Market Review
September 24, 2012

Regional Cat Losses Drive Asian Reinsurers To Focus on Profitability, Capital Strength

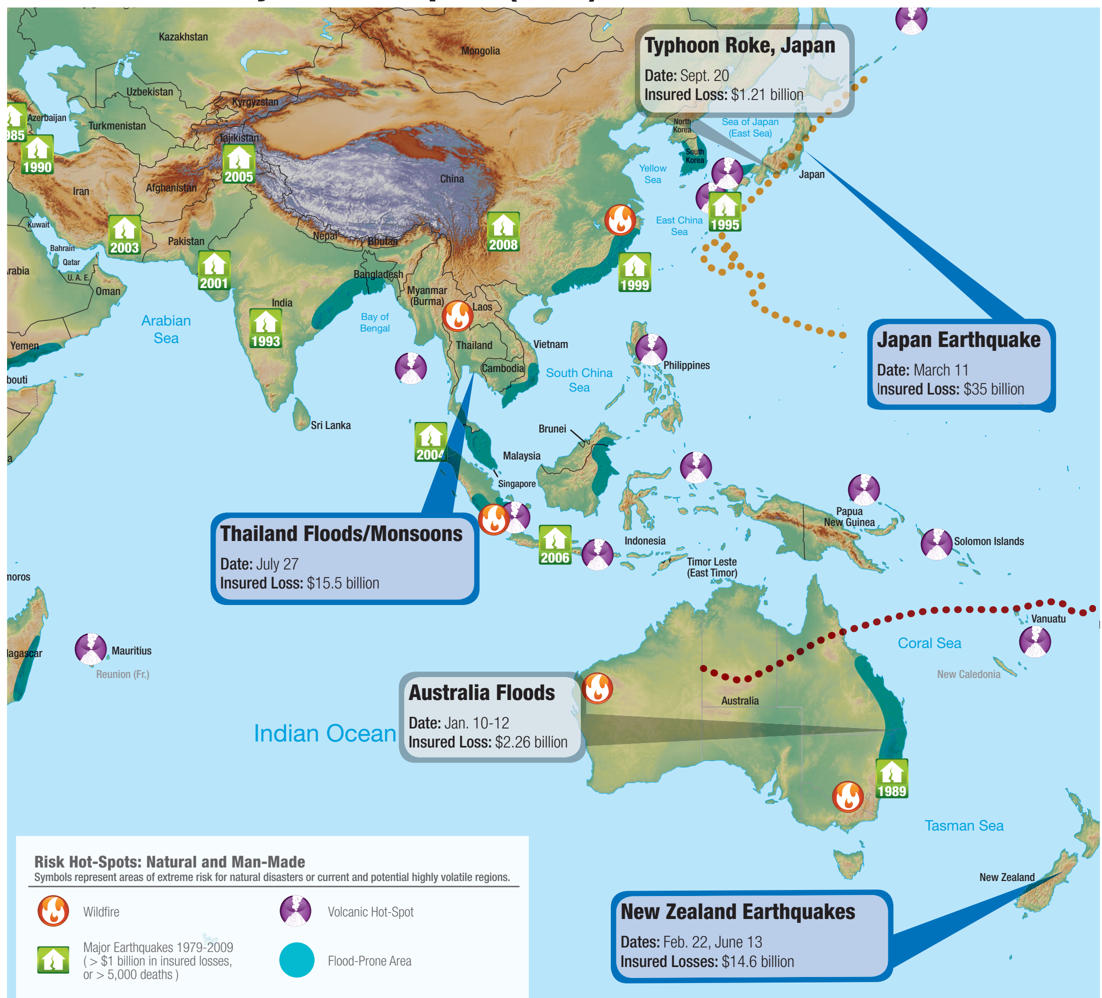
Risk Appetite Wanes as Claims Mount.

Many large-scale catastrophes occurred in the Asia-Pacific region in 2011, translating into sizable insured losses. The region simultaneously experienced floods in Australia and Thailand, as well as earthquakes in New Zealand and Japan.

These catastrophe events adversely affected the underwriting performance and financial strength of Asian reinsurers. Many of them already have restored their capital position in the first half 2012 by raising capital and/or releasing technical reserves.

However, capital and claims reserves buffers remain thin,causing a change in companies' appetite for risk as they shift their priorities toward profitability and building up a capital buffer, rather than growing premiums. A.M. Best expects Asian reinsurers to focus on preserving and replenishing capital before they aggressively pursue premium volume again.

Exhibit 1
Asia-Pacific – Major Catastrophes (2011)



Source: A.M. Best research

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Exhibit 2
Asia Reinsurance – A.M. Best Rated Companies
As of Sept. 14, 2012.

Company	A.M. Best #	Domicile	Financial Strength Rating	Outlook/ Implications	Issuer Credit Rating	Outlook/ Implications	Action	Effective Date
ACR ReTakaful MEA B.S.C. (c)	90059	Bahrain	A-	Stable	a-	Stable	Affirmed	1/4/12
China Life Reinsurance Co. Ltd.	90957	China	A	Stable	a	Stable	Affirmed	9/12/12
China Property & Casualty Reinsurance Co. Ltd.	88692	China	A	Stable	a	Stable	Affirmed	9/12/12
China Reinsurance (Group) Corp.	90955	China	A	Stable	a	Stable	Affirmed	9/12/12
Taiping Reinsurance Co. Ltd.	85029	Hong Kong	A- u	Negative	a- u	Negative	Under Review	8/10/12
General Insurance Corp. of India	86041	India	A-	Stable	a-	Stable	Affirmed	2/14/12
The Toa Reinsurance Co., Ltd. (As of 9/14/12)	85179	Japan	A+	Stable	aa-	Stable	Affirmed	5/29/12
(Previous)			*A+ u*	*Negative*	*aa- u*	*Negative*	*Under Review*	*12/22/11*
ACR ReTakaful Berhad	90060	Malaysia	A-	Stable	a-	Stable	Affirmed	1/4/12
Asia Capital Reinsurance Malaysia Sdn	90756	Malaysia	A-	Stable	a-	Stable	Affirmed	1/4/12
Labuan Reinsurance (L) Ltd. (As of 9/14/12)	86913	Malaysia	A-	Stable	a-	Stable	Affirmed	7/9/12
(Previous)			*A- u*	*Negative*	*a- u*	*Negative*	*Under Review*	*12/21/11*
Malaysian Reinsurance Berhad	78303	Malaysia	A-	Stable	a-	Stable	Affirmed	1/26/12
National Reinsurance Corp. of Philippines	86771	Philippines	B++	Stable	bbb	Stable	Affirmed	3/26/12
Asia Capital Reinsurance Group Pte. Ltd.	78461	Singapore	A-	Stable	a-	Stable	Affirmed	1/4/12
Samsung Reinsurance Pte. Ltd.	91577	Singapore	A	Stable	a	Stable	Assigned	12/13/11
Singapore Reinsurance Corp. Ltd.	85224	Singapore	A-	Stable	a-	Stable	Affirmed	2/28/12
Korean Reinsurance Co.	85225	South Korea	A	Stable	a	Stable	Affirmed	3/5/12
Central Reinsurance Corp.	86496	Taiwan	A	Stable	a	Stable	Affirmed	7/25/12
Asian Reinsurance Corp.	85568	Thailand	B+ u	Negative	bbb- u	Negative	Downgraded/ Under Review	7/2/12
PVI Reinsurance Co.	91541	Vietnam	B+	Stable	bbb-	Stable	Assigned	3/23/12

Source: A.M. Best Co.

