Segment Review
September 2, 2015

"It is Not Your Father's Reinsurance Market Anymore" – The New Reality

Reinsurance risk functioning like a tradable asset class seems to be the end game.

The reinsurance sector has always been a leader in terms of evolution, but over the past few years the pace of change has unquestionably been more rapid. Historically, changes within the sector had been cyclical in nature, but now many observers believe the current evolution to be structural. The market is operating in a "new reality" of abundant capacity from traditional and alternative sources, low interest rates and thinner reinsurance margins driven by intense competition against shrinking demand for reinsurance cover.

At this year's annual shareholders' meeting, Berkshire Hathaway Chairman and CEO Warren Buffett stated "It's a business whose prospects have turned for the worse and there is not much we can do about it." He added that the reinsurance industry in the next ten years "will not be as it has been in the last 30".

Historically, traditional reinsurance protection had been the primary source of capacity for cedents. That is clearly changing as primary companies are retaining more risk and are increasingly utilizing alternative markets for their risk management needs. At the same time, the old playbook of private equity starting a traditional reinsurance company and then exiting via an IPO is becoming less attractive. Investors would rather put capital to work for a relatively short period of time (typically 1 to 3 years) as opposed to creating new companies that require longer-term capital commitments with a less certain exit strategy. Ease of entry and exit, among other things, is key to reinsurance risk functioning like a tradable asset class. Ultimately that seems to be the end game, conceivably for all reinsurance risks, to be able to wake up in the morning, wait for the market to open, and trade in or out of various pools of reinsurance risk – even if there was an event the night before.

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A Bit of History

Hurricane Andrew in August of 1992 changed the reinsurance industry dramatically and led to Bermuda becoming a significant hub for property catastrophe reinsurance. At the time, Andrew created an amount of devastation and loss that had not been seen before. The storm propelled the demand for modeling of risk, knowledge of how to underwrite these risks and a significant amount of capital to insure these types of risks in the future. The class of 1992 (**Exhibit 1**) which included one of the most successful property catastrophe reinsurers to date (RenRe) was how the Bermuda reinsurance market as we know it today started taking shape. The need for capital and smart underwriting led the wave for new companies willing to write these types of risks. Bermuda as a reinsurance hub was born to compete with what then were the traditional markets based in London and the massive balance sheets of Munich Re, Swiss Re, Hannover Re and SCOR.

After the 9/11 Terrorist attacks, the class of 2001 was formed to create some of the most successful companies today in the market (Arch Capital, AXIS, Allied World and Endurance to name a few). Once again, the market saw the need, and the opportunity, for permanent long-term capital following the event. Armed with the mantra of "unencumbered capacity", this new breed of reinsurer was able to take advantage of the market disruption created by legacy issues that burdened established players. At the same time, reinsurance brokers began to control larger shares of reinsurance premium, pushing many of the large direct reinsurance operations to relent and embrace broker market operations.

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Exhibit 1
Notable Classes of Reinsurance Companies

"Class of 1992 (Hurricane Andrew)"	"Class of 2001 (9/11 Terror Attacks)"	"Class of 2005 (KRW) "
Cat Ltd	Allied World	Ariel Re
Global Capital Re	Arch Capital	Flagstone
IPC Re	Aspen	Harbor Point
La Salle Re	AXIS	New Castle Re
Mid Ocean	Endurance	Lancashire
Partner Re	Max Re Capital	Validus
RenRe	Montpelier Re	
Tempest Reinsurance	Platinum Underwriters	
	DaVinci Re*	
	Olympus Re**	

After Hurricanes KRW (Katrina, Rita, Wilma) in 2005, what we believe will be the final "class" of companies was formed, with Validus, Flagstone and Harbor Point being some of the more well-known. Of the Class of 2005, only two companies remain standing today – Validus and Lancashire, all others have been acquired, with a significant portion of the original capital returned to investors.

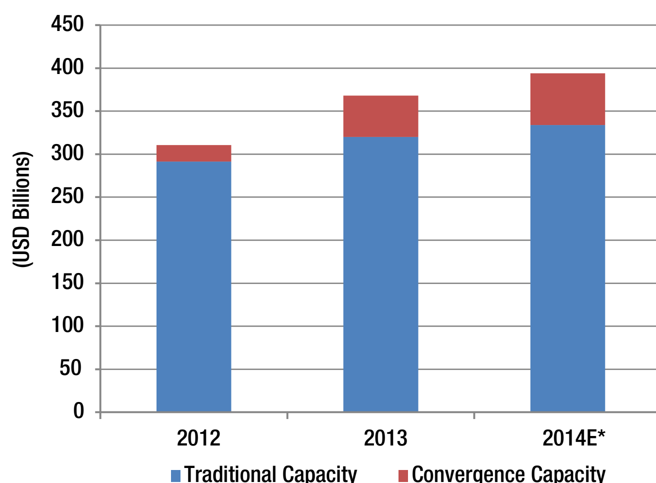
Following the Class of 2005, the market seemed to realize that long-term permanent capital may not be the most efficient or profitable way to take advantage of the opportunity for (re) insuring certain shorter-tail risks, hence the rise of third-party capital or alternative capital. Returns that were augmented by the much higher investment yields of the 80s, 90s and early 2000s are now mostly dependent on underwriting margin and reserve releases, and neither one of these can sustain double digit returns on equity for much longer given the current pricing environment.

The Rise of Alternative Capital

Alternative sources of capacity began to enter the market attracted by the increased reliability of risk models, diversification benefits and potential returns to investors. The low-yield environment that has been in place since the 2008 financial crisis made these types of investments all the more compelling for investors.

The proliferation of efficient structures (sidecars) and insurance linked securities (ILS) allowed for a shorter time horizon (1-3 years), in addition to a relatively quick entry and exit into the reinsurance market. Originally, reinsurers such as Hannover Re, Swiss Re and Munich Re became the leaders in the utilization of alternative capacity, largely provided by pension plans, sovereign wealth funds and hedge funds. The majority of this capacity was and has been deployed in the form of ILS and collateralized pools or temporary sidecars.

Exhibit 2
Estimate for Total Dedicated Reinsurance Capital



Source: AM Best and Guy Carpenter

More recently, investors and users of this capacity are bypassing the traditional reinsurer and transferring risk directly to the capital markets. Lower interest rates have led to an increased inflow of alternative capital as investors look for uncorrelated ways to improve returns (**Exhibit 2**). This phenomenon has given rise to collateralized funds, unrated sidecars, more flexible forms of ILS and the birth of "Hedge Fund Re", looking to optimize investment returns offshore while building a base of long-term assets under management.

According to Guy Carpenter, today's alternative capital accounts for about 18% of total dedicated capital in the global reinsurance market

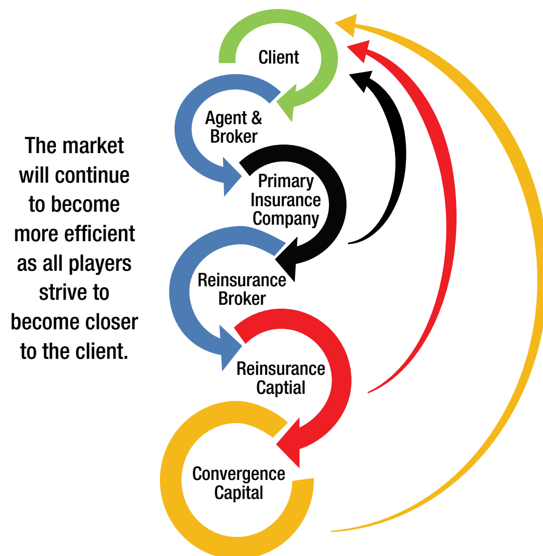
compared with only 8% in 2008. As a result, competition for U.S. property catastrophe business has been fierce since third-party capital exploded into the market (starting in earnest around 2006). The pressure has since rippled to other classes and geographies as capacity is reallocated.

Historical View of Rate-on-Line Tells the Whole Story

Since the hurricanes of 2005, when the industry saw the last real spike in pricing, companies have been focused on diversifying their books of business both geographically and in terms of product offerings. The abundance of available capital has led to the lack of significant price increases following a loss event. A.M. Best expects that if there were to be a catastrophe sufficient to move pricing, with the capital market's capacity and flexibility, the inflow of capacity could make any such opportunity very short-lived. However, the truth is in the details. If an event produces losses far different from modeled expectations then the market may react differently.

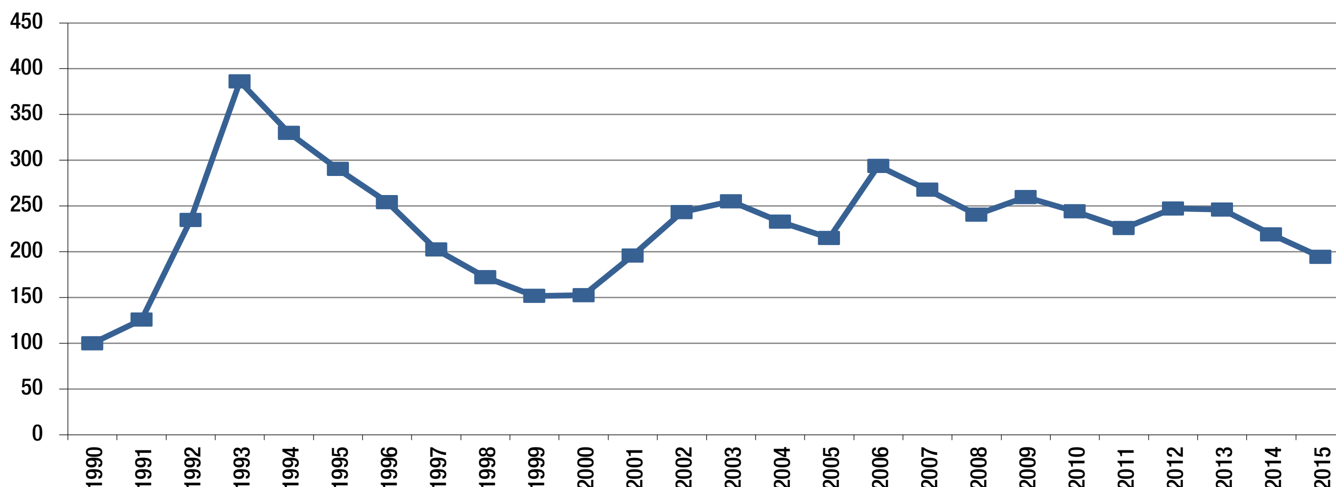
In 2011, the industry experienced over USD 110 billion in insured losses globally, according to SwissRe. However, global pricing barely increased following those events. In 2012, Superstorm Sandy led to USD 20-25 billion in insured losses and once again pricing barely moved for property cat and it continued declining in the double digits for every renewal season since then. The global reinsurance Rate-on-Line (RoL) is back to pre-9/11 and pre-KRW levels and even as companies continue to benefit from favorable reserve releases, the fact that yields remain at historical lows and rates continue to decline, companies have had to shift from a property cat focus to a broader view of the market. Books of business are becoming more diversified, and deployment of capacity increasingly more challenging. The shift from reinsurance to primary business has been on the uptick over the past couple of years given that pricing for reinsurance has declined in the double digits every year for the past 3 years and reinsurers increasingly seek to get closer to the source of risk. (See **Exhibits 3** and **4**.)

Exhibit 3
Market Conditions



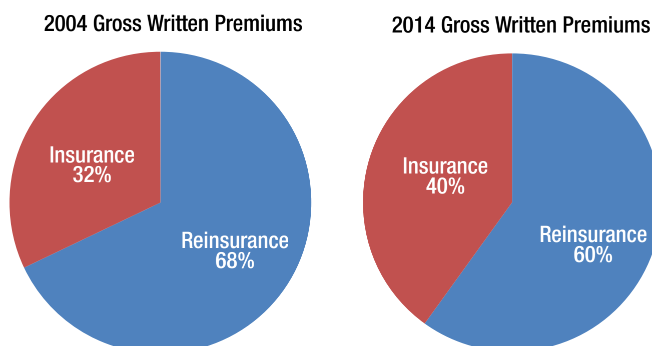
Source: A.M. Best data and research

Exhibit 4
Global CAT Rate-on-Line



Source: Guy Carpenter

Exhibit 5
Reinsurance Versus Insurance Business (2004 and 2014)



Source: Company reports

The Shift to Primary Business

Reinsurers have come to realize the benefit of having multiple distribution capabilities. The cyclical nature of the market has proven the benefits of diversification - if it is executed well - in terms of product offerings and distribution competencies. Building or acquiring primary insurance capability is common now and expanding reinsurance operations globally into emerging markets is gaining speed. Companies have slowly shifted their books of business from reinsurance to primary lines of business. For the companies that were in business in 2004, the split between reinsurance and insurance on aggregate for the publicly traded Bermuda market and the European "Big Four" was approximately 68%-32% weighted toward reinsurance (**Exhibit 5**). By 2014, the breakdown between reinsurance and insurance was a 60%-40% ratio. As long as reinsurance pricing continues to decline in the double digits and primary pricing remains more stable, primary business segments will likely continue to grow as a percentage of total premiums for some of the more diversified players.

M&A Will Continue

Traditional reinsurers are adapting to become the gatekeepers of insurance risk and manage the risk share and alignment with alternative capital for property and non-property classes of business. Reinsurance companies understand the need to form larger, global, well-diversified operations with broad underwriting capabilities to assess risk and to serve as transformers of risk to the capital markets. Reinsurance companies will make the argument that they can best serve insurance companies in terms of matching risk with the most appropriate form of capital. Although, as all market players look to become more efficient, be it disintermediation or going directly to sources of risk, this tug of war will result in fewer hands in the pot – ultimately making it better for the purchaser of protection.

