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Flood Losses Prompt Key Changes in Thai Insurance Industry

Insurers' estimates of industry wide losses from the Thailand floods have increased 50% to USD 15 billion since A.M. Best's last briefing on this event (*Thai Flooding Brings Industrial, Business Interruption Claims*), published Nov. 23, 2011. Such a loss would place the Thai floods in a tie for the fifth costliest insured loss event in the past 31 years.

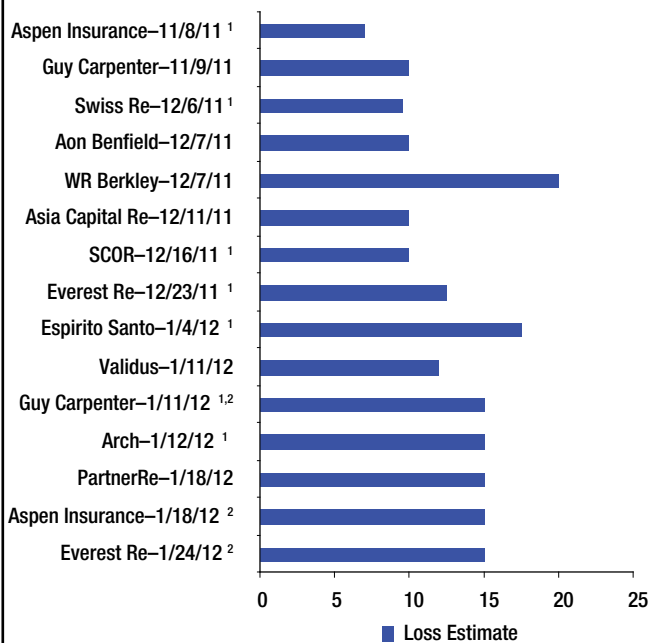
Aon Benfield estimated the floods in Thailand have damaged or destroyed more than 4 million homes, businesses and manufacturing facilities. This has generated structural damage four times greater than what resulted from Japan's earthquake and tsunami in March 2011, but only half of the total insured loss due to a low rate of insurance adoption.

It will take the industry significant time to reconcile the true impact of the floods because of a general lack of data on Thai exposures, the length and magnitude of the floods, and the complexity of business interruption and contingent business interruption (CBI) claims. As demonstrated by companies increasing fourth-quarter reserves for catastrophe events that occurred earlier in 2011, potential losses may creep upward throughout 2012. The Lloyd's market has yet to release its net estimate of flood losses, which will include a material loss from Kiln Syndicate 1880. That syndicate's loss currently is estimated at USD 700 million, and claims have been fully funded in cash by its sole capital provider and guarantor, Tokio Marine.

Policyholders and insurers are having difficulty accurately estimating income lost to production shutdowns, and incurred costs due to supply-chain disruptions and damage to property and equipment. Given the floods' impact on manufacturing in Thailand's industrial estates, one of the major uncertainties will come from the difficulties in calculating CBI losses. Insured parties have several limitations on their ability to make CBI claims. If property insurance does not cover a certain peril, then related CBI claims will not be covered. Insurers could encounter reinstatement issues and face problems on first-loss limits from firms with multiple locations, as dates of damage vary for different industrial estates. Event limits were not always specified in Thai insurance contracts. Classifying the floods as multiple events could increase costs for the insurers/reinsurers that are involved. Many impacted companies moved to Thailand to mitigate losses from the March 2011 earthquake and tsunami in Japan. This can bring

Exhibit 1 Thailand Non-Life – Insured Flood Losses (2011)

Estimates of industrywide losses provided by industry participants and observers.
(USD Billions)



¹ Midpoint of estimated range

² Increased estimate

Source: Company reports

about complex causation and adjustment issues as they will now need to figure out other contingency plans.

The four-month long deluge of flooding in Thailand, labeled the costliest natural disaster in Southeast Asia, delivered a shocking and unexpected blow to the global insurance industry in the form of an un-modeled event. Reinsurers no longer will spare Thailand from consideration as a risk for natural catastrophes, resulting in significant changes to flood insurance policies, including increased pricing and decreased coverage.

This event has shown that pricing of risk in Thailand has been inappropriate to date. In essence, flood coverage in Thailand was provided without premium payment. Flood coverage for most industrial and large commercial companies was automatically included in the industrial all risk (IAR) policies, with almost 100% of the sum covered. About 1% of homeowners

and small businesses in Thailand buy flood insurance. Homebuyers could add flood, storm, earthquake, hail and riot/terrorism insurance to mandatory fire insurance for only 0.02% of the sum insured. Few policies issued in Thailand required deductibles.

Impact: Pricing, Terms & Conditions

Guy Carpenter noted that at January renewals there was widespread interest in imposing limits on proportional treaties; Willis Re stated that besides capping proportional treaties, there were no immediate significant changes to underwriting. The Thai commercial insurance industry will likely begin facing sharply contracted capacity, higher pricing and tighter terms for coverage with the Asian and Japanese reinsurance renewals in April. In 2012, flood coverage will be separated from IAR policies. Flood policy premiums are expected to double or triple from previous levels, while the renewal and expansion of excess-of-loss protection has driven rate increases ranging from 500% to 1,000%. Policy limitations on coverage amounts available for specific types of loss likely will be cut to 10%-20% of the sum insured. Deductibles of 10% are likely to follow.