Direct insurance premiums continue to grow rapidly in emerging economies such as China and India. The overall risk profile for direct players in these markets is growing more quickly than capital, placing pressure on risk-adjusted capitalization. Further demand for reinsurance is driven by the need for solvency relief as well as greater awareness of catastrophe risk management.

Motor Continues to Drive China's Reinsurance Growth

Amid the consistent and strong premium growth in China's non-life insurance market, reinsurance premium from the domestic market continued to increase in 2011. As motor insurance dominated the non-life insurance market (more than 70% of total premium), motor reinsurance business remained the core source of income to reinsurers. Property reinsurance was another important contributor to premiums. The operating environment for the reinsurance industry remained favorable because of the profitable results in China's non-life insurance market, which remained on an upward trend in 2011 after returning to positive in 2010. The loss ratio stabilized since 2010 and is expected to hold steady in the coming year (see **Exhibit 3**).

Exhibit 3
China Non-Life – Combined Ratios of Top 3 Insurers (2007-2011)

	2007	2008	2009	2010	2011
Loss Ratio	66%	73%	65%	63%	62%
Expense Ratio	29%	26%	27%	24%	25%
Combined Ratio	**95%**	**99%**	**92%**	**87%**	**87%**

Source: – Statement File Global

The demand for catastrophe reinsurance in the local market grew because of the increasing accumulated risk exposure borne by direct insurers. There were no significant natural disasters in China last year. However, the massive insured losses from overseas events, such as the earthquake and tsunami in Japan and flooding

in Thailand, led to an increase in premium rates for catastrophe reinsurance in China. Reinsurance companies generally tightened event limits to control the risk. Data quality and transparency also were enhanced through interactive data communication between ceding companies and reinsurers. Combined with the increasing use of sophisticated catastrophe models by the insurance industry, these measures demonstrated improvement in risk management.

Exhibit 4

China Life Industry – Statutory Solvency Ratios of Major Insurers (2010-2011)

	Solvency Margin Ratio	
Company	**2010**	**2011**
China Life	212%	170%
China Pacific Life	241%	187%
New China Life	35%	156%
Ping An Life	180%	156%
Taikang Life	175%	151%

Source: Company annual reports

Tightened regulatory control over China's non-life insurance industry will benefit the local reinsurance market. In early 2012, the China Insurance Regulatory Commission (CIRC), the insurance regulator in China, set the maximum limit of premium retained by insurers based on their capital and surplus levels. The need for reinsurance will increase accordingly. Moreover, robust development in the non-life insurance segment will continue to support the reinsurance market. Business from the policy-driven agricultural insurance sector may supply new opportunities for reinsurers, offsetting the expected slower growth from motor insurance under more intense competition and regulatory reform.

Development of the local life reinsurance segment was affected significantly by the business environment of China's life insurance industry. Due to the relatively low sums insured with protection type products, the demand for protection risk reinsurance remained insufficient. Rather, savings insurance products dominated the life insurance market.

Adversely affected by weak momentum in the A-share market and capital strain from strong new business sales, many life insurers faced pressure to meet statutory solvency requirements (see **Exhibit 4**). This created a boom in demand for financial reinsurance last year. Under different financial reinsurance arrangements, the reserve recoverable abated the ceding companies' minimum capital requirements. The reinsurance commission, if any, accelerated earnings to the insurers and increased their capital.

CIRC already has noticed this increasing use of reinsurance transactions. In July 2012, CIRC released draft rules on the appropriate use of financial reinsurance and began consultations with the industry. Based on the proposed new rules, reinsurance arrangements to strengthen solvency are allowed but must involve risk transfer. Yearly renewable term, coinsurance and modified coinsurance are permitted arrangements, but not the combination of these choices. The rules formally state the necessary conditions for recognizing reserves ceded and reinsurance commissions in accounting statements. Given the persistent demand combined with poor investment markets in the first half of 2012, the new controls will provide a guided way for insurance companies to effectively use financial reinsurance. There should be room for further development in this sector.

Another growing reinsurance business observed in China last year was cross-border Renminbi (RMB) reinsurance treaties, mainly from Hong Kong. The RMB deposit base in Hong Kong surged in the past few years. Given the low offshore deposit rates and limited investment tools, many life insurance companies offered RMB five-year saving insurance products to attract policyholders. Due to the restrictions for corporations outside mainland China to access onshore, high-yielded investment markets, the insurers arranged coinsurance treaties

with reinsurers in China to obtain RMB investment exposure. This historical opportunity generated more than RMB 9 billion of premiums for the reinsurance market in China.

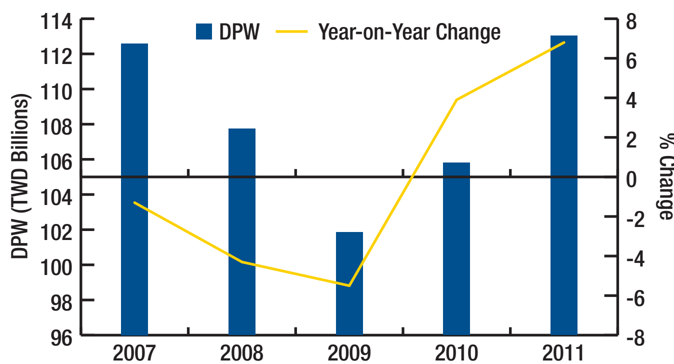
As China regulators gradually open the fixed-income securities markets to Hong Kong and other overseas financial institutions, the further expansion of existing business is expected to be sluggish. However, a wide variety of new RMB insurance products are expected from Hong Kong and other Asian regions. The reinsurance industry in China can establish other innovative types of cooperation with these overseas RMB insurance participants.

Competition Tightens in Taiwan Reinsurance Market

Taiwan's reinsurance market is becoming increasingly competitive because of the prevailing soft pricing environment and increased retentions by local direct insurers in 2011. Direct non-life premiums written showed growth in 2011, mainly due to continued robust new car sales and the early renewal of mega-size commercial fire polices before the implementation of a new natural catastrophe reference tariff in July 2011 (see **Exhibit 5**). The local non-life reinsurance market reflected the rebound in the direct insurance market, with non-life premium ceded by direct insurers increasing by 7.5% year-on-year to NTD 40.3 billion in 2011, from NTD 37.5 billion in 2010 (see **Exhibit 6**).

Exhibit 5

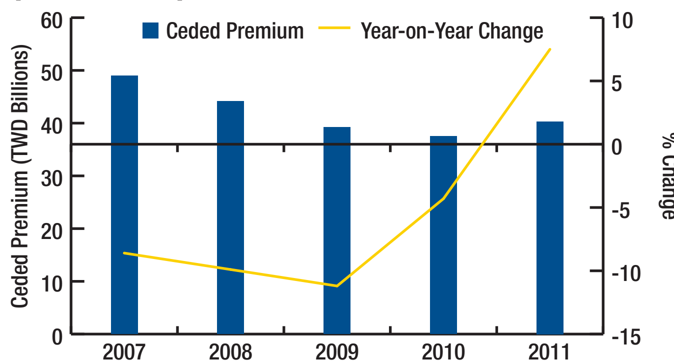
Taiwan Non-Life – Direct Premiums Written (2007-2011)



Source: Taiwan Insurance Institute

Exhibit 6

Taiwan Non-Life – Ceded Premium (2007-2011)



Source: Taiwan Insurance Institute

While the prospects of Taiwan's non-life insurance market are driven substantially by local economic sentiment, the market faces mounting pricing pressure since the implementation of the third-phase tariff deregulation on the automobile and fire segments in 2009. Direct insurers had strived to mitigate the decline in premium rates by increasing their retention, mainly in auto as well as other, miscellaneous lines such as casualty and personal accident businesses. This led to declining demand for reinsurers' capacity over the past few years. (see **Exhibits 7** and **8**) However, utilization of offshore reinsurance capacity increased (see **Exhibit 9**) which may be driven by the growing demand for high risk transfer in respect of commercial fire and marine businesses. International facultative reinsurance premium rates also were observed to have hardened in 2011.