Recently announced deals by some of the best -known reinsurance companies in the market seem to reflect the need for attaining greater global scale and diversified product lines and distribution (**Exhibit 6**). There is also the potential for significant expense savings associated with some of these transactions, however, that may or may not materialize. Reinsurers understand that the ability to

Exhibit 6
Recent M&A Deals – Reinsurance Sector

Date Announced	Acquirer	Location	Acquiree	Location	Price (USD mm)	Price to BV
23-Jun-14	Validus	Bermuda	Western World Insurance	USA	690	1.33x
22-Aug-14	Allied World	Bermuda	Hong Kong operation of RSA	Hong Kong	215	NA
24-Nov-14	RenRe	Bermuda	Platinum Underwriters	Bermuda	1,900	1.12x[1]
9-Jan-15	XL Group	Ireland	Catlin Group Limited	Bermuda	4,100	1.27x[1]
17-Feb-15	Fairfax	Canada	Brit	London	1,880	1.73x
31-Mar-15	Endurance	Bermuda	Montpelier Re	Bermuda	1,830	1.21x
3-May-15	Fosun International Ltd	China	Ironshore	Bermuda	2,304	1.2x
1-Jul-15	ACE	Switzerland	Chubb	US	28,300	1.83x
27-Jul-15	CM International Holding PTE Ltd	China	Sirius International Insurance Group, Ltd	Bermuda	2,235	NA
3-Aug-15	EXOR	Italy	PartnerRe	Bermuda	6,900	1.19x

[1] BV= Assets-intangibles-liabilities
Source: AM Best data and research, Bloomberg and company reports

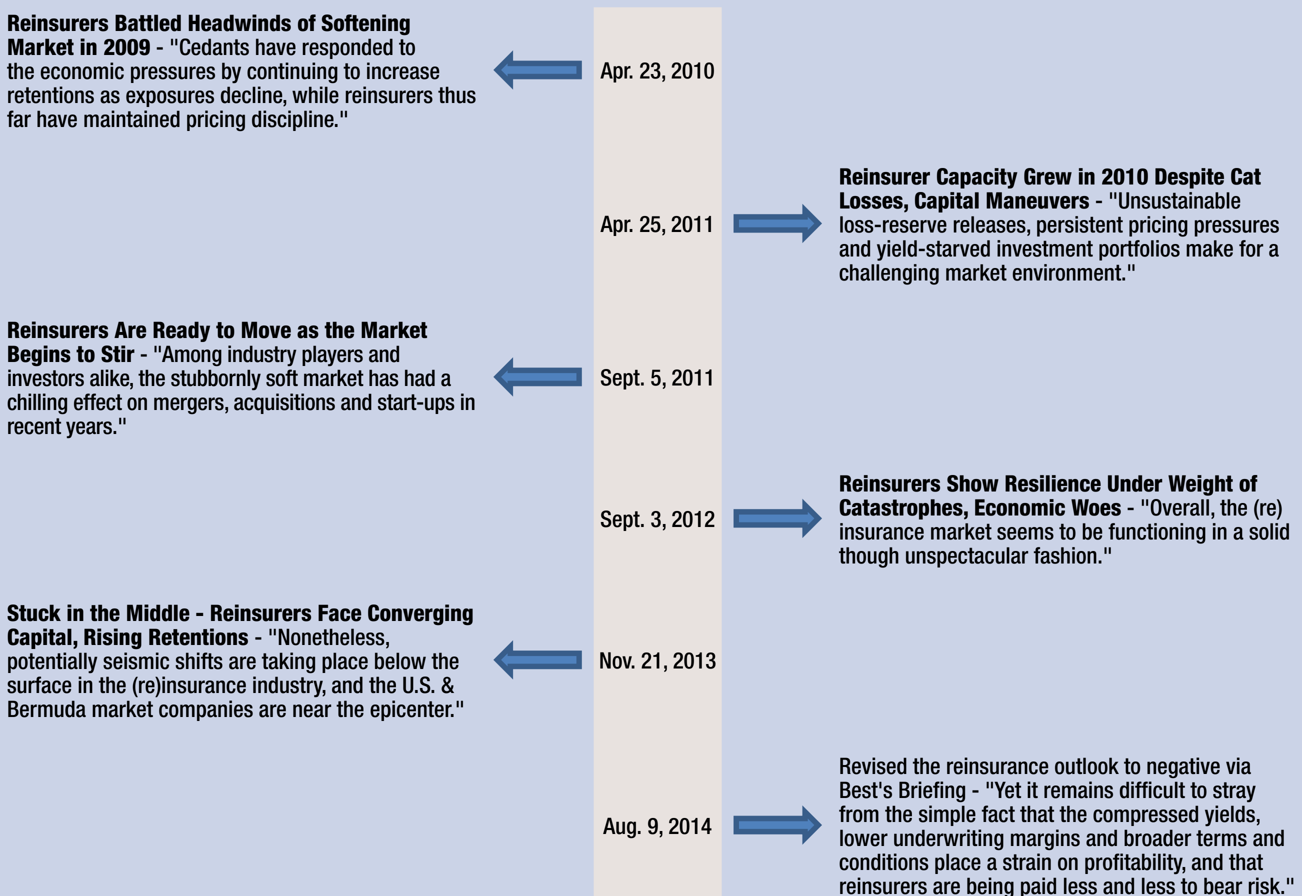
move in and out of certain classes of business swiftly through market cycles will lead to a strong advantage over competition. As the market gets increasingly more competitive and more challenging, companies with the scale and the global footprint to put money to work or shrink a particular offering will have the real advantage going forward. A.M. Best anticipates companies with well-diversified businesses and a global reach will likely see the majority of the deals in the market.

With current market conditions of double digit price declines, increasing commissions, lower premiums and increased competition, the need for M&A is becoming clearer and A.M. Best believes that consolidation will continue, particularly among smaller players in the market as acceptable returns become increasingly harder to achieve.

The reinsurance market of the 1990s and 2000s has likely changed forever for many reasons but a few are likely more obvious than others. Pricing to the levels seen after Hurricane Andrew may be a thing of the past, relying on double digit yields to deliver double digit ROEs may also not be seen again

Chronology

Let's take a short walk back in time as A.M. Best telegraphed its view of the market in somewhat real-time. How did the reinsurance sector arrive at this point? Even five years ago, the difficulties that were ahead were relatively clear but it seems that now the industry is facing the most challenging portion of this cycle.



That is where we remain today. The pressure has been building for some time and the pressure is real, such that the pace of M&A activity has significantly picked up, which is both a defensive and offensive strategy for some. The hope is that M&A will help to broaden the reach and/or provide expense synergies for some market participants. M&A is, in some ways, a soft market strategy. However, if the history of cycles is any guide, this cycle won't be complete until market participants experience significant pain.

during the career span of anyone working today. Continued favorable reserve development that has lowered the average industry combined ratio by about 6 points will likely not last much longer.

The new reality for the reinsurance market looks to be more of an industry where returns are less impressive and underwriting will have to become a larger contributor to profits and returns leading to more conservative risk selection, more diversification of product offerings, a wider geographic reach and conservative loss picks. However, that combined with the ability to take advantage of the new "cheaper" capital coming into the market by investors that may not have the reinsurance and underwriting expertise that most of these companies possess could actually lead to significant success for some. Not everyone will win in the end. The solid players will be the ones that have been conservative in underwriting and in reserving, have been able to develop a book of business that will remain relevant for today's market and that allows for quick shifts in and out of lines of business depending on market conditions, as well as companies that have created expertise in managing third-party capital to their own advantage.

The winners will be able to walk away from bad business; will have the capital and expertise to write new, more complex lines of business; will provide the products and services clients want in a global economy; will be able to manage the inflow of third-party capital to their own benefit; and will be able to participate in the new era of consolidation without being left out of the game.

Top 50 Commentary

This year's analysis of the top 50 reinsurers was complicated by the significant devaluation of global currencies against the US Dollar on which the ranking is based. In some instances the change in a company's ranking may have been significantly impacted by the strengthening of the US Dollar against its local reporting currency. For the purpose of this ranking, A.M. Best used the foreign exchange rate that coincided with the date of the financial statements, which typically is December 31, 2014. Since significant volatility in foreign exchange rates can make comparative analysis difficult, in our discussion of changes in the ranking and revenue growth, we also include commentary based on a company's original currency. (See **Exhibit 7**.)

There was some movement among the ranks of global reinsurers during 2014, as some companies continued to grow premium compared with 2013, despite very competitive market conditions, while others demonstrated restraint. The majority of the movement occurred within the first and third tier companies as the top 10 did experience some shifts, mainly due to the strengthening of the US Dollar toward the end of 2014.

Overall, non-life gross premium declined 3.0% compared with 2013. Life and non-life premium combined declined 1% compared with a year ago. The decrease in premiums is attributable in large part to the foreign exchange effect, but is also attributable due to continued discipline by some of the players in the market.

Noticeable declines in original currency include:
- W.R. Berkley (down 14.0%)
- ACR Capital (down 12.2%)
- American Ag (down 11.4%)
- Lloyd's of London (down 10.3%)
- Validus Re (down 8.5%)
- ACE (down 6.0%)
- Odyssey Re (down 6.0%)

Some of the noticeable premium increases in original currency included:
- Berkshire Hathaway (up 16.8%)
- R+V Versicherung (up 14.8%)
- NKSJ Holdings (up 13.4%)
- Catlin (up 12.2%)
- SCOR (up 10.4%)
- Everest Re (up 10.2%)
- Amlin (up 10.1%)
- Tokio Marine (up 9.9%)
- Africa Re (up 7.1%)

Some noted movements within the ranking included Berkshire Hathaway that moved up 2 spots from No. 6 in 2013 to No. 4 in 2014. The move was driven by premium growth of 16.8%. The growth in 2014 came in part from a retro agreement between National Indemnity Company (NICO) and Liberty Mutual Insurance Company in 2014. Consideration paid to NICO from this contract was approximately USD 3.0 billion.

Korea Re dropped from No. 9 to No. 11 due to the effects of foreign exchange as premiums actually grew 1.3% in original currency in 2014.

Partner Re and Everest Re each moved up a notch to reach No. 9 and No. 10, respectively, due

Exhibit 7

Top 50 Global Reinsurance Groups

Ranked by unaffiliated gross premium written in 2014
(USD millions)[12]

2015 Ranking	Company Name	Reinsurance Premiums Written: Life & Non-Life Gross	Life & Non-Life Net	Non-Life only Gross	Non-Life only Net	Total Shareholders' Funds[2]	Ratios[1] (%) Loss	Expense	Combined
1	Munich Reinsurance Company [3]	39,035	37,761	20,337	19,632	36,838	60.2	32.4	92.7
2	Swiss Re Ltd.	33,276	31,640	20,288	19,937	36,041	55.4	30.0	85.4
3	Hannover Rueckversicherung AG [3]	17,457	15,100	9,607	8,523	10,032	68.9	26.1	95.0
4	Berkshire Hathaway Inc. [4]	14,919	14,919	9,889	9,889	243,186	N/A	N/A	92.5
5	SCOR S.E.	13,756	12,324	5,999	5,369	6,964	61.1	30.3	91.4
6	Lloyd's [5 6]	13,199	10,416	13,185	10,403	35,085	44.5	36.8	81.3
7	Reinsurance Group of America Inc.	9,118	N/A	N/A	N/A	7,023	N/A	N/A	N/A
8	China Reinsurance (Group) Corporation [13]	8,506	7,991	5,072	4,969	8,900	64.0	34.1	98.0
9	PartnerRe Ltd.	5,932	5,720	4,667	4,500	7,104	56.1	30.0	86.2
10	Everest Re Group Ltd.	5,749	5,257	5,749	5,257	7,451	56.2	26.6	82.8
11	Korean Reinsurance Company	5,461	3,582	4,837	3,063	1,677	81.2	18.6	99.8
12	Great West Lifeco	3,916	3,809	N/A	N/A	18,834	N/A	N/A	N/A
13	Transatlantic Holdings, Inc	3,600	3,410	3,600	3,410	5,130	57.3	32.3	89.6
14	General Insurance Corporation of India [7]	2,428	2,216	2,403	2,197	6,706	87.9	21.9	109.8
15	MAPFRE RE, Compania de Reaseguros S.A.	2,255	2,011	1,784	1,542	1,433	64.6	25.9	90.5
16	Axis Capital Holdings Limited	2,176	2,127	2,176	2,127	5,880	51.7	29.6	81.3
17	R+V Versicherung AG [8]	2,123	2,073	2,091	2,057	2,503	75.2	25.0	100.3
18	XL Group plc	2,118	1,811	1,785	1,633	11,436	42.3	31.0	73.3
19	Catlin Group Limited	2,076	1,845	2,076	1,845	3,992	46.0	39.8	85.8
20	QBE Insurance Group Limited	2,035	1,571	2,035	1,571	11,802	59.2	28.6	87.8
21	Assicurazioni Generali SpA	1,990	1,990	867	867	29,399	58.6	22.5	81.1
22	The Toa Reinsurance Company, Limited [7]	1,979	1,742	1,979	1,742	1,662	69.5	24.2	93.7
23	Amlin plc	1,765	1,569	1,765	1,569	2,774	55.0	29.1	84.0
24	Odyssey Re Holdings Corp.	1,756	1,616	1,756	1,616	3,983	47.8	31.3	79.1
25	Caisse Centrale de Reassurance	1,608	1,557	1,488	1,443	2,515	56.2	25.2	81.3
26	RenaissanceRe Holdings Ltd.	1,551	1,068	1,551	1,068	3,866	18.6	31.5	50.2
27	Arch Capital Group Ltd.	1,527	1,266	1,527	1,266	6,130	41.6	32.0	73.6
28	MS&AD Insurance Group Holdings, Inc. [7 9]	1,321	N/A	1,321	N/A	25,316	N/A	N/A	N/A
29	Validus Holdings, Ltd.	1,272	1,086	1,272	1,086	4,047	28.4	23.7	52.1
30	Deutsche Rueckversicherung AG	1,262	772	1,216	741	251	75.3	29.4	104.7
31	IRB - Brasil Resseguros S.A.	1,199	811	1,108	734	996	57.2	37.9	95.1
32	Endurance Specialty Holdings, Ltd.	1,178	1,074	1,178	1,074	3,185	36.5	38.2	74.7
33	Aspen Insurance Holdings Limited	1,173	1,124	1,173	1,124	3,419	45.8	31.8	77.6
34	White Mountains Insurance Group, Ltd.	1,137	883	1,137	883	4,540	39.5	37.1	76.5
35	Markel Corporation	1,115	959	1,113	957	7,602	61.4	34.3	95.7
36	ACE Limited	994	935	994	935	29,587	42.0	30.3	72.3
37	Allied World Assurance Company Holdings, AG	939	903	939	903	3,778	49.9	27.4	77.3
38	Maiden Holdings, Ltd.	898	850	898	850	1,241	67.9	30.8	98.7
39	Pacific LifeCorp	896	896	0	0	8,970	N/A	N/A	N/A
40	Tokio Marine & Nichido Fire Ins. Co. Ltd. [7]	890	716	890	716	21,464	N/A	N/A	N/A
41	American Agricultural Insurance Company [10]	834	295	834	295	526	65.7	18.9	84.6
42	Taiping Reinsurance Co. Ltd	787	736	517	465	576	54.3	35.0	89.3
43	Montpelier Re Holdings Ltd.	740	651	740	651	1,915	29.4	36.3	65.6
44	Sompo Japan Nipponkoa Holdings, Inc [7]	722	644	722	644	15,257	N/A	N/A	N/A
45	African Reinsurance Corporation	718	623	678	587	737	56.5	33.3	89.8
46	ACR Capital Holdings Pte, Ltd. [7]	700	343	700	343	697	72.3	35.7	108.0
47	W.R. Berkley Corporation	695	651	695	651	4,624	62.0	34.0	96.0
48	Hiscox Ltd	655	335	655	335	2,259	22.0	27.8	49.8
49	Third Point Reinsurance Ltd	613	613	613	613	1,552	63.7	41.5	105.2
50	Qatar Reinsurance Company, LLC [11]	536	178	536	178	226	84.3	18.4	102.6

[1] Non-Life only.
[2] As reported on Balance Sheet
[3] Net premium written data not reported, net premium earned substituted.
[4] Loss and expense ratio detail not available on a GAAP basis.
[5] Premiums for certain groups within the rankings also may include Lloyd's Syndicate premiums when applicable.
[6] Total shareholders' funds includes Lloyd's members' assets and Lloyd's central reserves.
[7] Fiscal year-end March 31, 2015.
[8] Ratios are as reported and calculated on a gross basis.
[9] Non-affiliated reinsurance information only available on a gross basis.
[10] Data and ratios based on US Statutory Filing.
[11] Expense ratio calculated using NPW
[12] All non-USD currencies converted to USD using foreign exchange rate at company's fiscal year-end.
[13] Original data based on China Accounting Standards, revised data based on IFRS reporting.

N/A - Information not applicable or not available at time of publication.
Source: A.M. Best data and research

to a 6.7% and 10.2% growth respectively in 2014. For Partner Re the growth came mainly from PartnerRe Health's accident and health business. For Everest Re premium growth came primarily from new business opportunities, particularly for contracts with catastrophe exposed risks as well as new quota share contracts in the company's international book of business.

Central Re, Wilton Re, Platinum, and Greenlight dropped out of this year's ranking while Taiping Re, Hiscox, Third Point Re and Qatar Re are new to the list at No. 42, No. 48, No. 49, and No. 50, respectively.

Given the lack of any major events in 2014 most reinsurers delivered underwriting profits and solid earnings. Combined ratios for most were below 100, driven in part by continued reserve releases and well-diversified books of business. The growth in capital once again outpaced the net premium revenue which together with alternative capacity in the form of catastrophe bonds, sidecars and other structured products continued to fuel strong price competition. In 2014, USD 8.79 billion in capital flowed to new CAT bond issues alone, and thus far in 2015 over USD 6 billion has been invested. It is estimated that there are approximately USD 25 billion in outstanding CAT bonds currently.

