated with pricing cycles. Prior to last hard market, underwriting cash flow turned negative. It is significant that underwriting cash flow has turned at least marginally negative in 2008 and 2009.

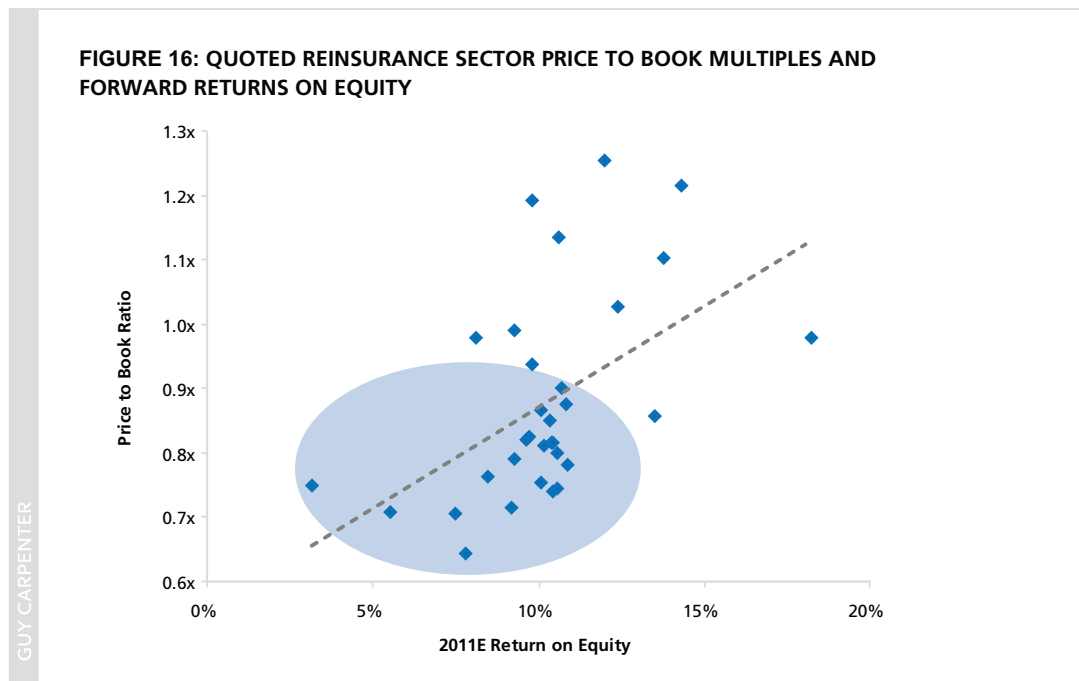


Source: Guy Carpenter, US Statutory Data

If all of the above trends were carried forward, they would eventually create enough pressure to moderate the current soft underwriting cycle. Stronger-than-expected GDP growth in coming years could accelerate this or even serve as a primary driver on its own.

Low Valuations

More immediately, however, the low valuations mentioned at the beginning of this section may themselves prove a catalyst for change by driving reinsurance sector consolidation. Figure 16 plots quoted reinsurance companies on price to book ratios and forward consensus returns on equity. The shaded area below 0.9x book value which now comprises the majority of the sector, is where mergers and acquisitions (M&A) have tended to take place in the recent past. Combined with significant share buybacks already taking place in the sector, additional M&A could slow the growth of dedicated reinsurance sector capital, thereby restricting the supply of reinsurance. This, in turn, could eventually drive rates higher.



Source: Guy Carpenter, Bloomberg Data

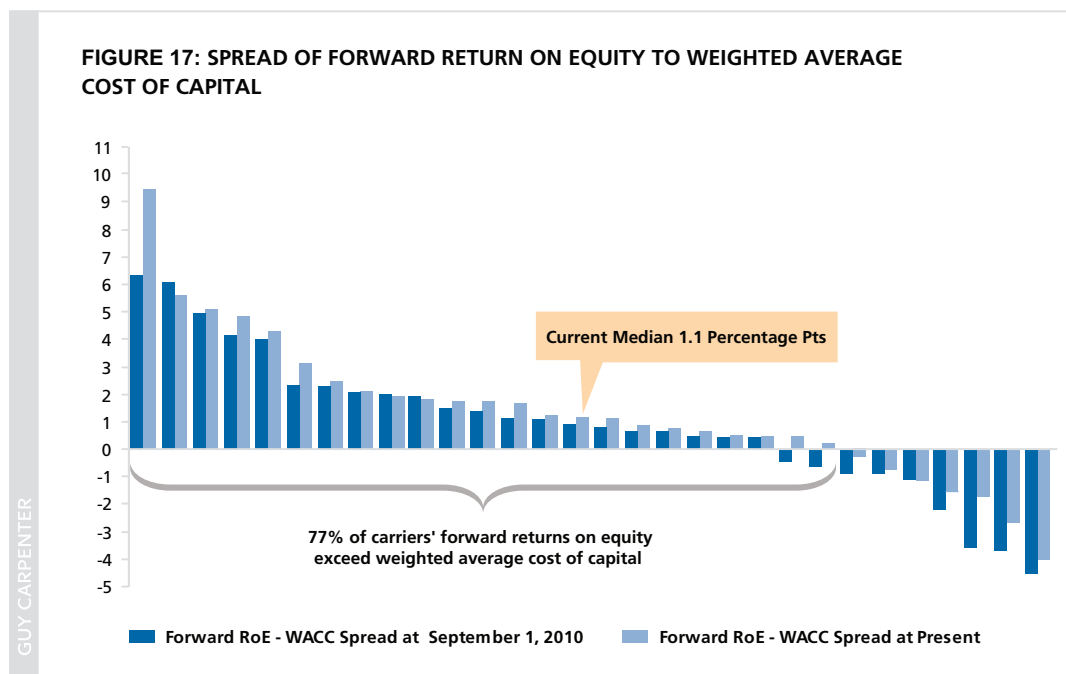
Conclusion: Awaiting a Catalyst

The market outlook presented in this section is a challenging one. As discussed, low yields, high levels of sector capital and lower rates on line are contributing to low valuations and forward earnings. In this environment, one of the questions that astute company managements should be asking is: “What happens if nothing happens?”

There is, at present, immense pressure on company managements to return capital to shareholders and to avoid “growing into a soft market”. Constituents of the Guy Carpenter Global Reinsurance Composite alone have returned nearly USD5 billion in capital to shareholders in the first nine months of 2010. Nevertheless, it has always been our opinion that with the right tools, the right strategy, and with the best access to reinsurance and retrocession capital, carriers can select risk strategically and navigate a softening market.

A recent study of forward returns on equity and costs of capital of selected Guy Carpenter clients seems to bear this out. Figure 17 shows percentage point spreads of one year forward consensus returns on equity over weighted average costs of capital (WACC) both at September 1, 2010 and at present. As is evident, the majority of constituents should retain capital and use it to navigate their way through the soft cycle, according to academic corporate finance theories at least. But there is a caveat: Only with the right tools, advice and access can the mistakes of the last soft cycle be avoided.

We are confident that those carriers that emerge with critical mass when the hard market eventually does come will be better for having managed risk and expertly navigated the current challenging environment, no matter how long it takes.



Source: Guy Carpenter, Bloomberg Data

3

Industry Issues and Trends

Regulatory Activity Remains a Central Focus

We enter 2011 with forces at work that are poised to reshape the global reinsurance industry. While the largest of them – Europe's Solvency II regulatory framework – will not become fully effective until 2013, preparations for its sweeping changes will be an important agenda item for many firms in the year ahead.

Solvency II: A Global Issue

We are closing in on the implementation of Solvency II in January 2013, and while there are still many issues that need to be resolved between now and then, its introduction will not be further delayed. While the January 2013 date appears very firm, the European Commission has agreed that a phased-in approach is required. Details on how this will work are not yet available.

The main purpose of Solvency II is to protect policyholders by ensuring capital adequacy. Most insurers will be required to hold more capital per unit of risk. This new regulatory framework will enact a fundamental change in the way European insurance underwriters quantify risk and undertake risk management practices, as it will force the convergence of all aspects of risk quantification with those of business decision making. This may be an opportunity for insurers to improve their operating models while possibly developing competitive advantages in very challenging economic and overall market conditions.

The main difficulties in implementing such a regime within any organization are driven mostly by the shortage of resources available to measure risks and manage regulatory measures. Solvency II is not only a change in risk management practices but also in management information systems – with a substantial burden resulting from documentation, transparency and disclosure requirements.

The resource costs associated with Solvency II's implementation are putting significant pressure on companies at a time when market conditions and underwriting results are less than optimal. As a result, smaller companies and niche players will be most at risk, which could potentially lead to significant consolidation in the insurance industry.

The latest Quantitative Impact Study (QIS5) on Solvency II's potential industry effects was completed in November 2010, with its results expected to be published in April 2011. A significant increase in participation is expected to be seen in the report, with approximately 2,500 companies taking part in QIS5 compared to some 1,400 under QIS4. The outcome of QIS5 is likely to be the last opportunity for insurance companies to influence the makeup and final calibration of the new regulatory framework. Given that each comprehensive study takes between 18 and 24 months to complete, there is unlikely to be another QIS before the implementation of the new regime.

Solvency II has been developed in the EU for EU insurers, but the regulatory impact will affect our industry on a worldwide basis. This has been addressed by the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) in its final advice on the topic of equivalence, which was issued in August 2010. In October 2010, the European Commission accepted CEIOPS's recommendation to include Bermuda and Switzerland in its first wave of assessments for all three levels of equivalence. These levels can be summarized as:

1. Reinsurance considerations
2. Group solvency calculations
3. Group supervision

It was also agreed that Japan would be considered for inclusion, but only for reinsurance considerations.

The United States, given the size of its reinsurance market, is a prime candidate for consideration, but its state-based regulatory environment poses significant hurdles. Under non-equivalence, the European supervisors would have the power to require that US companies would have to pledge collateral in support of any reinsurance transaction – whether internal or external – of an EU entity.

The topic of equivalence could create a significant disadvantage for insurance groups with meaningful subsidiaries domiciled outside of the EU and has caused several entities to review the potential implications of their current corporate structure.

Solvency II will continue to make headlines for the next 24 months as insurance entities get ready for its implementation and, in particular, continue to develop their model documentation (which is not insignificant and includes risk management processes and use tests, Own Risk and Solvency Assessments (ORSA), procedures for transparency and disclosure and catastrophe model vendor documentation).

US: The Legacy of the Financial Crisis

While Solvency II remains very much on the radar of US insurance and reinsurance companies, another important regulatory initiative – the Neal Bill – may encounter hurdles following the recent political shifts in Washington. This legislation seeks to discourage companies from ceding 'excessive' portions of their US premiums to offshore affiliates to lower their tax burden. A revised version of the bill was also incorporated into the Obama Administration's 2010 budget plan. However, prospects for the full bill's passage diminished in the 2010 US midterm elections, when the Republican Party took control of the House of Representatives and eroded the Democratic majority in the Senate. As demonstrated by the recent extension of the Bush tax cuts, the Obama Administration has been compelled to compromise on its legislative agenda, and the shift in power could prevent the Neal Bill from passing into law.

This would mark a change in the prevailing regulatory climate in 2010, when the legacy of the recent financial crisis continued to dominate the agenda. The Dodd-Frank Wall Street Reform and Consumer Protection Act became law in July, bringing sweeping changes to financial regulation with the aim of restoring public confidence in the financial system, preventing further crises and detecting future asset bubbles.

Much of the Act's 2,300 pages focused on the banking industry but there were some significant changes for the US insurance industry as well. The Act established the Federal Insurance Office (FIO), a body that will monitor the insurance industry and identify issues or gaps in insurance regulation. Although the FIO does not have supervisory or regulatory powers, and the industry will continue to be regulated at the state level, it does have the authority to work globally with other countries and pre-empt certain state regulations in specific international insurance matters.

In addition to the FIO, the Dodd-Frank Act enhanced regulation and transparency for credit rating agencies. One key change redefined rating agencies as "experts", meaning their future assessments are to be treated as such. By repealing Rule 436(g) under the Securities Act of 1933, the Dodd-Frank Act exposes credit rating agencies to "expert" liability if they agree to be named in registration statements and any related prospectuses. This would allow investors to bring private rights of action against the agencies if their ratings are found to be inadequate. However, all the major credit rating agencies have indicated they will not consent to their ratings being used in registration statements and prospectuses, and it remains unclear whether the dispute will affect rating agencies' assessments of insurers and reinsurers in the future.

In a separate development, state insurance regulators from the National Association of Insurance Commissioners (NAIC) continued to work on the Own Risk and Solvency Assessment (ORSA) for US insurers. The ORSA is a concept borrowed from the Solvency II regime, consisting of internal modeling and stress testing to assess capital adequacy in light of a group's particular business mix and strategy.

Europe: Regulators Respond to Critics

Regulators in Europe attempted to react to criticisms outlined in the de Larosi re Report that was released in early 2009 and reviewed financial supervision and stability in the EU. The report specifically criticized the lack of co-operation among supervisors, inconsistent supervisory powers across EU states, an inadequate macro-prudential supervision framework and ineffective early warnings, prompting the EU to publish draft legislative proposals in September 2009.

These proposals were recently approved by the European Parliament, formally setting up the European Systemic Risk Board, an EU body responsible for the macro-prudential oversight of the financial system within the Union. For micro-prudential supervision, three new European Supervisory Authorities (ESAs) for the banking, securities, insurance and pension sectors are to

replace the three existing regulatory bodies; a new European Insurance and Occupational Pensions Authority is to replace CEIOPS. The ESAs will primarily be charged with considering EU interests and ensuring harmonized rules and coordinated responses, being accountable to both the European Council (representing member states) and the European Parliament (representing the general community).

Domiciles: Reinsurers Look to Europe

Since 2005, a notable shift in reinsurers' domiciles has taken place. Europe's transition towards risk-based capital requirements has prompted global regulators to call for some level of equivalence in key markets. This has, in turn, prompted carriers to reassess corporate structures, with a particular eye to the location of group balance sheets.

Bermuda was long the preferred location for fresh capital entering the reinsurance industry after market-changing losses that included Hurricane Andrew in 1992, the terrorist attacks of September 11, 2001 and Hurricane Katrina in 2005. The island's attraction was owed to its speedy regulatory approval process combined with its favorable tax system and geographical proximity to the United States. But the industry has seen an increasing number of insurers and reinsurers moving back to Europe. The Republic of Ireland and Switzerland have been particularly successful in attracting new arrivals of late (see Table 2).

TABLE 2: COMPANIES THAT REDOMICILED IN 2010

Company	Redomiciled To	Redomiciled From	Date Announced
Flagstone Re	Luxembourg	Bermuda	March 22
XL Group	Ireland	Cayman Islands	July 1
Allied World	Switzerland	Bermuda	October 1
Amlin	Switzerland	Bermuda	October 8
Catlin Re	Switzerland	-	December 8

Source: Guy Carpenter & Company, LLC

Several factors are driving this trend. European domiciles have become more attractive due to the relative ease of obtaining work permits, accommodation and education in the region. Ireland is especially attractive because of its low corporate tax rate (of 12.5 percent) combined with EU membership, which provides cheaper access to all EU countries under the EU reinsurance directive. Switzerland is also in close proximity to the EU and has been confirmed by CEIOPS as a candidate for first-wave assessment to obtain Solvency II equivalence approval.

However, this migration certainly does not herald the demise of Bermuda. It too has been authorized to undergo Solvency II equivalency assessments, and the island remains a well-regulated (re)insurance domicile. Bermuda also continues to offer one of the most competitive tax systems in the world, with no levy on profits, income, dividends or capital gains. Although such low-tax domiciles have been threatened with new tax measures by governments burdened with large fiscal deficits following the financial crisis, it remains to be seen whether any legislation will be passed.

Terrorism Insurance: Costs Decrease as Insurance Increases

The perception of an elevated potential for terror attacks remains high. Meanwhile security breaches via WikiLeaks are providing a roadmap to crucial sites exposed to terrorism. The risk of terrorism remains a critical challenge for companies and for the broader population. The attempted attacks on Times Square in New York in May 2010 and the Detroit-bound flight on Christmas 2009 are reminders of the ongoing risk.

In Marsh's annual report on terrorism, "The Marsh Report: Terrorism Risk Insurance 2010," data was analyzed from 1,382 clients that purchased terrorism insurance in 2009. The survey found a take-up rate – the percentage of companies buying property terrorism insurance – of 61 percent for property terrorism insurance. An estimated 50 percent of general liability (GL) clients also purchase coverage against the peril of terrorism. To compare, only 27 percent of US companies surveyed purchased property terrorism insurance in 2003, when the Terrorism Risk Insurance Act (TRIA) was in its infancy and the market was still unstable in the wake of the attacks on September 11, 2001.

Marsh's report looked at the data by industry segments (as defined by Marsh); the following five had the highest take-up rates:

- Utilities (80 percent)
- Real Estate (76 percent)
- Health Care (76 percent)
- Transportation (75 percent)
- Financial Institutions (74 percent)

In addition to the above sectors, more than half of all companies in the following industries purchased terrorism insurance in 2009: media, hospitality, education, technology/telecommunications, public entity, retail and construction.

Although the purchasing of terrorism coverage is highest in the Northeast (73 percent), companies in all regions of the United States continue to purchase terrorism insurance in significant numbers: Midwest (60 percent), South (58 percent) and West (47 percent).

The cost of property terrorism insurance has fallen gradually over the years, with a more significant drop in 2009. The median premium rate for terrorism insurance was down from USD37 per million (0.0037 percent) in 2008 to USD25 per million (0.0025 percent) in 2009.