In 2011, both direct insurers and reinsurers enjoyed an absence of severe catastrophic events in Taiwan compared with the preceding two years. Although some reinsurers also were impacted negatively by the global catastrophic losses and unfavorable investment environment in 2011, reinsurers were able to mitigate

such volatility in earnings with the reserve redundancy accumulated through favorable runoff of prior-year losses, and they maintained adequate capital to sustain their capacity to meet local demand for reinsurance. The introduction of a natural catastrophe reference rate in July 2011 was positive for both premium rates and volume of fire business in 2011, while resilient new car sales also indirectly benefited reinsurers. However, total premium ceded by auto insurers grew more slowly than direct premium, as direct insurers continued to increase their retentions in this segment.

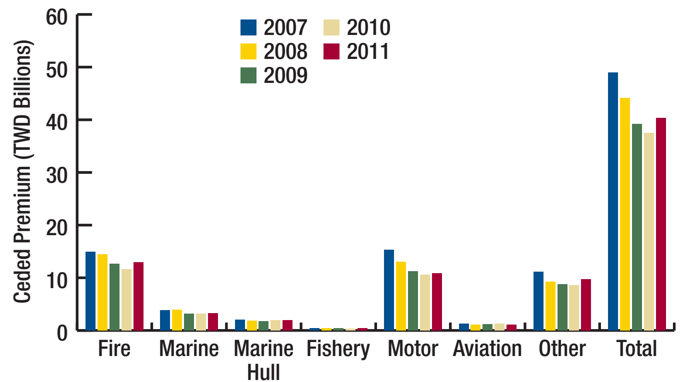
Outlook

Stagnant growth in the direct non-life market will continue to challenge the prospects of Taiwan's reinsurance market in 2012. Over the past two years, direct insurers had strengthened their capitalization for the retention of additional underwriting risk to mitigate deteriorating profit margins in the prevailing soft pricing environment, particularly in the auto segment. A potential slowdown in new car sales in 2012 also is expected to negatively impact business volume, placing further pressure on demand for reinsurance in the auto business.

For fire business, price hardening is anticipated in the commercial segment as policy renewals show the effects of the new natural catastrophe reference rate regime, as well as the hardening of the international property catastrophe reinsurance market after the global catastrophic losses in 2011. The increase in insurance cost may somewhat change the purchasing attitude of insureds facing budgetary constraints, resulting in lower natural catastrophe exposure for direct insurers across the board. Direct insurers in turn may consider reducing their limits on their reinsurance treaties to control their reinsurance expenses and enhance underwriting margins.

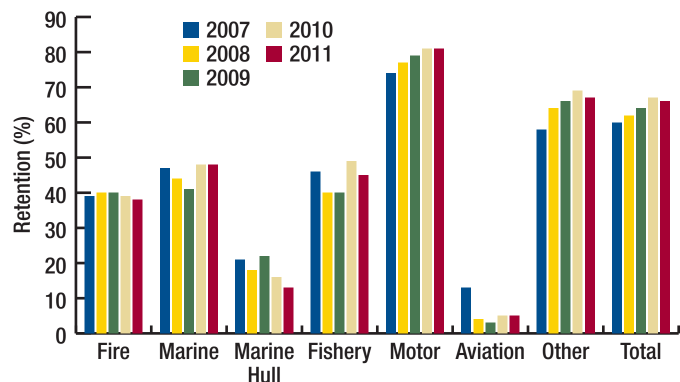
On the other hand, demand for marine and marine hull reinsurance (the third-largest source of ceded premium) may be lower because of a weaker trading environment. For longer tail business such as casualty and personal accident, reinsurers are under pressure from

Exhibit 7
Taiwan Non-Life – Ceded Premium by Line (2007-2011)



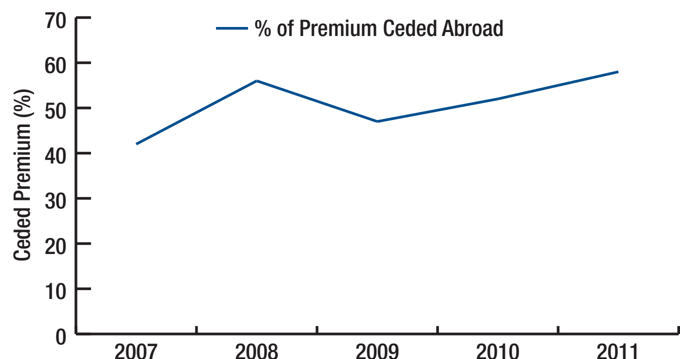
Source: Taiwan Insurance Institute

Exhibit 8
Taiwan Non-Life – Retention by Line (2007-2011)



Note: Retention = Net Premium Written/(Direct Premium Written + Inward Premium Written - Net Premium Written)
Source: Taiwan Insurance Institute

Exhibit 9
Taiwan Non-Life – Percentage of Premium Ceded Abroad (2007-2011)



Source: Taiwan Insurance Institute, 2011 Taiwan Insurance Factbook by Non-Life Insurance Association of the Republic of China, A.M. Best estimates

direct insurers to increase reinsurance commissions in view of the favorable trend in loss experience these lines have exhibited. Despite the fierce competition ahead, reinsurers are expected to tighten their underwriting terms and conditions in both loss-free and catastrophe-prone regions (such as Taiwan), given that effective risk management has proved to be imperative for reinsurers to maintain healthy capitalization. This is necessary for them to navigate through a tougher market environment, as well as the higher frequency of natural catastrophic losses observed worldwide.

Regulatory-Driven Changes Hit New Zealand Reinsurance

The implementation of the Insurance Prudential Supervision Act (2010) and release of the regulatory solvency standards for insurance businesses in New Zealand coincided with the 2010/2011 earthquakes. The regulator's stance toward the catastrophe risk capital charge calculation likely will lead to additional demand for upper-layer reinsurance capacity from non-life insurers operating in New Zealand.

The 2010/11 Canterbury quakes caused the largest recorded losses (see **Exhibit 10**) to New Zealand's non-life insurance industry.

The frequency, magnitude and subsequent loss development underlined the importance of having sufficient reinsurance cover to protect insurers' capital position from extreme events.

The catastrophe risk capital charge in the newly released regulatory solvency standard for non-life insurance businesses is intended to measure the financial impact of extreme events such as the 2010/11 earthquakes and help insurers to provision for such events.

In practice, the catastrophe risk capital charge is an estimate, based on the characteristics of the insurer's underwriting portfolio. As this estimate is one of the inputs to determine the level of protection (be it through actual solvency capital or reinsurance) needed to ensure an insurer's level of claims-paying ability, the estimate should be reasonably reliable. A 1-in-250 year return period (i.e., 99.6% probability of sufficiency) is one industry benchmark and has been a standard used in neighboring Australia.

Exhibit 10

New Zealand Non-Life – Top 10 Insured Catastrophes

(NZD Millions)

Year	Event	Claims
2011	Canterbury Earthquake (Accumulated Total)	NZD 14,590
1987	Bay of Plenty Earthquake	371
2004	Storm Damage – Lower Nth Island	140
1984	Invercargill/Southland Floods	140
2007	Storm Event – Far North/Auckland/Coromandel	69
1988	Cyclone Bola	68
1999	Queenstown Lakes District Floods	64
1975	Canterbury Storms	62
1978	Otago Floods	60
1968	Wahine Storm	57

Source: Insurance Council of New Zealand

In October 2011, the Reserve Bank of New Zealand, which recently had become the regulator for insurance businesses in New Zealand, announced its intention to move gradually to a 1-in-1,000 year return period to determine the catastrophe capital charge by September 2016. This followed the series of earthquakes New Zealand experienced from September 2010 to October 2011, which tested, and in some cases breached, the reinsurance protection of non-life insurance businesses and adversely impacted their risk-adjusted solvency. Reinsurance levels based on larger

return periods might have provided more reinsurance buffer to absorb adverse claims development. However, calibration of return periods is not likely the only reason why the Canterbury quake losses were larger than expected.