Going into 2016 pricing is expected to remain under pressure for reinsurance and to affect most lines of business. Rates for US property CAT continue to decline more significantly than in other regions; however, the reductions are starting to spill over to other territories and into other lines of business. During the Jan. 1, 2015 renewal season, reinsurance pricing was down 5% to as much as 20% for certain risks. The April 1 renewal season also saw pricing declines of 5% to 15%, and June and July renewals declined as much as 15% on average for some risks as well.

Over the past several years (re)insurers have voiced the need to remain focused on underwriting given the years of low investment yields and the expectations that favorable reserve releases will eventually come to an end. Companies continue to mention that they will walk away from business that does not meet profitability targets and that discipline remains their main focus even as competition continues to intensify and cedents continue to retain more business. However, the market is expected to remain extremely challenging and with that some companies may not be able to remain as disciplined as they need to be. Third party capital continues to pour into the market with no ease in sight as hedge funds, pension funds and other investors continue to look for yield and sources of diversification.

As the market becomes more challenging some are starting to accept the harsh reality that not everyone will be able to stand alone and remain successful. Mergers and acquisitions intensified at the end of 2014/early 2015 with several high profile deals being announced as some companies need to add scale, size, diversification, and global reach to their current books of business. XL bought Catlin, RenRe bought Platinum, Endurance won the bid for Montpelier Re, and EXOR signed a definitive agreement with PartnerRe following a bitter fight with AXIS. Most recently, although neither company are reinsurers, ACE announced that it is buying Chubb for USD 28 billion making it the most impressive and exciting deal in recent history for the (re)insurance industry. That combination, as CEO Evan Greenberg said to investors, came from a need to remain important in the market, add scale and reach and maintain a strong brand that continues to drive loyalty. For reinsurers, this combination will likely reduce the combined company's overall reinsurance spend and further shrink available opportunities in the market.

The new reality seems to be lower returns for broader coverage and some companies just can't sustain that risk for a long period of time without capital, scale and size. Looking forward, the top 50 landscape will likely look somewhat different next year and for years to come as M&A

is expected to continue given the challenges in the market of increased competition, higher commissions, lower prices and higher retentions. Aside from the top 5 to 8 companies that are expected to remain intact for the most part due to their size, the rest will likely look very different over the next few years. The question is who will merge with the right partner and who will merge out of desperation. There will be winners and there will be sinners. As we have mentioned before, M&A will continue; it is just a question of how well companies will navigate through this part of the cycle and how many will put personal egos aside for the benefit of policyholders.

Reinsurance Outlook Maintained at Negative

A.M. Best is holding its outlook for the reinsurance sector at negative, citing the significant ongoing market challenges that will hinder the potential for positive rating actions over time and may translate into negative rating pressures.

As compression continues bearing down on investment yields and underwriting margins, this strain on profitability will ultimately place a drag on financial strength. The market headwinds at this point present significant longer-term challenges that industry players need to work through. The companies that are not proactive will not lead their own destiny.

Declining rates, broader terms and conditions, unsustainable flow of net favorable loss reserve development, low investment yields and continued pressure from convergence capital are all negative factors that will adversely impact risk-adjusted returns over the longer term. On the positive side, the mid-year renewal for property catastrophe did provide some indication that the velocity of erosion on price and terms may be easing. It remains to be seen, however, if the market has reached bottom.

Reinsurers are responding to these challenges by employing greater capital market capacity to help optimize results and reduce net probable maximum loss (PML) for peak zones as a percentage of capital. Cycle management has been a key strategy for those organizations possessing the capability to oscillate between primary and reinsurance platforms. There has also been meaningful effort to embrace new opportunities and geographies, produce fee income and a subtle migration into asset classes that will produce some increased investment yield. Further market consolidation is also a likely response to the current market environment as balance sheet scale becomes even a more important attribute to retain and win new clients.

Broadly speaking, rated balance sheets are currently well-capitalized and capable of withstanding various stress scenarios. However, over time, this strength may be eroded for some carriers as earnings come under increased pressure, favorable reserve development wanes, earnings grow more volatile and the ability to earn back losses following events is prolonged by the instantaneous inflow of alternative capacity. All of these issues reflect increased concern that underwriting discipline, which until recently had been a hallmark for the reinsurance sector, is strained as companies look to protect market share at the expense of profitability.

Given where rate adequacy is, it will continue to take optimal conditions, including benign or near-benign catastrophe years, a continued flow of net favorable loss reserve development and stable financial markets to produce even low double-digit returns. Such return measures would have been considered average or perhaps mediocre just a few short years ago.

In our view, companies with diverse business portfolios, advanced distribution capabilities and broad geographic scope are better positioned to withstand the pressures in this type of operating environment and have greater ability to target profitable opportunities as they arise. It also places increased emphasis on dynamic capital management in order for companies to manage the underwriting cycle and remain relevant to equity investors.

Convergence Market - Update

Introduction

The evolution of the convergence market continues unabated as evidenced by the increase in the amount of peak exposures ceded to the ILS space, the record-breaking amount of cat bond issuance, the increase in assets under management of dedicated ILS investors and last but not least, the benign insured loss environment over the past years.

Recent estimates of the size of the convergence market places the value at between USD 45 billion to USD 60 billion at year-end 2014. The growth in the ILS property catastrophe exposure market has been phenomenal given an ILS market that was nonexistent twenty years ago. The total cumulative issuance of property/casualty-related catastrophe bonds has grown to approximately USD 63.3 billion from 1997 through June 30, 2015. (See **Exhibit 7.**) Catastrophe bonds issuance related to property/casualty exposures have witnessed an average annual growth of approximately 24.4% from 1997 through 2014), while the combined catastrophe bonds related to both property/casualty and life/health exposures saw an average annual increase of about 16% from 2006 through 2014. (See **Exhibit 8.**)

Exhibit 8
Catastrophe Bond Issuance - P/C-Related Risks

Year	Amount (USD mm)	% Change from Prior Year
2015*	4,354	n.a.
2014	8,298	13%
2013	7,314	24%
2012	5,878	37%
2011	4,279	0%
2010	4,299	26%
2009	3,398	25%
2008	2,729	-63%
2007	7,430	58%
2006	4,693	136%
2005	1,991	74%
2004	1,143	-34%
2003	1,730	42%
2002	1,220	24%
2001	985	-14%
2000	1,139	18%
1999	967	14%
1998	846	34%
1997	633	n.a.
Total / Average	63,329	24%

Notes: *Through June 30, 2015
Source: A. M. Best data and research

Exhibit 9
Catastrophe Bond Issues

Year	Property/ Casualty Related Perils (USD mm)	Life/Health Related Perils (USD mm)	Combined Perils (USD mm)	% Change from Prior Year
2015*	4,354	699	5,053	n.a.
2014	8,298	500	8,798	15%
2013	7,314	330	7,644	21%
2012	5,878	425	6,303	37%
2011	4,279	330	4,609	-2%
2010	4,299	425	4,724	36%
2009	3,398	75	3,473	23%
2008	2,729	100	2,829	-64%
2007	7,430	521	7,950	63%
2006	4,693	179	4,873	n.a.
Average				16%

Notes: *Through June 30, 2015
Source: A. M. Best data and research

Convergence Market Dynamics

The emergence of the convergence market, which blends traditional reinsurance/insurance contracts with financial instruments, has generally been caused by perceived inefficiencies in the traditional reinsurance market, insurance underwriting cycle due to pricing and major catastrophe events, the desire by holders of peak insurance exposures to diversify the source of reinsurance coverage and the emergence of enterprise risk management (i.e. credit risk reduction).

Most of the financial instruments underlying the convergence market have been patterned on asset-backed securities, futures and options, and other derivative instruments that provide direct access to the capital markets, which has greater capacity than the traditional reinsurance market. This process has led to the transferring of insurance risks from insurers/reinsurers to capital market participants.

Convergence Market Trends

Last year saw a record cat bond issuance of approximately USD 8.8 billion (combined perils), the highest USD amount since the initial cat bonds related to property/casualty exposures of about USD 633 million was transferred to the capital market in 1997. The increased issuance occurred despite an overall decline in spread and the spread to expected loss multiplier of cat bonds compared to previous years. (See **Exhibit 9**.)

The cat bond market continues to be dominated by

the following perils: U.S. wind, U.S. earthquake, European wind, Japanese earthquake and Japanese typhoon. Non-model perils including U.S. wild fires, meteorite impact and volcanic eruption were added to the mix in 2014 and the first half of 2015. The potential for adding other insurance lines, such as the casualty arena, to the property cat business as part of the cat bond fray still exists.

Cat bond lite

One notable development in the cat bond marketplace is the evolution of "cat bond lite" transactions, which are gaining traction due to the efforts of the major insurance brokers, overseas insurance managers and the Florida Take-out companies through the depopulation program of Citizens Property Insurance Corporation. An alternative to the traditional 144A cat bond offerings, cat bond lite are private catastrophe bond platforms designed to create an efficient way to fund smaller catastrophe reinsurance programs by capital market participants by taking advantage of Regulation D, Regulation S and Rule 4(a) (2) of the Securities Act. Cat bond lite offerings, which are generally below USD 50 million, witnessed an increase in dollar amount and number in 2013 and have been on a steady growth trajectory in 2014 and the first half of 2015. (See **Exhibits 11A** and **11B**.)

Cat bond lite provides the following advantages compared to the traditional 144A cat bond offerings: lower transaction and structuring costs; reduced and streamlined documentation, easy entry for small- to medium-size insurers and easy accessibility for small investors. The number of platforms, the number and dollar amount of cat bond lite issuance will continue to flourish.

Indemnity and Non-indemnity Triggers

Another notable development in the cat bond market is the growing market share of indemnity triggers over non-indemnity triggers. During the last three years, cat bonds with indemnity triggers have outpaced non-indemnity triggers both in amount and number of issues. In 2014 and through June 30, 2015, over 70% of the amount and number of cat bonds issued were of the indemnity trigger type. (See **Exhibit 10**). The recent proliferation of indemnity over non-indemnity triggers is partly due to investors' becoming more comfortable with indemnity triggers and the willingness of sponsors to make available detailed company data for modeling purposes. This increase has occurred despite the potential possibilities in modeling errors and moral hazard, which may arise with indemnity transactions.

Exhibit 10
Breakdown Of Cat Bond Issuance - Indemnity & Non-Indemnity (P/C Related Risks)

	Value (USD mm)			Number		
Year	Total	Indemnity	Non-indemnity	Total	Indemnity	Non-indemnity
2015*	4,354.03	3,504.03	850.00	19	15	4
2014	8,298.44	5,963.44	2,335.00	32	23	9
2013	7,313.78	4,089.50	3,224.28	34	20	14
2012	5,878.11	3,092.78	2,785.33	26	12	14
2011	4,279.40	1,398.95	2,880.45	22	7	15
2010	4,298.79	1,245.00	3,053.79	21	4	17
2009	3,398.38	825.00	2,573.38	18	4	14
2008	2,728.66	1,444.00	1,284.66	13	7	6
2007	7,429.55	2,465.85	4,963.70	32	5	27

Percentage Distribution

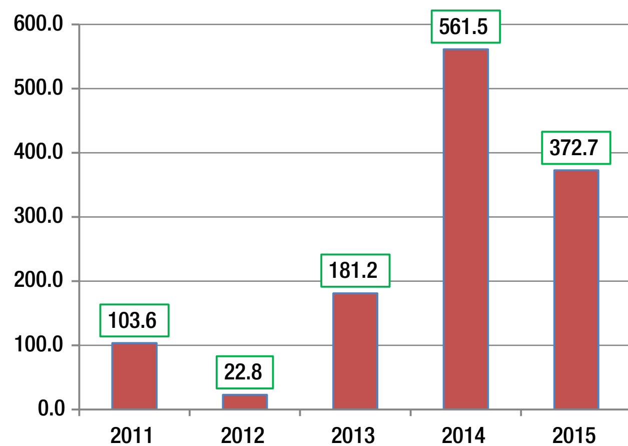
Year	Total	Indemnity	Non-indemnity	Total	Indemnity	Non-indemnity
2015*	100.00%	80.48%	19.52%	100.00%	78.95%	21.05%
2014	100.00%	71.86%	28.14%	100.00%	71.88%	28.13%
2013	100.00%	55.91%	44.09%	100.00%	58.82%	41.18%
2012	100.00%	52.62%	47.38%	100.00%	46.15%	53.85%
2011	100.00%	32.69%	67.31%	100.00%	31.82%	68.18%
2010	100.00%	28.96%	71.04%	100.00%	19.05%	80.95%
2009	100.00%	24.28%	75.72%	100.00%	22.22%	77.78%
2008	100.00%	52.92%	47.08%	100.00%	53.85%	46.15%
2007	100.00%	33.19%	66.81%	100.00%	15.63%	84.38%

Notes: *Through June 30, 2015
Source: A. M. Best data and research

Cat Bond Transaction Costs, Platform and Clearing

The USD 300 million Cat bond issued on June 1, 2015 by Compass Re II Ltd. and sponsored by AIG had some notable features that may have broader implications for cat bond issuance, including structural and transaction costs, delivery and clearing mechanisms. A parametric

Exhibit 11A
Private Catastrophe Bond Issued through 2011 – 2015 (P/C Related Risks)



Notes: Through June 30 2015 for year 2015.
Source: Guy Carpenter and A.M. Best data and research

Exhibit 11B
Private Cat Bonds Issued in 2015 as of June 30, 2015 (P/C Related Risks)

Platform	Amount (USD mm)	Issue Date	Maturity Date
Kane SAC Limited	27.53	1/2/2015	1/12/2016
Kane SAC Limited	16.82	1/2/2015	1/12/2016
Kane SAC Limited	26.68	1/2/2015	1/12/2016
Kane SAC Limited	54.81	1/5/2015	1/15/2016
Kane SAC Limited	20.70	2/20/2015	2/3/2016
Kane SAC Limited	18.80	5/28/2015	6/22/2017
Market Re Ltd.	6.70	6/10/2015	6/7/2016
Market Re Ltd.	70.51	6/10/2015	6/7/2016
Market Re Ltd.	24.38	6/10/2015	6/7/2016
Market Re Ltd.	10.00	4/29/2015	5/1/2016
Oak Leaf Re Ltd.	1.77	3/28/2015	6/7/2016
Oak Leaf Re Ltd.	47.00	3/28/2015	6/7/2016
Oak Leaf Re Ltd.	47.00	3/28/2015	6/7/2016

Source: A.M. Best data and research

cover, Compass Re II Ltd., has a six-month risk period, which is a far cry from most cat bond transactions with an average three-year risk period and was cleared on a new online platform. There was no risk analysis report included in the offering circular as the sponsor did not hire a modeling agent. Instead, investors assessed their own view of risk by performing or retaining the services of their own modeling agent. The ultimate goal from the sponsor's perspective was to reduce structuring and transaction costs. The transaction provided tremendous savings both in terms of sponsor's cost and time. Going forward, one would expect to see transactions that will be platform-based and involve exchange-cleared trading; each would bring about greater simplicity and efficiency to the cat bond market.

Other ILS Instruments- Collateralized Reinsurance, Sidecars, ILWs
Collateralized reinsurance, sidecars, and ILWs also continue to see traction as part of the convergence market capacity, with the collateralized reinsurance segment being the major driver among these three products. The collateralized reinsurance segment growth has been driven by specialized ILS Funds Managers. A.M. Best expects to see increased capacity from the collateralized reinsurance sector, with sidecars and ILW sectors providing a small fraction of the capacity as part of the convergence market in the near future.

ILS Funds – Assets Under Management
Dedicated investors, including specialized ILS Funds and reinsurer-backed managers, have been the driving force behind the convergence market. Recent estimates put the assets under management for specialized ILS Funds around USD 45 billion and approximately USD 10 billion for reinsurer-backed fund managers. **Exhibit 12** depicts recent asset under management estimates and key strategies for specialized ILS Funds with over USD 50 million or more assets under management.