Significant increased demand for insurance has led to temporary cancellations of risk protection by many insurers that have yet to finalize new policies on coverage. The hardening of rates, coupled with contracted capacity, could prompt more multinational firms to self-insure through captives.

Regulatory Impact

The Thai government and the Office of Insurance Commission (OIC) now face a twofold challenge – guaranteeing the population's access to insurance while protecting the Thai market's desirability.

Most reinsurance firms are now hesitant to renew flood-related contracts for Thai companies until the government develops a clear flood-prevention plan. A USD 9.4 billion plan for water management and flood prevention announced recently by the Thai government was met with skepticism. Some insurers remain undecided on whether to continue offering flood coverage as the next

monsoon season, being four months away, is expected to be particularly heavy because of the La Nina effect.

To ease insurers' concerns and ensure that flood protection remains available and affordable in the Thai market, the Thai government has agreed to establish a USD 1.62 billion catastrophe fund capable of covering losses up to USD 16.2 billion. While similar to models adopted in Japan, Taiwan, New Zealand and Australia, this potential risk-sharing scheme between the Thai government and 67 non-life insurance companies, if successful, would be the biggest excess-of-loss property catastrophe treaty in the world. These funds would help cover the massive disaster costs while helping insurers to continue underwriting risk. The scheme is expected to be criticized because of Thailand's small reinsurance premium base, but it is a step in the right direction to restore confidence in the Thai market. With ceded premiums of USD 1 billion and a potential loss of USD 15 billion, it likely will take decades for the reinsurers to recover losses. Logistics of the fund could take up to a year to negotiate, given speculation that reinsurers could be asked to cover the fund. The Thai government would need to convince reinsurers that the risk in Thailand is both manageable and profitable.

The OIC already has indicated that in January 2013 the minimum capital adequacy ratio requirement for insurers will increase to 140% from 125%. This could result in companies facing capitalization issues and being unable to meet the new requirements without considerable primary rate increases. This is further exacerbated by an anticipated rise in reinsurance rates.

Foreign Investment

Many foreign investors seem anxious and uncertain whether the Thai government is doing enough to prevent flooding during future monsoons. Some manufacturing companies are shifting production facilities from Thailand to Malaysia, the Philippines, Vietnam, China and Poland. Honda, Mitsubishi, Hitachi, Toshiba, Toyota and Canon have remained committed to their Thailand facilities and announced plans to further invest through restoring or building new factories. However, they do

Exhibit 2

Thailand Non-Life – Rating Actions (2011-2012)

Company	Action	Reason	Date	FSR
Labuan Reinsurance (L) Ltd.	Under review, negative implications.	Impact of estimated net loss from the Thai flooding.	21-Dec-11	A-
Toa Reinsurance Co., Ltd.	Under review, negative implications.	Has not yet provided estimate for Thai flood losses. Actual losses sizable to its capitalization.	22-Dec-11	A+
Taiping Reinsurance Co. Ltd.	Outlook revised to stable from positive.	Deteriorated risk-adjusted capitalization and exposure to cat events.	20-Jan-12	A-
Partner Reinsurance Co. Ltd.	Under review, negative implications.	Aggregation of catastrophe losses, including Thai floods.	24-Jan-12	A+

Source: A.M. Best Co.

expect the government to come up with a credible, comprehensive plan by April 2012 to prevent a repeat of this year's massive floods. Continued confidence will rely on how effectively the government launches measures to prevent future flooding problems and other disasters.

Industry Consolidation

Mounting claims and the new risk-based capital rule have left certain foreign carriers financially constrained. This has prompted certain reinsurers/insurers to dramatically reduce catastrophe exposure in the Asian market or exit the market completely. French state-owned reinsurer Caisse Centrale de Reassurance – a major player in the Thai reinsurance market – did not renew any of its contracts in Thailand, Australia or New Zealand following heavy cat losses. Lloyd's Singapore-based Syndicate 1965 has been placed into runoff after it stopped writing new business in the wake of heavy cat losses, including the Thai flood. Lloyd's insurer Hardy put itself up for sale following sizable Thai flooding loss exposures.

High insurance payouts likely will force financially weak insurers to seek new partners, as evidenced by Fairfax's recent agreement to acquire 25% of Thai Re for USD 70 million. Insurance Australia Group stated that it will likely take advantage of consolidation with-

in the Thailand insurance sector to expand its market presence. ThaiSri Insurance, formerly known as Thai Zurich Insurance, has stated an interest in investing in or acquiring other insurers. A.M. Best anticipates additional acquisitions or mergers in 2012.

Conclusion

This unprecedented flooding has forever changed the perception of risk in Thailand and brought about significant changes to the Thai insurance industry. Additional mergers, acquisitions and deals appear likely as companies look for ways to offset heavy losses. Given the overall uncertainties and previous experience with other significant, un-modeled losses, A.M. Best expects to see additional upward revisions to initial loss estimates and feels that the amount of the total insured loss could change. A.M. Best will continue to monitor the situation and review individual ratings as more updated loss figures are released.

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