2008 Special Report

Global Reinsurance – Market Review

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Global Reinsurance – Market Review

September 1, 2008

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Though Industry Balance Sheets Are Healthy, Challenges Abound

The global reinsurance sector should remain profitable in 2008, though A.M. Best believes results will reflect more accurately market trends as margins are expected to moderate. While industry balance sheets are strong, recent history shows that soft casualty markets can inflict pain on required capital and catastrophes can remove massive amounts of capital quickly. A.M. Best, then, views 2008 as an important year, as it can influence the market for years to come.

- **Top 35 Reinsurers –** Two of Bermuda's "Class of 2005" made the list for the first time. The top five reinsurers were unchanged from 2006.

- **Nonlife Renewal Trends –** Property pricing fell at about double-digit rates for U.S. business. Casualty pricing was falling more gradually, though some primary writers cut rates to gain market share.

- **Insurance-linked securities –** Issuance exceeded $7.3 billion in 2007, a record. Softer prices may lead to fewer deals in 2008.

- **Life Reinsurance –** Longevity and investment risk are among the few avenues to growth.

- **U.S. Reinsurers –** First-quarter 2008 underwriting results deteriorated with sustained competitive pressures.

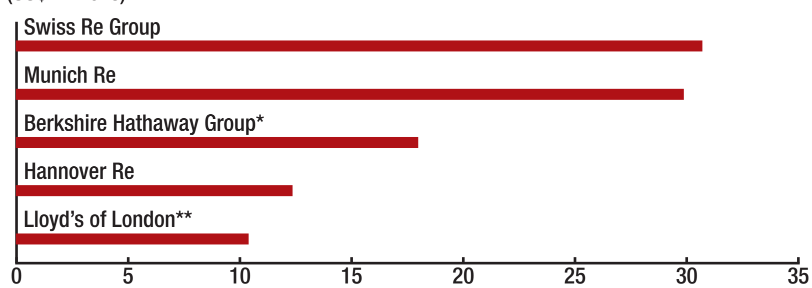
- **Bermuda –** Established players, maturing class of 2001 and recent class-of-2005 entrants continue to influence the global industry.

- **Europe –** Reinsurers may be the main beneficiaries as companies seek relief from higher capital requirements under Solvency II.

- **Lloyd's and the London Market –** The market cycle and investment-market volatility make 2008 a challenging year.

- **Asia/Pacific –** Capitalization will remain stable, but reinsurers with high equity exposure will have more volatile results.

2008 Top 5 Global Reinsurers
Ranked by Consolidated 2007 Reinsurance GPW
(US$ Millions)



*Gross premiums written are estimated by A.M. Best using publicly available financial filings. Included in 2007 GPW is a one-time, $7.1 billion premium attributed to the Equitas transaction.
**Lloyds premiums are all inclusive. GPW for certain groups within the rankings also may include Lloyd's Syndicate GPW when applicable.
Source: A.M. Best Co.

Overview & Outlook: Profits Under Pressure

The global reinsurance sector rode two years of moderate catastrophe losses and solid operating earnings into 2008, although catastrophe activity has increased in the year to date and more is expected, particularly in the form of Atlantic hurricanes. The sector's capitalization and the majority of its participants are healthy when just a few years back, many reinsurers needed to find capital. The hard market years and intensified risk management have left several companies with stronger loss reserves, while losses from earlier soft market years are a lingering but diminishing drag for a handful of companies. Nonetheless, with both property and casualty rates softening again, current reserving isn't likely to be sustainable or reliable for boosting earnings in future years.

Meanwhile, the weakening global economy and turmoil in the equity and capital markets have added to the pressure on reinsurers. Faced with shrinking profits, businesses are watching their expenses – including insurance costs – closely. Primary insurers are passing the pressure through to reinsurers. And as equity and credit markets falter, investment income also comes under pressure, providing less of a margin for error on the underwriting side.

While the reinsurance sector's position has improved, challenges remain in light of participants' increased capacity, new entrants and new forms of capital. The reality of the capital markets is now hard to ignore as an alternative solution for primary companies looking to manage risk. After paying high reinsurance costs over many years, financially stronger cedants are more sophisticated and are assessing how much reinsurance coverage to buy in more economic terms.

A.M. Best has seen the reinsurance sector embrace enterprise risk management (ERM) practices. However, enhancements to ERM have not been tested by a mega-catastrophe: two Category 5 hurricanes did make landfall in 2007, but the storms' paths – away from the United States and into areas with less insurance penetration and less value at risk – limited insured losses.

Outlook

Depending on catastrophe activity, A.M. Best Co. expects the reinsurance sector to be profitable for 2008, given that technical rates in most major lines remained profitable at this writing. Through the first half of 2008, insured U.S. catastrophe losses were $8.9 billion, already exceeding the total for 2007 and approaching the total for 2006, the Insurance Information Institute reported. But higher retentions at primary insurers and a continuing shift from quota-share reinsurance to

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excess-of-loss coverage have restrained reinsurers' share of catastrophe losses.

A.M. Best believes 2008 results will reflect more accurately current market trends, as margins are expected to moderate. Barring a mega-catastrophe that removes enormous amounts of industry surplus from the market, A.M. Best does not expect prices to increase for some time. Success in navigating these rough waters depends on reinsurers maintaining underwriting controls and standards to set adequate prices as they remain disciplined in a challenging environment. History indicates these are not easy tasks.

Although industry balance sheets are strong, recent history illustrates the pain that soft casualty markets can inflict on required capital year after year, and how large-scale catastrophes can remove massive amounts of capital from the market in the blink of an eye. A.M. Best sees 2008 as an important year for the reinsurance segment, as it can influence the direction of the market for years to come. A.M. Best expects favorable performance this year, but pricing and competition will shrink operating margins. An obvious caveat is the ultimate level of catastrophe activity for the year. Based on the capital position and improved risk management, A.M. Best maintains a stable outlook for the U.S. and global reinsurance sectors for the remainder of 2008. However, the sector remains subject to macroeconomic factors, and the industry is not at equilibrium.

Global Update: Seeking a Soft Landing

Nonlife Renewal Trends

Nonlife reinsurance renewal rates at July 1 showed a continued, steady descent – best described as a controlled glide, not a crash landing. Reinsurers for the most part maintained discipline in the face of intense pressure from cedants, which have seen steeper declines in almost all primary markets for both property and casualty. A notable exception is financial institutions business, where insurers and reinsurers continue to anticipate large losses in directors and officers (D&O) and errors and omissions (E&O) lines stemming from the subprime mortgage meltdown.

Property pricing generally declined at double-digit rates for U.S. business, including property catastrophe, while non-U.S. business saw varying rates of decline based on loss history. The declines extended even to terrorism exposure, including coverage for U.S. primary writers' retentions under the federal terrorism backstop. In U.S. property catastrophe business, the spreads between quoted and agreed-upon rates tightened, suggesting that reinsurers refrained from quoting unrealistic rates, according to a survey by broker Guy Carpenter.

Casualty pricing was falling more gradually, even as some primary writers cut rates in pursuit of market share. Reinsurers were giving rate decreases, but cedants had to earn them; those with unfavorable loss histories saw rates at best holding steady, and sometimes increasing. Reinsurers continued to seek greater control over pricing by shifting their business from proportional to excess of loss.

The pressure from primary companies reached beyond pricing to terms and conditions, and while reinsurers gave some ground, they were not "giving away" ancillary coverages as they did during the last soft market. As with pricing, terms and conditions depended on loss history; cedants aren't seeing a typical soft market in which reinsurers effectively subsidize primary business.

The increased retentions of primary companies further reduce the demand for traditional reinsurance. After several years of strong results, many balance sheets on the primary side are improved, and companies believe they are positioned to retain more risk. Additionally, many lines of business have demonstrated favorable trends in frequency and severity, such as workers' compensation and medical malpractice. By retaining more business, primary companies also can better maintain volume, as the challenges to grow are not a reinsurance-only issue.

Finally, after paying high costs for reinsurance over many years, primary companies are not blindly purchasing coverage for the sake of it and are looking more closely at the economics of transactions. One factor cedants are examining more closely is volatility; specifically, they are setting retentions to keep the most stable exposure on their books, while offloading the volatility inherent in the higher layers to their reinsurers.

Biggest Reinsurers Hold Their Ground

Global reinsurers enjoyed a strong year in 2007, with 32 of the top 35 companies as ranked by premiums achieving a combined ratio of less than 100. These companies benefited from a benign catastrophe year, and many also released reserves.

Exhibit 1

Top 35 Global Reinsurance Groups

Ranked by consolidated gross premium written in 2007.

(US$ Millions)

2008 Rank[1]	Group Name	Prior Rankings (1) 2007	2006	2005	2004	2003	Consolidated Premiums Gross	Net	Total Shareholder Funds	<-----------Ratios (5)-----------> Loss	Expense	Combined
1	Swiss Re Group	1	2	2	2	2	$30,673	$27,872	$28,453	63.5%	28.8%	92.3%
2	Munich Re	2	1	1	1	1	$29,843	$28,439	$37,997	68.4%	35.3%	103.7%
3	Berkshire Hathaway Group (3)	3	3	3	4	3	$17,952	$17,398	$120,733	72.8%	16.2%	89.0%
4	Hannover Re	4	4	4	3	4	$12,327	$10,779	$5,852	74.7%	25.2%	99.9%
5	Lloyd's of London (4)	5	5	5	5	5	$10,361	$7,990	$25,553	47.5%	34.2%	81.7%
6	SCOR Group (acquired Converium)	9	14	13	7	7	$7,106	$6,501	$5,416	67.9%	32.5%	100.4%
7	London Reins Group	13	8	14	14	12	$6,133	$5,155	$724	N/A	N/A	N/A
8	RGA Reins Co	6	9	12	15	15	$5,371	$4,909	$3,190	N/A	N/A	N/A
9	Transatlantic Hldgs Inc Group	8	11	9	12	11	$4,283	$3,953	$3,349	67.6%	28.1%	95.7%
10	Everest Re Group	7	10	8	8	13	$4,078	$3,919	$5,685	63.7%	27.9%	91.6%
11	Korean Reins Co (2)	12	13	16	17	18	$3,890	$2,775	$569	73.2%	27.1%	100.4%
12	Partner Re Group	10	12	10	13	14	$3,810	$3,757	$4,322	55.1%	31.1%	86.3%
13	XL Capital	11	7	7	9	9	$3,406	$2,812	$9,948	54.1%	29.9%	84.0%
14	Aegon (acquired Transamerica)	18	17	28	25	26	$2,462	$2,173	$22,613	N/A	N/A	N/A
15	Odyssey Re Group	15	15	15	16	16	$2,283	$2,089	$2,655	66.4%	29.0%	95.4%
16	Mapfre	17	26	26	32	35	$1,967	$1,826	$8,379	70.3%	21.0%	91.3%
17	RenaissanceRe	20	21	27	27	24	$1,810	$1,435	$3,478	33.6%	25.7%	59.3%
18	Toa Reins Group (2)(6)	28	32	30	22	20	$1,780	$1,552	$1,610	63.2%	28.6%	91.8%
19	QBE	30	28	24	18	23	$1,683	$1,366	$7,494	50.4%	30.8%	81.6%
20	ACE	21	20	19	23	28	$1,609	$1,578	$16,677	51.1%	24.0%	75.1%
21	Axis Capital Holdings Limited	26	30	34	---	---	$1,551	$1,537	$5,159	54.8%	21.5%	76.3%
22	Arch Reins Ltd	23	23	23	20	32	$1,518	$1,184	$4,036	45.6%	29.0%	74.6%
23	Paris Re	25	24	29	10	8	$1,411	$1,113	$2,474	61.4%	29.4%	90.9%
24	White Mountains Re	24	19	18	26	29	$1,295	$1,095	$4,713	61.1%	32.6%	93.7%
25	Platinum Underwriters Group	27	22	22	31	21	$1,140	$1,120	$1,998	55.9%	27.6%	83.5%
26	Endurance Specialty Ins Ltd	22	25	21	21	33	$1,068	$1,052	$2,512	43.4%	33.0%	76.4%
27	Aspen Insurance	29	31	33	28	---	$1,033	$920	$2,818	53.6%	29.1%	82.7%
28	Validus	---	---	---	---	---	$989	$918	$1,935	33.1%	28.9%	62.0%
29	American Ag	32	---	---	---	---	$847	$460	$553	67.4%	18.0%	85.4%
30	Amlin	---	---	---	---	---	$835	$745	$1,999	25.0%	25.7%	50.7%
31	W.R. Berkley	31	---	35	33	---	$732	$682	$3,569	65.3%	31.3%	96.6%
32	Harbor Point	34	33	32	34	---	$672	$567	$1,579	47.2%	38.9%	86.1%
33	Montpelier	33	35	---	---	---	$654	$549	$1,653	32.0%	29.4%	61.4%
34	Max Re	---	---	---	---	---	$647	$601	$1,584	55.4%	28.5%	83.9%
35	Flagstone	---	---	---	---	---	$577	$527	$1,210	40.5%	32.3%	72.7%