Terror Reinsurance Market Dynamic

At the January 1, 2011 renewal, loss-free terror reinsurance programs sustained rate decreases of 4 to 5 percent. This modest price softening is a continuation of the longer trend whereby the US stand-alone terror reinsurance market has generally drifted downward in activity and overall pricing since peaking during post- September 11, 2001 market conditions between 2002 and 2004. The downward trend has continued yearly at roughly the same pace, with a very minor blip in exploratory interest when the Obama Administration first mentioned its plan to consider decreasing TRIA as part of the 2010 budget proposal.

Terror reinsurance pricing methodologies remain comparatively less technical than methodologies used for pricing treaties exposed to natural perils only, partly because models are relied upon less with respect to terror exposures than with natural peril exposures. That said, reinsurers are using models to price terror more frequently than ever before as they find their own comfort level with balancing technical and non-technical price drivers.

A stabilizing factor for demand, and in turn for pricing, is the more formal, consistent attention being given by rating agencies to the impact that terrorism risk has on the financial strength of insurance carriers. This should continue to drive the evolution of technical underwriting for terrorism risk and better alignment between risk and rate.

In terms of capacity, in the current US marketplace, up to USD700 million of per-program coverage is estimated to be available, although that figure may vary based on the location and severity of the original insured risk. In the global terrorism market, certain regionalized governmental facilities secure reinsurance coverage of more than USD2 billion of capacity from the reinsurance market. For certain other US programs, notably workers' compensation programs where the terrorism exposure is limited to a single state, it is feasible to secure more than USD1 billion of capacity. Such capacity may expand or contract based on price, type of risk and overall reinsurance market conditions. With reinsurer capital levels at historically high levels, the marketplace is approaching the peak of hypothetical capacity, although we have yet to see demand to test that availability.

Catastrophe Update

The reinsurance industry enters 2011 with its highest prior-year catastrophe bill in two years and forecasts of another season of above-average hurricane activity. Despite the lack of big US losses in what was one of the most active Atlantic hurricane seasons on record, insured losses from other global catastrophes reached USD36 billion in 2010, up from USD27 billion in 2009². Natural hazards continued to be the largest source of losses in 2010 at USD31 billion, while man-made disasters cost reinsurers USD5 billion.

Global Losses in 2010

As shown in Table 3 on the following page, several catastrophes had a significant impact on the industry in 2010, including eight events that incurred insured losses of more than USD1 billion. Five were related to severe weather and storms in the United States, Australia and Europe, while powerful earthquakes in Chile and New Zealand also caused heavy losses. The Deepwater Horizon oil rig explosion was the only man-made event to cause a loss in excess of USD1 billion after it exploded in the Gulf of Mexico.

TABLE 3: SIGNIFICANT CATASTROPHIC EVENTS OF 2010

Date	Event	Region/Country	Insured Loss (USD Million)
January 12	Earthquake	Haiti	200
February 26-28	Windstorm Xynthia	Europe	2,900
January 27	Earthquake	Chile	8,000
March 1-3	Hailstorms	Melbourne, Australia	1,040
March 13-15	Severe Weather	United States	1,045
March 22	Hailstorms	Perth, Australia	1,050
April 20	Oil Rig Explosion	Gulf of Mexico	Up to 3,500
May 12-16	Severe Weather	United States	2,000
May	Riots	Bangkok, Thailand	500
May/June	Floods	Central & Eastern Europe	280
June 15-16	Floods	France	675
June/August	Floods	China	500
September 3	Earthquake	New Zealand	4,500

Source: Guy Carpenter, Swiss Re, Munich Re, PCS ISO, Insurance Council of Australia, French Federation of Insurance Companies

For the second year running, no significant insured loss arose from global tropical cyclones. The 2010 hurricane season in the Atlantic was notable for its above-average activity and negligible impact on reinsurers' bottom lines, while typhoon development in the West Pacific was the lowest on record. These trends were driven by the development of a moderate La Niña event and very warm tropical Atlantic sea surface temperatures.

The 2010 Atlantic hurricane season produced a total of 19 named storms, the highest number since 2005 and the joint-third highest since records began in 1851. Twelve storms became hurricanes (the joint-second highest number on record), five of which reached major hurricane status of Category 3 strength or higher.

Despite such high activity, the 2010 season was unique in that no hurricane made US landfall; several were steered away from the US coastline by prevailing meteorological conditions³. Only two previous seasons (1969 and 2005) have seen 12 or more hurricanes, and there were major US landfalling hurricanes in both these years (Hurricane Camille in 1969 and numerous storms – including Katrina – in 2005). Indeed, the 2010 season was unprecedented in generating more than 10 hurricanes but with none making US landfall. Eighteen hurricanes have now developed in the Atlantic since Hurricane Ike hit Texas in 2008. None of these went on to hit the United States; the historical average of Atlantic hurricanes striking the US coastline is one in four.

³ The Azores/Bermuda high was located further east than normal, steering storms away from the US East Coast. In addition, a high pressure over the US Gulf Coast deflected storms away from the region and into Central America.

2011 Outlook

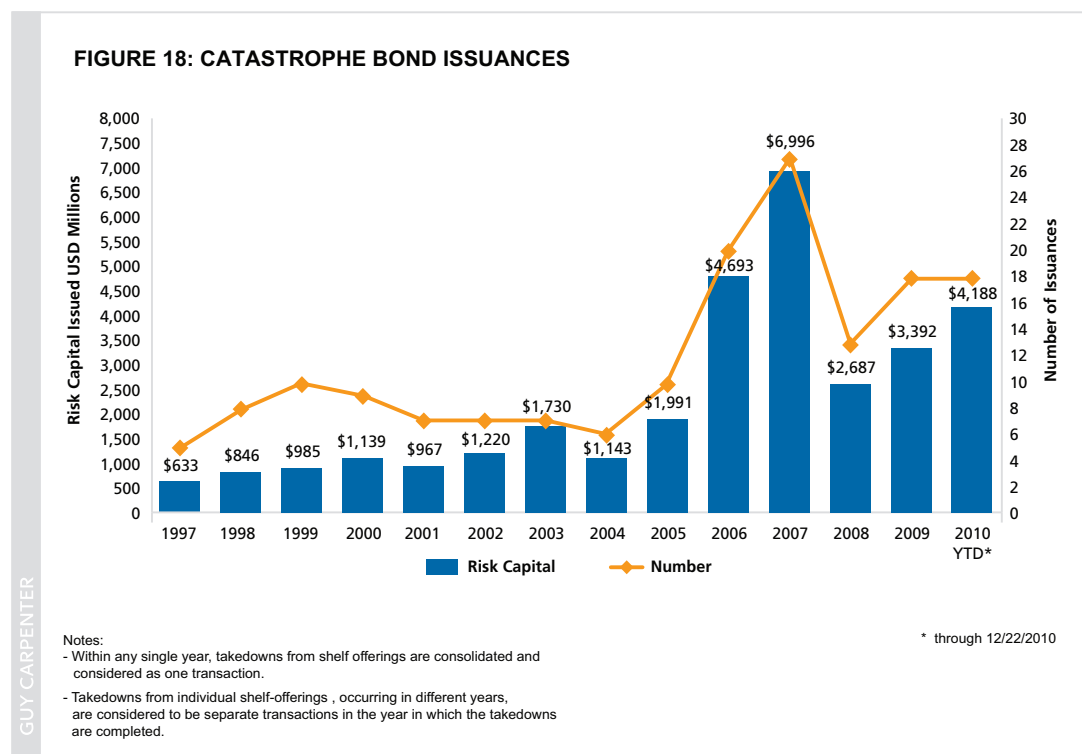
If predictions that La Niña will persist into 2011 bear out, this will have an impact on natural hazards worldwide. La Niña events have historically caused abnormally heavy monsoons in Southeast Asia and fueled tropical cyclone development during the Australia cyclone season. Heavy rainfall and flooding have also hit Southern Africa, Central America and Eastern Australia during previous La Niña events, while prolonged dry periods have occurred in Central Africa and Northern Mexico. In the United States, La Niña's potential impact includes above-average precipitation in the Pacific Northwest, Northern Rockies and Ohio Valley and below-average precipitation in the south-central and southeastern states.

Meanwhile, the first Atlantic hurricane forecast for 2011 has just been released by the Colorado State University (CSU) and it again suggests above average hurricane activity. Forecasters have estimated that there is a 25 percent chance of La Niña lingering through the year and a 50 percent chance of El Niño-Southern Oscillation (ENSO) being neutral, both of which can mean a more active hurricane season in the Atlantic. Consequently, CSU predicts 17 named tropical storms, nine hurricanes and five major hurricanes.

As demonstrated by events in 2010, such heightened activity does not necessarily guarantee landfalling hurricanes, but the forecast reinforces the uncertainty associated with catastrophes.

Catastrophe Bonds*

The Insurance-Linked Security (ILS) or catastrophe bond market has roared back. New issuance for the year was over USD4 billion, an increase of about 25 percent from 2009, and investors' appetite unfulfilled.



Source: Guy Carpenter & Company, LLC

The overall trends for 2010 were tightening bond spreads resulting in lower costs for the sponsor and, therefore, increased issuance. Sponsors continue to integrate accessing cat bond capacity into their main reinsurance purchase programs. This trend is supported by the continuing inclination on the part of sponsors to include broker-dealer affiliates of reinsurance brokers as deal managers for their cat bonds.

Mid-year 2010 saw significant US hurricane ILS issuance, with USD1.55 billion of cat bonds being issued with US hurricane exposure in May. While this surge in issuance caused some investors to run up against US hurricane exposure limitations, as evidenced by widened clearing spreads and less upsizing of deals there was still sufficient capacity provided by the ILS market to provide the needed protection in time for the US hurricane season. In this rush of demand, we also saw strong support for two first time issuers, including a single state wind pool that found diversifying new capacity from the capital markets for its indemnity bond.

After the usual third quarter lull in activity during the US hurricane season, the market picked up the pace in the fourth quarter, starting with several Europe windstorm issues and then a rush of US peak and multi-peril issuances. The Europe windstorm deals received widespread market support in part due to their diversifying benefits for investors' portfolios, and in some instances we saw clearing rates that were comparable to traditional reinsurance pricing.

Having increased exposure to US hurricane risk in May, the second half proved a fertile environment for new diversifying perils, including new perils such as thunderstorm/hail and medical expenses. However, particularly during December, broad based demand across all perils was evident as US peak peril transactions Lodestone Re Ltd. and Montana Re Ltd. were both dramatically upsized relative to stated initial issuance targets. Montana Re Ltd., which included a tranche paying an annual spread of 16.4 percent, also demonstrated significant market appetite for higher-yield (and riskier) transactions.

On average, overall pricing levels for the second half of 2010 were down approximately 20 percent from the second half of 2009.

Structures continue to evolve, particularly with respect to the collateral aspects of the bond. The focus continues to be on increased transparency and valuation metrics that are significantly improved from pre-financial market distress approaches. The market consensus is to preserve the ability to employ diverse approaches rather than focus on any single approach of utilizing treasuries, tri-party repos or total return swaps.

On the maturity front, property cat bonds are still in the three to five year range, just enough to offer sponsors some diversification in their predominantly one-year reinsurance programs. This remains an interesting opportunity to lock in the current market rates on a multi-year basis.

Investor development efforts have been significant in 2010, focusing on global institutional investors' interest for substantially uncorrelated investments. New interest from institutions in Asia (predominantly Japan) and Australia/New Zealand helped grow assets under management in the space. While a small number of institutional investors continue to participate selectively on deals, we expect the bulk of new cash inflows to be allocated to the dedicated ILS fund managers.

Prospects for 2011 look good as the pipeline discussions are increasing and point to an active year for cat bond issuance. The diversification theme will likely continue and gather momentum, and investor interest continues to provide support for non-US/Euro property risk.

We may begin to see a bifurcation of risks and structures between the more remote/tail risk deals as compared to the riskier or more esoteric structures. This may result in a broadening of deal forms beyond the 144a private placement convention and expand to 4(2) private placements or other cash or derivative forms. We see this as a function of the broadening scope of investor preferences that are driving this market.

Lloyd's Market: New Year, New Strategy

The new year follows a challenging renewal season for the bellwether Lloyd's Market, which, despite losses incurred during 2010, showed that rates continued to soften. Lloyd's enters 2011 focused on its new market-level strategy plans and preparation for Solvency II, now less than two years away from implementation.

2010 in Review

The Lloyd's Market started 2010 with record high capacity, driven partly by new entrants and by the impact of foreign exchange, principally between the US dollar and the British pound. With capacity at over GBP23 billion and the market gradually softening, the challenge was to maintain underwriting discipline and focus on risk management.

The first major loss of the year occurred on February 27, when an 8.8Mw earthquake struck off the coast of Chile, with an estimated cost to the Market of USD1.4 billion. Further large losses were incurred during the year, notably the April Deepwater Horizon oil rig explosion and subsequent associated losses (forecast to cost up to USD600 million) and the 7.0Mw earthquake in New Zealand.

Throughout 2010, the Market has also endured depressed investment returns, and despite the loss activity, softening primary and reinsurance pricing across the majority of business lines, a situation which continues into 2011.

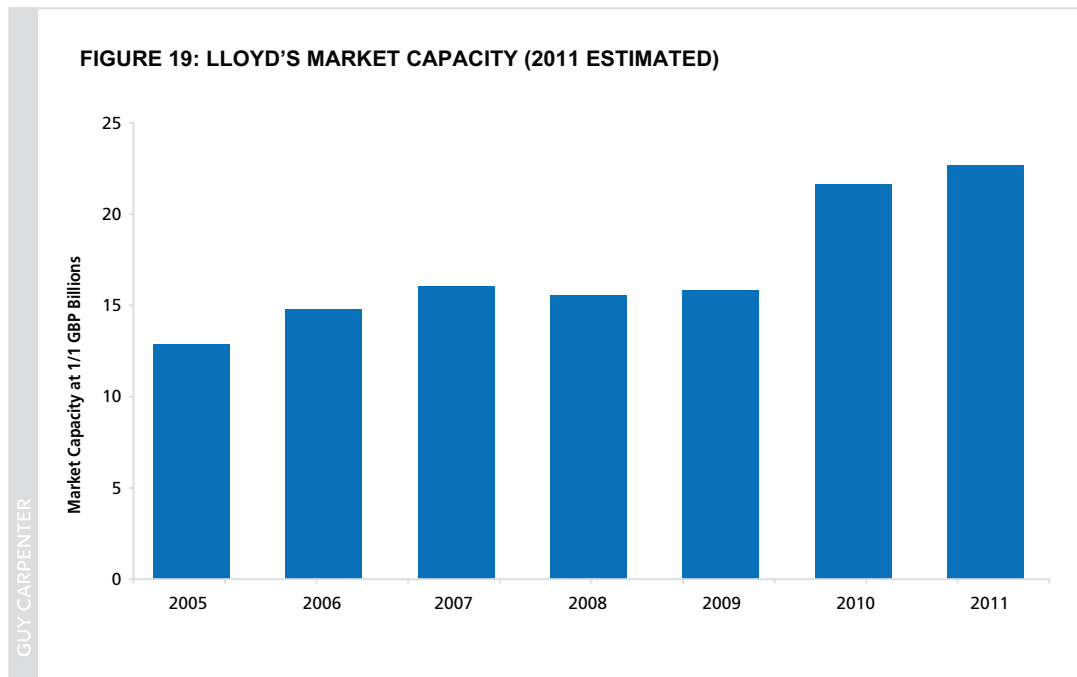
Nevertheless, Guy Carpenter expects that the full year 2010 results for the Lloyd's Market will remain positive, with a combined ratio of 95 percent or better.

A Fresh Approach in 2011

Toward the end of 2010, Lloyd's announced a new one-year and three-year strategy centered around the need for continued underwriting discipline while maintaining the flexibility for growth through expansion in profitable lines of business and new entrants to the market.

The strategy also includes a particular focus on determining the impact of and preparing for the upcoming Solvency II regulatory changes. This adds an element of uncertainty to the future prospects for Lloyd's, although the current security offered by the Market places it in a strong position to weather any adverse impact to capital requirements.

Capacity for 2011 is expected to be broadly flat compared to 2010, as some syndicates lower capacity and others increase or enter the Market. Operating margins will be squeezed in 2011, although the overall Market profitability will remain driven by the catastrophe losses which may or may not be incurred.



Source: Guy Carpenter, Moody's

Solvency II – Opportunity and Threat

Lloyd's considers the successful implementation of Solvency II (in particular, the approval of the Lloyd's internal model) to be its biggest challenge – and, indeed, opportunity – over the coming years. The Market must obtain FSA approval for its model and demonstrate that all managing agents meet the required standards.

The potential impact of failing to obtain approval is considered severe, as the alternative – the Solvency II standard model – would be penal to Lloyd's capital requirements, with an average capital raise forecast to be over double the current Individual Capital Assessment (ICA) requirements for each syndicate.

Lloyd's has been monitoring the readiness of the Market, and Guy Carpenter believes that the majority of it is regarded as 'On Track' or better. Concerns do exist over a minority of syndicates that need to make significant progress, despite all market participants now being fully engaged in the progress.

Rating Agency View

Lloyd's enjoys favorable ratings and published opinions from both Standard & Poor's (A+/Stable "Strong") and A.M. Best (A/Stable "Excellent"). Notably, both these ratings are at the same level as prior to the terrorist attacks of September 11, 2001, a significant difference with respect to all major peers that have failed to restore their ratings to those historic levels.