Life/Health-Related Risks
The life/health-related risks in the convergence arena have not been robust in comparison to the property/casualty segment despite growing interest in this sector and the sheer volume of longevity risk exposures. During the past few years, A.M. Best has seen a yearly average of two cat bond transactions covering mortality and health risks. (See **Exhibit 13**). In terms of the life/health-related arena, the U.S. market has been more geared toward reserving financing needs for capital relief and redundant reserves transactions while the focus has been on longevity risk transactions in the U.K. market. In the longevity arena, management of longevity risk continues to be dominated

Exhibit 12
Specialized ILS Fund Managers With Asset Under Management Greater Than USD 50 Million

Entity	Asset Under Management (USD mm) (estimates)	ILS Strategies	Products				
			ILS	ILW	Collateralized Reinsurance	Retro	Life
Nephila Capital	9,500	Multi-instrument funds, also invest in weather	Y	Y	Y	Y	N
Credit Suisse Asset Management	6,500	Various Funds with different risk levels	Y	Y	Y	Y	Y
Fermat Capital Management	5,100	Cat bond focus	Y	Y	Y	Y	Y
LGT Insurance-Linked Partners	4,100	Various Funds and mandates	Y	Y	Y	Y	Y
Securis Investment Partners	3,250	Life, P&C and mixed strategy funds	Y	Y	Y	Y	Y
Catco	2,800	Retrocession writer	N	Y	Y	Y	N
Aeolus Capital Management	2,700	Retro and Collateralized reinsurance	N	Y	Y	Y	N
Stone Ridge Asset Management	2,122	Cat bond and sidecar funds	Y	Y	Y	N	N
Leadenhall Capital Partners	1,800	Non-life and mortality funds, life/non-life mandates	Y	Y	Y	Y	Y
Elementum Advisors	1,700	Multi-strategy	Y	Y	Y	Y	N
Schroders (Secquaero Advisors)	1,500	Three funds: one cat bond; two multi-instrument	Y	Y	Y	Y	Y
Twelve Capital	1,027	Cat bond and multi-instrument ILS funds	Y	Y	Y	Y	Y
AQR Re Management	552	Two funds; one low risk, one high risk	Y	Y	Y	Y	N
Coriolis Capital	550	Multi-strategy including weather	Y	Y	Y	Y	Y
Axa Investment Management	510	Various funds	Y	Y	Y	Y	Y
Pillar Capital Management	375	Collateralized Re focus, runs two funds and mandates	Y	Y	Y	Y	N
ILS Capital Management	250	Specialty focus - ILS	Y	Y	Y	N	N
Eskatos Capital Management	200	Life & PC fund	Y	Y	Y	Y	Y
Cartesian Iris	175	ILW writer	Y	Y	N	N	N
Plenum Investments	95	Cat bond focus	Y	N	N	N	Y
Eastpoint Asset Management	50	Cat bond focus	Y	Y	Y	Y	Y
Mercury Capital	45	ILW tracker fund	N	Y	N	N	N
Total (Estimates)	44,901						

Source: Trading Risk

by the use of traditional reinsurance agreements and buy-ins/buy-outs agreements. Capital market solutions have utilized swaps and futures to mitigate longevity risk. Of late, the use of other capital market platforms to cede pandemic risk and longevity risk has also emerged.

Other market trends

Another market trend that is evolving is the balancing act between traditional reinsurers and ILS Fund Managers, which is blurring the capital source between alternative capital and traditional reinsurance. Some of these activities include ILS Fund managers finding ways to increase leverage and improve profitability on collateral reinsurance transactions by entering into fronting arrangements with rated reinsurers, the formation of reinsurance transformers by both ILS Funds and reinsurers and the big ILS Fund managers creating business models similar to traditional reinsurance/insurance in order to access the primary insurance market. The latter includes the formation of hedge fund reinsurers and insurance entities (e.g., Lloyd's syndicates). These actions in the long run will blend the capacity provided from both capital market participants and traditional reinsurers.

The involvement by various international organizations in the ILS market through various mechanisms, including cat bond issuance, drought swaps and disaster programs with capital market features continues to gain momentum. This has provided needed insurance capacity to other regions of the world that have been under-represented in terms of traditional reinsurance and capital market participation.

Regulatory Developments

The regulatory environment has been very positive and friendly for the ILS market as various regulatory regimes position themselves through various legislation to woo ILS market participants.

Bermuda was first to take the lead with the creation of the Special Purpose Insurer (SPI) class

Exhibit 13

Catastrophe Bond Transactions: Life and Health Related Risks (As of June 30, 2015)

Year	Issue Date	Vehicle	Sponsor	Capital Amount (USD mm)	Peril Type
2015	Apr-15	Benu Capital Limited	AXA Global Life	324.39[1]	Excess mortality
2015	Jan-15	Valins I Limited	Aurigen Reinsurance	175.00	Embedded value life - Mortality and lapse risk
2015	Jan-15	Vitality Re VI Ltd.	Aetna Life Insurance Company	200.00	Health - Medical Benefit
2014	Dec-14	Chesterfield Financial Holdings	RGA	300.00	Embedded Value - Pandemic & Mortality Risks
2014	Jan-14	Vitality Re V Ltd.	Aetna Life Insurance Company	200.00	Health - Medical Benefit
2013	Sep-13	Atlas IX Capital Ltd	SCOR Global Life SE	180.00	Extreme mortality
2013	Jan-13	Vitality Re IV Ltd.	Aetna Life Insurance Company	150.00	Health - Medical Benefit
2012	Jul-12	Vita Capital V Ltd	Swiss Re	275.00	Extreme mortality
2012	Jan-12	Vitality Re III Ltd.	Aetna Life Insurance Company	150.00	Health - Medical Benefit
2011	Dec-11	Vecta I Ltd.	Aurigen Reinsurance Ltd	117.10[2]	Mortality Risk & Lapse Risk
2011	Aug-11	Vita Capital IV Ltd	Swiss Re	180.00	Extreme mortality
2011	Apr-11	Vitality Re II Ltd.	Aetna Life Insurance Company	150.00	Health - Medical Benefit
2010	Dec-10	Kortis Capital Ltd.	Swiss Re	50.00	Longevity Risk (UK-US)
2010	Dec-10	Vitality Re Ltd.	Aetna Life Insurance Company	150.00	Health - Medical Benefit
2010	Oct-10	Vita Capital IV Ltd	Swiss Re	175.00	Extreme mortality
2010	May-10	Vita Capital IV Ltd	Swiss Re	50.00	Extreme mortality
2009	Nov-09	Vita Capital IV Ltd	Swiss Re	75.00	Extreme mortality
2008	Feb-08	Nathan	Munich Re	100.00	Extreme mortality
2007	Jan-07	Vita Capital III Ltd	Swiss Re	520.95[3]	Extreme mortality
2006	Dec-06	Vita Capital III Ltd	Swiss Re	179.39[4]	Extreme mortality
2006	Nov-06	OSIRIS Capital PLC	AXA Cessions	446.95[5]	Extreme mortality
2006	May-06	Tartan Capital Limited	Scottish Annuity & Life Co. (Cayman) Ltd	155.00	Extreme mortality
2005	Apr-05	Vita Capital II Ltd	Swiss Re	362.00	Extreme mortality
2003	Dec-03	Vita Capital Ltd.	Swiss Re	400.00	Extreme mortality
Total				5,065.78	

[1] US dollar equivalent of 285 million Euros at closing date. (1 Euro = USD 1.1382)
[2] US dollar equivalent of CAD 120 million at closing date.
[3] US dollar equivalent of 210 million Euros at closing date plus 250 million USD. (1 Euro = USD 1.290238)
[4] US dollar equivalent of 30 million Euros at closing date plus 140 million USD. (1 Euro = USD 1.313018)
[5] US dollar equivalent of 150 million Euros at closing date plus 250 million USD. (1 Euro = USD 1.313018)
Source: A.M. Best data and research

associated with insurance sidecars, cat bonds and other insurance-linked transactions in 2009. Despite the drop in the number of Bermuda-registered SPI registrations to 28 in 2014 from 51 in 2013, there has been significant business activity in the use of the SPI class in Bermuda.

Regulators in the Cayman Islands, Guernsey, Isle of Man, Gibraltar and Malta have enacted regulations with the goal to provide risk-bearing entities with protection other than the traditional insurance and reinsurance, and mostly through capital market participants. These new laws and regulations have created a surge in the ILS market.

The U.S. and the U.K. have also joined the bandwagon with the NAIC's current debate on the risk-based capital treatment of cat bonds held by U.S. life insurers and the U.K.'s plans to attract ILS through the development of a regulatory and tax framework. These regulatory developments are still in the embryonic stage.

Concerns and Risks

A whole host of concerns and emerging risks may manifest and impact the convergence market as it grows. These include basis and tail risks; collateral/counterparty risks; legal risks associated with the formation/legitimacy of special purpose vehicles and segregated cell structure; and the true potential value of the notional balances of parental guarantees by insurance and non-insurance entities acting as counterparties.

Basis Risk

Basis risk, i.e., the risk that an insurer or reinsurer would recover less from a hedging product

than their actual event loss is one of the key regulatory and rating concerns as the number and amount of ILS transactions continue to increase. The concern here is that a catastrophe bond or other ILS instrument may not trigger for a covered event when the sponsor has suffered a loss. This "negative" basis risk is especially a concern for ILS instruments with non-indemnity triggers. From A.M. Best's viewpoint, the objective in estimating basis risk is to determine how much reinsurance credit should be given to non-indemnity ILS instruments in Best's Capital Adequacy Ratio (BCAR) analysis, which is an integral element in assigning reinsurance and insurance company ratings.

Tail Risk

Tail risk is the risk borne by the insurer or reinsurer, the original sponsor of the transaction, if the ILS instrument is insufficiently capitalized to absorb losses and the risk assumed to be fully hedged by the ILS instrument may ultimately be borne by the sponsor. Sponsors of sidecars generally take reinsurance credit for transferring risks to sidecars. While some sidecars may be capitalized to full aggregate limits, others may not be adequately capitalized to absorb losses that deviate from expectations. In the context of sidecar transactions, tail risk refers to the risk that will have to be borne by the sponsor of the sidecar if the sidecar is not sufficiently capitalized to support the reinsurance transaction. From a rating agency perspective, the appropriate question that must be asked in order to determine tail risk is as follows: What capital level is needed such that the probability of exhausting that capital level is within a given rating tolerance?

Collateral and Counterparty Risks

The increase in the number and dollar amount of collateralized transactions will undoubtedly bring about the issue of collateral and counterparty risks. Although collateral and counterparty risks are not solely confined to the convergence market, the defaults of four cat bonds in 2008 due to missed interest/full repayment of principle because of the demise of the transactions' swap counterparty brought to light the risk posed by the type of collateral instrument/ counterparty used in these transactions. Although there have been improvements in minimizing collateral risks on how transactions are structured and the type of assets placed in a collateral or trust account, unless there is full collateralization of ceded exposures and changes in market value of the collateral instrument is not borne by the transaction sponsor, collateral and counterparty risks cannot be discounted.

Legal Risks – Special Purpose Vehicle and Segregated Cell Structures

One of the hallmarks of the convergence market is the proliferation and use of special purpose vehicle, protected cell and trust account structures to achieve securitization/ monetization of insurance risk. Despite the industry acceptance of the use these structures, the preponderance of legal opinions and specific regulations in some jurisdictions that provide statutory segregation of assets and liabilities, to date, the walled-off feature between two or more cells, segregation of asset/liabilities and limited liability features have not been subject to judicial scrutiny in any jurisdiction. Although remote, legal risks relating to the formation and legitimacy of these structures is still a concern.

Parental Guarantees – Reliability of Notional Balances Estimate

Insurance entities are not only risk transferors but also risk transferees in the convergence market. In some ILS transactions, particularly ILW products, participation is heavily dominated by reinsurers. ILS funds backed by reinsurers also are heavily involved in the convergence market. The use of fronting arrangements and guarantees by reinsurers and insurers is not unusual in the convergence market. All these activities make it next to impossible to assess the true notional balances of parental guarantees in cases where guarantees are involved and may even pose a hidden systematic risk for reinsurers in case of catastrophic events of monumental proportion.

All these emerging risks and other unknown risks could potentially impact insurer/reinsurer capital adequacy. A.M. Best is increasingly looking at how insurance-linked securitization can affect the ratings of the insurance companies it evaluates. Within these analyses, A.M. Best takes into consideration the structural integrity of the transaction and the analytical rigor applied by various experts, advisers and servicers. These factors are critical in determining whether the transactions' stated objectives will strengthen, weaken or have no effect on the ratings of the participating insurers and reinsurers.

Convergence Market - Future Landscape

The convergence market is here to stay and will continue to play an important role in the risk transfer and risk mitigation process for both property/casualty and life/health catastrophe exposures. This could help dampen the pricing volatility observed in the reinsurance and retro markets, which has been a recurring phenomenon during capacity contraction and expansion. The growth of the market will depend on the continued decline in the structuring and transaction costs; the comfort level investors and rating agencies have about the modeling of the risks; development of the secondary market for trading of the various ILS instruments and other innovations; and capacity and pricing constraints in the traditional reinsurance market. The attraction for cedants to use programs like cat bonds or collateralized reinsurance, which are totally collateralized, versus unsecured promises–to-pay from a rated entity, the hallmark of traditional reinsurance, will continue to be the leading catalyst for growth of the convergence market.

Abundance of Reinsurance Capacity Challenges the Competitive Position of Lloyd's

Lloyd's occupies an excellent position in the global general insurance and reinsurance markets as a specialist writer of property and casualty risks. Its competitive strength derives from its reputation for innovative and flexible underwriting, supported by the pool of underwriting expertise in London.

On July 22, 2015, A.M. Best affirmed the Best's Financial Strength Rating of A (Excellent) and an Issuer Credit Rating of a+ on the Lloyd's market. The positive outlook on both ratings was maintained, recognising Lloyd's strong operating performance in recent years, in spite of the exceptional record of natural catastrophes in 2010 and 2011, together with A.M. Best's assessment of the robust oversight of the market by Lloyd's and its demonstrable success in reducing earnings volatility. The outlook also recognises the steady improvement in the market's risk-adjusted capitalisation.

Offsetting these positive rating factors are the ongoing challenges to Lloyd's competitive position. An abundance of traditional and alternative capacity is creating difficult trading conditions in the core markets of Lloyd's, particularly for reinsurance business. Consolidation of broker panels and growth of pre-brokered facilities are putting pressure on Lloyd's participants, particularly smaller managing agents without a niche offering. Meanwhile, the growth of regional (re)insurance hubs, combined with the comparatively high cost of placing business at Lloyd's, is reducing the flow of business into the London market.

Lloyd's has responded proactively to these threats. There is an ongoing drive to improve access to international business, supported by the Vision 2025 strategy, further development of international licences and the establishment of regional platforms. In addition, improving the efficiency of systems and processes and reducing operating costs remain a key focus of the Corporation.

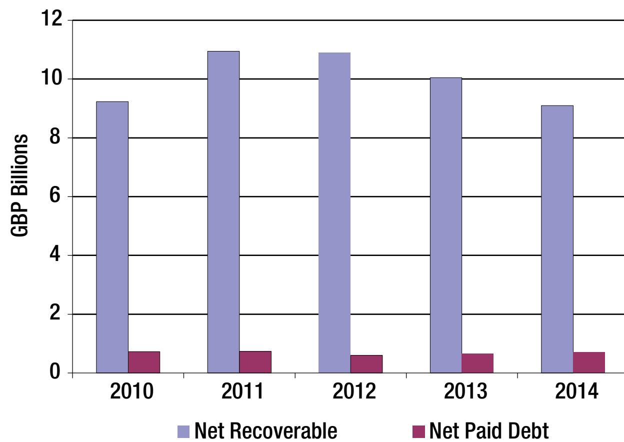
Total reinsurance premiums fell 5% in 2014 to GBP 8.5 billion, largely as a result of softening property and marine premium rates in the absence of major catastrophe events. There were several large losses during 2014, including Hurricane Odile in Mexico, other weather-related losses in the United States and Japan, and substantial aviation losses following the loss of two Malaysia Airlines aircraft and several aircraft through fighting at Tripoli Airport (Libya). However, with capital in the reinsurance market continuing to be plentiful, none of these major losses, either alone or in aggregate, had a lasting positive effect on premium rates in the lines of business concerned. It was a similar scenario of surplus capacity and softening rates in the casualty market but casualty reinsurance saw 5% growth in gross written premium (GWP) during 2014, reflecting in part the economic recovery experienced in some parts of the world.