(1) - Rankings based on prior year gross written premium. Excluded are state-sponsored reinsurers.
(2) - Year-end is March 31, 2008.
(3) -Gross premiums written are estimated by A.M. Best using publicly available financial filings. Included in 2007 GPW is a one-time, $7.1 billion premium attributed to the Equitas transaction.
(4) -Lloyds premiums are all inclusive. GPW for certain groups within the rankings also may include Lloyd's Syndicate GPW when applicable.
(5) - P/C only
(6) - While Toa benefited from a strengthening yen against the $US and a growth of approximately 1.5% in NPW, most of their jump in the ranking is due to the fact that their past premiums reported were on an unconsolidated basis.
(N/A) - Information not applicable or not available at time of publication.
Note: In previous year, Generali was ranked as 14 in Top 35 due to the inclusion of intra-group reinsurance. Whereas in 2007, in an effort to be consistent with a uniform methodology, AMB was able to segregate non-affiliated GWP reinsurance assumed by Generali as $506 million, ranking it out of the Top 35.
Source: A.M. Best Co.

The top five reinsurers were unchanged from 2006. These giants had 2007 premiums of about $101 billion, far more than that of the next 30 companies. The top 35 generated some $167 billion in premiums. This concentration at the top makes it harder for cedants to spread risk, but the top five reinsurers also have some of the highest ratings.

Only six U.S.-domiciled reinsurers are in the top 35: Berkshire Hathaway, RGA, Transatlantic, Odyssey, American Agriculture Insurance Co. and W.R. Berkeley. No. 3 Berkshire Hathaway looks poised for growth this year after entering a 20% quota share agreement with top-ranked Swiss Re.

Several European-based companies improved their rankings – not organically, but more likely through the growing strength of the euro against the dollar. Also, French reinsurer SCOR Group jumped to sixth on the list from ninth in 2006, driven by its acquisitions of Swiss reinsurer Converium and German reinsurer Revios. Scottish Re, which encountered financial difficulty, fell from the top 35, but another life reinsurer, London Reinsurance Group, vaulted to eighth place from 13th as it participated in a one-time finite reinsurance transaction.

Members of Bermuda's Class of 2005 broke into the top 35 for the first time. Validus was aided by its acquisition of Talbot, a Lloyd's insurer, in 2007 – a purchase that added more than $285 million to Validus' premium volume. Flagstone Re made the list on the strength of an acquisition, and with the help of Allied World Assurance's fall from the rankings. Allied World has launched a new U.S. platform, however, which could in time propel it back into the top 35. Max Re, a 2001 start-up, made the top 35 in 2007 primarily because gross premiums written increased through seven life reinsurance transactions and the inclusion of its newly acquired surplus lines business.

Overall, positive rating activity among the top 35 reinsurers has outpaced negative activity.

Conversely, there may be some movement back toward lower retentions as cedants seek to shed business written at unprofitable rates; already in 2008, brokers report that 2007's upward trend in retentions appears to be leveling off. This and other factors may offer some signs of hope for reinsurers facing ever-increasing pressure to loosen their underwriting. The absence of a single major loss since the 2005 hurricane season has fueled excess capacity in the market, but it also may be fostering an uneasy sense that statistically, the next big catastrophe is overdue. This in turn could drive some increase in demand for reinsurance. There also are some signs of capacity leaving the reinsurance market, and on the primary side, reserve releases eventually will be exhausted as a buffer against the effects of the soft market.

Meanwhile, the credit crisis and related turmoil in the financial markets have planted doubts among insurers and reinsurers about their ability to recapitalize after a mega-catastrophe. Will there be enough liquidity? The answer is not clear, but the uncertainty gives underwriters another reason not to gamble with underpriced business.

Charting Strategies

Growth, Diversification & Capacity

The reinsurance sector has seen all three major players – traditional reinsurers, primary insurers and the capital markets – encroach on one another's turf. Companies such as Munich Re, Allianz, Swiss Re, American International Group and Ace Ltd. are spread across reinsurance and primary insurance – some quite visibly, others with a lower profile. Pure reinsurers are increasingly rare, and those that have expanded their reach into the primary and capital markets have few regrets, although there are caveats.

Sales and administration differ between the primary and reinsurance sectors, but otherwise the business is the same in many respects. Straddling both markets can help a group to better manage through the market's cycles and provide the reinsurance side with insight into the primary business. However, leakage of client-specific information from one side to the other could irreparably damage the reinsurer's perceived trustworthiness and reputation.

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Capital Markets Ascending

By just about every measure, 2007 was a banner year for property/casualty risk transfer into the capital markets. Issuance of insurance-linked securities (ILS) topped $7.3 billion, up by more than 55% over what had been a record $4.7 billion of bonds issued in 2006.

New issuance in 2008 may not outpace the record amount of issuance in 2007, however. Reinsurance pricing remains soft, while several primary insurers and reinsurers opted in 2006 and 2007 for multiyear transactions – meaning they won't have to tap the market again this year for similar coverage needs. Through June 2008, catastrophe bond issuance was about $2.4 billion, down from slightly more than $4.0 billion for the same period in 2007.

New sidecar capital illustrates how softer reinsurance prices and somewhat ample capacity in traditional markets are impacting the alternative risk transfer market. Total sidecar capital (debt and equity) in 2007 fell to about $1.9 billion, compared with about $4.5 billion in 2006. Through June 2008, Globe Re, a $133 million transaction sponsored by Hannover Re, represented the year's only dedicated sidecar.

The outlook for new catastrophe bond issuance always could change. Should a particularly devastating hurricane season or other catastrophes produce significant third-quarter losses, capital needs could result in more bond deals or even another wave of new sidecars in the final months of the year.

And because of the negative sentiment in global credit markets in the past year, more companies may consider contingent capital facilities. The industry is keenly aware that its ability to replenish capital through debt and equity offerings may not reach the heights achieved after hurricanes Katrina, Rita and Wilma (KRW) in 2005.

The transaction announced in early July between the Florida Hurricane Catastrophe Fund (FHCF) and Berkshire Hathaway Inc. is a recent example. It illustrates how contingent capital products structured as put options can satisfy capital calls in the wake of severe losses and result in lower pricing than traditional reinsurance. In exchange for a payment of $224 million, Berkshire agreed to buy $4 billion of FHCF bonds if the FHCF's hurricane losses in 2008 exceed $25 billion. Market participants say similar coverage in the traditional reinsurance market would have cost four times as much.

During the past two years, the alternative risk transfer market appears to have achieved its stated aims. After record catastrophe losses in 2004 and 2005, catastrophe bonds, sidecars and industry loss warranties (ILWs) helped the global industry through significant market dislocations – namely the heavy losses for a handful of important retrocessionaires that constrained capacity for some peak catastrophe zones. The new capital also helped reinsurers rebuild battered balance sheets.

As the market has grown, sponsors have been able to issue bonds at lower cost through "shelf programs." These programs allow transactions to close at lower cost and more quickly. Sponsors also may issue bonds opportunistically, depending on market conditions and investors' appetite.

The market's development also led in 2007 to a number of brand-name, first-time issuers sponsoring transactions, including Allstate Insurance Co., Chubb Group, State Farm Mutual and Travelers Indemnity Co. Allstate and Chubb each sponsored deals again in 2008, the latter including wildfire risk, among other perils, in the $200 million East Lane Re II Ltd. deal that closed in March.

Both Chubb and State Farm are among the growing number of sponsors with deals that base losses on actual incurred losses, rather than parametric or index triggers. These indemnity triggers limit basis risk, or the possibility that a catastrophe bond may not be triggered even if the sponsor has suffered a loss.

Nevertheless, sponsors continue to structure transactions with parametric and index triggers, which have been somewhat more popular with investors in the past. A July 2008 transaction featured a twist. The $120 million deal, known as Blue Coast Ltd. and sponsored by Allianz Risk Transfer (Bermuda) Ltd., provides Allianz with three-year protection from hurricanes in eight coastal states, though much of the potential for loss is in Florida.

Loss triggers are based on state losses calculated by Property Claim Services. But the deal drills down to county level to reduce basis risk without Allianz having to structure the transaction with an indemnity trigger. Losses at the county level will be calculated by AIR Worldwide Corp., the catastrophe modeling firm.

For investors, another benign catastrophe season produced what could be considered the cat bond market's greatest success in 2007: The ability to produce significant returns that weren't correlated with other asset classes shaken by the subprime storm and credit-market turmoil.

As a result, more capital now is dedicated to investing in catastrophe risks, either from hedge funds directly buying insurance-linked securities, or from funds that manage a pool of insurance risks through collateralized debt obligation-like structures. The remoteness of loss from investing in bonds with a trigger of, say, a one-in-250-year event also has become attractive for traditional investors that see the value in the lack of correlation with other portfolio assets. Modeling firms, too, have developed benchmarking tools enabling investors to gauge the risks and loss estimates on their portfolios.