TABLE 4: COMPARISON OF STANDARD & POOR'S FINANCIAL STRENGTH RATINGS 2001 VS 2010

Group	2001 GLOBAL REINSURANCE HIGHLIGHTS			2010 GLOBAL REINSURANCE HIGHLIGHTS		
	Ranking	Rating	NPW	Ranking	Rating	NPW
Munich Reinsurance Group	1	AAA	13,566.10	1	AA-	33,704.60
Swiss Reinsurance Group	2	AAA	12,838.80	2	A+	22,896.70
Berkshire Hathaway Reinsurance Group	3	AAA	9,452.50	4	AA+	12,362.00
Employers Reinsurance Group	4	AAA	6,921.10	na	na	na
Gerling Global Reinsurance Group	5	AA-	3,937.90	na	na	na
Lloyd's	6	A+	3,799.20	5	A+	9,733.50
Assicurazioni Generali Group	7	AA	3,533.40	na	na	na
Allianz Reinsurance Group AG	8	AAA	3,299.00	na	na	na
SCOR Reinsurance Group	9	AA-	2,720.60	6	A	8,314.70
Hannover Rückversicherung Group	10	AA+	2,564.40	3	AA-	13,639.00

Source: Standard & Poor's Global Reinsurance Highlights (NPW in USDmn and relates to reinsurance business only)

Both rating agencies highlight similar strengths and weaknesses for Lloyd's, notably strong capitalization, operating performance and competitive advantages offset by potential volatility in results (principally related to catastrophe losses) and the challenges of the current soft market.

Overall Outlook is Positive

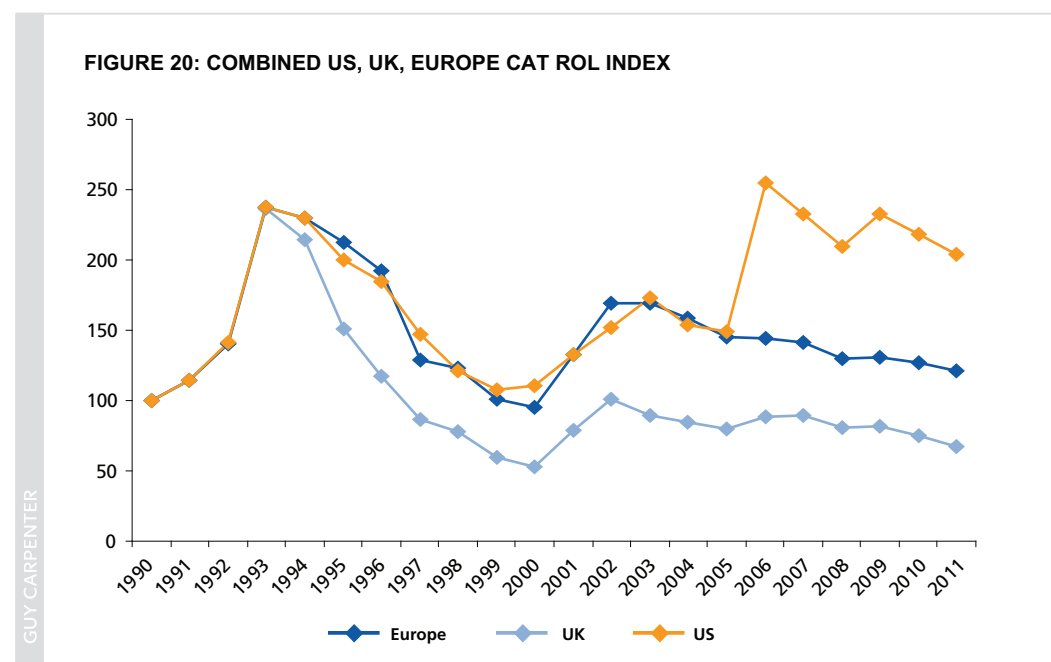
While challenges exist, the overall strength and competitive position of Lloyd's remains supportive to the global reinsurance industry, particularly brokered risks. Lloyd's strategic plans establish a framework for ensuring underwriting discipline and clear targets for maintaining the competitive advantages of Lloyd's in the post-Solvency II environment. While rating agency upgrades are not expected, the potential weaknesses of Lloyd's have been addressed, and the propensity for downgrades appears lower than during previous soft cycles.

4

2011 Reinsurance Renewal Rates

An overview of reinsurance rates reveals a picture of a generally softening market on an overall basis, with ample reinsurer capacity available for most lines. But beneath this generality lies a range of experiences for individual reinsurance buyers, according to the class of business, their own loss record and the territorial scope. In many cases, reinsurance purchasing strategies in a softening market were one of the few places buyers could turn to mitigate the effect of soft conditions in original markets.

As is evident in the regional breakout below, the United Kingdom, Europe and the United States all experienced decreases in risk-adjusted rate on line.



Source: Guy Carpenter & Company, LLC

Property Lines

Property Cat rates were reduced in most territories, with exceptions only for those buyers affected by loss in 2010. The amount of reduction available for large programs in the major markets was generally limited to the single digit percentage range though, as in past soft market renewals, buyers with smaller capacity requirements, excellent records, or outside of key zones were able to achieve greater reductions. Losses from earthquakes in New Zealand, Chile, Australia, and those resulting from Xynthia in Europe, floods in Central Europe, winter freezes in Scandinavia and others, caused price increase in some cases, but often only on those layers affected. There was not any broad regional hardening as the result of any loss activity; so buyers in countries neighboring those affected by loss were not themselves affected. In the US, there was little restructuring activity, but in international markets, buyers were willing to turn to restructure or re-layer in order to help them achieve their price goals. At the

quoting stage there appeared to be a resignation amongst reinsurers to the fact that ultimate firm order pricing would be down, and this was reflected in the fact that the average 2011 quote was relatively lower than in 2010.

The perception of a soft market is often the catalyst for buyers and their brokers to consider the chance to fix price and capacity for more than the standard annual period, and in response there was increased interest in multi year arrangements. This interest was well publicized in the trade press in the period leading up to renewal. Reinsurer response to multi-year offerings is very diverse, but certain markets have an appetite for such deals, and there was growth in the amount placed on a multi-year basis.

Property per risk excess of loss and pro rata renewals generally saw declining rates, moderated by individual results. Capacity was sufficient.

The property retro market is not such an important driver of the reinsurance market as it was in former years. In a late renewal typical of this market, rates were flat to down for loss-free accounts. Increases in some 2010 losses, especially the New Zealand earthquake, happened very late in the season and generated further uncertainty into end of season price negotiations.

Casualty Lines

It is hard to generalize about as wide ranging a sector of the market as casualty lines, but as in property there was a generally softening trend in loss free lines. But unlike property there were more individual lines where poor results have resulted in flat or even upward pressure in the rating environment. Examples of classes with increasing rates were motor and general third-party liability (GTPL) in certain European territories and working level covers for US workers compensation accident (WCA). Conditions in original markets are also mixed, and cedents had to use a variety of strategies, including retention and co-participation management as well as reinsurance price reduction, to protect their own margins.

Accident and Health

Personal accident rates were down and capacity was sufficient on most renewals. There was evidence that cedents looked to enhance coverage terms to drive value if significant rate reductions were proving hard to achieve. Nuclear, biological and chemical (NBC) only top layers were used as a technique to reduce pricing in some cases. Medical expenses rates were increased, but cedents had to deal with larger increases on reinsurance treaties than it was possible for them to achieve in the primary market. The accident and health sector remains of interest to capital markets and there was further activity in this area during 2010.

Specialty Lines

The marine market saw a range of rate experiences: international hull, war and liability rates were flat, and cargo was down. The effect of the Deepwater Horizon loss was to drive prices for energy business significantly, up 15 percent to 35 percent, though these increases were not as great as had been predicted by many commentators prior to the renewal season.

The aviation market endured another year of indifferent results, with several significant losses leading to poor results for insurers. Nevertheless capacity remains ample, and rate reductions were still available for many buyers, dependent on individual results.

The Surety, Credit and Bond markets saw a generally softening trend, with individual experience the guide to renewal pricing.

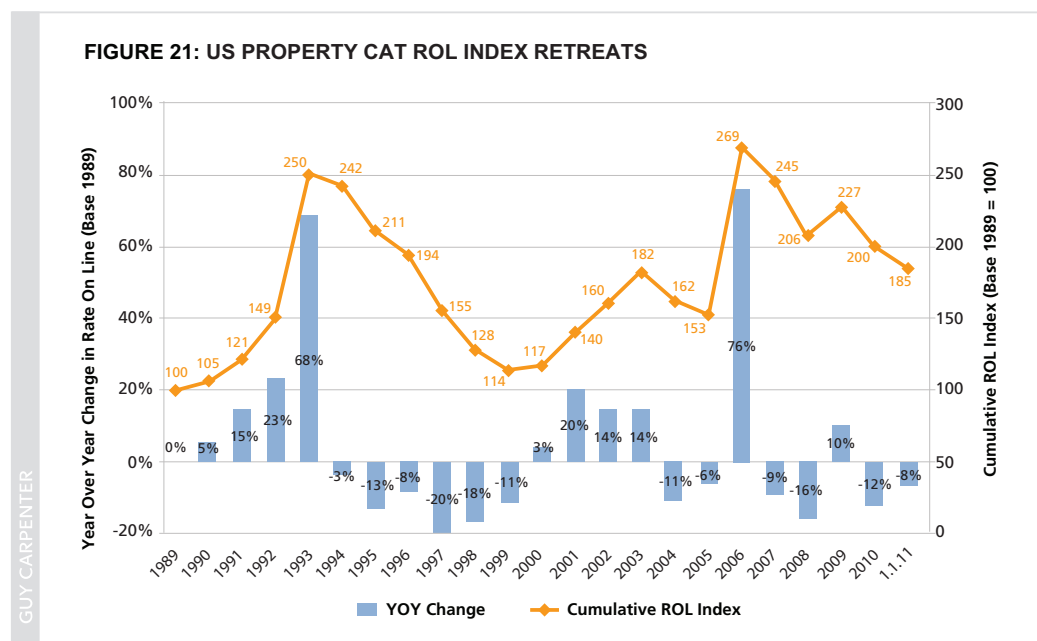
Property

United States

Property Catastrophe Market

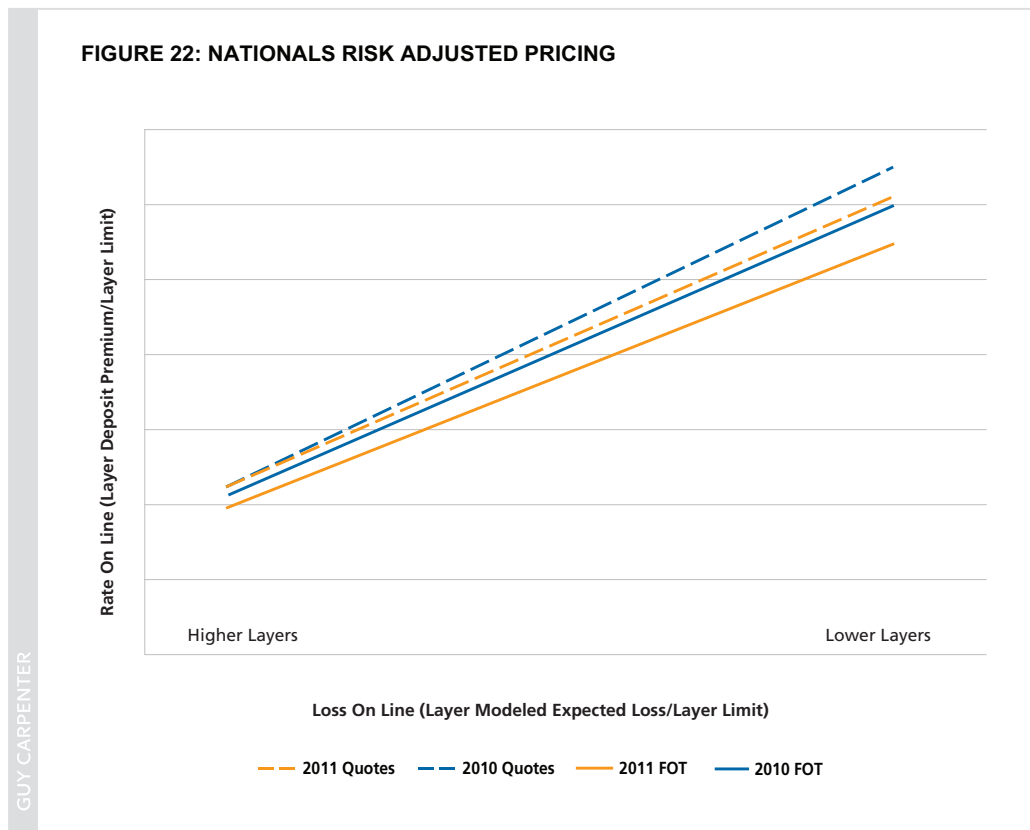
Rates on line decreased by an average of 7.5 percent on US programs, but there were significant variations depending on cedents' results, regional characteristics and coverage.

Catastrophe activity started off strong in 2010 with overall global losses in the range of double the average amount for the first half loss average since 2000. This activity included significant weather events in many parts of the United States. Even with these occurrences, rates declined through the July 1, 2010 renewals, primarily as the result of excess capital. As noted earlier this fall, this decreasing price trend was unlikely to change going into 2011 without a significant catastrophe event impacting the second half of the year. This did not occur, and as expected pricing decreased at the January 1, 2011 renewal on average at a risk adjusted rate of down 6 percent to down 10 percent.



Source: Guy Carpenter & Company, LLC

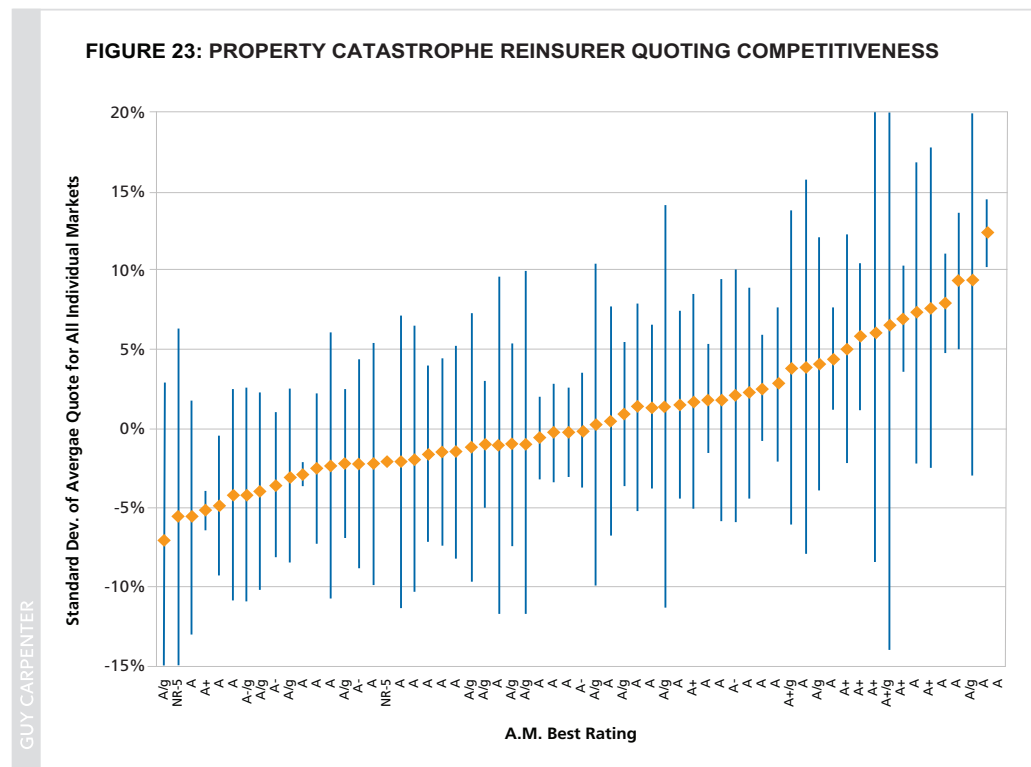
On a risk adjusted basis, measuring the relationship between the rate on line (the amount charged) and the loss on line (the amount of risk) for both the January 1, 2010 renewals and the January 1, 2011 renewals, the comparison indicates a decrease of between 6 percent to 10 percent in the amount charged per unit of exposure. Reviewing this relationship in the chart below, it is apparent that the amount of downward movement in pricing was not as significant in upper layers with low loss on line. This is in part due to minimum capacity charges.



Source: Guy Carpenter & Company, LLC

2011 quotes were on average 3 percent higher than 2010 firm order terms (FOT) but 5 to 8 percent lower than 2010 quotes. Overall, 2011 firm orders were approximately 90 percent of reinsurers' average quote on a given program. Limits and retentions were relatively stable.

In reviewing how markets quoted relative to each other, the range around the average quote narrowed slightly from a year ago from up 10 to down 10 at January 1, 2010 to up 10 to down 5 for 2011 renewals. Market quoting behavior is similar to prior years, with similar markets providing the lowest quotes and similar markets providing the highest quotes.



Source: Guy Carpenter & Company, LLC

While substantial reinsurance capital continues to drive market behavior, there are factors that may begin to mitigate these current conditions, including continued pressures on earnings from low investment returns, diminishing reserve releases, inflation concerns and the impacts of Solvency II implementation, which may erode some available capital. The largest impact may still occur in response to catastrophe model changes.

Impact of Model Version Changes

Both AIR and RMS have introduced or will introduce new model versions significantly impacting US hurricane results. AIR released v12 in June 2010. RMS is due to release its v11 model update in February 2011. However, many reinsurers assessed changes to their pricing approach based on the RMS pre-release indications.

In the AIR v12 release, multiple components of the model were revised, creating a broad impact on results depending on the characteristics of the individual portfolio. Across Guy Carpenter's book of business renewing at January 1 the average annual loss impact ranged from a decrease of 21 percent to an increase of 62 percent.