Unknowns also have contributed to larger than expected losses. These unknowns include indirect loss variables such as land damage; the question of to what standard damaged buildings should be repaired; and the allocation of damage among successive events. Another unknown was the fact that Canterbury actually would be the location of significant earthquakes, as it was not near known fault lines.

Return Period to Drive Demand

The gradual move to a 1-in-1,000 year return period to estimate non-life insurers' catastrophe charge likely will lead to increased demand for catastrophe reinsurance protection, especially among New Zealand-owned non-life insurers, which unlike their foreign-owned peers do not benefit from a group's global catastrophe reinsurance capacity.

So far, A.M. Best has observed substantial increases in reinsurance limits among the larger, domestically owned New Zealand non-life insurers after the 2010/1 earthquakes. While the increased demand for reinsurance is significant in the New Zealand context, it is less so in the context of global reinsurance capacity. Average annual outward reinsurance from private sector non-life insurers (i.e., excluding the Earthquake Commission) amounted to around NZD 537 million (USD 416 million) in the five years to 2011.

The Canterbury earthquakes have shown that indirect loss variables such as land damage can lead to significant adverse loss development. Without sufficient reinsurance buffer, such adverse loss development easily could damage an insurer's capital position. Higher reinsurance protection limits under 1-in-1,000 year return periods would be helpful in absorbing adverse loss development that arises from complex damage and would help to protect insurers' solvency capital positions.

However, implementing higher reinsurance limits alone might not be sufficient for an insurer to maintain its risk-adjusted capitalization after a big catastrophe. After a hypothetical 1-in-1,000 year event that is effectively absorbed by reinsurance, a direct insurer would find a large amount of reinsurance recoverables on its balance sheet. As a result, asset quality would change, especially in the case of smaller insurers. These reinsurance recoverable balances could expose their balance sheets to higher credit risk as well as higher reinsurer dispute risk. A reinsurer credit downgrade or a reinsurer dispute on even a small proportion of reinsurance recoverable balances could have a significant impact on the insurer's capital position.

The slow progress of settling the Canterbury quake claims (only 21% of all residential insurance claims had been settled by private-sector insurers as of June 2012, according to the Insurance Council of New Zealand), as well as the increase in reinsurance recoverables due to adverse claims cost development, show that these risks could remain a drag on insurers' risk-adjusted capitalization for a considerable time and be more significant than initially expected. Hence in protecting their balance sheet strength against large catastrophes, insurers also should consider whether their capital position could absorb 1-in-1,000 years' worth of reinsurance recoverable risks (credit as well as dispute risk) without significant, lasting damage to their risk-adjusted capitalization.

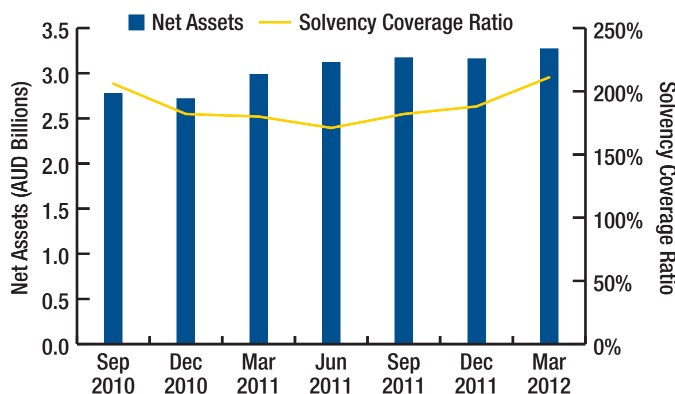
Australia Reinsurers' Capitalization Weathers Catastrophe Losses

2011 was a most memorable year for the 12 reinsurance companies registered in Australia, of which Munich Re, Swiss Re and Hannover Re are the largest. The unprecedented series of major catastrophe events that started at the end of 2010 included the Canterbury earthquakes in New Zealand and the Queensland floods in Australia. In spite of these events and the portion of losses that fell to the reinsurance segment, the reinsurance sector's capitalization has remained largely intact. Both net assets and solvency ratios have recovered from most of the 2011 losses, ending higher than at year-end 2010.

Due in large part to the impact of catastrophe-related losses in 2011, the reinsurance segment's underwriting result has deteriorated. Reinsurance companies incurred gross losses of AUD 5.4 billion for 2011. Yet approximately 77% of these losses have been transmitted to the retrocession market. As a result, the reinsurance segment reported a net loss ratio of 90%, despite a high gross loss ratio of 273%.

Exhibit 11

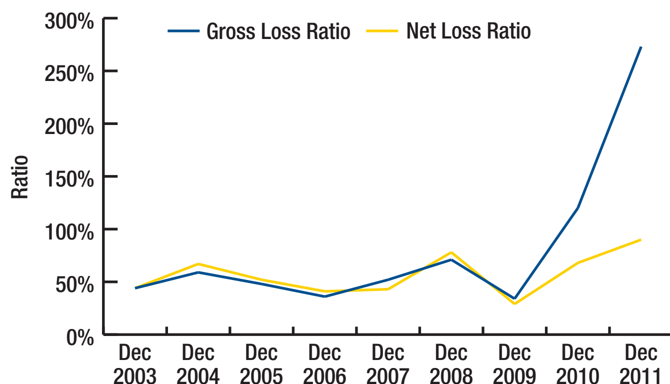
Australia Reinsurance – Net Assets & Solvency Coverage Ratio (2010-2012)



Source: Australian Prudential Regulation Authority (APRA) - General Insurance Quarterly Performance as of March 31, 2012

Exhibit 12

Australia Reinsurance – Gross & Net Loss Ratio (2003-2011)



Source: Australian Prudential Regulation Authority (APRA) - General Insurance Quarterly Performance as of March 31, 2012. A.M. Best has annualized the quarterly data from APRA.

The underwriting losses did not, however, result in deterioration in net assets, as investment income has helped the bottom line to remain positive (see **Exhibit 11**). A slight improvement in return on equity to 13.6% was recorded for 2011. Risk-adjusted capitalization remains adequate, as demonstrated by conservative net premium leverage.

Challenges overhanging reinsurers in the region include the sizable reinsurance recoverable balances and the potential pricing pressures from the retrocession market.

The frequency and severity of catastrophes in 2010-2011 left the reinsurance segment with a sizable reinsurance recoverable balance of AUD 4.5 billion as of Dec. 31, 2011. This represents about 144% of net assets, the highest over the past nine years.