Hannover Re, an early participant in alternative risk transfer back in 1994, has ceded its own portfolio of risks in 15 transactions since that time. But it's taken a cue from competitors such as Munich Re and Swiss Re with the Globe Re transaction (briefly discussed above), which directly transfers Hannover Re's clients' business into the capital markets. This transformer function allows ceding companies to access the capital markets for risks that might not be transferable to the capital markets independently, Hannover Re notes.

The one-year structure of the vehicle is highly leveraged: Hannover Re only has a $5 million participation in the deal's $33 million equity tranche and minimal co-insurance in the underlying reinsurance contracts indemnified by Globe Re's issuance of $100 million of notes. Roughly half of the transaction is for Florida wind coverage, though other U.S. catastrophe business, including tornado and earthquake, is included in the underlying contracts.

Munich Re has been active in passing on earthquake risks assumed from clients through catastrophe bonds in so-called third-party deals. For example, the Midori Ltd. transaction in October 2007 resulted in $260 million of protection for Munich Re's assumption of Japanese earthquake risk from East Japan Railway (JR East). The five-year deal allows JR East to make premium payments to Munich Re in yen, while losses would be paid out to JR East in dollars.

Reinsurers also are keen to lock in multiyear programs based on their own exposures. They realize that the coverage terms, pricing and financial flexibility of securitization may not be available if catastrophe losses revert to experience similar to the 2004 and 2005 hurricane seasons.

A recent example is the $104 million Valais Re Ltd. transaction sponsored by Flagstone Reinsurance

Exhibit 2

Catastrophe Bonds and Sidecar Transactions Closed in 2008

Issue Date	Vehicle	Sponsor	Capital[1] (US$ mil)	Rated Debt Amount (US$ mil)	Unrated Debt Amount (US$ mil)	Equity Amount US$ mil	Peril Type
Catastrophe Bonds							
Aug-08	Topiary Capital Ltd.	Platinum Underwriters. Bermuda Ltd	200.00	200.00			U.S. hurricane, U.S. earthquake, European windstorm & Japan earthquake
Jul-08	Blue Coast Ltd	Allianz Risk Transfer	120.00	120.00			U.S. hurricane
Jun-08	Vega Capital Ltd.	Swiss Re	150.00	43.50	106.50		Multiple perils
Jun-08	Cealus Re Ltd.	Nationwide Ins	250.00	250.00			U.S. hurricane & U.S. earthquake
Jun-08	Willow Re Ltd.	Allstate	250.00	250.00			U.S. hurricane
Jun-08	Nelson Re Ltd.	Glacier Re	180.00	180.00			U.S. hurricane, U.S. earthquake & European windstorm
May-08	Mangrove Re Ltd.	Homewise Ins. Co.	210.00		210.00		Florida windstorm
May-08	Valais Re Ltd.	Flagstone Re	104.00	104.00			Multiple perils
May-08	Residential Re (2008) Ltd	USAA	350.00	350.00			Multiple perils
May-08	Muteki Ltd.	Munich Re/Zenkyoren	300.00	300.00			Japan earthquake
Mar-08	East Lane Re Ltd.	Chubb	200.00	200.00			Multiple perils
Mar-08	Queen Street Ltd.	Munich Re	264.66[2]	264.66			European windstorm
Feb-08	Newton Re Limited (Series 2008-1)	Catlin Group Limited	150.00	150.00			Multiple perils
			2,728.66	2,412.16	316.50	–	
Sidecar							
Jun-08	Globe Re	Hannover Re	133.00	100.00		33.00	
			133.00	100.00	0.00	33.00	
			2,861.66	2,512.16	316.50	33.00	
			133.00	100.00	0.00	33.00	
Total			**2,541.66**	**2,192.16**	**316.50**	**33.00**	

Notes:

[1] Capital amounts for sidecars include both debt and equity.

[2] U.S. dollar equivalent of Euro 170mm debt. (rate at 1.55680 dollar to 1 euro)

Source: A.M. Best Co.

Capital Markets Ascending (continued)

Exhibit 3
Catastrophe Bonds and Sidecar Transactions Closed in 2007

Issue Date	Vehicle	Sponsor	Capital[1] (US$ mil)	Rated Debt Amount (US$ mil)	Unrated Debt Amount (US$ mil)	Equity Amount (US$ mil)	Peril Type
Catastrophe Bonds							
Dec-07	Redwood Capital X Ltd.	Swiss Re	498.60	478.60	20.00		California earthquake
Dec-07	Successor Hurricane Industry Ltd.	Swiss Re	60.00	60.00			U.S. hurricane
Dec-07	Green Valley Ltd.	Groupama	289.00 [2]	289.00			France windstorm
Dec-07	GlobeCat Ltd.	Swiss Re	85.00	85.00			Tranche 1: U.S. hurricane; Tranche 2: U.S. earthquake; Tranche 3: El Salvador and Guatemala earthquake
Dec-07	Newton Re Ltd.	Catlin Ins. Company Ltd.	225.00	225.00			U.S. hurricane and earthquake
Nov-07	Atlas Re IV Ltd.	SCOR SE	235.40 [3]	235.40			Europe windstorm and Japan earthquake
Nov-07	Blue Fin Ltd.	Allianz SE	293.00 [5]	293.00			Europe windstorm
Oct-07	Midori Ltd.	Munich Re/East Japan Railway	260.00	260.00			Earthquake in the greater Tokyo region
Jul-07	Javelin Re Ltd.	Arrowpoint/Goldman Sachs	125.25	125.25			Multiperil
Jul-07	Spinnaker Capital Ltd.	Swiss Re	50.00	0.00	50.00		U.S. hurricane
Jul-07	Merna Re Ltd.	State Farm	1,180.60	1,180.60			Multiperil; indemnity catastrophe bond
Jun-07	Residential Re 2007 Ltd.	USAA	600.00	600.00			U.S. hurricane and earthquake
Jun-07	Fusion 2007 Ltd.	Swiss Re	140.00	140.00			Japan typhoon and Mexico earthquake
Jun-07	Willow Re Ltd.	Allstate	250.00	250.00			Northeast U.S. hurricane
Jun-07	Nelson Re Ltd.	Glacier Re	75.00	75.00			U.S. wind and earthquake, and Europe wind
Jun-07	Mystic Re II Ltd.	Liberty Mutual	150.00	150.00			U.S. hurricane
Jun-07	Fremantle Ltd.	Brit Insurance	200.00	200.00			Multiperil; (CDO type structure)
Jun-07	CCRIF[4]	World Bank	20.00	0.00	20.00		Hurricane and earthquake; benefits 16 Caribbean countries
Jun-07	Spinnaker Capital Ltd.	Swiss Re	330.20	330.20			Tranche 1: U.S. hurricane; Tranche 2: Florida hurricane
May-07	MedQuake Ltd.	Swiss Re	100.00	100.00			Mediterranean earthquake
May-07	Gamut Re Ltd.	Nephila	310.00 [6]	240.00	25.00	45.00	Facility that will invest in various reinsurance contracts (CDO type structure)
May-07	Akibare Ltd.	Mitsui Sumitomo	120.00	120.00			Japan typhoon
May-07	Carillon Ltd.	Munich Re	150.00	150.00			U.S. hurricane
May-07	Longpoint Re Ltd.	Travelers	500.00	500.00			Northeast U.S. hurricane
May-07	Successor II Ltd.	Swiss Re	100.00	100.00			Multiperil; risk locations - Europe, Japan and United States
Apr-07	East Lane Re Ltd.	Chubb	250.00	250.00			Northeast U.S. hurricane; indemnity cat bond
Apr-07	Ajax Re Ltd.	Aspen	100.00	100.00			California earthquake
Apr-07	Blue Wings Ltd.	Allianz	150.00	150.00			Great Britain flood, and Canada and U.S. earthquake (excl California)
Mar-07	Puma Capital/Bridge Re	Various	182.50	160.00		22.50	Hybrid cat bond/sidecar transaction (CDO type structure)
Mar-07	Australis Ltd.	Swiss Re	50.00	50.00			Australia earthquake and cyclone
Jan-07	Calabash Re II Ltd.	ACE America	250.00	250.00			U.S. hurricane
			7,329.55	7,147.05	115.00	67.50	
Sidecar							
Nov-07	Norton Re II Ltd.	Brit Insurance	118.20	0.00		118.20	Multiple perils
Nov-07	Cyrus Re II Ltd.	XL Re	140.00	105.00		35.00	Multiple perils: property
Jul-07	Mont Gele Re Ltd.	Flagstone Re	60.00	0.00	60.00		Multiple perils; property, energy, marine, aviation & workers compensation
May-07	Emerson Re Ltd.	CIG Re & New Castle Re	500.00	500.00			Natural perils; predominately personal insurance
May-07	Starbound Re II Ltd.	Renaissance Re	341.50	239.00		102.50	Florida wind
Mar-07	Kepler Holdings Ltd.	Hannover Re	200.00	200.00			Worldwide natural perils; a segregated cell sidecar
Jan-07	Kaith Re Ltd.	Hannover Re	106.00	0.00		106.00	Multiple perils
Jan-07	MaRI Ltd.	Marsh Inc/ACE	400.00	0.00		400.00	U.S. commercial property
			1,865.70	1,044.00	60.00	761.70	
Total			**9,195.25**	**8,191.05**	**175.00**	**829.20**	

1 Capital amounts for sidecars include both debt and equity.
2 U.S. dollar equivalent of Euro200 debt.
3 U.S. dollar equivalent of Euro160 debt.
4 Caribbean Catastrophe Risk Insurance Facility.
5 Total debt amount includes U.S. dollar equivalent of Euro155 notes.
6 Includes an equity tranche of $45M and an unrated debt tranche of $25M.
Source: A.M. Best Co.

Holdings Ltd. Through the offering, Flagstone was able to access retrocessional aggregate and per-occurrence indemnity coverage for three years, providing the reinsurer with a greater level of price certainty over the cycle. Valais Re is able to sell additional series of notes in the future.

The $64 million of notes issued by Valais Re to collateralize its retrocession agreement protects Flagstone against multiple worldwide events, including hurricanes, Japanese and North American earthquakes, Japanese typhoons and European windstorms. Flagstone said the aggregate coverage would have been difficult to obtain in traditional markets. The $40 million of per-occurrence notes cover Flagstone for a similar set of perils.

Exchange-traded products represent another liquid market developing for catastrophe risks. The New York Mercantile Exchange and the Chicago Mercantile Exchange launched catastrophe risk futures and options contracts in March 2007. The annual contracts are based on exposures that are nationwide, from Texas to Maine and Florida. Losses are calculated by Property Claim Services.

In September 2007, event-linked futures contracts developed by the Insurance Futures Exchange (IFEX) debuted on the Chicago Climate Futures Exchange. IFEX offers first- and second-event contracts for U.S. tropical wind events. Specific contracts for Florida and the Gulf Coast were added in July. The contracts are similar to ILWs and available in $10 billion increments to a maximum of $50 billion for first-event coverage for 2008 and 2009. Industry losses are calculated by PCS.

The potential benefits of exchange-traded products for reinsurers include the ability to set natural catastrophe pricing out through the end of 2009, albeit based on industry loss triggers. Reinsurers, then, can lock in 2008 prices and avoid price increases should a major catastrophe or other market trends lead to higher prices come 2009 renewals.