TABLE 5: IMPACT OF AIR MODEL VERSION CHANGE

Peer Group Region	AAL		1 in 100		1 in 250	
	Weighted Average Change	Range of Changes	Weighted Average Change	Range of Changes	Weighted Average Change	Range of Changes
Gulf	+3%	-4% to +44%	+3%	-10% to +58%	+18%	-15% to +81%
Midatlantic	+7%	-10% to +62%	+3%	-18% to +92%	+5%	-6% to +50%
National	+16%	-5% to +46%	+7%	-10% to +43%	+8%	-3% to +35%
Northeast	+5%	-21% to +25%	+8%	-13% to +48%	+2%	-12% to +52%
Super Regional	+1%	+1% to +1%	+8%	-8% to +10%	+8%	+1% to +9%

Source: Guy Carpenter & Company, LLC

While RMS is not due to release v11 until February 2011, this represents the largest version change in their history. Several reinsurers have advised that they are incorporating some adjustment for the new model output into pricing, before the model release. While no primary carrier, broker or market has a “beta” copy of the software, nor will any actual portfolio losses in the new version be provided by RMS before the model is released, RMS has provided indications of changes.

The range of change provided by RMS is based on its industry exposure database, not actual portfolios. When reviewing actual client portfolios, the change in loss can vary by over 100 percent. In addition, RMS has not completed testing, and the model does not yet meet quality standards for individual portfolio analysis. For these reasons, making assumptions before running the actual model is risky. RMS has indicated it will be providing greater directional detail in January when it is further along in the testing process.

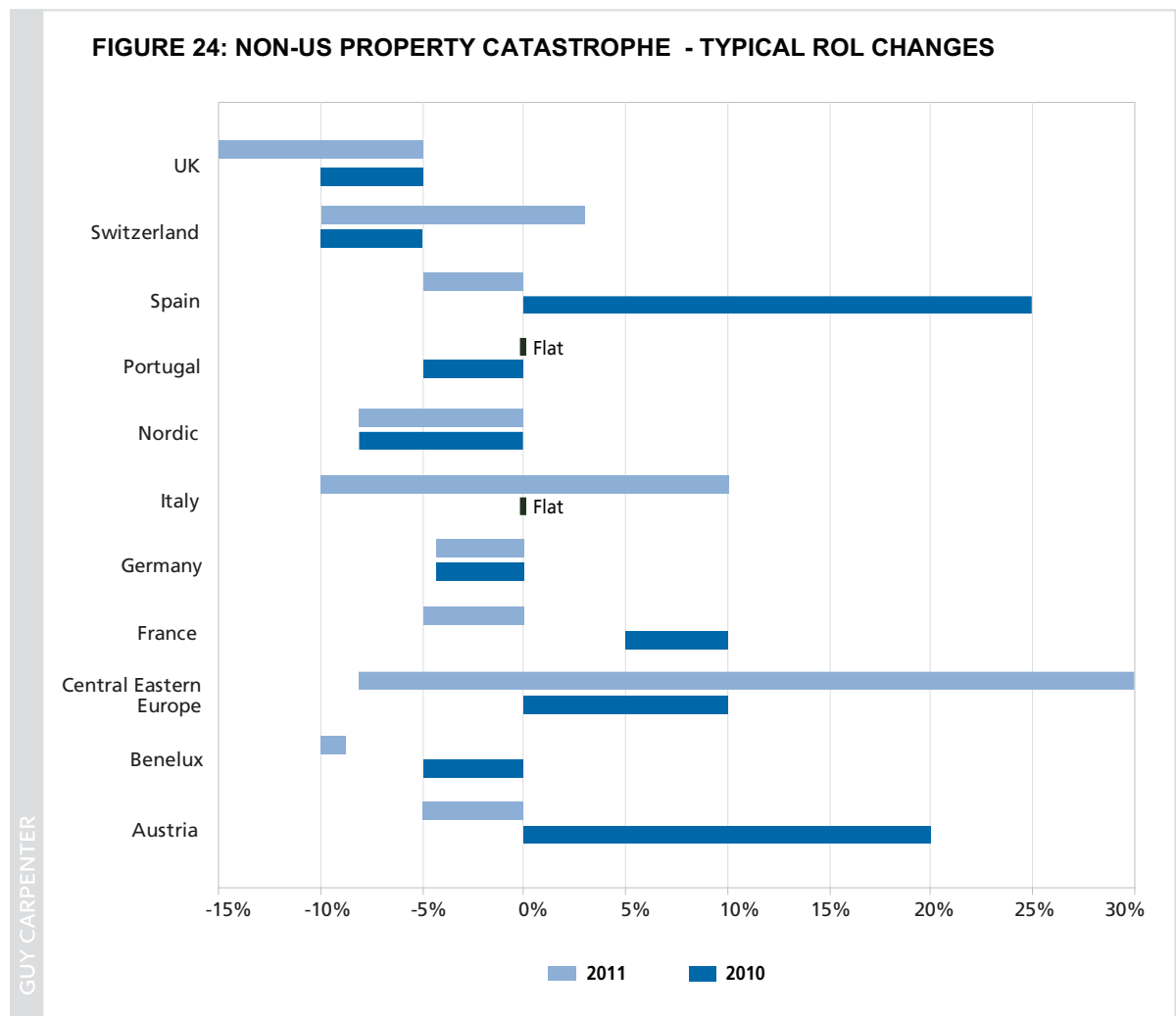
Guy Carpenter has discussed the AIR and RMS changes with reinsurers and has learned that their approaches differ. Each reinsurer’s approach is heavily influenced by its own concentrations, the type of business it favors and the adjustments it was building into its previous pricing approach. Many reinsurers agree that several of the factors influencing increased modeled results have already been incorporated into their pricing methodology.

Analysis of the model version change shows a limited impact on the January 1 renewals. For RMS, reinsurers indicated they were building in adjustments before the version release demonstrated pricing behavior that was still largely in line with the rest of the market.

That said, due to the extreme difficulty in estimating changes to a given book of business, reinsurers have a very limited view of how their own PMLs will be impacted by the RMS v11 release. This, coupled with the potential need for some companies to evaluate the purchase of additional limit once they are able to assess their own new results, could result in a scenario with greater demand and less supply through the first half of 2011.

A.M. Best has indicated in a recent conversation that they will not grant a grace period in dealing with companies at risk when the impacts of the model version changes are calculated. AIR results have been available for some time, and RMS has provided the industry with enough information to shed light on the regions and types of business that will be impacted by the new version. A.M. Best expects that affected companies should anticipate the potential impact as they renew their 2011 catastrophe protections. In addition, these companies should be prepared to discuss with A.M. Best any risk management changes they have made in the event they have a meeting or call with their analysts prior to running RMS v11.

Europe



Source: Guy Carpenter & Company, LLC

United Kingdom

Reinsurance rates continued to favor cedents in the UK at the January 1, 2011 renewal. Catastrophe rates on line fell 5 percent to 10 percent year over year, continuing the January 1, 2010 declines of 7.5 percent to 10 percent from the previous year. Per risk programs were off 5 percent to 15 percent for working layers and high-risk excess programs, compared with a year ago.

Insurance rates varied by line of business. Commercial property was flat, while personal lines increased by 5 percent and motor by 20 percent. Loss ratios have been under pressure due to historically low rating levels. With capital markets recovering, merger and acquisition activity is again on the rise, returning to a long-term trend in the UK market. In the coming year, 2010 trends are set to continue.

In general, subject base incomes are falling because the UK insurance market is saturated, and original rates are falling, though casualty classes (including motor) are exceptions. In 2011, we expect Solvency II to have a noticeable impact on cedent purchasing habits, in particular for those with capital bases that rely on catastrophe reinsurance as a capital management tool.

There have been few structural changes to reinsurance cover with retentions and FGU amounts unchanged. Solvency II will be a key driver of this trend, but until now the FSA's ICA capital regime has imparted discipline and uniformity into UK Cat purchasing decisions. Capacity increased from last year as new reinsurers entered the market, e.g., Lloyd's syndicates and new players in Zurich.

Switzerland

Reinsurance rates on line for Swiss CAT programs were 5 to 10 percent lower year over year. Per risk high-risk excess programs also sustained price decreases of 5 percent to 10 percent.

Last year, the non-life insurance market grew only 0.7 percent. This growth is attributable to the stable private and small and medium enterprise sector, while rates for industrial risks reduced by 5 to 10 percent. Marine and business interruption were most affected by recent economic trends. There were no major changes to industry loss ratios, which remain at low levels.

In 2011, significant changes are not expected, as the market is saturated. Intensified competition will put further pressure on rates.

Catastrophe losses were small in 2010 and insufficient to attach reinsurance programs meaningfully. Subject base exposure remained flat year over year, though cedents believed pricing for property-catastrophe reinsurance was excessive over past years providing them with the opportunity to ask for reductions during this year's renewal. Per risk exposures were flat, but pricing remained under pressure, given the absence of catastrophe claims for the past few years.

The Swiss Solvency Test (SST) became mandatory for all Swiss companies on January 1, 2011, even though the supervisory authority may have insufficient resources to verify insurers' internal models before implementation. There is no requirement to publish new solvency figures, but we expect them to be shown in cases where the outcome is favorable to the carrier.

Capacity was ample at the most recent renewal, and most programs were oversubscribed, as was the case a year ago. Reinsurance capital increasingly came from Switzerland, as carriers moved it to regions with the best terms.

Spain

Reinsurance rates were flat or down for most loss-free programs at the January 1, 2011 renewal in Spain. Property risk and property catastrophe were both flat to down 5 percent year over year, with motor and personal accident down 5 percent to 10 percent. General third-party liability reinsurance was flat. Programs affected by losses were also flat or down slightly, with property risk flat to down 5 percent, property catastrophe rates flat and motor flat to down 5 percent.

Though there was some entry and exit activity, capacity has remained consistent with a year ago, and it continues to be sufficient.

The non-life insurance market has been affected by economic problems, but it showed signs of recovery by the second quarter of 2010. The life savings business fared better as customers preferred investing in insurance products over those offered by banks.

Personal property insurance rates were flat year over year, with commercial and industrial property flat to down 10 percent. Motor rates were flat to down 5 percent. Competition for a relatively small amount of new business and existing customer retention kept pricing stable. Loss ratios are deteriorating because of premium declines, though frequency and average costs are relatively stable.

The worst of the financial crisis appears to have passed in Spain, and a slow recovery is likely through 2011. Premium income is expected to be flat in 2011, except for some specialized lines of business (e.g., professional liability and credit).

Several catastrophe events affected Spanish insurers in 2010, including the earthquake in Chile, the El Pozo industrial loss, Windstorms Flora and Xynthia and snowstorms in Catalunya. Nonetheless, they were not sufficiently significant to affect reinsurance rates.

Base exposure and premium decreased in proportion with primary market trends, driven largely by pressure on the Spanish economy. Solvency II has yet to have an impact on the (re)insurance business in Spain. Structural changes have been limited, though it is likely that the bodily injury indemnity table for motor insurance will be updated. Also in motor, variable rates are being removed from reinsurance contracts, and profit commissions are being removed from life reinsurance contracts.

Nordic

Reinsurance rates fell 5 percent for loss-free catastrophe programs in the Nordic region. This follows a decline of 2.5 percent to 7.5 percent at the January 1, 2010 reinsurance renewal. Loss-affected programs generally renewed at rate on line similar to 2010. For per risk working layers, rates fell 5 percent to 10 percent, with high-risk excess programs stable year over year.

Reinsurance structures did not change at the January 1, 2011 renewal, and capacity was both consistent with the prior renewal and plentiful. Capacity for per risk programs increased.

Cedent interest in transferring risks on a proportional basis has increased over the last couple of years and continues to do so. The drivers for proportional solutions are both capital relief and a wish to decrease volatility in their own books. Ceding commissions are increasing due to increased appetite for proportional business in the market. Straightforward fixed or sliding scale commissions were preferred.

The economic recession hit the Nordic market hard (with the exception of Norway), leading to a decline in gross national product and a resulting decline in commercial and industrial insurance premiums. After three years of flat premium income, the insurance industry expects real growth in the premium income for 2011. In Sweden, rates fell 5 percent to 10 percent, were up 5 percent to 10 percent in Denmark and remained flat in Norway and Finland.

After a difficult first quarter, in which combined ratios were well in excess of 100 percent, the insurance industry recovered. Combined ratios are again below 100 percent, with the best-performing companies in the lower 90 percent range.

In 2011, we expect the Danish property and casualty market to continue to recover, while competition will remain fierce in Sweden and Norway.

The entire Nordic cedent base was affected by harsh winter conditions at the beginning of 2010, and many large catastrophe programs sustained losses, but the programs were only penetrated at the lower ends. During the summer, there were some heavy rain losses in Denmark but again only affecting lower layers.

The underlying exposure in Nordic reinsurance programs remains relatively flat, with a low increase in the underlying insured values. The reason is a remaining impact of the economic recession and low inflation.

Portugal

Reinsurance rates were generally flat for loss-free programs in Portugal at the January 1, 2011 renewal. Property catastrophe and property risk pricing were stable, as was workers compensation. Motor reinsurance was down 5 percent to 10 percent year over year. Loss-affected programs experienced similar pricing behavior. Property catastrophe pricing would have fallen but for heavy rains and flooding in Madeira.

Capacity was basically unchanged year over year, though there was a small increase in catastrophe lines through reinsurers in Bermuda.

Property industrial insurance rates are down 5 percent to 10 percent year over year, with private and commercial property flat to down 5 percent for the same period. Motor insurance rates are flat to up five percent, with workers compensation posting an increase of 5 percent to 20 percent. Loss ratios for motor and workers compensation fell from the third quarter of 2009 to the third quarter of 2010 – from 76 percent to 74.8 percent for motor and from 80.1 percent to 79.4 percent for workers compensation. Property loss ratios increased from 50.9 percent to 66.3 percent during this period.

The outlook for market health and insurance pricing in 2011 reflects what was experienced in 2010. Look for a slow recovery to begin in the insurance industry, with virtually no new business. There is likely to be a need to increase primary insurance rates for some lines, particularly motor and workers compensation.

Reinsurance and primary insurance pricing remain aligned, though there is a short lapse in timing adjustment for workers compensation. Subject base exposure and premium are declining in roughly the same proportion as the global economy indicators.

Structural changes did come to workers compensation programs. Until recently, only the mathematical provision was covered. With medical expenses growing rapidly, companies are now looking to include them in reinsurance contracts.

Benelux

Catastrophe reinsurance rates fell 7.5 percent to 10 percent at the January 1, 2011 reinsurance renewal in Belgium, the Netherlands and Luxembourg. This represents a slight acceleration from the 5 percent decline a year ago. Per risk working layer and high-risk excess program rates were down 5 percent to 7.5 percent for loss-free layers. Capacity was both ample and consistent with some reinsurers increasing capacity to meet cedent demand.

The primary insurance market in Belgium saw increases in residential fire insurance as a result of losses from Windstorm Xynthia, the July storms and flooding in November. Losses have also led to rate increases for motor insurance in Belgium and the Netherlands in 2010. In the coming year, merger and acquisition momentum from 2009 and 2010 is likely to continue.

Loss events this past year did not have a significant effect on reinsurers, with the November flooding the only noteworthy event. Likewise, there were no significant changes to reinsurance structures. Capacity was both ample and consistent year over year, with some reinsurers increasing capacity to address cedent demand.

Italy

Loss-free programs were down 5 percent to 10 percent at the January 1, 2011 reinsurance renewal in Italy. Those affected by losses experienced average increases of 10 percent, on average. For per risk working layers, general third-party liability and fire risk rates were stable. Motor third-party liability rates rose 15 percent to 20 percent year over year, driven by the V Directive and new parameters used by courts to assess permanent disability.

Because the reinsurance industry was profitable in 2010 in Italy and rates are not under pressure, there was stability in the excess points. Additionally, there was demand for more capacity, particularly because of improved data quality. Reinsurers generally showed plenty of interest in Italian catastrophe excess of loss as a way to diversify risks written in Northern Europe and the United States.

All major companies in the Italian market are in the process of studying internal models in preparation for the introduction of Solvency II in 2013. Smaller and medium-sized carriers are still evaluating whether the use of internal models is more advantageous than the standard formula for determining the Solvency Capital Requirement (SCR).

Germany

In Germany, catastrophe excess of loss reinsurance rates were flat to down 4 percent at the January 1, 2011 renewal, with stop loss and aggregate excess of loss flat year over year. Loss-affected programs, of which there were not many, showed increases of 5 percent to 15 percent from 2010 to 2011. For working layers and high-risk programs in per risk treaties, rates were flat.

The primary market outlook in Germany is stable for 2011. In the forefront of Solvency II, the pressure to explore M & A opportunities is expected to increase.

There were no major market losses of a caliber high enough to impact reinsurance-buying behavior, as Windstorm Xynthia mostly hit cedent retentions. The frequency of small losses did affect frequency covers, with minor implications for reinsurance pricing. Without generic growth in the market, exposures have remained stable. Catastrophe capacity has increased to facilitate compliance with Solvency II and rating agency requirements, and Quantitative Impact Study 5 (QIS 5) has put some pressure on pure stop loss or aggregate excess of loss covers due to insufficient horizontal capacity (no reinstatements). However, there have been no changes to reinsurance structures so far.

Reinsurance market capacity for catastrophe reached approximately EUR7 billion this year and was stable. A few markets exited or reduced capacity. This was offset by increased risk appetite from markets with a higher focus on Germany.

Long-tail liability reinsurance rates remained stable at Germany's January 1, 2011 reinsurance renewal. Loss-free programs were flat. General third-party liability (GTPL) was flat to up 5 percent for per risk working layers, while motor third-party liability (MTPL) was up 5 percent to 10 percent. High-risk excess programs were stable. GTPL and MTPL were heavily influenced by the development of the interest rates and the economic cycle. Rates are expected to increase next year.

There has been virtually no change in exposure for MTPL, while GTPL has seen a slight increase because of the economic recovery. Premiums have increased slightly for MTPL and have remained stable for GTPL. There have been no structural changes to covers, and capacity continues to be ample.

France

Rates on line (ROL) for loss-free programs in France were relatively stable, as they were at the January 1, 2010 reinsurance renewal. On a risk-adjusted basis, pricing fell between 0 to 5 percent. There were few loss-affected programs in 2010, and those hit had only slight reinsurance rate increases. In the liability sector, markets remained disciplined.