The weather-related losses and substantial aviation losses gave rise to a modest deterioration in the sector's accident-year combined ratio. On a calendar-year basis, favourable development of prior years' reserves reduced the combined ratio by 11.5 percentage points.

Lloyd's reinsurance ceded was stable at approximately 17% in 2014 (excluding reinsurance placed within Lloyd's). The Performance Management Directorate's (PMD) ongoing focus on syndicate business plans and their reinsurance dependence is expected to support continued stability in this ratio in 2015. The Lloyd's reinsurance panel remains well-diversified, with

Exhibit 14

Reinsurance Debtors (2010-2014)



Source: Lloyd's

the top 10 external reinsurance groups accounting for 44% of total reinsurance recoverables in 2014 (2013: 44%).

Exhibit 14 shows the development in Lloyd's net recoverables and total net paid debt. Total net reinsurance recoverables were down to GBP 9.0 billion at year-end 2014 from GBP 10 billion in 2013, partly reflecting benign catastrophe experience during the year.

Lloyd's continues to monitor its reinsurance exposure through a range of submitted returns, complemented by monitoring of Realistic Disaster Scenarios (RDS) for individual syndicates. The security required by managing agents for their syndicate reinsurance programmes is reviewed on a regular basis in order to address any issues which have the potential to affect the financial strength of the overall market. In particular, total outstanding reinsurance recoverables, counterparty concentration risk and the purchasing trends of individual syndicates are all closely monitored.

Soft Market Conditions, But Growth and Profitability Prospects in Latin America Continue to Appeal to International Reinsurers

Insurance markets in Latin America continue to catch the eye of global reinsurers given their good growth prospects and attractive profitability, especially when compared to more developed insurance markets around the globe. The low insurance penetration rates, around 3% average for the region, continue to provide an interesting margin for expansion, which has resulted in increasing participation from Latin America and the Caribbean as a percentage of global premiums. In general, insurance markets in this region have grown at least at twice the rate of their economies during the past two years.

While an attractive market for reinsurers, the rates, terms and conditions of Latin America in 2014 continued to be driven by a soft market. The main drivers behind the pressure on reinsurance pricing are the abundance of capital support in the global markets, and the absence of large catastrophic losses within the region. Furthermore, the introduction of new regulatory frameworks in the region in line with best international practices and the continuing low interest rate environment, could lead to an increase in the use of alternative risk transfer products, which until now have not been relevant in these markets. The use of insurance-linked securities might become another source of competition for traditional reinsurance in Latin America, thus pressuring margins in the middle- to long-term.

Additionally, the increasing number of global insurers looking for geographic diversification and markets with higher growth potential lead them into Latin America through the acquisition of local players. This also contributed to the soft market conditions, since reinsurance capacity provided by parent companies has reduced the universe of primary insurers demanding reinsurance coverage in the market. Also, subsidiaries that have access to their parent's support are better suited to negotiate reinsurance terms and conditions in the current environment. Even in those cases where local regulators set capital requirements for reinsurance concentration, the quality or security from their parent counterparties has been enough to counterbalance the lack of diversification in their reinsurance programs.

Strengthening of solvency regulations in the region could also impact reinsurance market dynamics. The most recent example is the recent implementation of Solvency II-type standards in Mexico, a trend that A.M. Best believes will gradually permeate to the rest of Latin America. In fact, in June 2015, Brazil and Mexico, the two largest insurance markets in Latin America, were included within the first group of countries whose existing regulatory framework is considered to achieve Solvency II equivalence by the European Insurance and Occupational Pensions Authority (EIOPA).

Demand for reinsurance might increase in the initial stages of the strengthening of solvency regulations, particularly as the introduction of new corporate governance structures, regulatory capital requirements and reserve standards could result in additional capital burden for middle- and small-size companies in some lines of business. Insurers that decide to invest in the development of an internal economic capital model might reach a better grasp and understanding of all their risks and how to efficiently shift their strategy when market conditions change. Also, there could be price adjustments in some products considering that, in theory, reserve creation would be more accurate, since technical reserve adequacy will be based on internal models considering the best estimate of their liabilities.

In this environment, A.M. Best believes that strengthening the regulatory framework will result in opportunities for market consolidation in the medium- and small-size participant segment, thus having an impact on the overall demand for reinsurance within these markets.

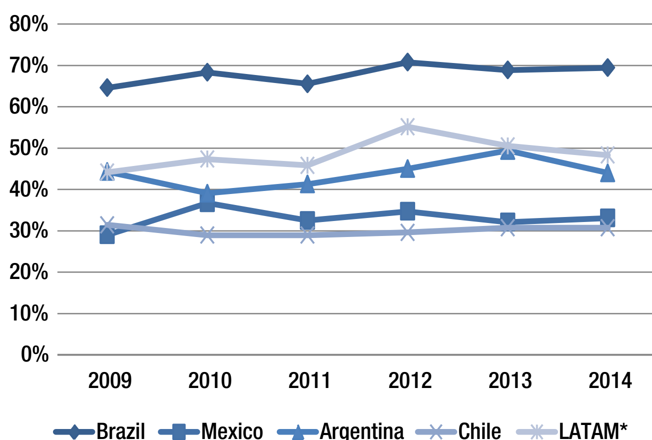
Despite the pressure experienced in reinsurance rates in previous years as a result of the issues mentioned above, A.M. Best expects to see upward adjustments to reinsurance rates in 2015 mainly derived from the impact of Hurricane Odile in Mexico in 2014, which stands only second to Hurricane Wilma in 2005 in terms of catastrophic losses, in addition to droughts in Brazil and Central America.

The dependence on reinsurance support from direct insurers continues to be high in the region. For example, in Mexico, the second largest insurance market in Latin America just behind Brazil, premium retention levels for property & casualty products, excluding auto insurance, remain around 30%. Despite a gradual increase in premium retention from direct insurers within the region, which also has contributed to the soft market conditions, the dependence on reinsurance is expected to remain in the foreseeable future. Insurance companies within Latin America have taken advantage of lower reinsurance rates during the soft part of the cycle and utilized reinsurance capacity as a cheaper alternative to capital in order to support their growth.

As previously mentioned, retention levels from direct insurers in Latin America have experienced an upswing. Higher profitability in some of these markets, in line with conservative dividend policies, has contributed to strengthen the capital base of insurance companies, which is the main factor behind higher premium retention. The previous effect is further strengthened by the creation of catastrophic reserves considered in the regulation of different countries throughout Latin America. The equity-like characteristics of such reserves, since their main objective is to cover deviations in claims for long-terms risks with low frequency and high severity, provides additional flexibility to insurance companies when navigating through hard and soft reinsurance market cycles.

Exhibit 15

Latin American – Premium Retention (%) Non-Life Excluding Auto



* Member countries of ASSAL (Association of Insurance Supervisors from Latin America), excluding Spain and Portugal
Source: A.M. Best calculations on ASSAL's webpage

Latin American Regional Reinsurers Are Looking to Diversify Outside Their Region

A few reinsurance companies established in Latin America are in the process of expanding their geographic diversification outside their continent. In particular, we have seen an interest in expanding to Europe through vehicles like Lloyd's syndicates. In order to support their growth into new geographies, such Latin American reinsurers have considered different alternatives to access additional capital required to enter other markets. For example, hedge fund reinsurers have been looking to partner with existing reinsurance companies as some of these Latin American players already have ratings, as well as existing underwriting teams with good track records and an active book of business.

Additionally, global development institutions have been really active in terms of due diligence throughout Latin America.

This could also represent an additional source of resources in order to support the growth of Latin American companies into new territories. And finally, we find the companies that will try to expand overseas with their own excess capital.

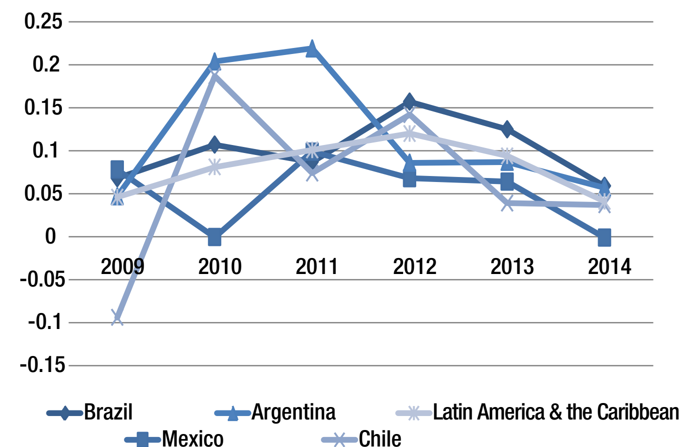
While geographic diversification may be a good strategy in theory, as some of the local markets in which the Latin American reinsurers have become crowded and subject to fierce competition, the risk of entering a new market is something that should be thoroughly assessed by the management teams of these companies. The need for a partner or an underwriting team with aligned goals that really comprehends the dynamics of the target market is a must when expanding to new products and geographies. A.M. Best has seen a number of these attempts to grow overseas fail in the past. Strong Enterprise Risk Management (ERM) practices and systems that successfully capture the real risk retention of the companies become compulsory for successful growth overseas. Even if the premium weight from the overseas business in the portfolio appears to be low, it does not necessarily imply that the risk retention is low, especially for severity risk where underwriting leverage could be significant.

Rating Outlook for Latin American Reinsurers

Even though the outlook for Latin American reinsurers is not as negative as for global players, there are a number of factors that limit the current ratings of these companies. The Latin American market is immersed in a strong competitive environment and presence from global reinsurance groups with major capital capacity and good ratings (as observed in particular for the Mexican market in **Exhibit 17**) will continue to pressure reinsurance rates. Maintaining underwriting discipline is more important than ever, especially in light of the low interest rate environment that has pressured financial revenues during the past few years. In addition, the successful expansion strategy of some of these players outside their local markets is a big question mark.

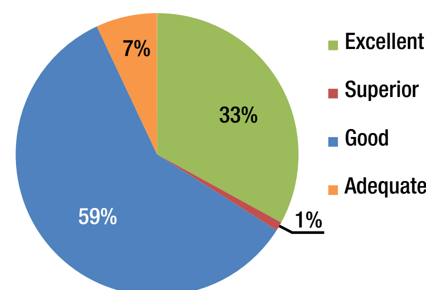
Capitalization of reinsurers rated by A.M. Best according to our risk-based capital model is strong and supportive of the ratings and has remained fairly stable over the past four years. Sharp reductions in risk-based capitalization could lead to negative rating actions. The small size and flexibility of Latin American reinsurers relative to global participants has allowed them to swiftly adapt to the soft cycle and mitigate its impact in their profitability levels. In the current environment, some Latin American reinsurers have opted to decrease their retentions by taking advantage of the current soft cycle, but the trick is to be prepared in terms of capacity and flexibility to rapidly respond to hardening market conditions.

Exhibit 16
Latin America – Premium Growth (Inflation Adjusted)



Source: Sigma Re

Exhibit 17
Mexico – Level of Security of Registered Reinsurers



Source: CNSF (Mexican Insurance & Surety Regulator)

At a Crossroad for Asian Reinsurers

Asian companies continued to show stable results in 2014 but face increasing challenges demanding a change in business model that is sustainable for the long-term. Traditionally, many of the Asian reinsurers were characterized by a dominating local market position and a portfolio that is concentrated on proportional businesses. And due to these characteristics, generally they showed less volatile results regardless of the market cycles, albeit with a higher combined ratio.

With the changes of the local insurance market dynamics and intense competition amongst reinsurers, however, this business model is facing increasing challenges. Means for capital supply have widened for the direct insurance industry and, moreover, the business retention capability of the direct players is on a rise, especially for the larger ones. Even for those reinsurers who continue to maintain or even increase their market share in their respective local markets, the business portion from large cedents is decreasing. On a positive note, the change in market dynamics is a gradual shift whereby the Asian reinsurers have time to respond; but on a negative note, Asian companies are not allocating sufficient time and resources to carefully study the fundamental market change.

Profile of Asian Reinsurers:

The number of Asian companies in the 2015 Top 50 Global Reinsurance Groups remained the same compared to the previous year. Due to the strong U.S. currency value, the rankings of a few companies came down. As there is still strong growth momentum in markets like China and India, China Re and GIC of India have potential to move up the rankings further. In terms of number of companies, we may see a few more companies make the list in the short- to medium-term.

As the growth rate of their core domestic markets have slowed down, Asian reinsurers are actively diversifying into other business lines and broadening their geographical scope as well. Life reinsurance, personal lines business with some solvency relief characteristics and agricultural business are lines with higher premium volume. Broadening geographical scope into other countries is a priority for many Asian reinsurers but the experiences have not been too favorable thus far as the overseas premium reaches a certain size. (See **Exhibits 18** and **19.**)

Profitability of Asian Reinsurers:

Most Asian reinsurance companies in the 2015 Top 50 Global Reinsurance Groups show higher combined ratios compared to the others in the list. There are different reasons for that but it is mainly due to a higher composition of business with variable commission (profit commission). In some cases, the reinsurance companies exhibit less volatility than the direct companies in their own markets. In absolute terms, the underwriting profitability of Asian reinsurers seems to exhibit a clear gap relative to others, but from a risk-adjusted (profitability) point of view, the gap may not be as significant as it seems.

The results of the big four Asian reinsurers were driven by investment income rather than a positive underwriting income over the past five years. Thus, the profitability outlook of the Asian reinsurers would be in line with the investment income outlook, which varies by market but is generally negative.

Capitalization of Asian Reinsurers:

Risk-adjusted capitalization of Asian reinsurers has remained stable since 2012. As the markets are experiencing a slower growth rate relative to the past, immediate pressure on the capitalization is low. On a relative basis, as more reinsurance companies with higher capacity and ratings are entering Asia, the competitive environment is getting tougher and tougher for Asian reinsurers, especially the ones with relatively small absolute capital size.

Whereas we have seem numerous M&A activities in the reinsurance market outside Asia, it will be difficult for Asian reinsurers to adopt this strategy other than a regulator driving consolidation within a single market where multiple domestic reinsurers operate. Thus, if companies were to adopt a strategy for a larger capital base, the capital will be sourced mainly through the capital market.

Things to Look Out for in 2015:

Previously, both Toa Re and Korean Re reached top ten in the Top 50 Global Reinsurance Groups but in terms of absolute capitalization, they were small relative to the major reinsurance companies. However, China Re recorded an absolute capital size close to USD 9 billion in 2014 and is going to breach USD 10 billion once they go public by the end of 2015.

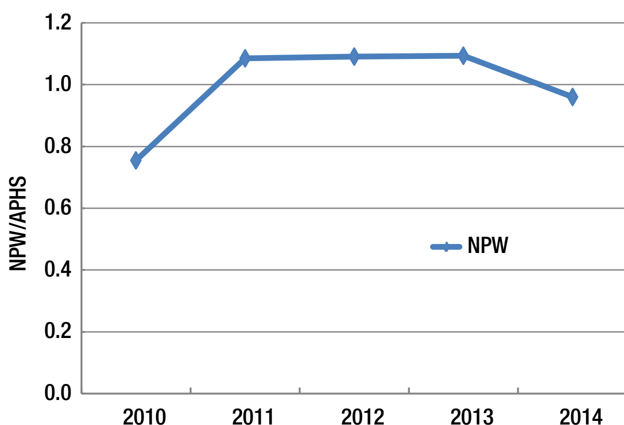
Just like in Japan where major insurance groups conduct reinsurance business, major Chinese insurance groups will have reinsurance subsidiaries in the near future. The size of the reinsurance business of companies like PICC and other large insurance groups could quickly rise up the list of the Top 50 Global Reinsurance Groups depending on their reinsurance strategy. We will see Shanghai emerging as another reinsurance hub in Asia over the next few years, just like we have seen Singapore emerge as a reinsurance hub in Asia over the past few years.