■ **STRATEGIES**, From Page 5

Growth by acquisition is a complicated matter for reinsurers. Buying another reinsurer may amount to buying into risks the purchaser or its peers already rejected in the market, especially for a large reinsurer that already has a global reach. However, smaller, weaker reinsurers, or opportunistic start-ups whose initial investors are ready to cash out, are likely candidates for merger or acquisition, especially in a market such as today's that could benefit from shedding excess capital.

Diversifying into primary business, however, broadens a reinsurer's scope for strategically sound acquisitions. A reinsurer expanding in this way is far more likely to find an opportunity to diversify into noncorrelated risk or to fill a gap, whether geographically or by line of business. Bermuda-based Endurance Specialty Holdings Ltd., for example, recently acquired ARMtech Insurance Service Inc., a U.S. multiperil crop insurance underwriter.

Buyers do run the risk of overpaying for an acquisition if they are too eager. Cross-border deals in particular can make it difficult to achieve provable cost savings.

Regardless of how a company slices its portfolio between primary and reinsurance or by line of business, flexible deployment of capacity around the world also can provide diversification and access to desirable markets. Capital increasingly follows opportunity, from London to Bermuda to Switzerland to Dubai. Traditional London market players have beachheads in Bermuda. Conversely, Bermuda stalwarts and start-ups have launched or acquired syndicates at Lloyd's, where attractive ratings and global licenses ease the sting of the market's relatively high expense structure. In July, for example, Bermuda-based Max Capital Group Ltd. announced the acquisition of Lloyd's insurer Imagine Group (UK) Ltd. – which itself was an offshoot of Barbados-based Imagine Insurance Co. Ltd.

Other underwriters have set up shop in Switzerland, which offers a long-standing reinsurance market and friendly tax provisions – including a treaty with the United States and negotiable tax regimes in individual cantons. Dubai, meanwhile, offers a platform to enter the emerging Middle East and North African markets.

Other platforms are available for entering emerging markets: Puerto Rico, for example, can be a portal to Central and South America. Bermuda-based Flagstone Re found a South African reinsurer as an avenue into African and Middle Eastern business, as well as a Cyprus-based reinsurer as an additional springboard into the surrounding Mediterranean region. Small, regional reinsurers can receive a boost to their ratings through a sale to a large, highly rated company.

Distribution

An oversimplified view of distribution divides the reinsurance market into two categories: companies that sell through brokers and those that sell directly to primary insurers. The latter are fewer in number – principally Swiss Re, Munich Re and General Re, with the latter remaining closest to a pure direct writer. Each model has distinct advantages, and which is best for a given reinsurer depends on myriad factors, including the level of resources the company wishes to commit and the types of business it pursues.

Direct reinsurers, if they assemble the necessary resources and use them effectively, can enjoy clear, unfiltered communication on multiple levels with their clients, helping them to understand those clients' needs and goals, as well as the risks presented by the primary companies. Compensation arrangements also are more clear-cut in the absence of a broker.

In addition, direct reinsurers benefit to the extent that they maintain a local presence in the markets where they operate, thereby gaining first-hand insight. These companies must be able to rely on their own resources and expertise to offer comprehensive services and make prudent underwriting decisions based on internally generated data and intelligence. One reward of the direct model is a generally more loyal clientele, rooted in deeper relationships. This can be a liability, however, if a direct reinsurer is too slow to part with unprofitable business because of the time and resources that have been devoted to building the relationship.

Broker reinsurers tend to fare well in business that requires a capital commitment greater than any one company's capability. It simply is easier for a broker, with access to many markets, to assemble a package of coverage when multiple reinsurers are needed. But such business is not closed to direct reinsurers, and their relatively smaller share of the subscription market has systemic causes beyond the convenience of assembling large packages through a broker.

A broker reinsurer can look at far more business than a comparably sized direct reinsurer at little additional cost. Even the rejected risks provide market intelligence, reduce the risk of pricing errors and expose underwriters to innovations being developed by their brokers and competitors.

The worldwide population of reinsurers has been shrinking, with capital concentrated in a decreasing number of players. As capital has left the market, more has come in to replace it, and much of that has been invested with lightly staffed companies that concentrate on underwriting, leaving brokers to prospect for the business. This has been the model for many of the companies that launched – often in Bermuda – after watershed catastrophes such as Hurricane Andrew, the Sept. 11 attacks and the 2005 hurricane season.

But companies operating out of one location have found some holes in that model; for one, business in recent years has tended to stay closer to home than in the past. Reinsurers that want to play globally have been forced to put operations on the ground around the world, just to gain access to the local brokers who are placing the business for local carriers. Alternatively, a Lloyd's syndicate can provide instant access to an array of licenses in markets worldwide. Also, as soft market conditions have forced companies to diversify from, say, property catastrophe business to lines such as U.S. casualty, local knowledge has become paramount for managing such long-tail business. All of this can undermine the lean staffing and centralized control on which these broker-dependent companies were founded.

Changes in broker compensation could in turn change the game for both direct and broker reinsurers. As business and the compensation schemes move more toward a fee-based consulting role for the broker, rather than commission-based selling of coverage, the broker acting in good faith may face the prospect of steering a client to a direct reinsurer. The consulting model also may challenge brokers in serving smaller insurers at an affordable price, given the costs of offering such services.

Cycle and Capital Management

Capital management is critical to managing the market cycle. While share-repurchase programs and increased dividends have given a sizable portion of accumulated earnings back to stakeholders, reinsurers face considerable pressure to achieve targeted returns on equity. Many carriers have established diversified operating platforms, while newer formations have looked to build underlying capabilities to manage the cycle and deploy capital toward noncorrelated risks. Some have pulled back on top-line growth. In 2007, the industrywide merger-and-acquisition mania never materialized as some expected, but there were opportunistic purchases in selected markets. A.M. Best expects the merger-and-acquisition buzz to continue through 2008, with more deals possible.

Enterprise risk management has helped industry participants to discern that the current downturn in the market will be different and to ensure that they are adhering to cycle management. A.M. Best has seen evidence that many reinsurers have enhanced controls, systems and technology while managing exposures to catastrophic losses. There also is a sense that companies learned lessons from 2005 and are focusing on improved data capture, risk modeling and correlation analysis. However, can it be certain that all companies have achieved desired goals with respect to establishing and maintaining a dynamic

Sectors in the Spotlight

While many nonlife reinsurance trends have been global in nature, a few sectors have followed unique trajectories of late:

Financial Institutions – As the subprime mortgage and credit crises unfold, exposures are emerging for financial institutions in D&O, E&O and, to a lesser extent, fidelity business. Reinsurers have relatively little exposure, however. The major D&O writers carry little or no reinsurance on this business, and those that do reinsure it, retain substantial risk. Insureds that face D&O lawsuits stemming from the current crisis include publicly traded banks and major mortgage companies.

There is virtually no reinsurance of financial institutions E&O business, which reinsurers have shunned in the wake of losses dating as far back as the savings and loan crisis, and as recent as backdating of stock options. In the latest crisis, hedge funds, investment managers and advisers, and investment banks are among the institutions facing lawsuits over mismanagement of funds, nondisclosure and failure to follow corporate policy, among other claims.

At renewal, financial institutions are facing rate hikes of 25% and up – and in triple digits where there has been any claim activity. This makes the financial institutions (FI) business a lone firm spot in an otherwise sagging commercial insurance market. Primary D&O insurers that haven't bought reinsurance to date may now try to do so, but they are likely to pay dearly for the coverage.

Agriculture – Reinsurers in recent years have been drawn to agricultural coverage as a reliably profitable line that is not correlated with other property/casualty underwriting cycles. Numerous reinsurers, including Bermudian players, have entered this business – but ironically, that very surge of capacity has put pressure on pricing, perhaps making it more attractive to play as a primary writer than as a reinsurer. Still, rates are declining less sharply than in commercial lines, as a whole.

Whether as primary or reinsurance coverage, the business is expected to grow for the foreseeable future as worldwide demand for food drives expansion in farming and increases in commodity prices. Premium this year is expected to be $9.3 billion, up by double-digit percentages over recent years. Recent flooding in the Midwest and adverse conditions in other regions of the United States led to some crop losses, but not in proportion to the headlines these events generated. The flooding in particular came early enough in the season to permit replanting of many fields with the same or different crops, and federal reinsurance also limits losses. As for property losses, they generally were uninsured or fell under the National Flood Insurance Program. The net effect is expected to be diminished profitability, but not a fall into loss-making territory.

Windpools – Among various states' windstorm and catastrophe pools, there is a growing sense that traditional backstop mechanisms, such as assessments on participating insurers, are not sufficient protection against a mega-catastrophe. These pools are seeking out reinsurance they once considered unnecessary, and reinsurers are happy to oblige. The underwriting is little different from what they do for primary insurers in the private market, with modeling tools readily adaptable to the risks in the pools. While in the United States, this business tends to be a layer removed from the primary coverage, some non-U.S. pools effectively insure specified catastrophe risks directly, and reinsurers of these pools are next in line when a triggering event occurs.

ERM framework? A.M. Best believes the reinsurance segment in particular must do more than pay lip service to ERM. As reinsurance is a capital-intensive business with high stakes, ERM must be culturally ingrained throughout the organization to prevent surprises from unanticipated risks. Moreover, it may be easier to embrace ERM when times are good. The key is to maintain this discipline through all phases of the pricing cycle.

Insurers that hold the line on underwriting may face wide swings in their returns on equity as they manage toward their long-term targets. One reinsurer, aiming for a long-term ROE of 13%, expects returns to swing from near 20% during hard markets to 10% or less during soft markets.

Insurers from Bermuda's Class of 2001 have found themselves evolving as the market shifted. They started in turbulent times amid falling equity markets, shrinking capacity, a hardening market and newfound awareness of the terrorist threat in the aftermath of Sept. 11. Lloyd's was reeling. Seven years later, the picture is radically different in many ways. The market is soft, capital is overabundant, the memory of Sept. 11 isn't as raw, and other venues, such as Lloyd's, have roared back. Narrowly focused writers have had to broaden their scope, not only to different lines of insurance but to primary lines, including the ever-shifting boundary between admitted and surplus lines. The experience of the 2001 start-ups underscores how event-driven the discipline of cycle management can be.

Share repurchases offer another way to manage excess capital, but timing can be crucial. When hurricane season approaches, companies may be reluctant to part with capital they might need in the event of a major hurricane catastrophe. But once the danger is past, there may be opportunities for repurchases, particular when equity markets are down. White Mountains Insurance Group Ltd., for example, recently repurchased more than 1.7 million shares of its stock from Berkshire Hathaway Inc., in part as a means of reducing undeployed capital while redeeming shares at a relatively low price.

Underwriting and investment income ideally stand on their own, without one subsidizing the other, but in a soft market, investments can provide a cushion against thin underwriting margins. And even in turbulent capital markets, there can be opportunities with the right investment strategy.