2010's windstorm activity, such as Xynthia, mostly impacted cedent retentions and thus did not have a substantial effect on the reinsurance market. Risk-adjusted ROLs were flat, despite increased original property rates and reflecting a net advantage for cedents. In the motor sector, the same dynamic is at play, with original rates increasing faster than reinsurance rates. This is a change from 2010, in which reinsurance rates increased while original rates fell.

Capacity was stable at around EUR10 billion. Several reinsurers have increased their appetites to write business, offsetting those that have either cut or stopped entirely. The annual aggregate excess of loss market is nearly saturated.

Central & Eastern Europe (CEE)

Reinsurance rates were driven by loss history for carriers in Central and Eastern Europe at the January 1, 2011 renewal. Consequently, it is difficult to point to a standard rate experience in this region.

Catastrophe excess of loss rates on line were generally down 5 percent to 10 percent for loss-free programs, with those affected by losses up by as much as 20 percent to 30 percent at the lowest layers. Middle layers were up around 7.5 percent, and top layers were flat or slightly reduced. Per risk working layers were also up 5 percent to 10 percent, generally as a result of either losses and/or increased exposure. Higher layers were flat to down.

Loss history has been an issue among CEE-based carriers in 2010. There has been a modest increase in fire risk loss frequency in southeastern Europe, for example. Several significant losses occurred in the catastrophe market in 2010, most notably flooding in Poland, Slovakia, Hungary and the Czech Republic. Hail storms in the Czech Republic and Slovenia and snow pressure in Poland and the Czech Republic were also a concern. Catastrophe frequency has eroded cedents' retentions and resulted in a number of losses to lower cat layers.

Subject base exposure for property cat business was generally up by around 5 percent, with the premium generated down approximately 5 percent. Pricing on loss-free business tended to reflect the primary market. Reinsurers tended to look for shorter payback periods and higher rates on loss-affected layers, especially where they had suffered heavier losses.

Retentions increased for programs that experienced frequency losses in 2010, with some carriers purchasing higher limits in line with increased model results. Aggregate excess of loss programs protecting net retentions after inuring cat programs were in greater demand, as a result. Capacity remained generally unchanged, though some catastrophe-focused reinsurers were eager to write more excess of loss treaties. There is approximately EUR1 billion in catastrophe capacity available for the region, with around EUR 300-400 million for risk excess of loss. New Lloyd's syndicates and Zurich-based start-ups brought some additional capacity to the market.

At this renewal, it was apparent that appetite for CEE business remains high, especially for reinsurers interested in taking advantage of increased rates and retentions for loss-affected programs. Some reinsurers are also looking at CEE opportunities as a way to diversify portfolios already heavy with Western European risks.

In terms of the reinsurance market, Solvency II is in its early stages in CEE, and some larger foreign-owned groups are already underway with their preparations, while many local domestic insurers, with a few exceptions, have yet to react to the forthcoming regulatory requirements. Nonetheless, carriers in this region are starting to seek more insights into Solvency II compliance, particularly in respect to their solvency margins and the extent of their catastrophe reinsurance protection.

Austria

Reinsurance rates on line (ROL) fell in Austria at the January 1, 2011 renewal, reversing a trend from the year before. While ROLs were flat to up 7.5 percent for loss-free programs at the beginning of 2010, cedents were able to attain flat pricing to decreases of 5 percent in 2011.

With no major losses in 2010, ample capacity and no major changes to reinsurance structures, rates were flat to down slightly this year. Subject base exposure is up approximately 4 percent, which is roughly in line with rate changes. Solvency II is having a gradual effect on the amount of capacity purchased by cedents for natural catastrophe events, but the changes have not been significant. There were generally no changes to proportional treaties, though capacity increased slightly year over year as a result of solid 2010 results.

Primary insurance rates for natural peril risks increased 10 percent to 20 percent year over year in Austria, with fire and motor staying stable. There were no significant changes to industry loss ratios. Austrian carriers have been expanding and consolidating their merger and acquisition activities, mostly in Central and Eastern Europe. The outlook for 2011 is stable – consistent with 2010.

Latin America

Reinsurance rates were flat for loss-free programs in Latin America, though those affected by the Chile earthquake sustained rate on line increases of 40 percent to 60 percent, depending on specific loss experiences. Per risk working layer programs were flat to up 10 percent if there was loss activity, and high-risk excess programs were flat year over year.

GDP growth (particularly Brazil) is driving the primary markets. In many countries, a new emerging consumer class is developing. Inflation is under control in all countries, apart from Argentina and Venezuela, where motor and health insurance portfolios are being compromised. Meanwhile, competition in Brazil, from multinational entrants and the opening of new reinsurance offices is driving down rates in large commercial risks. Rates are down 10 percent to 15 percent for the country. The major primary market loss came in Chile, with the earthquake, but more than 95 percent of it was reinsured. Multinationals are looking to make further acquisitions in the region, and local groups are also looking to defend their positions. For the coming year, further growth and relative stability are likely.

In Latin America, premium is increasing in line with the increase in exposures (like for like, but no more). There is a trend in some countries, Venezuela and Brazil, for example, for regulators to be more protective of their markets. Other regulators (e.g., in Mexico and Brazil) are keen to adopt Solvency II before the markets are quite ready for this.

Structurally, the prevailing trend for catastrophe excess of loss programs among internationals has been to increase retentions, while the local carriers have preferred to keep retention levels lower; per risk structures are essentially unchanged. Capacity has increased from both existing and new players, with Bermuda and Lloyd's becoming more active in Latin America, though less so in the Caribbean. The market is saturated with good quality catastrophe reinsurers, both for the Caribbean and Latin American business. There are very few capacity programs, but growth and currency revaluations are putting some pressure on capacity requirements emanating from Chile and Colombia.

For per risk programs, machinery and process sophistication are on the rise, leading to larger risk losses in the region. Also, business interruption is becoming a greater factor. In the proportional space, cedents are looking to maintain existing structures, given favorable terms from reinsurers. Ceding commissions, profits and overrides remain effectively unchanged, although there has been some (minor) upwards movement on commissions in the Caribbean. Also, proportional capacity is increasing for the first time in about three years.

Notwithstanding the above, terms and conditions in Chile at mid year did tighten quite significantly with the introduction of lower event limits, minimum earthquake rates, and lower natural perils commissions, which were sufficient to satisfy the appetites of most existing players, that were keen to block out any new entrants.

Argentina

Per risk reinsurance for both working layers and high-risk programs generally fell 10 percent to 15 percent in Latin America at the January 1, 2011 reinsurance renewal. Inflation and a flat exchange rate relative to the US dollar have led to the need for more capacity, which caused some programs to renew either at flat or lower rates year over year.

There was no significant loss activity or changes to subject base exposure and premium in 2010. Consequently, reinsurance rates generally fell, especially as a result of new capacity coming into the market and an increase in net retentions among cedents.

Inflation continues to be the main economic challenge, especially in Argentina. Official results put it at 8 percent, though the reality may be higher than 25 percent. Primary reinsurance rates are down 10 percent to 15 percent relative to 2009, due largely to constraints on capacity, as loss ratios have not changed. In 2011, look for rates to continue to fall, perhaps as much as 10 percent. But, currency market developments and inflation may cause a net flat effect.

Brazil

For the excess of loss treaties that placed this year, rate on line halved relative to the year earlier. Automatic capacity continues to be a major force in the market.

Downward pressure on rates continues, with all lines sustaining decreases of 15 percent to 20 percent or more on certain classes. A large amount of automatic treaty capacity is available, and co-insurance is widely used. Liability and marine rates are also being squeezed, while engineering rates have plummeted. This is because large infrastructure projects, as well as the World Cup and the coming Olympic Games, have attracted cheap reinsurance capacity. Government budget cuts, however, could slow the pace. Loss ratios are consistent with 2010.

In 2011, continued downward price pressure is expected, and insurance penetration is likely to increase.

Loss experiences by business sector have resulted in some differences this year. Warehouse and supermarket risk, because of various losses over the past few years, tend to be placed outside of reinsurance treaties, and port authority losses are now heavily sublimited. Purchase of vertical catastrophe cover however, is on the rise. Capacity continues to increase with many new players in the market.

Asia Pacific

Australia/New Zealand

In Australia and New Zealand, reinsurance rates trended up slightly for loss-free programs, with those affected by losses sustaining higher increases. Few programs avoided losses, given a busy catastrophe year for the region. Those that did remain loss free saw risk-adjusted reinsurance rate increases of 3 percent to 5 percent at the January 1, 2011 renewal, while those with losses experienced increases of 10 percent to 15 percent on a program-wide basis. Specific layers affected had even higher rate changes. Per risk working layers and high risk excess programs were generally flat.

There was much natural catastrophe activity in the Australia and the New Zealand region in 2010, with three events – the Melbourne hail storm, Perth hail storm and Christchurch earthquake – each generating insured losses of above USD1 billion. Each loss impacted both insurers and reinsurers and in some cases, the damage is still being assessed. Insured losses from the Christchurch earthquake alone could reach USD4 billion.

Both aggregate and premium exposure base grew around 6 percent in 2010, with premium levels slightly above aggregate levels due to original rate increases beginning to gain traction in the region.

Capacity was more than adequate at the January 1, 2011 reinsurance renewal and was sourced from all major markets for catastrophe business. Those reinsurers that were local, had ratings of AA- or better or had more favorable rates dominated non-catastrophe placements. There was pressure on net retentions this year, as reinsurers wanted to move away from attritional loss levels, preferring instead to be in the range where modeled perils constitute their key exposures.

For per risk programs, smaller markets sought multi-year contracts, a viable option given the competition for such placements' programs. The motivation was to respond to opportunities in an over-supplied market.

For proportional treaty, cedents were willing to retain more risk in order to increase net earned premium levels. In other cases, loss-affected programs were unable to secure capacity. Commissions were affected heavily by loss experience, with loss-free and long-standing profitable accounts continuing to achieve improved commission terms. Loss-affected programs were flat at best.

China

A rationalized market environment and strong economic conditions have led to market stability in China. Primary rates remained stable, though those for engineering have increased. For catastrophe lines, high economic losses from the floods in the middle of 2010 – reaching USD51 billion – did not have an impact on insurance and reinsurance rates: a low level of insurance penetration kept insured losses contained. A late renewal season saw catastrophe buyers looking for reductions in the range of 5 percent to 15 percent. Capacity was generally

plentiful for excess of loss placements. Renewals of property pro rata treaties are always the subject of detailed negotiations: in the end commissions largely remained at expiring levels while increases have been achieved for a few better performing programs. Capacity for these is stable with modest increases for some programs. For the coming year, look for further increases in insurance penetration, as a decade-long trend of 20 percent annual premium growth appears likely to continue. Insurance growth should be matched by accompanying rises in demand for reinsurance.

India

The sole renewal date for India is April 1, with the exception of the National Reinsurer (GIC) which renews at May 1. The non-life sector in India is expected to grow around 20 percent for the fiscal year ending March 31, 2011, with the automobile and health segments providing the major impetus. Momentum is likely to continue after that, albeit at a slower pace. For the first six months of the fiscal year, the general insurance segment grew 22 percent, with the subsequent fiscal year to post growth of approximately 15 percent.

Taiwan

Loss-free catastrophe programs secured rate decreases of 5 percent to 15 percent (risk-adjusted) on average at the January 1, 2011 reinsurance renewal in Taiwan. Loss-affected programs were flat to down 15 percent, as well. Per risk working layer rates were up 5 percent to 25 percent for loss-affected layers, depending on experience, and down 5 percent to 10 percent for those that were loss free. High-risk excess program rates were flat to down 5 percent in Taiwan.

Subject base exposure increased 20 percent to 30 percent year over year, but premium income has declined 15 percent to 20 percent because of deregulation. The Insurance Bureau in Taiwan has begun to implement enterprise risk management (ERM), and each company is required to report its 2011 risk appetite. There are also preparations for Solvency II on the horizon.

Capacity increased from USD3.1 billion last year to USD3.4 billion at the January 1, 2011 reinsurance renewal – a gain of around 1 percent. Some of this was due to new reinsurance capacity, such as the establishment of new Lloyd's syndicates in Singapore. More local reinsurers purchased retrocession cover. Capacity was adequate to meet demand.

Structurally, most companies maintained their catastrophe deductibles, and there was a tendency to purchase additional earthquake layers, depending on renewal pricing for expiring structures and 2011 reinsurance budgets.

Most cedents maintained their proportional treaty structures at the most recent renewal. Reinsurance commissions fell 3 percentage points to 8 percentage points for treaties that had loss ratios of above 80 percent. They stayed flat where loss ratios grew by less than 15 percent.

South East Asia

Philippines

Filipino catastrophe excess of loss clients have tended toward increased event cover in 2011 as a result of continually increasing exposures and the jump in loss reserves from 2009 typhoons Ondoy and Pepeng. Furthermore, reinsurers felt that 2010 pricing did not reflect true experience as clients were still gathering information on the typhoons, putting upward pressure on pricing. That said, to combat upward pressure on pricing, cedents offered private layers to leaders that reduced pricing on the main programs.

As a result of these factors, the loss-affected catastrophe market ended up. Treaties unaffected by losses were renewed as expiring.

Vietnam

Competition in the primary market remains very strong. Vietnamese non-life insurance premiums grew 14.9 percent to USD 767 million (Sigma No 2/2010). There are around 30 insurers in the Vietnamese market. Market concentration of the top five companies is around 73.5 percent. Market concentration of the top 10 companies is 85.7 percent. There is little merger and acquisition activity at the current time.

There has been no significant change to industry loss ratios in 2010. There were some reported losses from flooding, but the impact to the insurance industry appears minimal. In 2009, Vietnam was hit by typhoons Ketsana and Mirinae, but the impact to the insurance industry was relatively low as the typhoons hit the central region of Vietnam. The most heavily concentrated exposures are in the north (Hanoi) and south (Ho Chi Minh City).

Given limited to exposure to catastrophe, most reinsurance programs are purchased on a risk/cat basis. Rate on line reductions continue for loss-free programs, both on a nominal and risk adjusted basis. Given the level and location of exposures, increases in sum insured aggregates may not translate proportionally into increases in catastrophe exposures. As such, the exposure adjusted rate on line reductions would be approximately 10 percent to 15 percent. Loss-affected programs have seen rate on line increased by 20 percent on nominal basis. However on an exposure adjusted basis, rate on line has decreased by about 5 percent to 10 percent.

For proportional programs, commissions have increased by 2.5 percent to 5.0 percent for profitable treaties. For loss-affected programs, commission rates have decreased between to 2 percent to 4.5 percent. Proportional structures are largely unchanged.

New reinsurers have shown a keen interest to enter the Vietnam markets this year compared to 2010. Reinsurers with an established presence have maintained position or indicate willingness to provide additional capacity provided acceptable terms and good treaty results.

Indonesia

The Padang earthquake in 2009 is showing its effects at the 2011 renewal, as the market loss reserve has increased over 50 percent. Exposures have increased between 20 and 50 percent.

These dynamics result in price changes for loss-free programs in the range of down 5 percent to up 10 percent. Loss-affected catastrophe rate on line has increased in the range of up 5 percent to up 30 percent.

Proportional and non-proportional structures are generally unchanged, although there is growing appetite for non-proportional treaties as proportional results have been weak in recent years.

We expect consolidation in a few Asian markets in 2011, including Indonesia, as a result of tightening capital requirements squeezing out smaller players.

Thailand

Despite two major flood events in the central and southern regions of Thailand, the reinsurance market is still soft. There has been no significant change in price in both proportional and non-proportional classes. Furthermore, flood activity does not encourage Thai companies to buy higher limits as they view the loss severity of this flood as still far below the 2004 tsunami loss.

International sanctions against Myanmar are of particular concern due to Thailand's proximity to the nation, although cedents prefer to confirm that they will not do business with sanction countries rather than incorporate a sanction clause into reinsurance arrangements.

The new Risk-Based Capital regime commences in 2011. Many small and medium size companies have to either inject more capital or buy more reinsurance. The major motor-dominated companies, in particular, have to work harder in order to meet minimum solvency margins. However, Thai companies are in favor of changing ownership rather than consolidation, so we do not foresee merger activity to happen in the near future.

Property Retrocession

At the time of writing, this year's retrocession renewal season is heading to a late close. Early indicators point to a pricing environment of flat to minus 10 percent off rate for loss-free cat retro and cat on direct and facultative programs. There has been significant international catastrophe loss activity in 2010; estimates for these losses are being steadily revised upwards, which has resulted in some lower layers and aggregate covers being hit twice. The impact of New Zealand and Chile earthquakes on programs has sometimes, but not always, led to some price and attachment adjustment. Markets were relieved to be spared the potential losses that could have arisen from the US windstorm activity many predicted.

Buyers have not been engaging in defensive purchasing seen in previous soft markets, while sellers have been very sensitive to price and selective towards clients when deploying capacity. Portfolios that were growing or forecasted to grow often appeared to fare well in pricing.

Some early indicators suggested that the forthcoming release of a new model version by RMS, which predicted increased PMLs, would result in markets holding firm or increasing price. This did not materialize, perhaps as many markets will have already factored in model inadequacies into their assumptions.

There was also some appetite for multi-year cover in the retrocession market, similar to that experienced in some other sectors of the reinsurance industry.

While some markets contracted capacity a little, this was offset by increases from existing and new market participants. There were no significant market entries or exits, though some collateralized capacity did enter the market in the second half of the year. Capacity overall remains fairly consistent as a result.

In the risk excess market, there were no noticeable changes in attachment points, and pricing was driven by exposure. For quota share cover, there was an increase in capacity. This led to an improvement in commissions and override terms.