The general direction of regulatory development in terms of solvency requirements can be summarized in a single word, which is 'convergence'. Although different risk charges are being introduced depending on the market conditions, the basic solvency framework is similar. However, when it comes to treatment of reinsurance, regulations can differ by countries. Distinctions are generally given by credit quality of the reinsurance companies but preferential treatment is given to locally registered companies in some Asian countries. Indonesia introduced regulations favoring domestic companies toward the end of 2014 with short notice, creating confusion in the market, and China's new solvency regulations favor companies registered in China or companies with very high ratings if ceded overseas. It should be noted that both countries are highly exposed to natural catastrophes.

It is unlikely that the insurance loss from the Tianjin explosion in August will change the regulatory direction nor the soft market condition in China. This will be recorded as one of the

Exhibit 18

Asia-Pacific Reinsurance – Net Premiums Written/Adjusted Policyholders' Surplus*

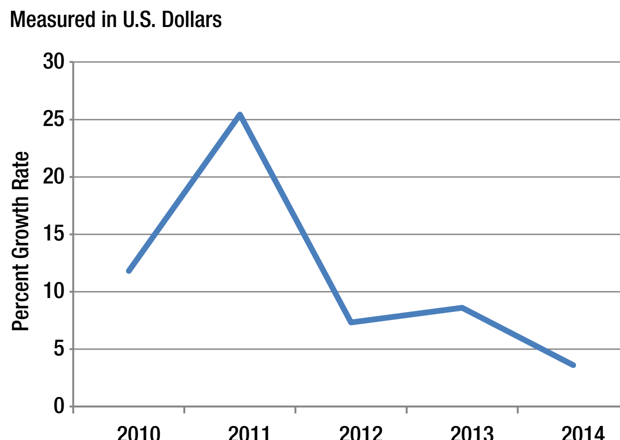


*For Asian 4 reinsurers: China Re, Korean Re, Tokio Millennium Re, General Insurance Corp. of India.
Source: A.M. Best data and research

Exhibit 19

Asia-Pacific Reinsurance – Net Premiums Written Growth Rate*

Measured in U.S. Dollars



*For Asian 4 reinsurers: China Re, Korean Re, Tokio Millennium Re, General Insurance Corp. of India.
Source: A.M. Best data and research

largest, if not the largest, insurance loss in China to date, but the absolute size of the loss can be easily absorbed by the available capacity in the market. A few primary companies that are directly hit from the Tianjin explosion will face higher pricing for their next renewal, but the overall market in China will not experience a tougher reinsurance environment. This incident, however, will reinforce the importance of credit risk (including disputes risk) management.

Overcapacity Weighs on Technical Performance of Reinsurers in the Middle East & North Africa

Insurance markets in the Middle East and North Africa (MENA) region have grown significantly over the past decade. MENA insurance premiums surpassed USD 50 billion in 2014, with the main markets being the United Arab Emirates (UAE), Saudi Arabia, Iran and Turkey. The low level of insurance penetration seen in many MENA countries, combined with the robust, albeit deteriorating, profitability achieved by the leading primary insurers, has made the region a target for both international and domestic reinsurers. **Exhibit 20** shows the largest MENA-domiciled reinsurers ranked by gross written premiums (GWP) in 2014. Despite the growing presence and capacity provided by regional reinsurers, their profiles remain small compared with international peers.

Exhibit 20

Middle East & North Africa Reinsurers –
Largest Domiciled Writers Ranked by Gross Written Premiums, 2014
(USD millions)

Company	Abbreviation	Gross Written Premiums	Net Written Premiums
Qatar Reinsurance Company LLC	Qatar Re	$535.9	$178.2
Trust International Ins & Reins Co. B.S.C. (c) Trust Re	Trust Re	444.9	286.6
Milli Reasurans Turk Anonim Sirketi	Milli Re	412.6	354.6
Arab Insurance Group (B.S.C.)	ARIG	315.3	260.4
Compagnie Centrale de Reassurance	CCR Algeria	255.2	154.1
Societe Centrale de Reassurance	SCR Morocco	239.2	143.5
Hannover ReTakaful BSC (c)	Hannover ReTakaful	205.4	201.1
Saudi Reinsurance Company	Saudi Re	148.3	137.1
Kuwait Reinsurance Company K.S.C.P	Kuwait Re	117.0	103.7
Arab Reinsurance Company SAL	Arab Re	81.6	59.3
Emirates Retakaful Limited	Emirates Re	77.4	73.3
Gulf Reinsurance Limited	Gulf Re	55.3	13.6
Societe Tunisienne de Reassurance	Tunis Re	52.5	27.4
ACR ReTakaful MEA B.S.C. (c)	ACR ReTakaful	41.3	23.0

Notes: Excludes branches of reinsurers not domiciled in the MENA region. Premiums are not restricted to MENA region. Excludes companies for whom financial data was not available.
Source: A.M. Best data and research

Many MENA markets, such as those of the Gulf Cooperation Council (GCC) countries, are perceived to have relatively benign exposure to natural catastrophe events, allowing reinsurers to establish geographically diverse underwriting portfolios without exposing themselves to increased earnings volatility. Despite this, the influx of reinsurance capacity in the MENA region and the prevailing competitive market conditions that have grown ever fiercer over the past three years have begun to place pressure on the technical performance of regional reinsurers. The issue of overcapacity in the region has been further amplified by reinsurers operating in the Indian subcontinent, the Asia-Pacific territories and Africa, expanding into the MENA region.

International reinsurers continue to play a pivotal role in the market, providing capacity as well as technical expertise for primary insurers to underwrite increasingly sophisticated and high-value risks. The support provided by international reinsurers includes surveying expertise, pricing models and risk management/mitigation techniques. A significant contributor to premium growth in the primary market has stemmed from the expansion of “big ticket” commercial and industrial risks, for which the direct writers are typically only capable of supporting a minimal retention. This reflects the fact that primary insurers usually lack sufficient underwriting capacity and balance sheet size to retain these large-scale risks.

Despite a period of economic slowdown in the region following the 2008 financial crisis, growth and productivity has gradually improved over the past three years, albeit remaining below pre-crisis levels. Infrastructure projects, as well as consumer and business confidence, has rebounded to a stronger level. The resulting expansion in infrastructure and commercial risks, which typically require extensive reinsurance support, has fuelled increased demand for the reinsurance sector.

Additionally, whilst the 2014 decline in oil prices and the future value of this commodity cannot be disregarded as a factor driving economic growth in the MENA region, the impact on the (re)insurance sector is expected to be minimal over the medium term. Despite high oil prices having historically propagated budget surpluses for oil-rich countries in the region, supporting elevated levels of government spending on infrastructure and property development, current scheduled expenditure is not expected to change. Moreover, even in the case of moderate economic contraction arising from persisting low oil prices, A.M. Best believes there is still opportunity for increased insurance demand in the region, given the low levels of insurance penetration and continued rollout of compulsory insurance.

The majority of MENA markets are open, with few restrictions on reinsurance operations; however, there are initiatives in some countries aimed at nurturing growth and the retention of business within the local market. Mandatory cessions are important to the dynamics of reinsurers in countries such as Algeria and Morocco. In these markets, local players are obliged to place a component of their reinsurance programme with state-backed reinsurers. This typically bolsters the government's involvement and participation in local insured risks and is often a mechanism aimed at supporting the country and its insurance sector in the event of natural catastrophes. Furthermore, the existence of long-standing local and regional reinsurers, in addition to reinsurance pools (where the shareholders and pool members are typically local insurance companies), helps to retain business within the regional market.

In a recent briefing ("Sanctions Removal to Attract Insurers and Reinsurers to Iranian Market"), A.M. Best commented on how the lifting of trade restrictions placed on Iran may present a significant opportunity for the reinsurance market, given that the Iranian direct insurance market is one of the largest by premium volume in the region. To date, the Iranian insurance segment has operated principally as a closed market, with reinsurance business captured predominantly by the country's domestic reinsurers: Amin Reinsurance Company (Amin Re), Bimeh Markazi Iran and Iranian Reinsurance Company (Iranian Re), and a small number of select reinsurers from surrounding countries that are open to trading with Iran. With the removal of sanction restrictions, reinsurers are anticipated to re-engage with the Iranian market.

Whilst the size and the sophistication of the MENA insurance market has increased notably over the past decade, it remains both developing and dependent on international reinsurance support, with local and regional reinsurers generally acting in a follower capacity. Whilst some reinsurers have exited the market, the number of new entrants is far greater than those leaving. Reinsurance capacity (both from international and regional reinsurers) remains well in excess of local demand, resulting in the continued exacerbation of the current competitive pricing environment.

Domestic Reinsurers – Established Participants vs. New Entrants

Domestic MENA reinsurers can be split into two distinct groups – established participants and new entrants (see **Exhibit 21**). Established participants were typically formed with government affiliations in order to provide reinsurance capacity to retain risks within the region. These reinsurers were all established before 1990, with some having operated in the market for more than 50 years. The new entrants were all established in the last fifteen years and followed an influx of local and foreign capital into the MENA region.

Exhibit 21

Middle East & North Africa Reinsurers – Established Participants vs. New Entrants

Established Participants

Year of Establishment	Reinsurer	Domicile
1929	Milli Re	Turkey
1957	Egypt Re	Egypt
1960	SCR Morocco	Morocco
1971	Bimeh Markazi Iran	Iran
1972	Kuwait Re	Kuwait
1972	Arab Re	Lebanon
1973	CCR Algeria	Algeria
1974	Arab Union Re	Syria
1980	ARIG	Bahrain
1981	Tunis Re	Tunisia
1989	Trust Re	Bahrain

New Entrants

Year of Establishment	Reinsurer	Domicile
2003	Amin Re	Iran
2005	Takaful Re	UAE
2006	Hannover ReTakaful	Bahrain
2008	Saudi Re	Saudi Arabia
2008	Emirates Re	UAE
2008	Gulf Re	UAE
2008	ACR ReTakaful	Bahrain
2009	Qatar Re	Qatar
2009	Oman Re	Oman
2010	Iranian Re	Iran

Notes: Excludes branches of reinsurers not domiciled in the MENA region. Egypt Re ceased to exist in 2007 following a merger with other state owned companies.
Source: A.M. Best data and research

Whilst both new entrants and established participants have been faced with the prevailing landscape of overcapacity and soft premium rates, their profiles and performance vary considerably. The profiles of established participants typically benefit from local government support, whether via state ownership or through local legislation that generates compulsory cessions from the direct markets. These participants also tend to have well-established business profiles with long-standing relationships with key cedents.

By contrast, new entrants usually do not benefit from government support. Ownership typically comprises a mixture of local, regional and foreign private investors. Where foreign ownership does exist, this is increasingly from international insurance groups, which often brings an enhanced level of insurance expertise and support to regional participants. Furthermore, many new entrants were somewhat hindered by the 2008 financial crisis, which commenced shortly after these companies were established.

By contrasting technical performance over the last five years, A.M. Best notes a clear divergence between the two groups. As illustrated in **Exhibit 22**, the new entrants have struggled to generate underwriting profits, with a five-year weighted average combined ratio of 114% reported for this group from 2010 to 2014. This compares with the established participants, which achieved a 98% average combined ratio over the same period.

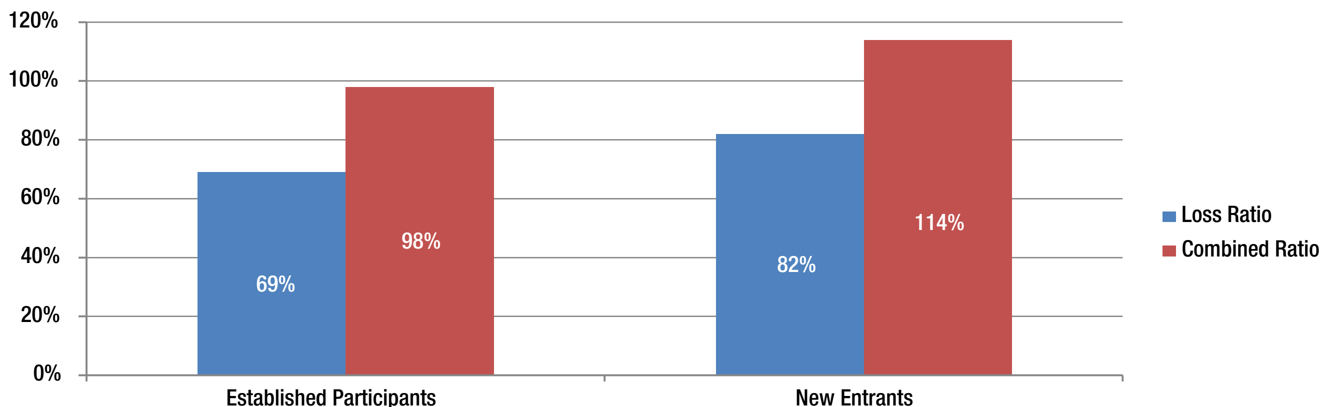
The considerable variance in performance can be attributed to both higher loss and expense ratios for the new entrants. In part, this is a factor of the level of competition in the region, which has seen many of the new entrants writing business at lower rates in order to penetrate the market and grow their profiles. In addition, the typically smaller scale and start-up costs have resulted in higher expense burdens. Conversely, the established participants have tended to maintain stable expenses, benefitting from economies of scale and, in some cases, have been supported by good quality and higher margin business generated through compulsory market cessions. Furthermore, the larger-scale operations of the established participants typically affords a greater ability to absorb large losses, whereas the smaller profiles of the new entrants can lead to larger losses resulting in earnings volatility.

Whilst a differential between the technical performance of new entrants and existing participants is clearly evident, it is also important to recognise that there has been a more general shift in underwriting performance across the regional reinsurance segment. The weighted average combined ratio for

Exhibit 22

Middle East & North Africa Reinsurers – Five-Year Average Non-Life Underwriting Performance (2010-2014)

A comparison between established participants and new entrants.

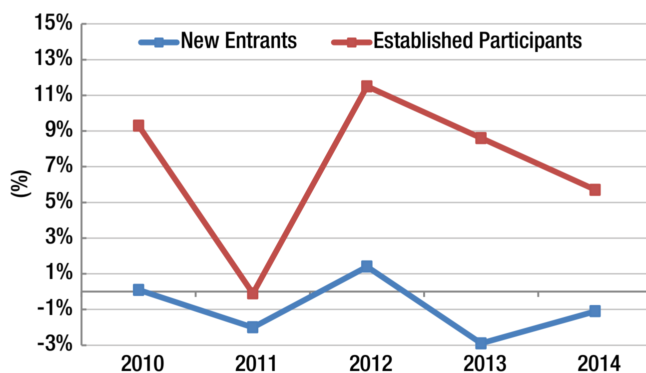


Notes: Excludes companies for whom financial data was not available.
Source: BESTLINK – *Best's Statement File - Global*

Exhibit 23

Middle East & North Africa Reinsurers – Return on Equity

A comparison between established participants and new entrants.