From a cost perspective, retrocession pricing seems well positioned for further increases. This largely reflects the substantial losses ceded to retrocessionaires in 2011. Before 2011, on a cumulative basis, retrocessionaires had incurred a cumulative gross loss ratio of 68% since September 2002. However, the cumulative gross loss ratio developed adversely to

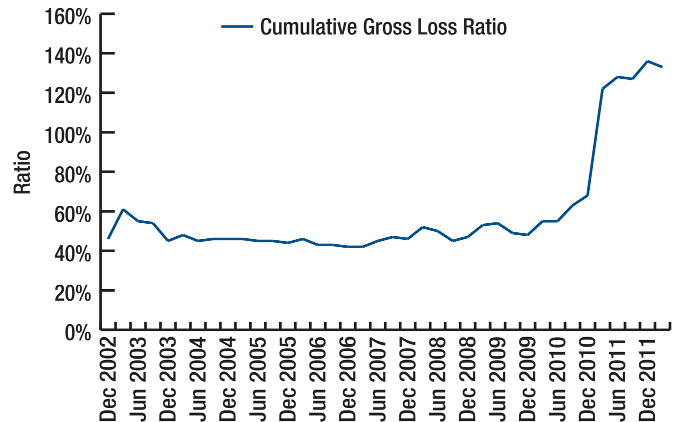
133% as of March 31, 2012, as a result of the AUD 2.8 billion gross loss in the March 2011 quarter (see **Exhibit 13**). A.M. Best believes there are still strong incentives to lift retrocession rates from the current levels.

Although reinsurers may attempt to pass on the full retrocession rate increases to direct insurers, it could be challenging in a market where demand for reinsurance capacity is relatively flat. Over the past nine years, the total reinsurance premium of the general insurance industry (including inwards premium by direct insurers) has remained at around AUD 5 billion-6 billion.

Over the past nine years, demand for reinsurers' capacity has not expanded along with direct premium, as direct insurers have increased retentions, and there is a sizable inwards reinsurance market by direct insurers that can act as a substitute for capacity from reinsurers.

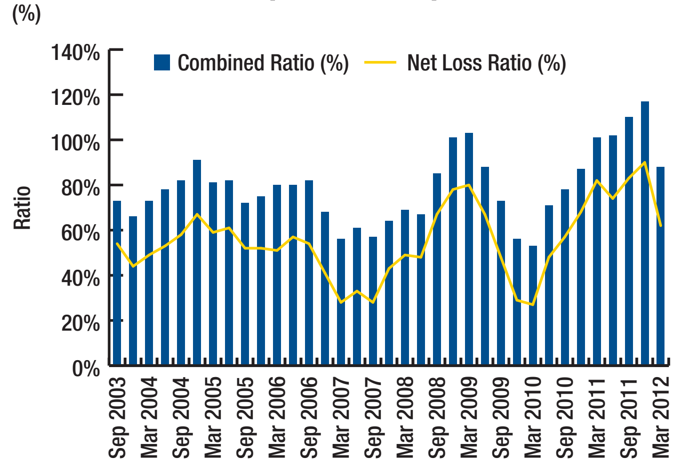
Recent catastrophe events and regulatory changes in the region could have shifted the reinsurance demand, but are yet to be observed. It could be challenging to pass on the full retrocession rate increases to direct insurers. Reinsurers themselves may have to absorb part of the prospective increases.

Exhibit 13
Australia Reinsurance – Cumulative Gross Loss Ratio (2002-2012)



Source: Australian Prudential Regulation Authority (APRA) - General Insurance Quarterly Performance as of March 31, 2012.

Exhibit 14
Australia Reinsurance – Net Loss & Combined Ratios (2003-2012)
(%)



Source: Australian Prudential Regulation Authority (APRA) - General Insurance Quarterly Performance as of March 31, 2012. A.M. Best has annualized the quarterly data from APRA.

Asset Growth, Retrocession Protect Capitalization

Reinsurers remain well capitalized, despite the unprecedented series of major catastrophes. The segment's growing invested assets and retrocession arrangements in place were able to absorb the significant losses from a combination of events. These loss events proved to be manageable from a capital perspective.Assuming a normal level of catastrophe activities, the reinsurance segment is expected to achieve improved underwriting results in 2012.

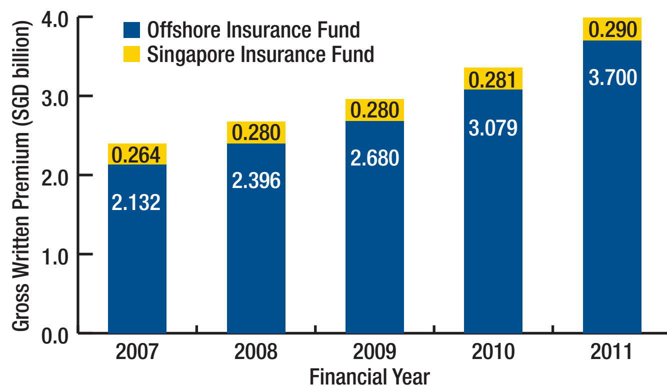
Cats Hit Operating Results in Southeast Asia, India

Most reinsurers in Southeast Asia and South Asia have regional exposures. Their operating performance in 2011 was adversely impacted by catastrophes occurring within as well as outside their own countries. Major catastrophes in the region that caught reinsurers' attention in Southeast and South Asia were the earthquakes in New Zealand and Japan, as well as the floods in Australia and Thailand. These catastrophes resulted in poor operating results for reinsurers.

Singapore is a major reinsurance hub in the region. Reinsurers there provide reinsurance protection to insurance companies in Southeast and South Asia, as well as across the whole Asia-Pacific region. The total gross written premium of Singapore reinsurers was SGD 3.99 billion for financial year 2011, of which more than 90% was contributed from the Offshore Insurance Fund (OIF), marking the fourth consecutive year of double-digit annual growth (see **Exhibit 15**). The proportion of Singapore reinsurers' gross premium generated from the Singapore Insurance Fund (SIF) continued to shrink.

Exhibit 15

Singapore Reinsurers – Gross Written Premium (2007-2011)

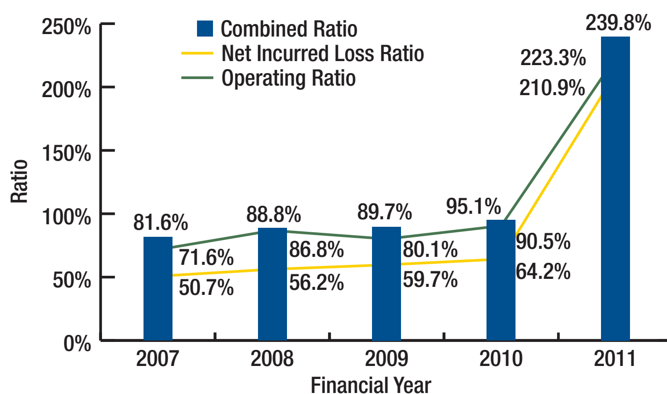


Source: Monetary Authority of Singapore, Insurance Statistics

Exhibit 16

Singapore Reinsurers – Operating Performance (2007-2011)

Singapore Insurance Fund and Offshore Insurance Fund combined.



Source: Monetary Authority of Singapore, Insurance Statistics

However, both the loss and combined ratios worsened during this period of growth in gross premium. The combined ratio of Singapore reinsurers deteriorated from 81.6% in 2007 to 95.1% in 2010. Losses from the catastrophes in 2011 boosted the combined ratio to a historical high of 239.8% (see **Exhibit 16**). The total operating loss of Singapore reinsurers in financial year 2011 was SGD 3.5 billion, which exceeded the total of nine consecutive years of operating profit generated by Singapore reinsurers between 2002 and 2010. The multiple catastrophe events in the Asia-Pacific region in 2011, together with the unsatisfactory underwriting performance of Singapore reinsurers in that year, suggest that geographical diversification of natural catastrophe exposures may not be a sound risk management tool for reinsurers' catastrophe risks.

Despite the absence of major catastrophes in the first half of 2012 that had material impact on Singapore reinsurers' underwriting performance, A.M. Best expects these companies' overall loss ratio for financial year 2012 will still be higher than the historical average, due to adverse development of loss reserves in 2012 from the 2011 catastrophes. Total claim liabilities doubled in financial year

2012 compared with the previous year. Singapore reinsurers need to maintain sound liquidity to meet their claims-payment obligations.