Life Re: Push and Pull

The volatile equity markets continue to pose a threat to life reinsurers' earnings, as a decline in capital gains erodes (or in some cases completely wipes out) an important source of income for these companies. Meanwhile, primary life insurers are shifting their mix of business away from unit-linked or variable products and offering more guarantees, with two important effects: They have a greater need for reinsurance, and guaranteed business transfers a higher proportion of risk to the reinsurers. Increasing use of proportional treaties will deliver top-line growth to life reinsurers, but their bottom lines will continue to be challenged by the investment climate.

Longevity risk – the type posed by pension products and the like – has been an area of growth especially for non-U.S. primary life insurers, but reinsurers have approached this business with caution. Some, however, including players from Bermuda, have moved to expand their pension-related business, beginning with pure mortality and longevity risk but also venturing into elements of investment risk with some transactions.

In February 2008, U.K.-based Standard Life plc announced the reinsurance of 6.7 billion pounds of U.K. immediate annuity liabilities – representing more the 50% of Standard Life's liabilities in this area – with Canada Life International Re, a unit of Great-West Lifeco Inc. Scottish Re specifically cited the benefits of lowering its longevity risk.

Overall, the life reinsurance sector faces more volatility and less certain profitability than in the past. Companies are seeking to expand their markets, and longevity and investment risk are among the few avenues to growth. After a period of watching and waiting, reinsurers are entering the field. A.M. Best believes that the volatile earnings experienced in the first half of 2008 will continue for the remainder of the year, making the life part of the business the most significant driver in overall earnings of composite reinsurers.

Securitization of the value of in-force business could provide an opportunity for life reinsurers to grow, as they are in an ideal position to aggregate and package several portfolios before offering them to the market. However, investors for such transactions are few, and the overall market's appetite is low, meaning this segment is unlikely to experience strong growth in the next six months.

Finally, emerging markets hold some potential for growth in life reinsurance, although growth that appears large on a percentage basis will be built on a small initial numbers. Nonlife products tend to dominate in newly developing economies before life and pension products take hold. Still, life reinsurers are establishing footholds in these markets. In June, Hannover Re announced an exclusive cooperation agreement with India's government-owned GIC Re to develop, market and underwrite life reinsurance in India. Also, in announcing 2007 results, Scor Global Life noted its ambitions in markets such as Russia, Israel, Brazil and a number of Asian countries.

In the United States, cession rates generally have been declining. But like other markets, the United States has seen growth in guaranteed products, with a corresponding increase in risk to the primary insurers. Reinsurance has been relatively scarce but is growing as reinsurers become more at ease with the hedging programs necessary to offer capacity for guaranteed products.

Market Updates: Tracking the Regions

U.S: Dwindling Premiums, Profits

The U.S. reinsurance segment's net premiums written declined 1.1% to $6.7 billion in the first quarter of 2008, compared with $6.8 billion a year earlier. This followed a double-digit decline in 2007 compared with 2006, but a shrinking top line is better than a burgeoning loss ratio if opportunities for profit simply aren't there. The first-quarter 2008 decline would have been more pronounced, but certain carriers retained more business by reducing cessions to offshore affiliates. Furthermore, net premiums earned declined 14% during the first quarter, suggesting where future results are headed.

Although still profitable, the U.S. reinsurance segment's underwriting results deteriorated in the first quarter of 2008, as sustained competitive pressures finally influenced actual results. The segment's combined ratio increased to 94.8 in the first quarter of 2008, up 5.6 percentage points from 89.2 during the same period of 2007. In addition, with financial markets volatile and uncertain, realized capital losses, mostly in the form of mark-to-market adjustments, eroded total return measures for certain U.S. reinsurers. Furthermore, sizable unrealized capital losses led to a modest decline in the segment's policyholder surplus compared with year-end 2007.

Despite the deterioration in the segment's underwriting performance in the first quarter, results remained in line with the year-end 2007 combined ratio of 94.4. A.M. Best expects the U.S. reinsurance segment to generate favorable underwriting results at year-end 2008, but at lower margins than in the prior year, with the obvious caveat being what impact catastrophe-related losses may have on the industry. Driving this expectation is price softening in both property/casualty (P/C) markets and the expectation that casualty loss reserve releases likely will have less of an impact on prospective underwriting results.

Overall catastrophe loss activity in the form of tornadoes and windstorms led to a significant increase in first-quarter 2008 catastrophe insured losses for the overall U.S. P/C industry; however, the majority of insured losses were incurred at the primary level. Among the factors that have influenced this phenomenon are continued increases in primary carriers' policy-retention levels and the fact that insured losses are being driven by the frequency of smaller catastrophes and not the severity associated with a noteworthy event such as a large hurricane that typically impacts reinsurers.

U.S. reinsurers are balancing capital-management initiatives with cycle management in mind. With a healthy surplus base and somewhat limited market opportunities, shareholders demand that capital either is put to use or returned in the form of dividends and share repurchases. This can get quite risky for financial planning departments in the midst of hurricane season, and with a large portion of today's earnings relating to business written in accident years marked by hard market conditions. Adding to the challenges of capital management is the diminishing prospect of generating future earnings in a declining pricing environment.

A.M. Best believes 2008 results will reflect more accurately the competitive conditions in the marketplace, as rates are falling in most P/C lines of business. Catastrophe-exposed accounts also are experiencing rate reductions, but to a lesser extent. As rates decline, concerns shift to terms and conditions, which have started to waver but not to the point of widespread deterioration.

Two consecutive years of solid operating results, in addition to a handful of major reinsurance transactions to affiliate and parent companies strengthened the balance sheet of the U.S. reinsurance segment as it entered 2008. No material storms had hit the United States since Wilma, and reinsurers had the opportunity to rebalance their portfolios after identifying and establishing their ultimate exposures and appetites for risk. Additionally, the impact from the soft casualty market of the 1997-2001 accident years continued to diminish, with favorable development on recent accident years further offsetting the impact. The reinsurance segment, it seems, went from riding coach to riding somewhere between business and first class rather quickly. However, it's important to remember that just as positions were strengthened over a relatively short time, the earth can shake in a minute. What would have happened if the paths of the two Category 5 hurricanes that hit Mexico in 2007 had veered sharply to the north before reaching land?

As uncertain as the path of a meandering hurricane is the course of legislation, regulation and taxation relating to the U.S. reinsurance industry. In Washington, in state capitals and in Bermuda, moves under consideration could profoundly influence how the U.S. and Bermudian insurance and reinsurance markets operate and interact.

Current collateral requirements for foreign unauthorized reinsurers continue to be challenged. Opponents argue that it is unduly burdensome for alien reinsurers to post collateral to allow the ceding company to account for those recoverables as a statutory asset, thus creating barriers for alien companies into the U.S. market. The National Association of Insurance Commissioners (NAIC) is assessing measures that could relax the collateral requirements for unauthorized reinsurers. In 2007, the Reinsurance Task Force adopted a proposed new framework for cross-border transactions. The three major pieces of the framework would be the establishment of the Reinsurance Supervision Review Department (RSRD) to assess the regulatory compatibility of international jurisdictions with U.S. regulation; a single-state U.S. regulator for U.S. reinsurers; and a single-state U.S. regulator for alien reinsurers from jurisdictions approved by the RSRD. The final piece of the proposed framework would create access to the U.S. market through "one port of entry." Under current regulations, alien reinsurers must be licensed in states where they conduct business.

At issue is the cedant's disadvantage in seeking legal recourse in a foreign jurisdiction if a reinsurer is not subject to U.S. regulation. This disadvantage is exacerbated by political and dispute risks. Groups such as the American Insurance Association (AIA) argue that the proposed changes to the current collateral requirements would benefit only international reinsurers and increase the credit risk for U.S. cedant companies, and that the current system has worked effectively for decades. Reinsurance disputes and slow payments create cash-flow and liquidity concerns. Without collateral, cedants may settle for considerably less than 100% of their outstanding balances through commutations. Additionally, New York and Florida already are reviewing proposals at the state level to implement relaxed collateral requirements which appear more liberal to alien reinsurers. Given the prominence of these states, other states may follow their lead.

A.M. Best believes the new framework clearly would benefit international carriers while weakening the relative competitive position of U.S.-licensed carriers, which already have a disadvantage from a corporate tax position. This could leave little incentive for reinsurers to maintain a U.S. presence or to attract new capital. International carriers that historically have maintained onshore operating subsidiaries to facilitate transactions might find it easier to transact business against an offshore balance sheet. Results of the provision would be twofold. Relaxed collateral provisions may result in reduced cost with more foreign competition, but dispute risk may increase, and overall security of recoverables may decrease. A.M. Best believes larger carriers with greater scale and diversification in their reinsurance programs would have more influence over terms and conditions when establishing credit protection. Conversely, small to midsize carriers likely would have less flexibility in garnering security.

Bermuda: U.S. Effects, Concentrated

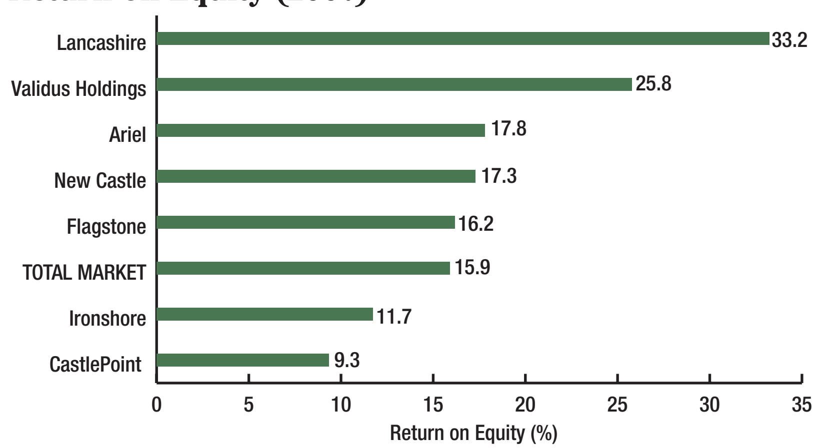
The prominent impact the Bermuda market has on the global industry grows every year. Established players, members of the ever-maturing Class of 2001 and recent entrants from the Class of 2005 continue to influence the reinsurance industry. Market conditions for the Bermuda segment mirror the competitive themes of the U.S. segment, with profitability trends that are similar in direction but more pronounced in absolute terms, given the strong results for the island's companies. Additionally, many Bermudian companies have entered the U.S. primary market through the purchase of U.S. primary companies, namely shell formations. Thus far, the focus primarily has been specialty excess and surplus markets that are sold through managing general agents.

Another major trend is Bermuda companies entering Lloyd's markets through the formation of a Lloyd's syndicate, such as Aspen and Montpelier Re, or through transactions such as Ariel Holdings and Validus Holdings acquiring Atrium and Talbot, respectively. A common theme of these trends is admittance to essential distribution networks to access certain classes of business. Each entity's goals may differ but are to satisfy one or both of the following: management's desire to diversify away from catastrophe business, or shareholders' requirements to garner more return by deploying more capacity and accessing perceived profitable business opportunities. Excluding pure reinsurers such as PartnerRe and Platinum Underwriters, established carriers such as Ace, XL Capital and Everest Re have had a presence in the U.S. primary markets for years and have developed seasoned books of business. The attractiveness of Lloyd's to the Class of 2005 has its own merits in the immediate access to global markets through the Lloyd's licenses and higher financial strength ratings.