Notes: Excludes companies for whom financial data was not available.
Source: BESTLINK – *Best's Statement File - Global*

reinsurers domiciled in the MENA region has deteriorated over the past three years, going from 96% in 2012 to 103% in 2014. This is in marked contrast to the global reinsurance market, where technical margins have remained robust and improved over the same period, following the absence of major catastrophes. The weakening performance, whilst in part continuing to reflect overcapacity and prevailing competitive pricing conditions, has also been driven by a higher frequency and severity of large losses stemming from the MENA markets. Typically, these losses have emanated from commercial property lines, including fire, engineering and industrial risks, with business interruption also being a significant contributor to the overall cost of claims. As a consequence, some (re) insurers have started to become increasingly selective in the risks they assume and impose stricter risk mitigation requirements on higher-risk commercial properties, such as requiring water-sprinkler systems and fire retardant structures.

A.M. Best notes that the established participants typically have stronger levels of investment income, reflecting their more mature and generally larger invested asset bases. Higher investment returns, combined with lower combined ratios, results in the earnings of the established participants being significantly stronger, enabling more robust returns on equity to be achieved. (See **Exhibit 23.**)

The overarching decision for all MENA-domiciled reinsurers remains whether to grow their profiles, which, given the current competitive environment, is likely to put pressure on underwriting margins, or whether to focus on profitability at the expense of profile and market share. This decision remains all the more pertinent for new entrants, which need to grow in order to offset high start-up expenses.

Exhibit 24

Middle East & North Africa Reinsurers – Non-Life Underwriting Ratios

		Loss Ratio				Combined Ratio			
Company	**Country**	**2012**	**2013**	**2014**	**5yr Av.**	**2012**	**2013**	**2014**	**5yr Av.**
Qatar Re	Qatar	87%	82%	84%	82%	114%	111%	103%	106%
Trust Re	Bahrain	66%	64%	67%	66%	95%	95%	97%	94%
Milli Re	Turkey	70%	79%	83%	84%	99%	113%	116%	108%
ARIG	Bahrain	59%	63%	67%	65%	97%	99%	104%	102%
CCR Algeria	Algeria	47%	47%	40%	44%	78%	76%	72%	75%
SCR Morocco	Morocco	50%	28%	77%	57%	84%	67%	90%	88%
Saudi Re	Saudi Arabia	59%	119%	75%	87%	84%	154%	109%	120%
Kuwait Re	Kuwait	68%	70%	68%	71%	94%	97%	106%	101%
Arab Re	Lebanon	65%	72%	78%	71%	97%	105%	113%	104%
Emirates Re	UAE	59%	62%	65%	67%	96%	98%	92%	100%
Gulf Re	UAE	72%	86%	128%	83%	104%	121%	258%	125%
Tunis Re	Tunisia	55%	50%	58%	57%	100%	98%	100%	100%
ACR ReTakaful	Bahrain	77%	28%	21%	90%	178%	177%	39%	133%
	Average	**64%**	**66%**	**72%**	**71%**	**96%**	**100%**	**103%**	**101%**

Notes: Excludes companies for whom financial data was not available. Takaful Re is consolidated into Arab Insurance Group (B.S.C.). Gulf Re's 2014 combined ratio is increased by the adoption of intragroup reinsurance protection. All averages are calculated on a weighted basis. Combined ratios reflect the sum of the loss ratio and expense ratio. The loss ratio is calculated using net claims incurred / net earned premiums. The expense ratio is calculated using net operating expenses / net written premium.
Source: A.M. Best data and research

Retention and Pricing

Cession rates of MENA insurers vary considerably, although the proportion of business ceded to reinsurers has generally trended downwards over the past decade. Analysis conducted by A.M. Best on 151 companies operating in the GCC countries of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE showed that in 2004 more than 50% of direct written premiums were ceded to reinsurers. This compares with a lower level of reinsurance participation in 2014, with the same insurers ceding approximately 30%.

The increase in risk retention by MENA insurers in part reflects a shift in the composition of the market's business mix over the past decade. In particular, medical healthcare has become an increasingly significant component of insurers' profiles, reflecting the product line being made compulsory in a number of countries. The growth in medical business combined with typically high retention levels on this product line has resulted in a gradual increase in insurers' overall retention ratios. Furthermore, as insurers in the region have grown their profiles, balance sheet sizes and technical expertise, they have sought to gradually increase their retentions on large and complex commercial risks. Despite this steady increase, insurers continue to retain relatively small portions of commercial risks, with significant support still required from reinsurers.

The MENA insurance market largely utilises proportional reinsurance protection, although there has been a steady shift toward non-proportional coverage in recent years. The use of "bouquet" treaties is commonplace. Most non-life lines (excluding medical) are typically packaged together and covered under a single whole account reinsurance contract. From a reinsurer's perspective, this makes the pricing and structuring of these programmes all the more complex. In order to set appropriate terms, conditions and prices, consideration must be given to the overall composition of the portfolio and factor in both over- and under-performing business segments.

In recent years, MENA insurers have benefited from reinsurance pricing that has been amongst the lowest in emerging markets. A.M. Best believes that this mainly reflects the abundance of reinsurance capacity available in the market, combined with the generally low level of catastrophe exposure associated with the region. In order for premium rates to materially increase over the medium term, a major shock to the market would likely have to occur. This could be triggered by an unexpected major catastrophe in the region, or a series of large and high-value losses emanating from previously low-loss experience lines such as infrastructure and energy.

Medical business has historically been written on a proportional basis. However, the level of competition in this line has contributed to underwriting losses for many insurers and reinsurers over recent years. Reinsurers, in particular, have suffered from outwards commission structures, which have been particularly onerous. As a consequence, reinsurers have more recently begun to dictate stronger terms, move from proportional treaties to excess-of-loss coverage, reduce commissions or shift to sliding-scale commission structures. The dominance of the medical segment in the region makes it important for insurers to have continued reinsurance support.

Financial Hubs and the Presence of Lloyd’s

The introduction of financial hubs such as the Dubai International Financial Centre (DIFC) and Qatar Financial Centre (QFC), alongside well-regulated offshore centres (including Bahrain under the Central Bank of Bahrain), have helped to open the market and encourage international players to establish a physical presence in the region. This has been particularly true for internationally recognised reinsurers and brokers, many of which have strategies that acknowledge the importance of operating under a “hub and spoke” business model, enabling “global” products and services to be offered “locally” to clients. Close proximity to clients is also increasingly being recognised as a fundamental mechanism for (re)insurers to better understand the characteristics of the markets they operate in and ultimately the risks they underwrite.

In March 2015, a significant milestone for the region was reached when Lloyd’s established an underwriting platform in the DIFC. This action was part of Lloyd’s 2025 Vision strategy, which includes a mandate to expand its presence in high-growth and developing markets around the world. The creation of a regional office also demonstrates Lloyd’s commitment to strengthening its relationships and developing a deeper risk insight in the MENA region. The new office brings with it an increase in the number of Lloyd’s businesses trading in the region to nine – Amlin, Argo Re, Beazley, Catlin, Liberty, Markel, Talbot, Visionary and Watkins – seven of which will be operating from the new Lloyd’s platform in the DIFC.

Following the success of financial hubs such as the DIFC, the model has been replicated in other countries such as Morocco, which has established the Casablanca Financial City (CFC). A.M. Best understands that a number of regional reinsurers have expressed an interest in using the CFC to service the expanding African insurance markets.

Primary Market Participants Writing Facultative Business

In recent years, an increasingly common feature of the MENA reinsurance market is that of primary insurers writing facultative business. The direct companies that have engaged in this practice are typically those local or regional insurers that hold a financial strength rating at the higher end of the scale, usually A- or above. The tendency has been for these companies to participate in a limited number of facultative placements, where they are able to control their exposure by taking relatively small line sizes.

Whilst there is an argument that a portfolio of facultative risks can complement and diversify a direct writer’s portfolio, there are a number of potential issues that should be considered. The very nature of reinsurance, whether it is facultative or otherwise, means that the underwriter is one further step removed from the insured risk than if they were writing a direct insurance policy. Obviously, this is the case for all companies writing reinsurance; however, it can be argued that a specialist reinsurer is likely to be better-equipped with the necessary tools, knowledge and experience to make more-informed underwriting decisions. A primary insurer writing a small number of facultative policies on a sporadic basis is less likely to be able to support a permanent underwriting function specialising in these placements.

Primary insurers engaging in facultative business are usually unable to set prices or dictate terms, given that they normally participate as followers. Given this situation, direct writers are heavily reliant on the terms, conditions and prices agreed by the programme leads. A level

of comfort may be gained if the leading reinsurers are internationally recognised. However, the risk appetites of international players are likely to vary considerably from those of local or regional insurers. A single loss arising from a facultative placement is likely to bear a much smaller impact on the overall earnings and balance sheet strength of an international reinsurer compared with that of a local or regional direct writer.

For regional reinsurers, a pertinent issue arising from primary insurers participating on facultative placements is the potential for unexpected risk accumulations. Primary insurers may write the majority of their direct portfolio in a single or select few countries; however, it is possible that they may choose to diversify by underwriting facultative risks in other parts of the MENA region. For reinsurers that provide treaty coverage on these direct writers' portfolios, which include exposure to regional facultative placements, it becomes increasingly difficult to keep track of the location of the original risk. In response to this issue, some reinsurers have looked to tighten their terms and conditions by reducing or completely excluding inwards facultative risks from their treaty programmes.

The Risk Landscape

When discussing the risk landscape for reinsurance sectors in most parts of the world, it is customary to begin by talking about the latest natural catastrophe to hit the market. However, for the MENA reinsurance sector, catastrophe activity remains minimal. There have been some small events in the past decade, such as flooding in Oman following cyclone activity in the North Indian Ocean and floods in Saudi Arabia driven principally by poor drainage capacity, but for the most part, catastrophe activity has been contained.

Despite the limited number of catastrophes to date, it must be noted that the past is no guarantee of the future. Furthermore, although earthquake, windstorm and flood risks are believed to be relatively minimal in the region, should even a small event occur in a highly developed and densely populated area such as Dubai, the cost to reinsurers could be significant. Conversely, whilst the region's reinsurers have not been hit by local catastrophes, a handful of players have encountered losses from worldwide events that occurred between 2010 and 2012, following their participation in international programmes.

For MENA reinsurers, the most severe losses tend to emanate from commercial risks, including property, engineering, marine and energy lines. In particular, large commercial property losses, such as the 2014 Almarai Dairy fire in Saudi Arabia, have been drivers of volatility in technical performance. This particular event not only generated a meaningful property loss for the market but also a material business interruption exposure.

Furthermore, there is a tendency for reinsurers to price commercial property risks in the MENA region at relatively low “rates-on-line” compared with equivalent risks in other emerging markets. Whilst part of the difference can be attributed to the lower levels of catastrophe activity experienced in the region, it is not always clear whether local risk factors such as culture, less onerous regulatory standards and internal loss mitigation practices for these large commercial property exposures, are fully considered when setting prices, terms and conditions.

Ratings Issues for MENA Reinsurers

All A.M. Best rated reinsurers domiciled in the MENA region have secure Financial Strength Ratings (FSRs). The highest rating assigned at present is an FSR of A. The outlook for the FSRs and Issuer Credit Ratings (ICRs) on all of the companies is currently stable or positive. (See **Exhibit 25**.)

Reinsurers domiciled in the region are generally well-capitalised, with existing participants strengthening their capital positions through retained earnings and new entrants typically

holding surplus capital to support their expanding franchises. Capital requirements are largely driven by underwriting risk, with most reinsurers adopting conservative and diverse investment profiles and high net retentions that minimise exposure to counterparty credit risk.

Operating performance remains profitable for most MENA-domiciled reinsurers; however, for many this reflects robust investment income that has offset increasingly pressured underwriting earnings. The persistence of thin technical margins coupled with an increase in large loss experience from commercial lines has resulted in diminishing underwriting results for many regional reinsurers in 2014. Given that technical margins in the MENA region have been declining in recent years, regional reinsurers are looking further afield, mainly in the Indian subcontinent, the Asia-Pacific territories and North Africa, to search for higher margin business that compliments their existing portfolios. Whilst this can be viewed as a positive step, aimed at improving technical performance, there is undoubtedly execution risk associated with expanding into unfamiliar markets. This is particularly true given the higher anticipated catastrophe risks that may be assumed by writing new business, and which could result in unexpected volatility in company earnings.

With premium rates in the market expected to remain stagnant over the medium term, regional reinsurers have sought to improve their approach to risk selection and are expected to continue to hone their risk appetites even further over the coming years. Many regional reinsurers have invested significantly in advancing their risk management functions, which not only enables companies to improve underwriting practices but more importantly limits earnings volatility by understanding aggregation and accumulation of large losses. An increasing focus on data quality, surveying techniques and risk mitigation practices is assisting reinsurers to improve their underwriting approach.

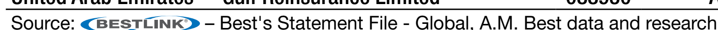
Overall, A.M. Best believes that whilst MENA-domiciled reinsurers continue to grow their presence and penetration in the region, they remain small when compared with their international counterparts. Technical performance remains pressured and a key rating issue over the medium term. However, improving enterprise risk management goes some way to reduce earnings volatility.

Exhibit 25

Middle East & North Africa Reinsurers – A.M. Best Rated Entities

Ratings as of August 14, 2015

Domicile	Company	AMB #	Best's Financial Strength Rating (FSR)	Best's Long-Term Issuer Credit Rating (ICR)	Best's FSR & ICR Outlook / Implications	FSR & ICR Rating Action	Rating Effective Date
Algeria	Compagnie Centrale de Reassurance	090777	B+	bbb-	Stable	Affirmed	Jul. 10, 2015
Bahrain	ACR ReTakaful MEA B.S.C. (c)	090059	A-	a-	Stable	Affirmed	Dec. 19, 2014
Bahrain	Arab Insurance Group (B.S.C.)	085013	B++	bbb+	Positive	Affirmed	Dec. 19, 2014
Bahrain	Trust International Insurance & Reinsurance Company B.S.C. (c) Trust Re	086326	A-	a-	Stable	Affirmed	Aug. 21, 2014
Kuwait	Kuwait Reinsurance Company K.S.C.P	085585	A- u	a- u	Negative	Under Review	Aug. 14, 2015
Lebanon	Arab Reinsurance Company SAL	089190	B+	bbb-	Stable	Affirmed	Dec. 11, 2014
Morocco	Societe Centrale de Reassurance	084052	B++	bbb	Stable	Affirmed	Aug. 08, 2014
Qatar	Qatar Reinsurance Company LLC	092611	A	a	Stable	Affirmed	Dec. 04, 2014
Tunisia	Societe Tunisienne de Reassurance	083349	B+	bbb-	Stable	Affirmed	Jul. 10, 2015
Turkey	Milli Reasurans Turk Anonim Sirketi	085454	B+	bbb-	Stable	Affirmed	Jun. 04, 2015
United Arab Emirates	Emirates Retakaful Limited	093190	B++	bbb+	Positive	Affirmed	Jun. 04, 2015
United Arab Emirates	Gulf Reinsurance Limited	088930	A-	a-	Stable	Affirmed	May. 29, 2015


Source: BESTLINK – Best's Statement File - Global, A.M. Best data and research

Capacity Flows into the Sub-Saharan Reinsurance Markets Despite Economic Challenges

Much has been said in recent years of the opportunities presented by the buoyant strides in economies across the African continent together with challenges that market participants have to overcome. The continent's (re)insurance sectors are no exception.

In particular, following years of strong economic activity, led in part by high commodity prices and foreign direct investment, uncertainty remains as to the sustainability of the robust levels of growth experienced in recent years, particularly with low oil prices. Subsequently, this is increasing the levels of capital being repatriated as the momentum in investors' confidence in Africa's economic prospects slows.

Nonetheless, the (re)insurance markets of the sub-continent continue to attract interest from around the world as foreign investments in this sector seek growth, returns and diversity outside of their core markets. At the same time, domestic reinsurers remain focused on their strategies to expand beyond their borders as they look to strengthen their profiles and achieve critical mass.