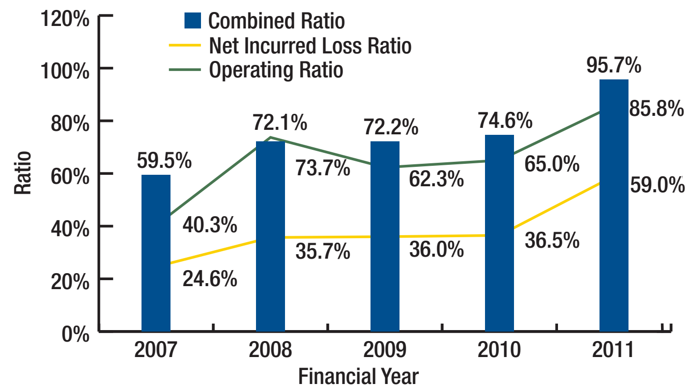
Capitalization of some reinsurers in the Southeast and South Asia regions suffered to varying degrees. Reinsurers took different ways to partially or fully restore their capital position that was eroded by the 2011 catastrophe losses.

In Singapore, A.M. Best affirmed ratings of ACR Capital Holdings Pte. Ltd. (ACR Holdings) and its associated companies in January 2012. ACR had recorded material losses from the various natural catastrophes in 2011, due to its geographically diverse portfolio in the Asia-Pacific region. In April 2012, there was a material change in the share ownership structure of ACR Holdings. Marubeni Corp. (Marubeni) and ACR Holdings signed an agreement for the issuance and allotment of shares in ACR, under which Marubeni will hold about 22% of all outstanding shares of ACR Holdings.

In Malaysia, A.M. Best placed the financial strength rating of A- of Labuan Reinsurance (L) Ltd. (Labuan Re) (Malaysia) under review with negative implications in December 2011, as a result of losses from the Thai flooding. This status was removed in July 2012, recognizing the restoration of Labuan Re's capital position, with its capital rising through the issuance of subordinated bonds.

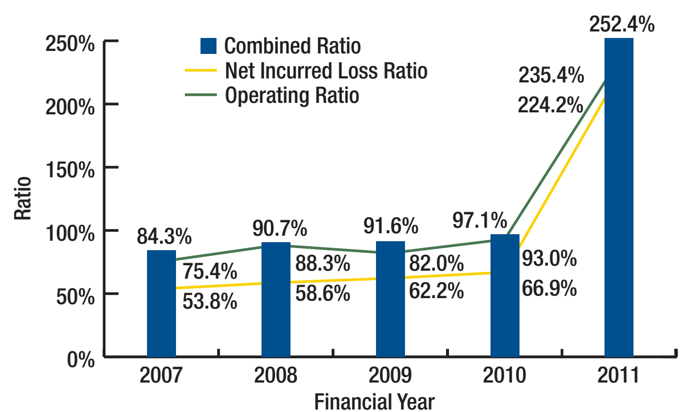
In India, GIC Re, the sole reinsurance company of India, faces various challenges. On one hand, GIC Re faced multiple hits of major catastrophic events in 2011. On the other, GIC Re's domestic business also contributed to its unfavorable underwriting performance in 2011. GIC Re is the pool administrator of the Indian Motor Third Party Insurance Pool (IMTPIP) and has a 10% share of the pool though an obligatory cession. The additional IBNR provision established for IMTPIP had worsened the fiscal year loss ratio.

Exhibit 17
Singapore Reinsurers – Operating Performance, Singapore Insurance Fund (2007-2011)



Source: Monetary Authority of Singapore, Insurance Statistics

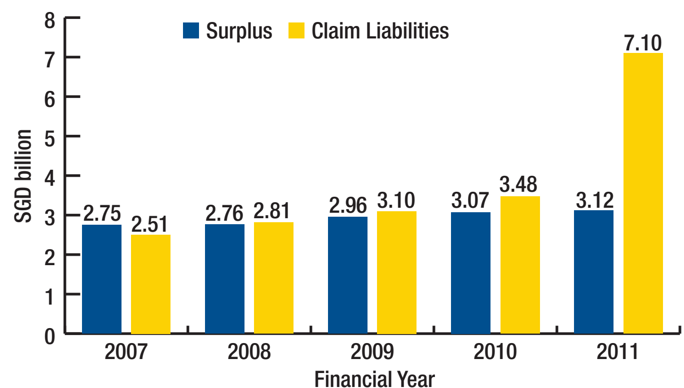
Exhibit 18
Singapore Reinsurers – Operating Performance, Offshore Insurance Fund (2007-2011)



Source: Monetary Authority of Singapore, Insurance Statistics

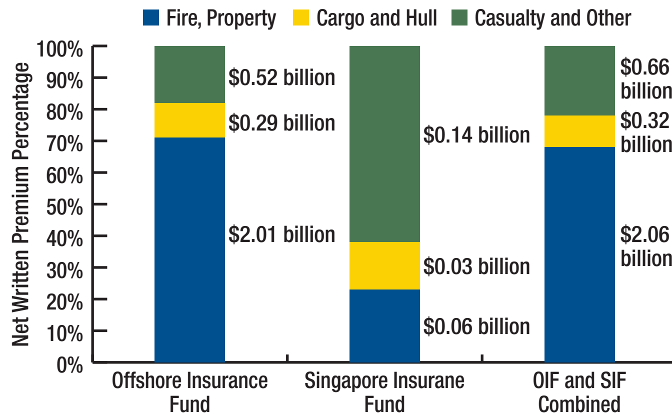
Exhibit 19
Singapore Reinsurers – Development of Surplus and Claim Liabilities (2007-2011)

Singapore Insurance Fund and Offshore Insurance Fund combined.



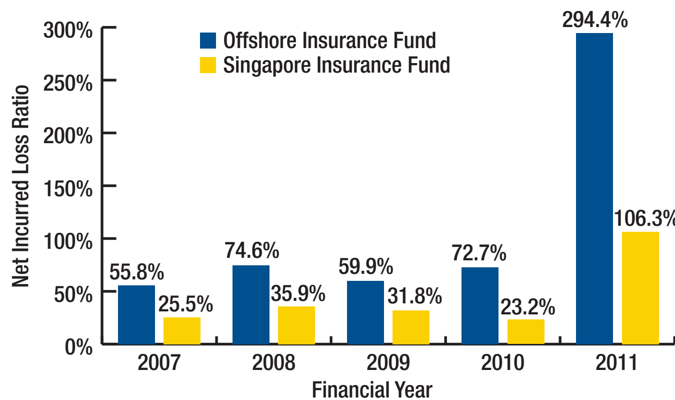
Source: Monetary Authority of Singapore, Insurance Statistics

Exhibit 20
Singapore Reinsurers – Net Premium By Line of Business (2011)



Source: Monetary Authority of Singapore, Insurance Statistics

Exhibit 21
Singapore Reinsurers – Net Incurred Loss Ratio of Fire, Property Business (2007-2011)



Source: Monetary Authority of Singapore, Insurance Statistics

In Thailand, A.M. Best downgraded the financial strength rating to B+ (Good) from B++ of Asian Reinsurance Corp. in July 2012, and the rating was placed under review with negative implications, reflecting the drastic erosion of the capital position of Asian Re due to severe losses from the Thailand flooding.

Price Hikes Ahead

Reinsurers in the region will respond to the catastrophes' lessons in various ways, in addition to just raising reinsurance premiums in the 2012 and 2013 renewals.

Both underwriting guidelines and underwriting capacity will be tightened. A.M. Best expects that many reinsurers in the Southeast and South Asia regions will reduce their writing in the countries where the major 2011 catastrophes occurred. These reinsurers also will be cautious in writing business in other countries not traditionally classified as cat prone, and they will reduce accumulation of exposures originated from cedants' offshore business.