As the Bermuda insurance market continues to grow, the Bermuda Monetary Authority (BMA), the regulator of the financial services sector, also has grown in terms of its role within the global financial system. As a result, the BMA's standards of regulation have become subject to increased scrutiny by regulators around the world, as well as by other stakeholders, including investors and policyholders. This comes at a time when regulation of the insurance industry is in the midst of a transformation: the European Union is implementing its Solvency II initiative, and the United States is contemplating a federal charter; reform of collateral

Exhibit 4

Bermuda Start-Up Insurers/Reinsurers – Return on Equity (2007)



Note: Total equity is the total reported equity of the company.
Total revenue excludes foreign exchange gains/losses.
Source: A.M. Best Co.

Exhibit 5

Bermuda Property/Casualty – Prior Year Favorable Reserve Development (2007)

Ranked by combined ratio.

	Points From Favorable Development	Reported Combined Ratio
XL Capital	6.6	89.1
Max	12.3	88.2
Platinum	6.9	83.5
Allied World	10.6	81.3
Partner Re	12.9	80.4
Endurance	10.0	79.9
AXIS	12.3	75.3
Validus Holdings	7.9	60.5
Renaissance Re	16.4	59.3
IPC	7.6	49.9
Total Market	**5.2**	**82.9**

Source: A.M. Best Co.

requirements for non-U.S. reinsurers; a principles-based approach to insurance accounting; and many other potential changes.

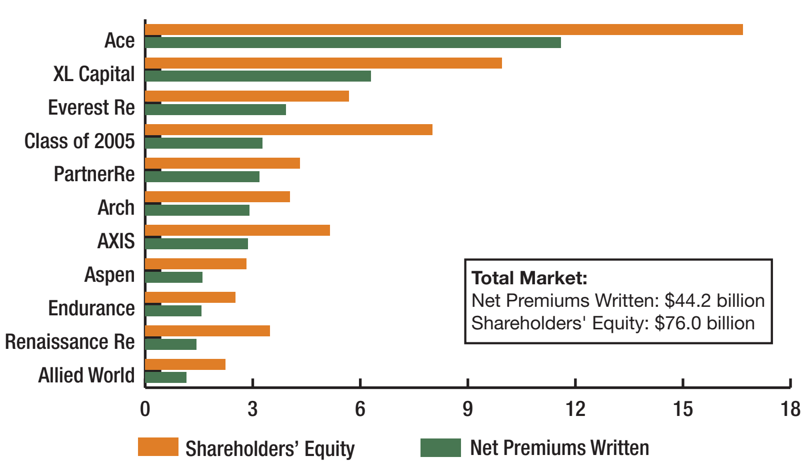
Similarly, the BMA has initiated plans to enhance its regulatory framework. Among the initiatives implemented by the BMA are utilizing a risk-based capital model, which can be supplemented with a company's own capital model, and the requirement for all Class 4 companies to file financial statements prepared under generally accepted accounting principles by the fourth quarter of 2008.

Exhibit 6
Bermuda Property/Casualty – Financial Indicators (2006-2007)

	YE 2006	YE 2007	% Change
Total Equity	66,393,585	75,969,628	14.4%
Net Premiums Written	43,826,961	44,178,667	0.8%
Net Premiums Earned	42,513,323	44,291,081	4.2%
Net Investment Income	6,525,624	7,928,076	21.5%
Net Realized Gains (Losses)	-62,868	241,738	-484.5%
Losses & LAE	23,834,770	24,308,389	2.0%
Operating Expenses	11,705,443	12,423,413	6.1%
Net Income	11,481,570	11,379,034	-0.9%
Loss & LAE Ratio	56.1%	54.9%	
Underwriting Expense Ratio	27.5%	28.0%	
Combined Ratio	83.6%	82.9%	
Less: Loss Reserve Development	-2.3%	-5.2%	
AY Combined Ratio (Normalized)	85.9%	88.2%	
Return on Equity %	20.5%	15.9%	

Source: A.M. Best Co.

Exhibit 7
Bermuda Insurers/Reinsurers – 2007 Net Premiums Written and Shareholders' Equity



Note: Excludes Life data
Source: A.M. Best Co.

Some Class 3 companies are to follow in 2009 in an effort to increase transparency.

These efforts are driven by the BMA's commitment to adopt internationally compliant regulatory standards to compete with other jurisdictions, given the growth of the Bermuda insurance market and the increased scrutiny of the BMA's standards of regulation.

Broader conditions in Bermuda also are uncertain. The Class of 2005 and an influx of hedge fund operators have added to the growing strain on the island's infrastructure in terms of office space; housing for key personnel brought to the island from abroad; and even necessities for their families, such as slots in the island's schools. Obtaining work permits has become more difficult, and the government is contemplating measures such as new limits on non-Bermudian staff and requirements on companies to train locals for more of the positions currently held by expatriates. There is also talk of new taxes on international business, which would erode one of the critical advantages that has made Bermuda a world-renowned financial hub.

Meanwhile, the advantages of Bermuda and other "tax havens" continue to draw scrutiny in the United States. The issue is whether the federal government will revise its stance on allowing foreign-based insurers with U.S. affiliates to move much of their taxable income by reinsuring the business offshore to an affiliate located in a tax-advantage country, thereby avoiding federal income tax. A coalition of several U.S.-based insurers contends that this gives the foreign carriers an unfair competitive advantage in the U.S. markets. The U.S. Senate Finance Committee held hearings relating to issue in September 2007, but current speculation is that Congress may not take up the issue again until 2009, after the presidential election.

While foreign carriers do enjoy a tax advantage, this has been a primary driver in attracting additional capital to the U.S. reinsurance market, particularly in catastrophe-prone areas. Significant capacity continues to enter the U.S. market on the heels of large, catastrophic events. As a result, Bermuda reinsurers provide approximately 40% of the capacity for current hurricane and earthquake coverage. The viability and competitive nature of the reinsurance marketplace could be somewhat compromised if changes in current tax structures adversely impact this market segment. Continued capacity and competition ultimately benefits insureds. In addition, as foreign entities provide parental support to U.S.-based subsidiaries through various intercompany reinsurance mechanisms, A.M. Best has provided rating enhancement to the subsidiaries, reflecting the parent company's rating. Without such support, A.M. Best may re-evaluate the current ratings.

Europe: Awaiting Big Changes

The long journey for the implementation of Solvency II continues, with many European insurers and reinsurers participating in the QIS4 (fourth Quantitative Impact Study). While it is quite early to predict what the final impact will be on specific types of companies, a few things are clear:

This is an exercise that requires intensive lobbying, something that both national insurance associations and individual companies have been engaged in actively for the last few years.

Reinsurers as a whole are likely to be among the main beneficiaries of the directive. The higher capital requirements for certain types of business and exposures are likely to compel corrective action from the management of companies exposed to these risks. Reinsurance is likely to be the first port for capital relief, because the solution is both familiar and simple. After all, the impact of traditional reinsurance is likely to be similar to the much more complicated securitisation that will produce the same benefit under Solvency II. Furthermore, under Solvency I, companies were allowed to get credit for reinsurance of as much as 50% of their liabilities. Under Solvency II, an insurer ceding more than 50% would incur increased counterparty risk, but nevertheless, such cessions offer an alternative solution (at least for short-term capital alleviation) that until now was not available.

One of the main debating points of Solvency II, and of particular importance for reinsurers, is group supervision. The regulation of a purely EU-based group seems to be the most simple of cases. Still, there is significant debate as to what will be the responsibilities and rights of the lead regulator versus those of the national regulators in practice. In theory, lead regulators, if they are satisfied with a group's risk management, can grant waivers under which the Solvency Capital Requirement (SCR) of individual entities is calculated at group level and national regulators only retain the right to ask for an increased Minimum Capital Requirement (MCR), or for the SCR to be kept locally, after discussion with the company and the lead regulator. However, even this point may raise significant debate with political undertones related to losing control of the national insurance industry to a larger regulator. This, in practice, would mean that Germany and the United Kingdom and, to a lesser extent, France (and Luxembourg) would be the lead regulators for the majority of the reinsurance industry in Europe. Even if this were to remain unresolved, European reinsurers likely would proceed with establishing branches for their current separate entities and thus would circumvent any regulatory obstacles remaining.

Probably more complex are cases in which the parent company of a group and its subsidiary are not both within the EU. Especially when the parent is based in a third country, e.g., the United States, Bermuda, Switzerland, the issue would be what capital requirements are to be applied:

a. To their EU subsidiary and

b. To the parent in respect of that subsidiary.

Solvency II provides for regulatory equivalence under which the home regulator of a non-EU group based in a country with regulatory equivalence can decide the level of capital required for an EU subsidiary of that group. While it seems straightforward, in practice there are several issues that need to be negotiated and agreed upon. Switzerland is the only country, to date, which the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) has recommended for regulatory equivalence. Most notably, Bermuda and the United States are not on the list now. While the United States may seem a more complex case with the multitude of state regulation, it is of reduced importance for the reinsurance industry, given the number of global reinsurers domiciled in the country. Far more important to the reinsurance market is equivalence between the EU and Bermuda because of the number of Bermudian companies operating in the EU. The Bermuda Monitory Authority is lobbying strongly for its equivalence with the EU regulators to be granted by 2012, given its own drive to introduce Solvency II-type regulation, but there are no indications that this is imminent.

Internal capital models and their use, diversification and specific treatment of certain risks remain on the radar screen for reinsurers. However, A.M. Best believes the more contentious point for the global reinsurance industry is the issue of lead regulators, inside or outside the EU.

Market Trends

Because of the concentration of reinsurance players in Continental Europe, trends in this market broadly follow the dynamics of the global underwriting cycle. The four global European reinsurers, Swiss Re, Munich Re, Hannover Re and Scor together have a market share of well above 50% in the larger countries – Germany, France, Italy and Spain. With the exception of established Bermudian players, such as PartnerRe, newer companies have not been able to significantly penetrate the market.

The increasing frequency and severity of natural catastrophes in Continental Europe remain a concern for reinsurers, although less so in France and Spain, where there are government catastrophe solutions – in France through Caisse Centrale de Reassurance (CCR) and in Spain through Consorcio de Compensacion. Motor insurance, with its importance for both primary and reinsurers, is another segment reinsurers are watching. Motor insurance claims development continues to diverge in the major markets, partially due to the inflation in awards for bodily injuries in certain countries, which has been driven by court decisions or government intervention. The good results in industrial insurance in the past two years have put pressure on prices. On the other hand, potential directors and officers claims from the subprime crisis and the introduction of no-fault environmental liability for polluters could counteract the pressure.