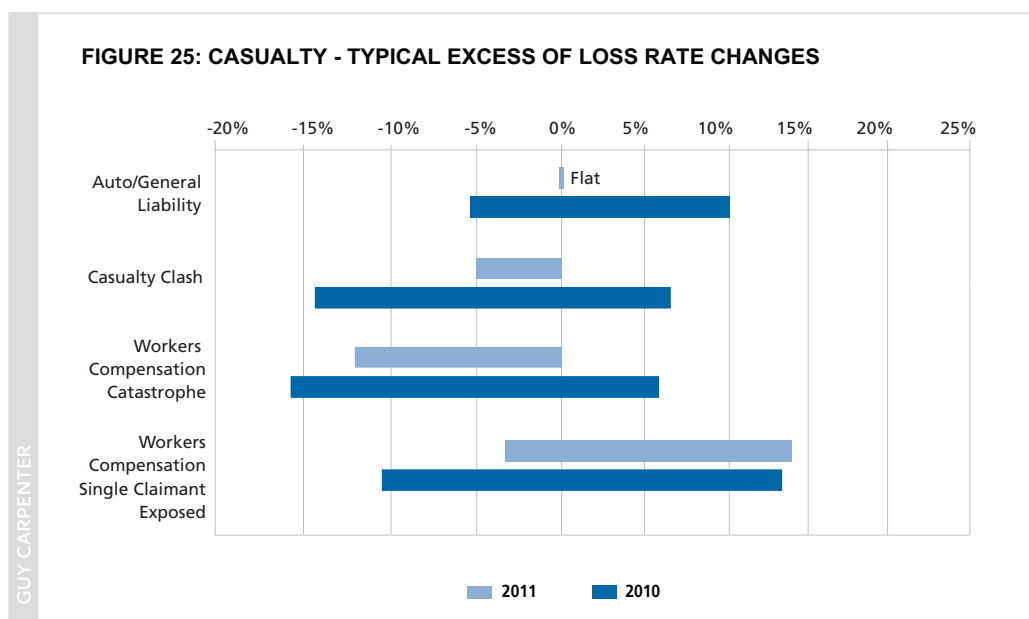
Casualty

US Casualty

The casualty reinsurance market continues to be concerned about the level of primary market pricing, with that impact being felt most strongly in proportional treaties where some ceding commissions are being reduced. Reinsurance pricing is averaging flat to down by 5 percent.

The casualty primary market continues to be impacted by the economy's downward pressure on exposures and intense industry competition in many areas. Where there is any stability of insured exposures there is more pressure on rates. Few sectors show exceptions to this trend, such as personal lines automobile liability, and some segments can be still be intensely competitive, such as those the larger insureds put out for competitive bid or some of the excess layers in an umbrella/excess tower. Loss ratios are trending up and M&A activity may increase as insurers find it increasingly difficult to grow profitably.

Program structures are seeing little change other than those driven by constraints on reinsurance budgets due to top line pressure. The question of how much capital should be allocated to casualty will be a subject of discussion throughout 2011 unless market conditions improve.



Source: Guy Carpenter & Company, LLC

Auto and General Liability

Intense competition led to primary insurance rates in the commercial sector decreasing by an average of 5 percent to 10 percent, while flat rates or increases of up to 5 percent continued in personal auto lines. Reinsurance capacity increased slightly, while cession levels remain generally unchanged.

A drop in interest rates constrained return on equity and economic factors, particularly unemployment, reduced exposures. Business contractions, driven by global economic conditions, put pressure on general liability premium income. Meanwhile, loss ratios have been trending up slightly over the past three years.

The result is an insurance market that continues to favor consumers, putting pressure on primary insurers and, as a result, reinsurers. Smaller carriers are feeling pressure to attain their financial objectives. Given these market pressures, primary rates are likely to decrease moderately or level off through 2011.

Casualty Clash

At the January 1, 2011 reinsurance renewal, casualty clash pricing continued the moderate downward trend that has characterized the market since 2009. With transactions still being finalized at time of writing, reinsurance rates on line (ROL) are flat to down 5 percent because of factors related to primary market pricing and premium volume. The number of larger carriers securing casualty clash cover is still small, but there continues to be renewed interest.

The 2011 renewal may represent a slight acceleration from a year ago, if current expectations are met, when average ROL reductions were 2 percent, with a range of down 14 percent to up 7 percent. Treaties with loss activity sustained moderate price increases. Subject premium will outpace reinsurance premium reductions, likely by an increase of above 5 percent. Contracts which include professional lines dominated the reductions.

Premium in the underlying lines of business continues to decline, extending a trend from 2009 to 2010. Over the past year, rates fell by 3 percent to 5 percent for most carriers, some by even more. There were two key drivers behind this trend: underlying competition with lower rates and additional underlying price and expense conditions (e.g., sales and employees) resulting from the current economic climate. Premium income, consequently, continues to fall, along with volume. Some carriers are letting business go, while others are losing opportunities as a result of competitive conditions.

Nonetheless, the sector continues to generate profitable business, though some insurers are starting to see combined ratios of above 100 percent in casualty lines of business. As a result, they are walking away from accounts that are not priced sufficiently.

The structure of casualty clash reinsurance protection did not change significantly from last year. Many of the carriers purchasing clash cover continue to do so, as their underlying retentions from working layer reinsurance are either flat or up. New purchases, however, have been curtailed mostly because of a tightening of reinsurance budgets. Capacity remains stable with around a dozen markets active in this space.

For 2011, casualty clash lines will be influenced heavily by the pace and nature of the economic recovery in the United States and around the world.

Umbrella & Excess

Primary rates on average are relatively flat (with individual accounts experiencing rate reductions of up to 10 percent). Exposure bases have stabilized since last year where we saw larger reductions in premium due to exposure reductions resulting from the economic recession. Reinsurance capacity for the business has contracted year over year with energy exposure the driver of concern along with original rate movement. Overall, the reinsurance market has a more pessimistic view of the profitability of the original business.

Revenues for underlying original insureds (manufacturing, service and distribution insureds) have begun to stabilize post-recession, leading to premium stabilizing on the insurance purchase. That said, the stabilization of exposure bases has caused increased pressure on the rates charged. In contrast to most other industries, the residential construction business is still significantly below 2007 levels, providing a huge reduction in the available business for carriers to write in this segment, creating increased competition for the remaining business.

Primary rate changes are relatively flat to slightly down in the industry right now. The offshore energy sector is experiencing rate increases (in some cases significant increases) because of the industry's reaction to the Deepwater Horizon event. In the non-energy market, rates are flat with individual accounts experiencing reduced rates in limited situations coupled with reduced exposure base. There is generally more rate pressure on national account business.

Umbrella and excess loss ratios have trended upward for large-account lead umbrella business on average during the past few years, as older accident years have developed further. Small and middle market standard accounts have experienced stable loss ratios through the cycle in many cases due to minimum premium redundancy. The Bermuda excess liability market has experienced loss activity during the last year. The insurance loss for Deepwater Horizon, however, may not be significant, as much of the loss will be self-insured.

In 2011, look for more of the same, with pockets of increasing rates for certain classes (e.g., energy). The energy sector is changing, and industry initiatives are underway to establish facilities specifically targeted to the energy sector, which could be a major development in 2011. Insurance and reinsurance carriers are looking for niche areas of the market where less competition exists in an attempt to grow organically. Next year, we also expect to see an increase in merger and acquisition activity, as carriers continue to find it difficult to grow organically.

The reinsurance market continues to be harder than the primary insurance market, making placements difficult. Reinsurers continue to believe that underlying loss ratios are higher than do primary writers of the business. 2010 exhibited an uptick in loss activity. Most of the year's loss activity has come from energy. Losses include Deepwater Horizon,

the PG&E gas explosion, Massey Energy Coal disaster, Enbridge oil spill and the Kleen Energy explosion. Additionally, concerns regarding Chinese drywall claims persist, as certain cases proceed through the court system.

Reinsurance proportional capacity has constrained slightly over 2010, and we expect a continued shrinking of proportional capacity in 2011, as reinsurers continue to manage aggregate exposure to casualty. Cedents have retained more risk on average, because top line premium is declining and there is a disconnect between cedents and reinsurers on loss projections for the subject business. This has resulted in reduced ceding commissions as well.

Workers Compensation

The impact of the recession has been particularly difficult on the workers compensation line of business. The convergence of shrinking premiums, higher overall primary loss costs and extremely low investment rates make profitability in this line a challenge to achieve. The current workers compensation market lack of profitability was recently described as a time bomb that will become even more costly when inflation shoots up. The national unemployment rate in November 2010 was 9.2 percent. A continued lack of business confidence in the construction and industrial sectors combined with wage growth well below historical averages continue to put extreme pressure on cedents' subject premiums. Country-wide workers compensation premium has fallen from nearly USD48 billion in 2005 to just over USD34 billion in 2009. The two principal reasons for this 29 percent decline are rate reductions and recession-reduced payrolls.

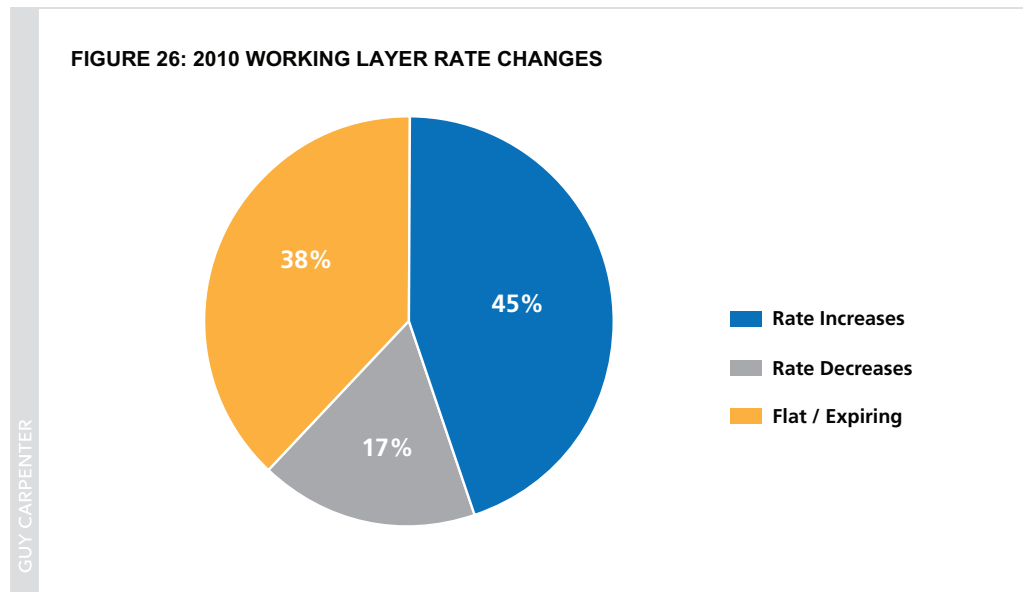
Pricing competition among the primary markets in the last few years has been aggressive as cedents attempt to retain their accounts and maintain premium levels and market shares in a declining rate environment. According to the National Council on Compensation Insurance, the ratio of voluntary market rate filing decreases was four times the level of rate increases between 2007 and 2009. The rate of decreases to increases for 2010/2011 season has so far leveled off to 17 states with decreases to 14 states with increases. Three large jurisdictions, California, Florida and New York are all looking at primary rate increase recommendations for 2011.

Heading into 2011, workers compensation treaty reinsurance renewal activity has to navigate the same headwinds from the overall lackluster economy and employment challenges of the primary market. The workers compensation treaty reinsurance market can be separated into two different segments. The first being described as "working layer" or single claimant exposed reinsurance and the second responding to multi-claimant losses or catastrophe reinsurance.

Typical working layer limits are in layered bands providing coverage up to USD10 million. We are seeing more companies looking for limits greater than USD10 million and expect that the interest in additional limits will increase as severity trends continue to increase. The underlying loss ratio is a factor in pricing working layer coverages and with industry

loss ratios increasing over the last four years, we have seen reinsurance pricing for working layer reinsurance stabilize and reinsurers are quoting rate increases. There is a limited core group of reinsurers that lead these working layers which means that there is not the same competition among reinsurers for working layers as for the catastrophe layers.

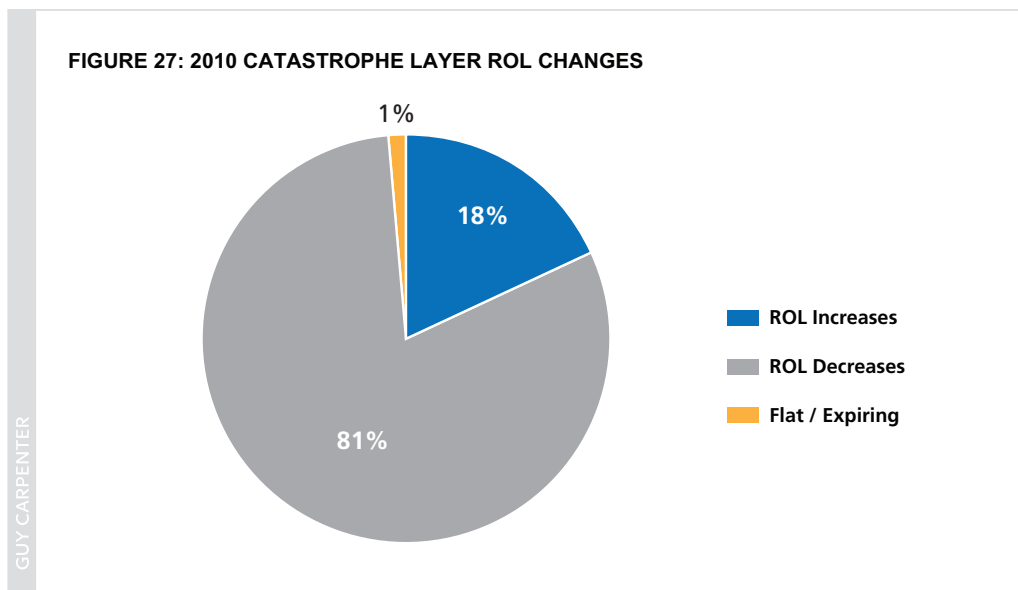
During the major renewal dates of 2010 working layers where comparison was possible, pricing tended either to increase or remain as expiring. Rate decreases were limited. We expect a similar outcome from the January 1, 2011 working layer renewals.



Source: Guy Carpenter & Company, LLC

Standard workers compensation multi-claimant / catastrophe layer capacity is about USD500 million for natural hazard and man made disaster events. Capacity is well in excess of what is required by only a few large workers compensation carriers. The workers compensation catastrophe reinsurance market has experienced continued price softening since 2003 along with more generous terms and conditions. During the major renewal dates of 2010, rate on line (ROL) decreases dominated increases or expiring ROLs. Average ROL decrease was over 7 percent with the typical range of decreases being from 5 percent to 10 percent. We are seeing a similar average decreases in an early review of bound January 1, 2011 renewals.

There is a loss limiting feature to the workers compensation catastrophe product referred to as a maximum any one life warranty, referred to as the MAOL. The MAOL is the maximum that any one injured employee can contribute to the loss. MAOL's have evolved from USD2 million in 2002 to USD10 million or more in 2010. In addition to the ample capacity for workers compensation catastrophe business, workers compensation catastrophe models for earthquake were updated in 2009, and ceding company projected losses for return periods at 100 and 250 years reduced notably from the prior model versions.



Source: Guy Carpenter & Company, LLC

There are two fairly recent developments in workers compensation reinsurance. Working Layer reinsurer demands for additional catastrophe capacity in exchange for supporting working layers and ceding company strategies involving reinsurance purchasing

In the working layer sector, there is a small group of reinsurers who have invested the resources to evaluate and support single claimant exposed reinsurance. Severity trends and the 10-20 year tail exposure to medical inflation (in a challenging investment market) have reinsurers being cautious in supporting working layers. In order to support working layers we are seeing an increasing number of reinsurers require sizeable minimum lines from the overlying workers compensation catastrophe programs to help subsidize the working layer risk. Many stand-alone workers compensation catastrophe-only reinsurers are seeing their capacity reduced in order for the reinsurers supporting the critical working layers to get their minimum requirements.

The overall market appears to be quoting a little later than usual, and it looks like it may be tied to more structure / program changes than usual for the January 1, 2011 renewals. Some clients are sensing an increased exposure to workers compensation volatility in 2011 and are seeking additional stability by reducing their working layer retentions.

Other companies are looking at structure changes tied to the decision to reduce the reinsurance "spend" in addressing expense ratio pressures. Ceding companies are making some very difficult decisions with their reinsurance buying based on controlling / reducing expense ratios.

UK Motor

Reinsurance rate changes varied widely for UK motor at the January 1, 2011 renewal. The most favorable rates maintained expiring rates on income, with allowances for underlying rate increases. There were some significant increases, however, with rate-adjusted costs for reinsurance approaching 50 percent. The cedents attracting the most favorable pricing were large, well-balanced accounts with diversified distribution and long-term viability. They also placed motor as part of a motor and liability program, had histories of genuine relationship management, demonstrated claims-handling expertise and paid a significant premium into the market.

A rise in the number of quota share deals at the most recent renewal made the coming of Solvency II a concern for motor mono-lines, especially those that may have been more thinly capitalized. Capacity remained abundant, with approximately 40 markets able to write effectively unlimited business, and constraints on motor retrocession availability did not have an effect on cedents and markets.

There are two major loss issues facing the UK motor reinsurance business: periodic payment orders (PPOs) and a possible reduction in the discount rate from 2.5 percent. The gross (undiscounted) reserves are reason for concern, especially with normal life expectancy with respect to a minor (gross reserves in excess of GBP30 million). In particular, this affects reinsurers whose accounting methods prevent the discounting of reserves. Also, PPOs doubled from the end of 2009 to 2010.

Perceptions of these developments differ among reinsurers. Taking an overly pessimistic view of this systemic issue means effectively taking themselves out of the UK motor market, but some estimate that a one percentage-point reduction in the discount rate could add twenty percentage points to forty percentage points to their ultimate loss ratios. This is an issue to watch closely.