Event limits will become a standard provision for most proportional reinsurance programs. Although reinsurers believe event limits can help mitigate reinsurers' losses from an extraordinary catastrophe event, some direct insurers may view such provisions as violating the "principle" of proportional sharing of premiums and losses. As a result, reinsurers may need to reflect the difference by offering higher reinsurance commission to cedants.

Managing unknown or hidden accumulations and capturing accumulation data are key areas for reinsurers to improve in catastrophe risk management. Reinsurers need to be aware of direct insurers' offshore exposure that could lead to high accumulation in "hidden locations." On the other hand, there is a lack of catastrophe modeling tools in many Southeast Asian countries. However, the 2011 catastrophes were good examples of the limitations of catastrophe models, even when they are available. As a result, risk awareness and preparing for "Black Swan" events are necessities in reinsurers' underwriting mindset from now on.

Reinsurance Capacity Withstands Demand Surge After Thailand Flooding

The Thailand flooding was one of the large-scale catastrophe events that occurred in 2011. The insurance industry loss evaluated by the Office of Insurance Commission of Thailand (OIC) is USD 16 billion (see **Exhibit 22**). Losses are derived largely from damage to industrial and major commercial companies, business interruption (BI) and contingent business interruption (CBI) claims.

As of May 15, 2012, the great majority of personal lines claims were paid. Claims from commercial lines still are developing because of their size and the complexity of evaluating losses related to BI and CBI. According to the OIC, 251 new cases were opened for industrial all risks (IAR) and fire (small and medium enterprises [SME]) between the middle of April and the end of May, bringing the number of claims to 12,387.

Losses from the flood largely were shared with the international market, especially with the Japanese insurance groups (namely Tokio Marine Holdings, MS&AD Insurance Group Holdings and NKSJ Holdings) (see **Exhibit 23**). A large portion of the industrial insured losses was generated by Japanese companies, which are insured chiefly by Japanese insurers.

As for the Japanese players, the Thailand disaster has generated much higher losses, although the industry loss from the flood is lower than from the Great East Japan earthquake. Cumulative net incurred losses recorded by Tokio Marine, MS&AD and NKSJ were slightly more than USD 6 billion from the Thai catastrophe, compared with more than USD 2 billion from the Japanese event.

The natural disasters in 2011 made the year the costliest for reinsured catastrophe losses. Unprecedented frequency and severity of disasters adversely impacted insurers' bottom line and capital position. Erosion of financial strength has resulted in some run-offs,such as Lloyd's syndicate 1965, which announced its run-off status in early December 2011.

To restore capitalization, some reinsurers have released technical reserves, while others have issued subordinated bonds or shares, and some have disposed of treasury shares in 2012. Purchase of additional retrocession, tightening of underwriting guidelines and shifting of capital use to more balanced portfolios also have been observed for some of the reinsurers

Exhibit 22

Thailand Non-Life – Estimated Net Insured Flood Loss (2011)

	Loss (USD Bln)	Local Currency (Billions)	% Total Insured Loss	Comment
Japanese group	7.26	JPY 597.70	47%	
Tokio Marine Group	1.58	130.00	10%	
MS&AD Group	3.32	273.50	21%	Issued USD 1.3B subordinated bonds.
NKSJ Group	1.33	109.80	9%	
Toa Re	1.03	84.40	7%	Issued USD 0.4B subordinated bonds.
Lloyd's	2.20		14%	
Munich Re	0.71	EUR 0.55	5%	
Swiss Re	0.68		4%	
Thai Re	0.28	THB 8.75	2%	
Others	4.39		28%	

Source: Company announcements and A.M. Best estimates

Exhibit 23

Thailand Non-Life – Shares of Insured Flood Losses (2011)

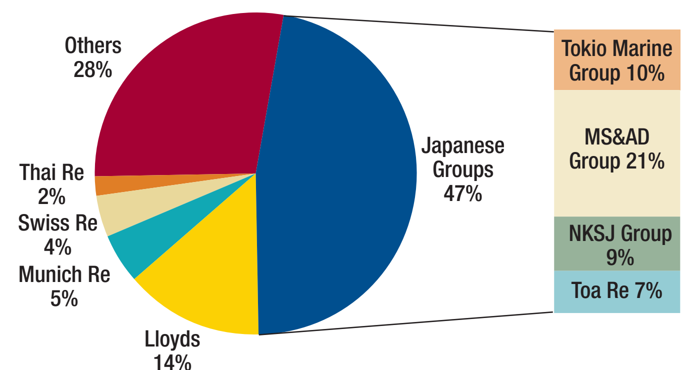


Exhibit 24

Thailand Non-Life & Life – Industry Flood Loss (2011)

As of May 15, 2012.
(USD Millions)

	Incurred losses				Paid vs Incurred loss	
	Claims		Incurred Loss			
	Number	%	Amount	%	Number of Claims	Claims Amount
Industrial All Risks	8,464	10%	USD 14,854	96%	30%	41%
Fire (Small/Medium Enterprises)	3,906	4%	433	3%	71%	30%
Fire (Personal)	36,067	41%	106	1%	90%	80%
Motor	39,797	45%	135	1%	95%	96%
Total Non-Life	**88,234**	**100%**	**USD 15,527**	**100%**		
Life	213	0%	1	0%	100%	100%
Total	**88,447**	**100%**	**USD 15,528**	**100%**		

Source: Thailand Office of Insurance Commission

Exhibit 25

Thailand Non-Life – Post-Flood Capital Raising (2012)

(USD)

Company	Capital Raising	Amount	Completion Month
Mitsui Sumitomo Ins. (MS&AD Group)	Subordinated bonds	1.3 billion	March
Thai Re	Shares to existing shareholders and Fairfax Financial Holdings	227 million	March
Toa Re	Subordinated bonds	365 million	March
Korean Re	Disposal of treasury share	119 million	March
ACR Capital Holdings	Shares to Marubeni Corp.	≈ 250 million	May
Labuan Re	Subordinated bonds	55 million	July

Sources: Company announcements and news releases

seeking to control catastrophe exposure and protect their capital bases.

While capital is being restored, A.M. Best is cautious about the ongoing profitability of some of the reinsurers in the near term because of higher retrocession costs, additional claims-reserve burdens and debt-service obligations.

Substantial impacts of the flooding on underwriting performance and capitalization have changed approaches to underwriting and catastrophe risk. Reinsurance and retrocession costs generally have increased by at least 10%.

Other observed tightening of underwriting comes through imposing event limits, increasing control of risk accumulation and lowering reinsurance commission rates. In addition, countries in Southeast Asia with potential flood risk no longer are viewed as low catastrophe exposed or catastrophe free.

A small number of reinsurers have decided to exit the Thai market,such as France's Caisse Centrale de Reassurance, while some have started to reduce their participation. Simultaneously, others see opportunity, such as Fairfax Financial Holdings, which invested in Thai Re in March, and some have reallocated capacity to specific markets.

To this end, the OIC established the Natural Catastrophe Insurance Fund (*www.ncif.or.th/*) after the Thailand flooding. The fund covers damage from flood, earthquake and windstorm,putting in question the future evolution of the practice of adequately estimating claims from BI and CBI.