Germany

Reinsurers providing coverage for natural catastrophe risks in Germany experienced a market loss of approximately EUR 2.5 billion from winterstorm Kyrill in 2007, one of the severest storms ever. As a result, they were able to increase premium rates for loss-exposed treaties between 5% and 10% at the January 2008 renewals. However, predictions are that loss events such as Kyrill are likely to be more frequent, Munich Re warned in its Natural Catastrophe 2007 report. Indeed, through the first half of 2008, a number of storms, floods and hailstorms already have caused significant losses. In March, winterstorm Emma resulted in insured losses of approximately USD 1.5 billion, and a freak hailstorm in June in Northern Germany pelted a Volkswagen factory, where more than 30,000 cars waited shipment to dealerships. Losses from that storm are estimated to exceed EUR 100 million.

Because of higher claims experience at the primary level, reinsurers are expected to increase rates further at the January 2009 renewals. Insurers have been struggling not only with more frequent catastrophe claims, but also with ongoing insured losses from leaking sewage pipes, which left the combined ratio for this class of business significantly above 100 in recent years.

In motor third-party liability, proportional reinsurance still is the most prevalent form of protection for primary insurers, despite attempts to move to nonproportional cover. Developments in the primary markets thus directly influence reinsurers' results. The fight for market share has led to further reductions in premiums, and this is likely to continue in the short term. Insurers also have to adjust to changes in insurance laws that were introduced earlier this year. Relevant for motor insurance is the abolishment of all-or–nothing provisions, whereby insurers were able to refuse payment if a policyholder breaches a policy obligation. The new law requires insurers to cover these types of claims based on causality of the breach.

France

Reinsurers in France are less affected by natural catastrophes due to the government scheme through Caisse Centrale de Reassurance (CCR), which provides cover for most catastrophic perils with the exception of windstorm. Where reinsurers have catastrophic exposure, premium rates are under pressure, and reductions between 5% and 10% have been possible.

Motor third-party liability remains a major pitfall. Reinsurers are bearing the brunt of accelerating awards inflation for bodily injury claims because of the low retentions of primary insurers. Despite attempts by the insurance industry and the government to limit awards made by courts, payments continued to increase in 2006 in excess of retail inflation. The latest statistics produced by the French Insurance Association (FFSA) showed an average increase of 6.9% between 2001 and 2006. On the other hand, reinsurers have been able to push through rate hikes in the past few years (averaging 20% in 2007 and 10% at the 2008 renewals), which alleviated some of the concerns. Opinion differs among Continental European reinsurers, however, on whether it is worthwhile to expand or retreat in this market, although the majority remains skeptical. There also is a positive result from the recent hike in gasoline prices: Car owners have become more economical in using their vehicles, which has contributed to a 7% decline in accidents in the first six months of 2008, according to the French government statistics. This, in turn, should have a positive effect on underwriting results in 2008.

Lloyd’s & London: Riding the Cycle

A.M. Best expects the downward path of the insurance cycle, combined with volatility in investment markets, to make 2008 a more challenging year for Lloyd’s and other U.K. reinsurers, although the incidence of major catastrophes will continue to be a major determining factor in performance. The U.K. reinsurance industry as a whole performed well in 2007, reflecting a continued strong rating environment for property lines, reserve releases, and good investment returns despite volatility in the fixed income sector caused by the collapse of confidence in credit markets. Although the benign catastrophe experience of 2006 was not repeated in 2007, the absence of a major hurricane affecting the mainland United States helped to support results.

Exhibit 8 compares combined ratios for Lloyd’s and a small group of leading London market reinsurers over the past five years. In most years, the combined ratios have closely tracked each other, although Lloyd’s produced a particularly strong result in 2006. Given that two of the five years presented were adversely affected by catastrophe losses, the overall underwriting performance is strong, reflecting buoyant market conditions throughout the period.

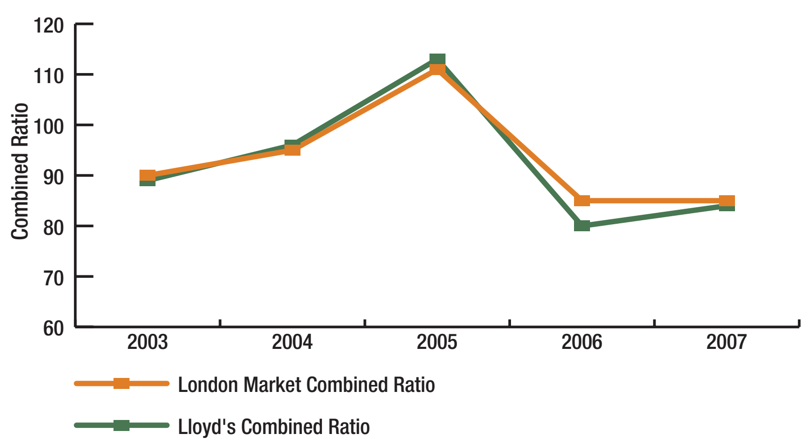
Both Lloyd’s and the London companies have had two exceptional years. Results in 2007 held up well despite the impact of the Kyrill windstorm in January, affecting the United Kingdom and Germany, and by U.K. flooding in June and July. Losses from the U.K. floods in particular were significant, but these largely were retained by the direct insurance market.

Further ahead, A.M. Best believes the fluctuations in performance of Lloyd’s and London market reinsurers will be less than in the past, despite the continuing impact of catastrophes. In this respect, the introduction of the risk-adjusted capital adequacy regime (Individual Capital Adequacy Standards) by the U.K. regulator (the Financial Services Authority), widespread use of catastrophe modeling, and more sophisticated pricing and reserving tools all will help. In addition, Lloyd’s has restructured and now is subject to more rigorous internal oversight from the Franchise Performance Directorate formed in 2002.

Competition

Lloyd’s has benefited for many years from a strong international profile, helping it to attract and retain business despite the development of alternative insurance centers in lower-tax jurisdictions. Increasingly, Lloyd’s capital-efficient structure is attracting international investment, particularly from other insurers. The support of central assets enables individual syndicates in Lloyd’s to hold less capital than otherwise would be required if the

Exhibit 8
Lloyd's and London Market Reinsurers – Combined Ratios (2003-2007)



Source: A.M. Best Co.

syndicates each were stand-alone insurance companies. This always has been the case, but implementation of phase one of the Equitas agreement with National Indemnity Co. and better overall performance from Lloyd's in recent years have helped to remove other factors that probably held back potential investors.

There has been less speculation about a decline in Lloyd's competitive position compared with Bermuda's position. In 2007 and 2008, several Bermuda companies acquired businesses in Lloyd's or started new Lloyd's-based operations, so the emphasis necessarily has shifted to one of cooperation rather than competitive hostility. The first to acquire a Lloyd's company in the current phase was Validus Holdings Ltd., which bought Talbot Holdings in July 2007. Ariel Holdings Ltd. followed closely behind when it acquired Atrium Underwriting plc. In April 2008, Argo Group International Holdings announced its recommended cash offer for Heritage Underwriting plc, and then in July, Ironshore Inc. announced its purchase of Pembroke Managing Agency Ltd. from Chaucer Holdings PLC. Bermudian companies that started new syndicates at Lloyd's over the same period included Montpelier Re Holdings Ltd. and Aspen Insurance Holdings Ltd.

Companies operating in the London market face a different situation. Before locating a company in London, an international insurance group will look at the comparative advantages of other European locations, including Zurich and Dublin, as well as Bermuda or Lloyd's itself. London companies obviously do not benefit from Lloyd's capital structure or its network of licenses. Although much of the debate about the competitive position of the U.K. insurance market has focused on Lloyd's position compared with other insurance centers, there is probably more of an issue relating to the position of London companies.

The development of insurance-linked securities (ILS) continues to present a challenge to reinsurers, as well as an opportunity as an alternative market for certain types of exposure. Investors' interest may well increase because the securities are not correlated with credit markets. However, despite some activity in the London market in recent years, it remains uncertain whether demand will develop strongly from issuers. Many of the underwriting operations in London are relatively small in international terms. This makes the costs associated with issuing securities a significant issue for many. Although views differ, most operations in London tend to prefer the security of conventional reinsurance protection without the basis risk associated with ILS. In the current softening phase in the market, conventional protection is becoming more available, and this is likely to result in a hiatus in London reinsurers' interest in ILS in the medium term.

Market Trends

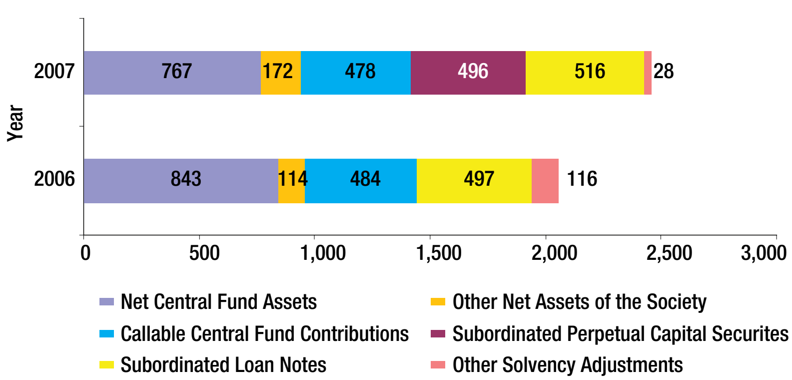
Another important factor in London's competitive position is business process reform. Lloyd's has made progress in updating its administrative processes across the three main work streams designed to achieve the objectives set out in Lloyd's three-year plan – the accounting and settlement (A&S) of financial transactions, electronic claims handling and pre-bind contract certainty.

The London market as a whole also has made some progress with the electronic placing of risks. However, without a market-led solution, progress has been fragmented as major market participants develop technology separately. This is a sensitive issue following the failure of the Lloyd's-sponsored company Kinnect Ltd. to deliver an electronic placing platform. Lloyd's is not ignoring the issue but now plans to adopt a step-by-step approach. Currently, a tendering process is being conducted with

Exhibit 9

Lloyd's – Central Assets for Solvency (2006-2007)

(£ Millions)



Source: Lloyd's Annual Report 2007

a view to identifying a supplier of a simple messaging hub that would enable market participants to exchange messages that conform to ACORD standards.

Lloyd's has avoided a return to the market solution approach tried by Kinnect. Nevertheless, it's difficult to see how the diverse participants in the market can effectively be brought together in the way necessary to implement electronic trading without a move to mandatory action at some stage.

Capital

A.M. Best believes that Lloyd's central solvency capital is likely to stay strong in 2008 and into 2009, remaining at a comparable level to year-end 2007 (GBP 2,457 million). **Exhibit 9** shows the breakdown in Lloyd's central solvency assets for 2006-2007 and illustrates the substantial increase over the period, supported by Lloyd's second subordinated debt issue.

The stable outlook for central solvency capital is supported by diminishing strain from existing insolvent members due to stabilising reserves and the closure of a significant number of open years. Also, the procedures Lloyd's now has in place for reviewing existing syndicates and entrants to the market are likely to help prevent the emergence of new problems.