General Liability & Professional Lines UK

The difficult economic environment continues to be of concern to insurers across all casualty and professional lines. The erosion of underlying fees/turnover/payroll affects premium levels for all lines. Increased incidence of fraud particularly affects professional lines and employers' liability insurance.

The financial pressures on many insureds are expected to transpose into increased litigation and adversely impacted loss ratios. There is widespread concern over sovereign debt in the so called PIIGS (Portugal, Italy, Ireland, Greece, Spain) economies and the impact this may have on financial lines insurance.

To exacerbate this situation, of equal concern to insurers, are the low investment returns available. These levels can no longer supplement a moderate underwriting loss ratio. Bodily injury losses are affected by the possibility of a reduction in the discount rate and the potential for periodic payment orders (PPOs). While less of an issue under limited employers' liability policies, PPOs remain of concern to insurers.

Primary employers' liability rates are relatively static and must be considered in the context of the poor underwriting loss ratios for this class, rather than viewed in isolation. The loss ratios are augmented with the better performing third party element of the original risks as these classes continue to be written on a combined basis. Stand-alone employers' liability policies are rarely written.

Capacity for all casualty and professional lines is abundant and this continues to suppress rates. On a positive note, however, is the disciplined approach the market has to non-mandated original policy wordings, which remain predominantly unaltered. .

What should not be underestimated is the positive impact of actuarial analysis. Insurers are able to manage their portfolios to a degree that has not been possible in previous market cycles.

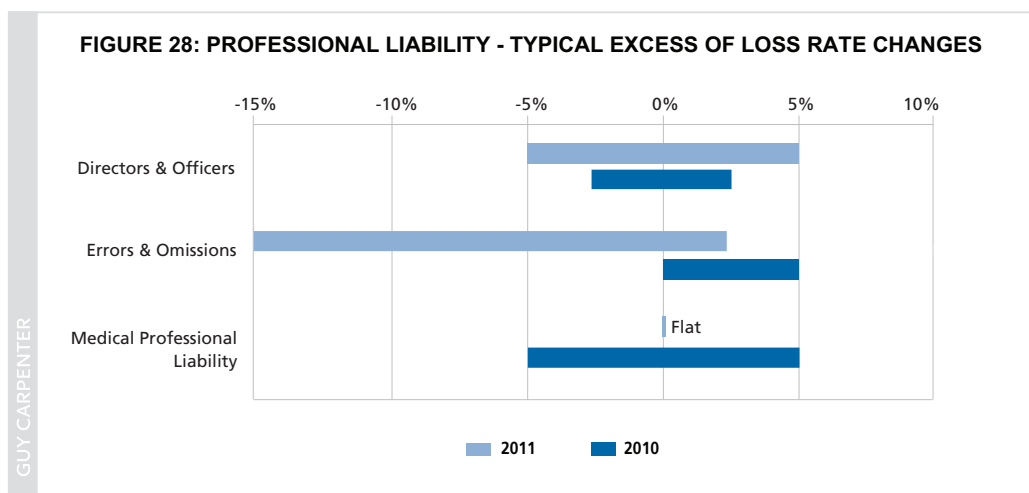
Reinsurance casualty claims are relatively benign and as a result reinsurance costing generally follows the original market. To some extent the same is true of professional lines, although those portfolios with an active loss history or perceived exposure to recession have received upward adjustments. Financial institutions exposures are attracting rate increases following the "cat" impact of Madoff, the subprime crisis and now, Storm Financial.

The implications of the tail on claim reserves (and the accompanying change under Solvency II) are becoming increasingly recognized. As a result, there is more interest in quota share treaty and adverse development reinsurance solutions, which reinsurers are very happy to provide.

Casualty capacity is abundant, especially for non-accumulating portfolios where we have seen increased appetite and new entrants.

Professional lines has seen some reduction in capacity, but with significant retentions on increasingly diversified accounts this has yet to be market-changing. There is a distinct lack of appetite for financial institution business and the market aggregate for peak risks in this sector has reduced significantly.

Professional Liability



Source: Guy Carpenter & Company, LLC

Directors & Officers

Pricing for proportional and excess of loss programs were flat for directors and officers (D&O) reinsurance at the January 1, 2011 reinsurance renewal.

The stock market recovery has brought mixed outcomes for D&O carriers. The recovery from the nadir of the financial crisis increases potential exposure, but low volatility mitigates this risk. This year, commercial rates fell 10 percent to 15 percent, largely because of a significant increase in capacity over the past three years and a relatively benign loss environment.

Financial institution rates, meanwhile, declined 5 percent to 10 percent, as the renewing risks are coming off of up to two years of substantial increases. In addition, many risks priced in 2008 or early 2009 based on a high probability of bankruptcy have been given significant rate relief in late 2009 and 2010. Further, several favorable court decisions on financial crisis lawsuits have left carriers less pessimistic about worst case scenarios. Nonetheless, carriers remain cautious in the community banking space, where there is a clear dichotomy between rates in relatively healthy areas (e.g., Northeast) versus other areas severely impacted by the real estate bubble (e.g., California, Georgia, Nevada and Florida).

Carriers continue to take down redundancies from the 2003 to 2006 accident years, but most of the profits from those years have been fully realized. Insurers have assumed incremental increases in loss ratios for 2011 based on continued rate softening.

Absent a new loss paradigm in the commercial sector, rates are expected to fall, although perhaps more modestly than in 2010. In the financial institutions segment, rate reductions may accelerate based on the view that carriers are further removed from the turmoil of 2007 to 2009.

In the commercial area, reinsurers are monitoring their exposure to the Deepwater Horizon event in the Gulf of Mexico, but so far it is not viewed as having a material impact to any carrier's D&O portfolio. Reinsurers in the financial institution segment continue to be focused on the resolution of financial crisis claims from 2007 to 2009, but there have been no new significant claim issues to arise.

Reinsurers are examining the potential effects of the Dodd-Frank Wall Street Reform and Consumer Protection Act, but this is not affecting their appetite for the class of business. Reinsurers have also noted an uptick in regulatory actions such as (in)formal SEC investigations and increased Justice Department and SEC vigilance around the Foreign Corrupt Practices Act.

Reinsurers have not added capacity to these classes of business. There is arguably excess reinsurance capacity due to the fact that cedents have signed back placements, and a number of reinsurers in this somewhat long-tail class are not approved by all potential ceding companies. The only structural changes we noted at January 1 were increased co-participation and retentions.

In the proportional treaty space, cedents have retained a higher proportion of their business year over year to maintain profitability in the face of a decreasing revenue. As those top line pressures increase in 2011 and begin to significantly impact expense ratios, this trend may reverse if carriers are able to obtain or increase ceding commission overrides. Loss ratio caps or corridors were essentially flat in 2010 and the expectation is the same for 2011. We noticed a slight change in preference from some reinsurers quoting corridors instead of caps.

Errors & Omissions

Per risk working layer program rate on line varied by subclass of business for per risk errors and omissions (E&O) reinsurance. Lawyers professional liability fell 10 percent year over year for the larger law firm segment, while flat to down 15 percent for smaller cedents. Real estate E&O rates were flat to up 2.5 percent year over year, and accountants professional liability was flat to down 10 percent. Large miscellaneous cedents had rate changes that were flat to down 10 percent, with smaller companies flat to down 7.5 percent.

Excess of loss pricing is dependent upon three factors: 1) actual results of the portfolio, 2) rate change on the portfolio and 3) investment returns. As a result of the interaction of these three levers, some programs received slight rate increases because of the deteriorating loss experiences of their portfolios. Some are including additional coverage in the programs as well (e.g., contract wording flexibility and new lines of business such as tech/cyber E&O) while others had decreases.

The exposure base (revenue) was down in several E&O classes (medical professional liability, architects & engineers, technology). It is hard to quantify an exact percentage decrease in revenues year over year, but if the industry were dependent on sectors such as construction, it would be off significantly. This has driven increased competition on the primary business as carriers are seeking to write business, but with a smaller premium base.

There is a dichotomy between reinsurance and insurance pricing as a few reinsurance markets are pushing for rate increases on E&O programs due to either loss emergence or rate erosions. This is causing a significant disconnection between the insurance and reinsurance market and reducing the amount of reinsurance capacity as well.

Cedents were pushing to renew deals at expiring terms and increasing their retentions either through increased attachments or co-participations. Several cedents considered switching from quota shares to excess of loss in an effort to increase retained premium. Consequently, several reinsurance markets elected to reduce their participations on programs due to the concerns stated above, without completely exiting the E&O marketplace. Others are looking to write E&O if the market conditions can be factored into the program.

In 2010 several buyers with proportional treaty structures sought to increase net positions to retain more upfront premium in the proportional treaty segment. There was also a disconnect between the clients' requested terms, e.g., increased ceding commission, removal of line of business restriction, caps, etc., and what the reinsurance markets were willing to support based on the program's performance. There were a few cedents that placed expiring or close to expiring percentages of their reinsurance programs.

Ceding commissions have been challenged due to rate/pricing deterioration on primary business. There were fewer reinsurers willing to support high ceding commissions due to increases in loss development and challenging pricing conditions.

Proportional capacity for this class of business has decreased slightly, but there are several reinsurers that still view E&O more favorably than management liability and other professional liability lines of business.

Medical Professional Liability

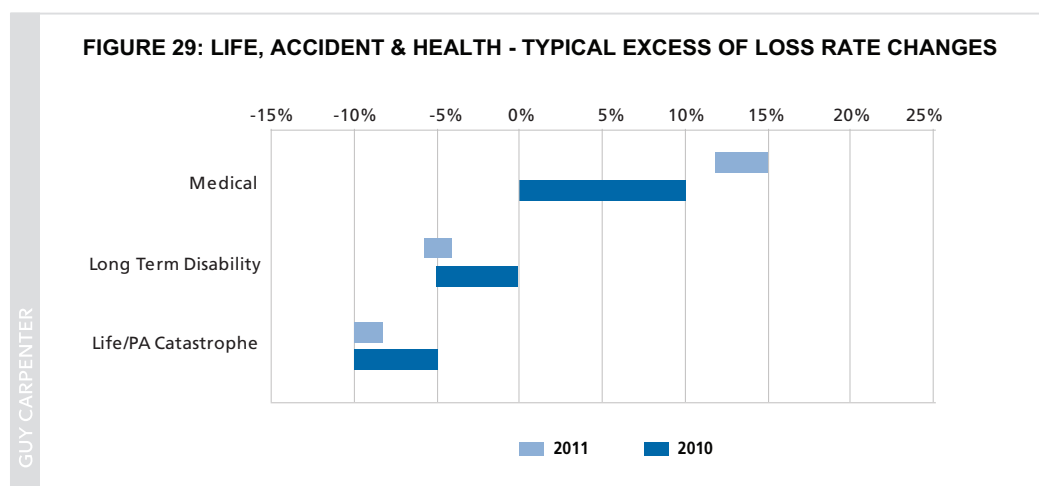
Medical professional liability reinsurance rates remained flat year-over-year for working layers and high-risk excess programs. A strong primary market contributed to this trend, along with increased cedent retentions relative to 2010 (and, for that matter, 2009). There was ample capacity available at the January 1, 2011 renewal to meet cedents' needs.

Rates are down 5 percent year-over-year for medical professional liability insurance, with claims frequency hitting record lows and carriers realizing higher profits. This environment promotes underwriting discipline for long-tail lines of business among carriers, since they cannot engage in "cash flow underwriting." This is reflected in loss ratios for the industry, which are running in the 60 percent range (again, record lows). Continued underwriting profitability is expected through 2011.

As a result of loss reserve redundancy and premium adequacy, merger and acquisition activity continues to be robust in the primary market, with two major transactions in 2010.

Claims frequency has fallen more than 40 percent since the early 2000s, with no indication of measurable increases noted to date. Base premiums are down approximately 5 percent from last year, due largely to base rate decreases and the increased use of rating credits. The principal challenge to the market is the prospect of implementing the new health care program that passed the US Congress in 2010. Carriers believe the legislation will subject them to additional exposure and liability, while also resulting in a smaller miscellaneous professional liability insurance market, as hospitals and large physician groups acquire smaller physician practices.

Life, Accident & Health



Source: Guy Carpenter & Company, LLC

US Personal Accident

Personal accident programs in the United States sustained modest decreases year over year at the January 1, 2011 reinsurance renewal. International treaties, however, saw considerable fluctuation in subject risk due to currency exchange rates, but rate on line tended to be stable, only being pressured on real changes in the underlying exposure.

Several buyers re-evaluated their programs with many making significant changes to their program structures. Insurers with plenty of capital increased retentions. Alternatively, coverage was very affordable and in a market where deep discounts were harder to achieve, a common strategy was to keep expenditure the same and add coverage. This could take several forms, including increased limits, lower retentions overall or in specific regions, and new covered business or territories. The largest program in the market retracted, while others grew the size of their coverage.

Some programs included high layers that respond only to the nuclear, biological and chemical (NBC) peril. The rationale is that NBC losses are the most likely reason those layers could attach, so why pay for other perils? Reinsurers responded with significant discounts, suggesting a differing opinion of x-NBC peril for upper layers, or a strong appetite for x-NBC coverage in their portfolios.

Overall market capacity, new capacity seeking shares in existing programs and a benign loss year across the board combined to continue cedent-advantaged market dynamics. However, it seems that many programs have started to approach minimum rate on line thresholds that markets are resistant to cross, and we are seeing some effects of that. Decreases are more modest than in past years and quoting markets are being disciplined – stepping out of the most aggressively priced covers. However, where markets like the price, they are generally offering full lines, creating a challenging dynamic with a very fine line between a program being unfilled and oversubscribed.

Buyers looking for the largest capacity have the most difficult time finding discounts at this renewal and are welcoming the new market entrants to give them options.

US Individual Life

The amount of life reinsurance purchased has declined each year since 2002. The movement toward lower-reserve products supports this trend, as reserve management has historically been a significant value driver for reinsurance.

Reinsurance pricing in this sector is model-based and reflects recent experience where possible, so it is rare to see big shifts in competitiveness due simply to capacity. However, reinsurers have unique and complex pricing models, creating pricing differences for certain blocks of business. Further, each reinsurer may have very different timing in updating their models to reflect changing outlooks on major pricing factors like interest rates, mortality and lapse assumptions. This dynamic created significant volatility in pricing between reinsurers and within the same reinsurer for different quotes or renewals. We expect more stability, as all major reinsurers have now completed a fairly comprehensive pricing review.

Activity in the market was slowed somewhat as major players focused significant resources on a few very large in-force opportunities and one leading reinsurer looking for a buyer.

While pricing remains disciplined, reinsurer appetite can be seen in other ways. Companies are more open to looking at in-force transactions that we have seen in the recent past. They are also offering slightly better terms in many cases, including higher automatic binding limits. Finally, they are spending more time exploring new product/risk offerings and ways to diversify their business.

In an almost universal trend, both insurers and reinsurers are increasing their retentions – seeking to maximize underwriting profits. This is starting to put pressure on retrocessionaires, creating very high risk concentrations in relatively few policies.

US Medical

Per risk medical reinsurance rates for working layers sustained a wide range of increases, based on actual experience of the underlying business. Average increases ranged from 12 percent to 15 percent, but with considerable outliers.

With more and more claims hitting in excess of one and even two million, these layers can almost be considered working as well. However, experience is quite volatile, and experience rating this year has driven rate changes from down 40 percent to over 250 percent.

The primary concerns in the medical insurance market are related to emerging changes from health care reform. Unlimited lifetime maximums, increasing annual maximums, managing increased minimum medical loss ratios, no pre-existing condition exclusions and more liberal age limitations for covered minors are among the factors that could affect carriers. Primary rates are constrained by regulatory approval and often do not reflect true underlying inflation in costs of coverage.

A large segment of the market is focused on Medicare and Medicaid, with the latter expected to grow significantly due to health care reform changes. In this market, hospital costs are expected to grow between 10 percent and 15 percent. However, physician costs are expected to remain flat or even decrease in some cases due to tighter allowable government reimbursement rates.

Concerned with the unlimited lifetime maximums, many insurers are exploring excess of loss coverage that protects against this risk, and markets are responding. It is becoming common for companies to buy high layers either with a big limit such as USD10 million or even unlimited coverage. Claims have not yet hit these levels in numbers to give any practical modeling guidance. Rather, pricing is more catastrophe-based, with unlimited coverage excess of USD5 million quotes converging to between .20 and .25 per member per month.

As the coverage available is on a risk attaching basis, it does not provide perfect protection for high multi-year claims. This problem will be exacerbated as annual maximums are phased out in 2014. We expect and support continued product development on multi-year and loss occurring products that can better address underlying risks.

Capital markets solutions for managing aggregate exposures came to the market. Similar to extreme mortality bonds, this cover responds to significant shifts in underlying experience, but without much of the basis risk and timing issues present in those structures. The cover attaches well out of the money and can be expected to react only to very sizeable increases in loss such as a pandemic.

The market remains hungry, with both new entrants and existing markets becoming more aggressive. Primary companies are being squeezed between low approved rate increases and higher reinsurance increases. Where possible, they are looking to increase retentions rather than pay an increasing share of their revenue for reinsurance. This forces reinsurers to push hard for the best business, keeping increases below trend in most cases.

The new interest in unlimited coverage for stop loss programs led to some speculation whether there would be sufficient capacity for these layers. However, after some initial resistance, a few reinsurers offered the cover, but required participation in lower layers or even within retention. However, other markets soon rushed to fill the vacuum and some of the initial requirements have been relaxed.

US Long Term Disability

Several factors converged on the long term disability reinsurance market to result in a year-over-year price decrease of approximately 5 percent. Non-price terms and conditions favored reinsurers slightly.