Japan Reinsurers Bear Typhoons, Floods, Quake

Japanese non-life insurers' underwriting loss widened to JPY 339 billion in fiscal year 2011 because of numerous catastrophe events during the period, compared with JPY 156 billion in fiscal year 2010, when they were hit by the Tohoku earthquake and tsunami. In fiscal year 2011, Japanese non-life insurers were hit by Typhoons 12 and 15 in the domestic region, in addition to the Thailand floods in fiscal year 2011. The aggregated incurred losses from the natural disasters in fiscal year 2011 amounted to JPY 724 billion (about 10% of the non-life net premium written in fiscal year 2011), compared with losses of JPY 248 billion (about 4% of NPW) in fiscal year 2010, according to the General Insurance Association of Japan (GIAJ).

The net incurred losses from the Thailand floods amounted to about JPY 502 billion, according to the GIAJ, most of which were borne by the major three primary non-life insurance groups. The gross losses are estimated at double the total amount of net losses, which indicates the hard hit to the reinsurers in Japan after the large scale of the Tohoku quake in 2011. For instance, Toa Re, the sole domestic reinsurer in Japan, reported a substantial loss from the Thailand floods and consequently issued subordinated notes to restore its capital.

In addition to the large scale of losses incurred in the past two years, financial market conditions continued to weaken, which exacerbated the non-life insurers' capitalization during the period. The Nikkei index plummeted from 11,809 at the end of March 2010 to 9,755 at the end of March 2011; it now is hovering near 9,000. Also, continued low interest rates mean weak investment incomes that cannot offset the widened underwriting losses.

The adjusted capital and surplus of the five major primary non-life insurers declined by about 10% to JPY 6,051 billion in fiscal year 2011 (see **Exhibit 26**). In the past two years, the combined catastrophe reserve of the five major companies fell JPY 237 billion to JPY 2,109 billion to offset the large losses from the recent natural disasters.

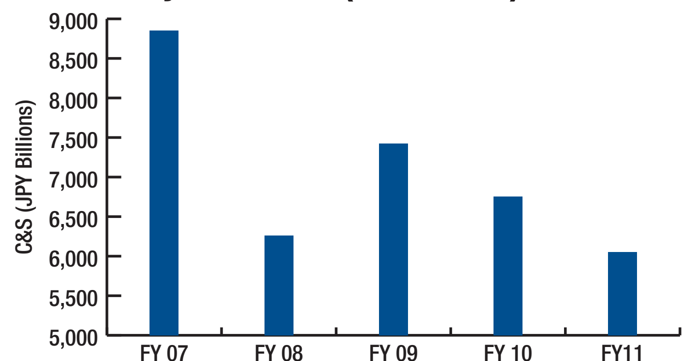
The statutory solvency margin is tightening for insurers in Japan, with recent revisions showing substantial declines that lead companies to enhance profitability and reduce risks through reinsurance.

Hardening to Persist

Companies have reported that pricing on property catastrophe risks increased by more than 10% in recent 2012 renewals, following the substantial increases in renewal pricing in 2011 in the wake of the Tohoku quake. The hardening trends in property catastrophe pricing are expected to continue in the wake of large-scale losses from recent natural disasters. On the other hand, casualty lines showed modest increases in pricing, which are expected to continue.

Exhibit 26

Japan Non-Life – Capital & Surplus Of Five Major Insurers (2007-2011)



Source: Company financial statements

The 9.0 magnitude Tohoku earthquake in March 2011 drew attention to "unmodeled

risks" such as tsunami. The unexpected large losses from the Thailand floods further forced companies to cope with risks that have not been captured in the current catastrophe risk models. Companies now are preparing to measure and control unmodeled risks across the region, particularly in Asia.

Meanwhile, companies have updated their probable maximum loss (PML) estimates to more conservative levels, which suggests increasing demand for reinsurance in the medium term. In a nutshell, the increasing demand for reinsurance and the expected hardening markets are expected to help reinsurers to improve underwriting results.

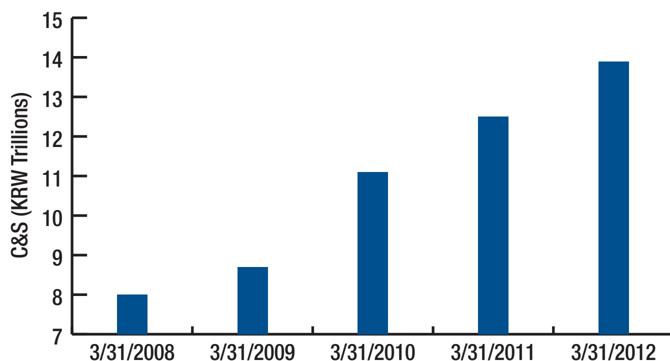
Modest Losses Moderate South Korea Pricing

Major primary non-life insurers in South Korea experienced favorable renewals with limited rises in renewal pricing, owing to their favorable loss ratios and limited exposure to natural disasters.

Overall, South Korea's major five primary non-life insurers cede about 44% of their general lines to reinsurers. The loss ratio for general lines gradually deteriorated from 43% in fiscal year 2007 to 55% in fiscal year 2011, which remains profitable even as margins continue to contract.

Korean Re, which commands about 70% of the domestic reinsurance market, reported an average combined ratio of 88% in domestic general lines over the past five years. Eight foreign reinsurers that account for about 12% of South Korea's reinsurance market reported returns on equity (ROE) exceeding 30% in fiscal year 2011, according to the Financial Supervisory Service (FSS). They posted a combined net profit of KRW 101 billion as they reported an underwriting profit of KRW 89 billion in fiscal year 2011. Indeed, the foreign reinsurers maintained robust capitalization with an average risk-based capital ratio of about 270%. The overseas exposures of non-life insurers are relatively small compared with their global peer groups, as demonstrated by Korean companies' limited losses from recent natural disasters such as the Japan earthquake and Thailand floods. The exception is Korean Re, the sole domestic reinsurer in Korea. After the large losses from the Thailand floods, Korean Re sold treasury stock to restore capitalization.

Exhibit 27
Korea Non-Life – Adjusted Capital & Surplus Of Five Major Insurers (2008-2012)
For direct business.



Source: Company financial statements

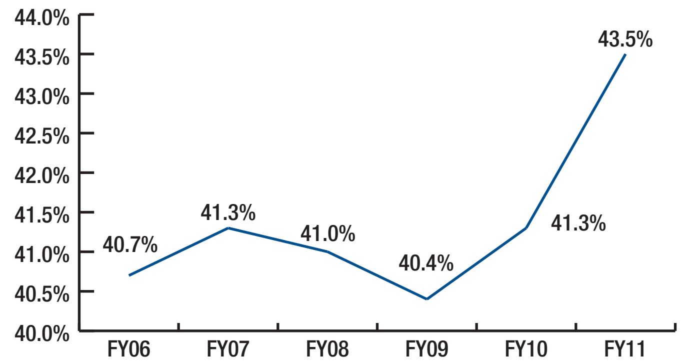
The retention levels of primary insurers are expected to increase gradually in the medium term, aided by strong growth of adjusted capital. In the past five years, the adjusted capital of the five major primary non-life insurance companies increased by an average of 15% to KRW 13.8 trillion (see **Exhibit 27**).

In summary, the pricing outlook is mixed in the South Korean reinsurance market, as increasing pressure for price hikes led by worsening profitability in general lines would be offset by increasing retentions, given the primary companies' strong

growth in adjusted capitalization.

Exhibit 28

Korea Non-Life – Retention (2007-2012)



Source: Company financial statements

On the other hand, catastrophe risk management is gaining importance as non-life insurers progress in overseas expansion, adding exposure to natural disasters. Incorporating catastrophe modeling such as for earthquake risk in South Korea remains on a trial basis because of the limited exposure. In the domestic market, primary non-life insurers started to further break down underwriting guidelines on flood risks for small and medium-size clients to better manage the risks. In overseas markets, the primary non-life insurers added sub-limits in overseas businesses with the benefit of the current favorable pricing.

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