Nevertheless, the period 2008-2010 is likely to be a challenge for Lloyd's franchise management structure that was put in place after Sept. 11, 2001. The major catastrophes of 2004 and 2005 have delayed the down cycle that otherwise might have tested the structure earlier. There is no doubt that Lloyd's is in good position at the start of this more challenging period, with solvency continuing to improve. At year-end 2007, members' solvency shortfalls were covered 14.6 times by central assets (2006: 8.1 times), due to a reduction in solvency deficits and the strong increase in central assets.

Investment Income

The main investment focus of Lloyd's syndicates and London market companies continues to be on fixed interest securities, despite a trend toward use of other asset classes, including equities. The currency of investments reflects the currency in which business is written, which leads to predominantly U.S. dollar and sterling portfolios. In 2007, the high credit quality of the investments held by Lloyd's and London market reinsurers provided insulation from volatility in the fixed income sector caused by the instability in the credit markets. At Lloyd's, the premiums trust funds produced a 5.2% return (2006: 4.2%), the highest return of the past five years.

The return on Central Fund assets also rose, increasing to 6.5% in 2007 from 3.2% the previous year. The return on these investments is subject to volatility because a significant proportion of the assets comprise proceeds from the subordinated debt issued by the Society of Lloyd's, and the assets are held to immunize the long-tail liabilities of the Society. The return on members' funds at Lloyd's (FAL) was stable at 6%. Subprime-related losses were insignificant across the market as a whole.

Further ahead, poor bond returns and low U.S. yields are likely to dampen investment returns in 2008. This may serve to increase the focus on underwriting returns, because the investment markets are unlikely to compensate for poor underwriting performance.

Loss Development

In 2008 and 2009, A.M. Best expects a broadly stable position for prior-year reserves for Lloyd's and London reinsurers, reflecting an end to the period of adverse development from U.S. casualty business written in soft market conditions between 1997 and 2001. This has particular relevance for Lloyd's, with its relatively high exposure to U.S. business.

In 2007, Lloyd's reported an overall surplus on prior years of GBP 856 million (2006: GBP 270 million), exceeding A.M. Best's expectations for the year. Positive development was driven by releases from reserves for 2002 and subsequent years. Development for the 2001 and prior years was within expectations for the second year in succession. Following deterioration of GBP 415 million in 2006, reserves for the major catastrophe events of 2005 remained stable.

Although Lloyd's run-off years reported a deficit of GBP 48 million at year-end

2007 (up from GBP 3 million in 2006), A.M. Best believes the likelihood of significant adverse development is diminishing because of the reduction in the number of syndicate years of account in run-off (54 at the end of 2007, down from 90 the previous year).

The reduction in run-off years and stabilization of 2001 and prior year reserves, taken together, represent a substantial positive development for Lloyd's, because these two areas have been the principal sources of reserve deterioration before 2006. Whether new areas for concern will emerge, particularly from subprime-related insurance claims, is impossible to answer. Even with this, there is some cause for optimism, because Lloyd's exposure to financial institutions, the most vulnerable area for subprime claims, has reduced since 2001. Reserves provide another strong indicator that Lloyd's has entered the current softening phase in the market cycle in a strong position.

Asia-Pacific: Looking Abroad

A.M. Best expects the underwriting results of Asian-based reinsurers to remain solid in 2008 but not as good as those of 2007. Overall capitalization will remain stable, but companies with high equity exposure will have more volatile results.

Asian reinsurers experienced another profitable underwriting year in 2007, due predominantly to the absence of major catastrophes. Most Asian reinsurers reported high net profits (see **Exhibit 13**), attributable to both good underwriting performance and strong investment results.

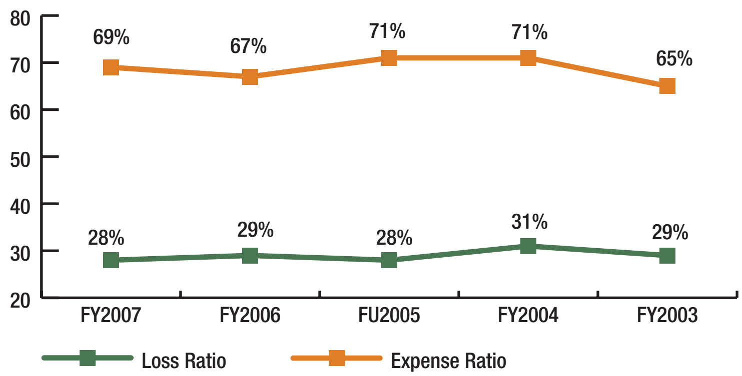
The picture looks different for the first half of 2008. Asia already has experienced several catastrophe events – the Sichuan Earthquake in May, flooding in Southern China, a number of serious typhoons in Taiwan and earthquakes in Japan. In addition, the soft market is continuing in 2008. Local differences can come into play, however; in Japan, for example, catastrophe modeling for windstorm and earthquake risk has wider acceptance, solidifying the calculation of premiums and easing some of the pressure on pricing.

Underwriting

Most Asian countries have a dominant reinsurance company in their market and these companies often dominate the proportional business in their domiciles. In Japan, Toa Re is the dominant player and enjoys steady, loyal relationships with primary companies. Still, with intensified competition in some domestic markets in recent years, A.M. Best has seen Asian reinsurers expanding their market presence overseas. Although proportional business still constitutes a major part of this overseas business, nonproportional business is increasing slowly.

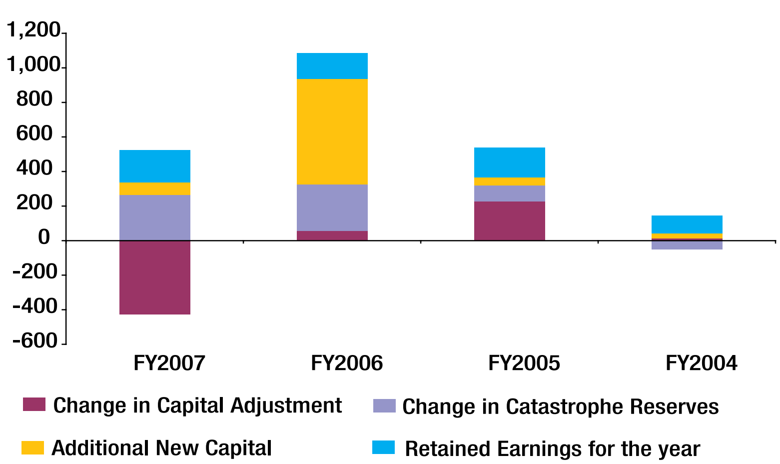
Because of the focus on proportional business, the underwriting performance of Asian reinsurers has been relatively stable (see **Exhibit 10**). Since domestic business remains the largest portion of the reinsurers' portfolio,

Exhibit 10
Asian Reinsurers – Combined Ratio (FY2003-FY2007)



Excluding General Insurance Corporation of India.

Exhibit 11
Asian Reinsurers – Change in Adjusted Policyholder Surplus (FY2004-FY2007)



Excluding General Insurance Corporation of India.

A.M. Best expects the overall underwriting performances of Asian reinsurers to remain solid but weaker than in fiscal year 2007. Nonetheless, the sustainability of underwriting profitability will become increasingly dependent on reinsurers' ability to generate profitable overseas business.

Capitalization

Generally, the capitalization of Asian reinsurers improved in the year 2007. Retained profits have been a stable source of capital for Asian reinsurers in the past four years (see **Exhibit 13**). On average, reinsurers retained more than 60% of their net profit each year.

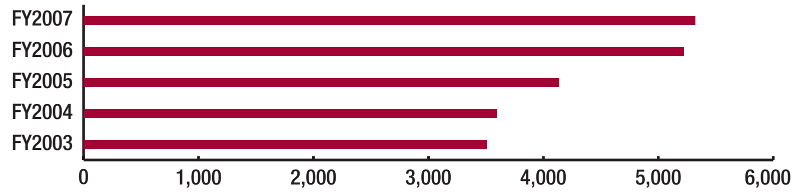
The change in capital and surplus often depends on two factors – capital adjustment, where the main component of capital adjustment is the change in unrealized capital gains or losses, and catastrophe reserves. For certain reinsurers, the change in the capital adjustment fluctuated greatly over the past four years as a result of the volatile equity markets in Asia. Catastrophe reserves, on the other hand, increased rapidly in fiscal years 2006 and 2007 because companies recorded good underwriting results.

The outlook of Asian reinsurers in 2008 will depend on each company's investment quality. Most Asian reinsurers invest predominantly in domestic bond markets. A.M. Best believes interest income from bond investment will continue to provide a stable investment income in 2008 and that capitalization will remain stable. However, capitalization of those companies that have high equity exposure will depend on the performance of the equity market.

New Capacity

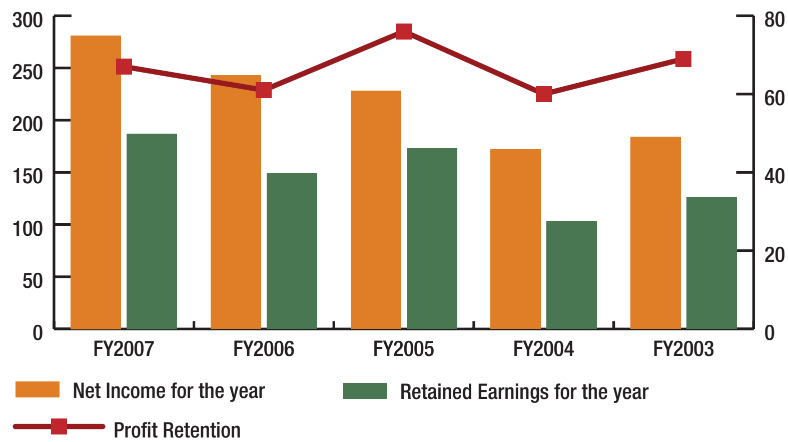
A start-up company (Asia Capital Reinsurance Group Pte Ltd.) brought USD 565 million of new capital into the market in fiscal year 2006. In 2007 and the first half of 2008, two more reinsurance companies were established in the region: ACR ReTakaful SEA Berhad (Malaysia), with paid-in capital of USD 100 million, and MNRB Retakaful Berhad (Malaysia), with MYR 100 million (USD 31 million). The latter two companies

Exhibit 12
Asian Reinsurers –
Adjusted Policyholder Surplus (FY2003-FY2007)



Excluding General Insurance Corporation of India.

Exhibit 13
Asian Reinsurers –
Profit Retention (FY2003-FY2007)
(USD Millions)



Excluding General Insurance Corporation of India.

focus on the fast-growing retakaful markets in Southeast Asia. In addition to the start-ups, other Asian companies also have strengthened their capitalization by initial public offerings and capital injections, mainly through new shareholders.

A.M. Best expects the Asian insurance market to grow steadily in the medium to long term, fed by economic growth and further increases in insurance penetration in the region. A.M. Best believes the new capacity will be absorbed steadily in the medium term.

Outlook

Premium rates have remained soft in 2008 as capacity continues to increase rapidly. With the soft market environment, A.M. Best believes managing the underwriting cycle is crucial to sustaining long-term operating performance.

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