With benefit costs rising and revenue falling, employers sought ways to limit their spending while still providing valuable benefits to their employees. This is leading to increasing use of voluntary supplemental benefits (including disability insurance) where the company's share of costs are fixed and the employee can choose to participate in a little or a lot and pay the difference themselves.

Most plans began to deteriorate because of increased incidence and lower terminations – two factors that led issuers to consider or implement higher retentions. This resulted in reductions in ceded reinsurance. Consequently, reinsurers have had to compete on price and value-added services to maintain market share.

Regulatory charges in Europe could increase European reinsurers' cost of capital supporting this business, putting additional pressure on margins. Finally, disability rates have historically been difficult to predict due to the ability of insureds to decide, in some cases, whether or not to submit a claim. Many participants in this business feel the experience could continue the downward trend, given policyholders' reactions to the economic environment.

Global

Reinsurance rates for global life, accident and health (LA&H) cover fell 5 percent year over year for loss-free programs. The US, London and broad international market followed this pattern, while China was flat at the January 1, 2011 reinsurance renewal. Per risk rates were flat from last year to this year.

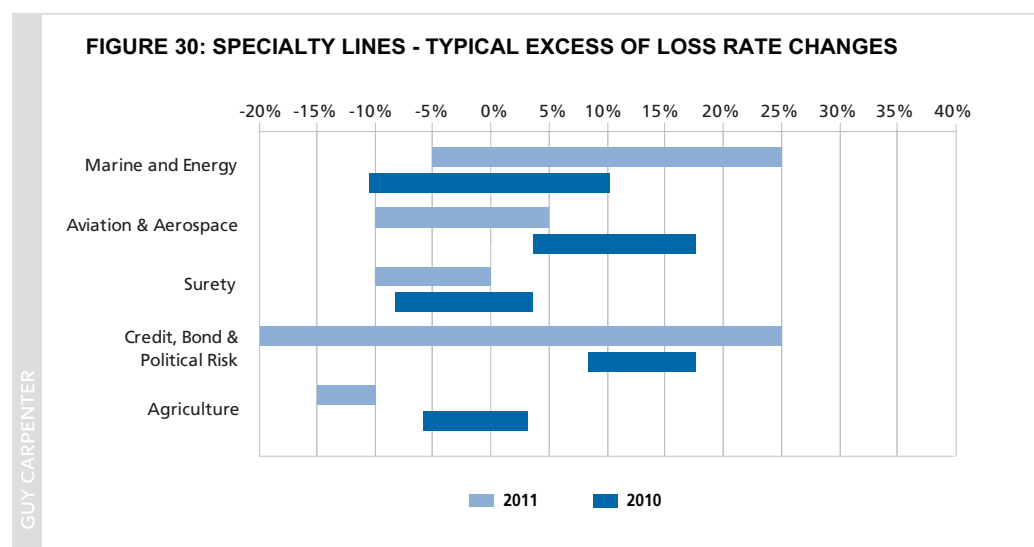
Concerns about a recession-driven rise in fraudulent claims did not materialize, and reinsurers' capacity increased. The outcome was a blended rate change of down 5 percent, with catastrophe nuclear, biological and chemical (NBC) down 10 percent and generic group personal accident (PA) flat in the primary market. Loss ratios remained stable, and the outlook for primary insurers in 2011 echoes this sentiment.

Losses were insufficient to change the global LA&H market in 2010. Subject base exposure was flat to up 5 percent, led by the economic recovery in the US and developing countries. Subject base exposure was up 20 percent in China, for example, as the economy continues to mature. Solvency II has led to several inquiries about abnormal mortality stop loss covers.

There was ample capacity for 2011, with USD350 million available for US and international risks – an increase of approximately 10 percent year over year. Some new entrants were notable, and no major players left the global LA&H space. London excess of loss capacity was USD50 million, up 20 percent year over year, and London Direct and FacD&F (Direct & Facultative) grew from USD50 million in capacity to USD60 million year over year. Reinsurers are now tending to write their maximums.

On the cedent side, some companies sought cost efficiency by combining PA and life purchases. Industry loss warranty (ILW) interest is also increasing.

Specialty



Source: Guy Carpenter & Company, LLC

US Marine & Energy

US marine and energy rates on line generally renewed at expiring terms for loss-free programs, and very few programs had losses. Those that did saw reinsurance rate increases of up to 10 percent, but they mitigated the cost by increasing retentions.

The cargo market is still impacted by reduced economic activity in the United States: Competition is fierce for a smaller volume of traded goods and cargo insurance. Cargo rates are off 5 percent to 10 percent, and hull is renewing at expiring terms. Offshore energy pricing is higher, and more liability limit is being bought following the Deepwater Horizon event. Offshore primary market energy rates increased 15 percent to 20 percent following this incident, compared to reductions of around 10 percent before April 2010. These trends are expected to continue in 2011.

In the reinsurance market, excess of loss is renewing at expiring terms or at a slight reduction of up to 5 percent where the program's record is superb. Many cedents did not attain EPIs (earned premium incomes) and sought relief from reinsurers. Programs without energy exposure are particularly attractive to reinsurers. Thus, they are renewing at expiring terms and pricing, while energy renewals are up 25 percent to 35 percent in London market. Capacity remains abundant.

Global Marine & Energy

Reinsurance rate on line (ROLs) for the international marine and energy market varied by sector at the January 1, 2011 renewal. Hull and war and marine liability were both flat, with cargo flat to down 5 percent and energy and energy liability up 10 percent to 15 percent.

While the global economy is recovering slowly from recession, the benefits to the marine insurance market are limited. The primary reason is that there is excess capacity. As a class, cargo is firmly at the bottom of the cycle, recently quoted by one Lloyds underwriter as "the worst he had experienced." Hull rates are generally flat, as plentiful new capacity has flooded into the market.

The Deepwater Horizon loss in April has reversed the negative trend in the energy sector, albeit not to the extent expected. The anticipated increase in buying activity in the energy excess liability sector is unlikely to materialize until the US government requires increased limits through the Oil Pollution Act.

Nevertheless, the impact of the Deepwater Horizon event on reinsurance rates is likely to involve significant increases on the programs affected most severely. After all, this will be the largest risk loss suffered in the marine market.

Energy liability business is likely to come under greater scrutiny in terms of transparency and multi-assured interests. Energy programs that cover significant liability exposures are also likely to be subject to restructuring, with the potential for additional separate pillars being required. Retrocession business should experience substantial increases based on the deepwater loss scenarios which, on mid-based estimates, will generally erode 60 percent to 70 percent of the existing program. Hull, cargo, war and marine liability contracts will likely be flat unless the loss record dictates otherwise.

Generally, exposures in this sector appear to be flat. Consequently, the key driver will be loss experience. Energy-related programs can expect reinsurance rate increases of 15 percent to 30 percent, depending on the loss and liability content. All other classes remain favorable to cedents, and rating should remain flat. Given that the direct energy market appears to be struggling to achieve expected rate increases, there exists the possibility of a disconnection between the direct and reinsurance market in this class.

In 2011, sanctions clauses are likely to have an impact on reinsurance coverage in international marine and energy. Specific issues include whether a standard market clause is being applied by the direct markets and whether clients will accept the reinsurers' insistence on a sanctions clause within contracts.

Global program purchasing, voluntarily increased retentions and co-insurance on higher ROL layers look to be a potential trend. More vertical coverage may be required should energy liability and physical damage remain on a combined basis.

Capacity is plentiful, with reinsurers looking to write more business in certain areas. Several players are viewing the increased retrocession prices as now being at the requisite level to enter the market place. They feel this offers a good opportunity to write the business, though there is a potential sense these entrants will only offer capacity short term which could work against clients over the longer haul should they decide to consider this option.

For proportional treaties, there is increased capacity available for energy quota shares following the increase of rates in the offshore space. For marine, there were no new market entrants. Meanwhile, hull and cargo proportional capacity continues to reduce due to primary market rating and performance.

Global Aviation & Aerospace

With continuing reductions in the direct airline market and capacity in excess of 200 percent, primary insurance rates will continue to drop in 2011. This will lead to more pressure on the reinsurance market to offer reductions, except in the event of a major incident or a substantial drop in capacity.

Airline rates continue to fall because of over-capacity in the market and intense competition among insurers to obtain the best terms available. Exposure drove rate activity, as airlines with significantly increased exposure were able to secure greater rate reductions than their peers with moderate-to-flat exposure changes. Insureds with significant loss ratios sustained rate increases, and in some cases, underwriters were able to write business at their own terms. Meanwhile, insureds with limited loss activity were able to negotiate minimal rate reductions.

The underlying aviation market clearly has been impacted by the recession, mainly in Western Europe and the United States. Insurers are conscious of reduced passenger numbers and other business activity, but with the year-over-year increases in passenger liability awards, severity remains a crucial component within modeling systems.

The airline segment has incurred significant net losses to the portfolio again this year, with no major incident impacting the excess of loss market to date. This will be the third year the airline insurance industry has incurred a loss ratio above 100 percent – the most significant losses in 2010 were sustained by Afriqiyah Airways, Air India Express, Saudi Arabian Airline spares warehouse and the first major loss to the Airbus A380 operated by a commercial airline.

With no sign of capacity falling this year, primary market rates could continue to decline for accounts renewing in the first and second quarters of 2011. Consequently, it is difficult to predict if the airline market is at the bottom of the cycle.

In February the general aviation market incurred its largest insured loss of the year: the collapse of the Dulles hangar, which damaged high value corporate/executive jets. To date the incurred loss reserve is greater than USD200 million, which has impacted both the general aviation risk excess facilities and major excess of loss programs. After this incident, the reinsurance market started reviewing the general aviation risk excess rating mechanism used to rate this business, and throughout 2011, insurers will seek to apply premium increases on all hull and liability risk excesses, which in turn will increase the underlying direct rates in this sector.

Insurers affected by the Dulles hangar, Saudi Arabian Airlines spares warehouse and Afriqiyah Airways losses in 2010 – or the two major losses in 2009 – have seen varying degrees of increases, depending on loss participation size. The majority of increases have been contained within the primary layers.

Insurers not impacted by these losses have seen substantial rate reductions across all layers. With no major incident hitting the lower layers and sufficient capacity available at all levels, insurers have been able to retain their current risk participations.

The capacity on the excess of loss market remains plentiful at all levels, although the layers attaching less than USD300 million original market loss (OML) for the major risks remains tighter with a smaller selection of lead markets.

The market and available leaders for general aviation are more limited and is reviewed continually.

Following the Dulles hangar collapse and the two major airline losses in 2009, some insurers who write a full book of major risks have been faced with a choice of price or retention increases, or both. For insurers with an attachment level of the equivalent of USD200 million OML increased their retention level to USD250 million OML for economic reasons and cost savings.

From a structural perspective, there were limited changes, other than higher retentions applied where insureds were impacted by losses. However, most insurers are continuing to purchase up to 1.5 times or twice their maximum lines to address potential clash scenarios.

US Surety

Continued industry profitability combined with decreases in exposure, and revenues have led to a decline in surety reinsurance pricing at the January 1, 2011 renewal. This follows relatively conservative pricing for the past three years, resulting from reinsurer uncertainty about the potential impact of the credit market developments in 2007 and ensuing financial crisis and recession. Reinsurers are modifying their outlooks on the market, which is leading to reductions in pricing because of low underlying losses.

Contract (Construction) Surety

Public construction spending is a key indicator for the contract surety segment, since most publicly funded projects are legally required to be supported by surety bonds. This measure has increased each year from 2002 through 2009. Public construction spending is generally expected to be flat or increase a few points in 2011.

Primary market surety pricing is flat year over year. Historically, it has been stable over long periods of time, and rate changes are not a primary driver of competition for the surety market. Changes in the size of work program or commission paid to brokers tend to be the areas that have the most impact in stimulating competition for writing new business.

Commercial Surety

It is not possible to identify an overarching position on rate changes in commercial surety due to the diversity of underlying obligations and related industry segments represented. The commercial surety segment has seen increased competition over the past 24 months with the entrance of new primary players. This has led to terms that favor original insureds, including larger lines of credit and reduced security requirements, along with rate decreases of 5 percent to 10 percent in certain pockets for high quality credits.

Outlook for 2011

Expectations are that loss ratios for contract surety will increase slightly in 2011 from their current levels due to an increase in frequency from smaller exposures. Even if loss ratios creep into the low 20s they will still be well below historical averages of closer to 35 percent and will generate strong profits for the industry.

Reinsurance pricing for surety programs has been at elevated levels relative to the underlying experience for the past three years. This has been driven in part by reinsurers' fear of the economic crisis resulting in industry wide loss activity. Based on actual results for the past three years, reinsurers are revising their market outlooks and corresponding views on pricing levels. As long as results continue in line with the past few years, reinsurance pricing is likely to decline in the coming year.

Surety reinsurance markets were again highly profitable this past year. Most surety reinsurance programs are written on an excess of loss basis, and loss activity has for the most part been retained net by the ceding companies. A small number of surety programs have experienced losses into the excess layers; however, this is not necessarily indicative of a trend toward deteriorating excess of loss results going into 2011.

Global Credit, Bond and Political Risk

Loss experience defined the credit, bond and political risk reinsurance renewal, with loss-free programs securing significant rate declines and those affected seeing steep increases. Reinsurance rates on loss-free working layers fell 20 percent on average, while those with losses saw increases of 15 percent to 25 percent, depending on severity. Rate increases were slight for high-risk excess programs if there was underlying activity and flat where there was none.

Primary market rates fell 5 percent to 10 percent in the credit, bond and political risk space, as market conditions (and loss ratios) have improved faster than even the most optimistic of forecasts. Though the number of insolvencies rose in 2010, there was a marked improvement in the industry, and 2011 is likely to be better than 2010, much better than 2009 and significantly better than 2008 (the year in which the global financial catastrophe struck).

Frequency was a greater challenge than severity in 2010, as loss activity generally did not reach attachment levels. Credit reinsurance exposure increased 25 percent to 30 percent year over year, with bond up 5 percent and political risk down 10 percent.

There were no significant changes to reinsurance structure for credit, bond and political risk treaties. Capacity was up across the board. Though the increase was only slight for political risk, there was a noticeable increase for bond risk and an even greater gain for credit risk.

For proportional treaties, profitable programs were up 10 percent because of a combination of ceding and profit commissions.

Contact Information

This report was prepared by Guy Carpenter's Business Intelligence Unit, with input from our Specialty Practice and Territory Leaders. Please contact one of the following team members if you have questions or require additional information.

David Flandro, Managing Director
Global Head of Business Intelligence
London, UK (44) 207-357-3267
david.flandro@guycarp.com

LOB Specialty	Leader	Office Location	Office Phone	Email
Specialties Practice Leader	Jeff Krohn	Philadelphia, PA - USA	(215) 864-3623	jeffrey.n.krohn@guycarp.com
Property	Lara Mowery	Minneapolis, MN - USA	(952) 832-2104	lara.a.mowery@guycarp.com
Property	Subhashish Dutta	New York, NY - USA	(917) 937-3191	subhashish.dutta@guycarp.com
Retro	James Boyce	London - UK	(44) 207-357-2631	james.boyce@guycarp.com
Casualty Lines				
US Casualty Leader	Janis Berger	New York, NY - USA	(917) 937-3398	janis.berger@guycarp.com
Auto and General Liability	Janis Berger	New York, NY - USA	(917) 937-3398	janis.berger@guycarp.com
Casualty Clash	Nicolaas Olijslager	Morristown, NJ - USA	(973) 285-7970	nicolaas.c.olijslager@guycarp.com
Excess and Umbrella	Josh Everdell	Norwalk, CT - USA	(203) 229-8805	joshua.w.everdell@guycarp.com
Workers Compensation	Aaron Bueler	Seattle, WA - USA	(206) 223-4891	aaron.d.bueler@guycarp.com
Professional Liability				
Professional Liability (International)	George Carrington	London - UK	(44) 207-357-5237	george.carrington@guycarp.com
Professional Liability Directors & Officers (D&O)	Nick Durant	Boston, MA - USA	(617) 424-3914	nicholas.l.durant@guycarp.com
Medical Professional Liability	Steve Underdal	Minneapolis, MN - USA	(952) 820-1030	Stephen.Underdal@guycarp.com
Specialty Lines				
Agriculture World Wide Leader	Ralph Bone	Minneapolis, MN - USA	(952) 832-2128	ralph.g.bone@guycarp.com
Agriculture - US Co-Leader	Jim Christianson	Minneapolis, MN - USA	(507) 537-1924	jim.christianson@guycarp.com
Agriculture - US Co-Leader	Mark Lenhart	Minneapolis, MN - USA	(952) 832-2226	mark.lenhart@guycarp.com
Aviation	Ian Wrigglesworth	London - UK	(44) 207-357-5225	ian.c.wrigglesworth@guycarp.com
Construction All Risk/Engineering All Risk	Simon Hayes	London - UK	(44) 207-357-2019	simon.hayes@guycarp.com
Credit, Bond and Political Risk	John Orchard	London - UK	(44) 207-357-1180	john.orchard@guycarp.com
Life, Accident & Health (US)	David Rains	Philadelphia, PA - USA	(215) 864-3786	david.a.rains@guycarp.com
Life, Accident & Health (International)	Shaun Scade	London - UK	(44) 207-357-2398	shaun.scade@guycarp.com
Marine & Energy (US)	Steve Vivian	New York, NY - USA	(917) 937-3374	stephen.vivian@guycarp.com
Marine & Energy UK	Martin Pepper	London - UK	(44) 207-357-2255	martin.pepper@guycarp.com
Surety - US Co-Leader	Eric Van Elkan	Glendale, CA - USA (Alabama)	(205) 870-4950	eric.van.elkan@guycarp.com
Surety - US Co-Leader	Scott MacColl	Philadelphia, PA - USA	(215) 864-3648	scott.maccoll@guycarp.com
Terrorism	Paul Knutson	San Francisco, CA - USA	(415) 819-2806	paul.r.knutson@guycarp.com

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