A.M. Best estimates that there are between 35 and 40 reinsurers domiciled in the sub-continent. This number is growing as lawmakers seek to supplement capacity available to the insurance industry as a result of the increasing discovery of oil reserves and the numerous infrastructure projects being undertaken, thereby reducing premium outflows to the international reinsurance markets and domesticating more profits. In 2015, Ghana saw the creation of its third domestic reinsurer, GN Reinsurance Company Ltd. With initial capital of GHS 80 million (approximately USD 25 million) the company is expected to enhance local capacity, thereby increasing the level of insurance profits retained in the country.

The number of national reinsurers established is also rising. These national reinsurers are typically government or quasi state-owned entities that are entitled to the first refusal of compulsory treaty business arising from the country of domicile. For example, in 2013, Uganda National Reinsurance (Uganda Re) commenced operations, with a mandate for Ugandan market participants to cede 15% of all reinsurance cessions to the company. Likewise, from 2012, insurers in Gabon have been required to cede a percentage of their reinsurance cessions to Société Commerciale de Réassurance du Gabon (SCG-Re) (15% and 10% of all non-life and life contracts, respectively).

With the intention of retaining more insurance business on the sub-continent, regulators are expected to continue to introduce 'local content laws', requiring domestic (re)insurance capacity to be largely utilised before risks are placed externally. A.M. Best believes that the impracticality of this legislation has so far been demonstrated in Nigeria, where the (re)insurance sector has yet to reach the regulatory target of retaining 70% of the risks arising from the hydrocarbon industry, as per the Nigerian Oil and Gas Industry Content Development Act of 2010. A.M. Best estimates that only between 25% and 40% of the country's oil and gas business is being retained compared to the less than 5% prior to the 2010 legislation.

Despite the influx of new entrants into the reinsurance markets and regulatory influence in developing the (re)insurance sector, the capital positions of domestic reinsurers remain low. This factor, combined with the substantial shortage in the skilled workforce of the (re)insurance sector, means that the industry as a whole remains reliant on the international

markets to support its capacity needs, thereby restricting the sector's ability to retain more insurance premium. In particular, companies are in need of actuarial, risk management and specialised underwriting skills to support their development. The entrance of international investors, particularly those from the global (re)insurance markets, is therefore viewed positively, with their significant capital positions, technical expertise and substantial international experience supporting the domestic market in developing frameworks that mirror internationally renowned ones.

A noteworthy transaction undertaken in the past year was the partnership of Bermudian-domiciled Partner Re with the Moroccan-based insurer, MAMDA (Mutuelle Agricole Marocaine d'Assurance) and the French reinsurer, MCR (La Mutuelle Centrale de Réassurance) to establish MAMDA RE, a new reinsurance company targeting agricultural risk across Africa. Additionally, this year has seen Fairfax Financial Holdings and AXA S.A. each purchasing 7.15% shares in the Pan-African reinsurer, African Reinsurance Corporation (Africa Re).

Reinsurance Purchasing Trends

The market dynamics of the Sub-Saharan (re)insurance industry remains relatively unchanged, with the limited capacity of the sectors driving the demand for predominantly proportional treaty protections to support their underwriting. (Re)insurers undertake a low net risk retention strategy, with heavy reliance on the international reinsurance markets to support the underwriting of high-value risks, whilst benefiting from significant reinsurance commissions that supplement their earnings streams.

Risks are typically offered as a bouquet or a packaged treaty, whereby better quality business is often combined with weaker performing risks in order to service the market. This makes the pricing of these policies important in order to achieve the appropriate balance of profitability. As (re)insurers are growing their capital bases, they are increasing the level of risks retained (whilst in some markets moderately shifting towards non-proportional arrangements) in a bid to take a bigger share of larger insurable risks.

As a result of the industry's dependence on the global markets for reinsurance - either through the direct purchase of reinsurance by the insurer or the placement of retrocession covers by the domestic reinsurance segment - the international markets may well dictate the change in domestic companies' business strategies when global conditions harden, a situation that these players will need to be mindful of given their low net risk retention strategies.

Reinsurers Manoeuvre through the Difficult Operating Environments

According to Swiss Re's sigma report "World Insurance in 2014", the African insurance market is estimated to have contracted by 1.8% in nominal terms to USD 68.9 billion, although premium volumes increased by 1.6% in real (inflation-adjusted using local consumer price indices) terms. (See **Exhibit 26.**) This reflected the depreciation in a number of currencies during the year, particularly the South African rand, which fell at a much faster rate compared to the rise in inflation in the year. South Africa remains the main contributor, representing approximately 70% of the continent's premiums in 2014, with the country's premiums contracting (on a currency-adjusted basis) by 4.7% in nominal terms, although increasing by 1.0% in real terms. In local terms, premiums derived from South Africa increased by 7.1% nominally (1.0% real). The mature South African insurance market remains the most advanced on the sub-continent, ranking 18th in the worldwide market with premium volumes of USD 49.2 billion in 2014.

The year to date has seen several African currencies (including the South African rand, Nigerian naira and Ghanaian cedi) depreciate against hard currencies due to a combination of their difficult economic environments, poor fiscal and structural policies and the impact of reduced commodity

Exhibit 26

Sub-Saharan Africa – Key Insurance Market Data (2014)

Country	Premium volume 2014 (USD millions) Life	% Change 2014 nominal Life	% Change 2014 inflation adjusted Life	% Insurance Penetration Life	Worldwide Ranking Life
Angola	31	10.7	na.	0.0	88
Kenya	632	23.6	18.0	1.0	60
Mauritius	522	6.7	na.	4.1	61
Namibia	648	-2.1	na.	5.0	59
Nigeria	457	14.7	5.9	0.1	63
South Africa	39,785	-4.9	0.9	11.4	15
Country	**Premium volume 2014 (USD millions) Non-Life**	**% Change 2014 nominal Non-Life**	**% Change 2014 inflation adjusted Non-Life**	**% Insurance Penetration Non-Life**	**Worldwide Ranking Non-Life**
Angola	1,110	10.7	na.	0.8	63
Kenya	1,152	14.5	9.3	1.9	62
Mauritius	244	6.7	na.	1.9	88
Namibia	283	-2.1	na.	2.2	86
Nigeria	1,332	8.6	0.2	0.2	59
South Africa	9,375	-4.2	1.6	2.7	30
Country	**Premium volume 2014 (USD millions) Total**	**% Change 2014 nominal Total**	**% Change 2014 inflation adjusted Total**	**% Insurance Penetration Total**	**Worldwide Ranking Total**
Angola	1,142	10.7	na.	0.8	73
Kenya	1,784	17.6	12.3	2.9	62
Mauritius	766	6.7	na.	6.0	84
Namibia	931	-2.1	na.	7.2	79
Nigeria	1,790	10.1	1.6	0.3	61
South Africa	49,159	-4.7	1.0	14.0	18

Source: Swiss Re, sigma No4/2015

prices. For those reporting in foreign currencies (or consolidating results into larger international groups), the growth of top-line revenue and profits will likely have been materially affected by policies written in domestic currencies, owing to lower premium volumes arising from these contracts on a currency-adjusted basis. In 2014, Africa Re reported a USD 38 million reduction in comprehensive income for the year. This represented almost a third of post-tax profits and was due to exchange rate differences arising from the translation of foreign operations.

From an earnings perspective, a consequent rise in claims inflation, due to the weakening in local currencies and subsequent increase in the cost of imported assets (for example, spare parts for automobiles), will likely constrain growth in technical earnings should currency strengths continue to deteriorate.

Certain countries also faced challenges. For example, the South African market continued to be affected by low economic activity, fuelled by the ongoing industrial actions in the mining sector and weak demand of its trading partners, which together with high inflationary pressures, intense competition and increased frequency of large and weather-related events (amongst other things) sustained the weak performance of the non-life sector. Reinsurers continued to implement risk selection strategies and focus growth on niche segments in a bid to manoeuvre through the soft conditions, whilst balancing the need to maintain market share, to varying degrees of success.

Additionally, Nigeria (and other commodity-dependent economies) has been affected by the fall in oil prices. Renewals for large commercial risks during the first quarter of 2015 all but stalled, mainly due to the uncertain political environment arising from the presidential elections, coupled with the economic slowdown. Although positive market sentiment appears to have

returned following the formation of the new government in Nigeria, the anticipated decline in government revenues and subsequent spending cuts to follow, along with the depreciation in the value of the naira, are likely to constrain growth prospects for the industry in 2015.

In spite of some of the difficulties facing certain economies in Sub-Saharan Africa, the medium- to long-term prospects remain positive, underpinned by strengthening economies and the higher disposable incomes of rising middle class segments, as well as the improving demographics.

Protectionist Policies Intensify Competitive Conditions

Cross-border, and, in some cases, international expansion into other developing economies remains the strategy for most reinsurers on the sub-continent in their pursuit of greater diversification and critical mass. Competition is intensifying as (re)insurers, which compete in a small sector that consists of a large number of participants, are targeting the same risks, given the underinsured and underdeveloped characteristic of their markets. Additionally, competition from captive operations is increasing as overseas investors enter the market.

Typically, international (re)insurers utilise captive subsidiaries for the purpose of centralising their reinsurance needs for their group operations to obtain more cost-effective coverage. The entrance of these investors into the shareholding structures of African (re)insurers means that these organisations are able to repatriate premiums derived from their companies to their domiciles. At the same time, the (re)insurance industry continues to compete with large multinationals that maintain their captives for risk management purposes. Again, these captives derive premiums from Africa and place it into overseas reinsurance markets, reducing opportunities available to the open market.

As a result of these pressures, the implementation of protectionist policies is on the rise across the sub-continent, with the intention of retaining more insurance profits in their respective economies. This is resulting in the establishment of new entrants, further intensifying competitive conditions in an already capital-abundant environment.

In Kenya, the discovery of oil reserves is resulting in market participants working on establishing additional capacity and expertise in order to support revenues arising from associated infrastructure projects. In 2015, the majority state-owned reinsurer, Kenya Reinsurance Corporation Ltd. (Kenya Re), had its compulsory cessions increased to 20% from 18% and their duration extended to 2020. This measure has come after a number of years in which it appeared that the insurance sector would be phasing out mandatory cessions. Combined with other privileged positions of reinsurers in the region, the rise in compulsory cessions to Kenya Re means that only 65% of business is available to the competition.

Additionally, Ethiopia is noticeably in the process of liberalisation. The country has exhibited double-digit average growth in gross domestic product over the past 10 years, and this outset of liberalisation will likely lead to an influx of investors that seek to capitalise on the country's prospects. A proposal has been agreed to establish a national reinsurance company, to be initially capitalised with ETB 1 billion (approximately USD 50 million), for the purpose of enhancing the sector's capacity and solvency. It is not yet clear whether this reinsurer will benefit from compulsory cessions, but this remains highly probable given the trends of the various reinsurance markets across the sub-continent.

Supranational or regional reinsurers, some of which play an important role in the promotion and development of the (re)insurance industry across Sub-Saharan Africa, continue to create additional competitive pressures for local reinsurers seeking geographic expansion. Africa Re is entitled to 5% of treaty cessions derived from both insurers and reinsurers in each of its 36

member states, whilst Compagnie Commune de Réassurance des Etats membres de la CIMA (Conférence Interafricaine des Marchés d'Assurances) (CICA RE) is eligible to receive 15% of cessions derived from companies operating in the CIMA Zone, again limiting the business opportunities to the open market.

At the same time, regulators are playing their part in limiting regional reinsurers' participation in their respective markets. In Ghana, all foreign reinsurers utilised by the primary sector must be rated, although no minimum rating level is specified. Additionally, minimum capital requirements for reinsurers are being raised, thus easily reducing the number of foreign competitors establishing subsidiaries in their markets and, at the same time, improving the financial stability of their respective reinsurance sectors. Pools are also increasingly being utilised as an alternative means to retain business on the sub-continent. For example, in January 2015, the Nigerian Insurance Association established the Energy and Allied Risks Insurance Pool of Nigeria. Managed by Africa Re, the pool consists of 14 members and has capacity to underwrite USD 4 million of oil and energy risks. Despite the use of pooling arrangements to support underwriting on the continent, in reality the capacity that these pools offer remains small in comparison to the scale of many of the large risks underwritten.

Protectionist frameworks employed for the purpose of retaining profits on the sub-continent inhibit cross-border opportunities and dampen growth prospects as domestic participants are restricted in their ability to achieve sufficient scale, either due to the onerous requirements of local legislation or as a result of the reduced levels of business available. Policies like these continue to perpetuate the use of the international market to support Africa's underwriting capacity, as domestic players are unable to achieve the critical mass required to support the underwriting of larger risks.

Exhibit 27

Sub-Saharan Africa Reinsurance – A.M. Best Rated Companies

Ratings as of August 14, 2015.

Domicile	Company Name	AMB #	Best's Financial Strength Rating (FSR)	Best's Long-Term Issuer Credit Rating (ICR)	Best's FSR & ICR Outlook / Implications	FSR & ICR Rating Action	Rating Effective Date
Nigeria	African Reinsurance Corporation	083411	A-	a-	Positive	Affirmed	19-Jun-15
Nigeria	Continental Reinsurance Plc	078723	B+	bbb-	Stable	Affirmed	07-Aug-15
Kenya	East Africa Reinsurance Company Limited	077803	B	bb+	Stable	Affirmed	13-Nov-14
South Africa	General Reinsurance Africa Ltd	086651	A++	aa+	Stable	Affirmed	17-Jun-14
Ghana	Ghana Reinsurance Company Limited	090035	B	bb	Stable[1]	Affirmed	12-Dec-14
Kenya	Kenya Reinsurance Corporation Limited	085416	B+	bbb-	Stable	Affirmed	19-Dec-14
Kenya	ZEP-RE (PTA Reinsurance Company)	078388	B+	bbb-	Stable	Affirmed	05-Dec-14

Notes:1: FSR: Stable and ICR: Positive

Source: *– Best's Statement File - Global*

U.S. Life Reinsurers Adjust to Consolidating Market

Ongoing consolidation in the U.S. life reinsurance arena has resulted in a market dominated by a few large players seeking new business opportunities in a low-growth domestic life market, exacerbated by low cession rates. While the market had historically been dominated by large players, completed acquisitions over the past several years has more clearly segmented the market into larger versus smaller players. With the backing of SCOR SE (Paris, France), SCOR Global Life Re (USA), which had been a marginal player, acquired two major properties--Transamerica Re in 2011 and Generali USA Life Reassurance Company in 2013, vaulting it into a leadership position in the U.S. life reinsurance market. Such acquisition activity is driven by the need for organic growth, which has been challenged by higher retention rates by direct writers, alternative solutions for redundant reserve financing and lackluster growth in the traditional life insurance market. Additionally, reinsurance pricing for commodity products such as term was viewed as highly favorable, creating pricing arbitrage opportunities for direct writers. Prices have since rationalized, and have contributed to lower cession rates in a meaningful way.

Following SCOR's acquisitions, A.M. Best does not expect any meaningful further consolidation of life reinsurers over the near- to medium-term as the top five reinsurers now account for more than four-fifths of total reinsurance volume. While counterparty concentration is now more of a concern for direct writers, and new entrants may be welcomed, the life reinsurance market presents significant barriers to entry. While fresh capital has entered the reinsurance space, new entrants have focused primarily on annuity reinsurance and annuity block acquisitions, and there have not been any meaningful new entrants into the life mortality space in a number of years.

Traditional life reinsurers are focused on their core life insurance underwriting capabilities and generally accept less interest-sensitive business than direct writers. RGA however, may have a different strategy, as it has accepted a fair amount of annuity business, while selling some older books of lower return mortality business. While all companies are feeling the impact of the extended low interest rate environment, life reinsurers' earnings are driven by mortality results—which have been favorable—and are less reliant on investment income than traditional writers. As a result, life reinsurers are less pressured for investment yield relative to direct writers, although certainly not immune from its impact, and their balance sheets are generally more conservative. Notwithstanding stable earnings, the extended low interest rate environment is pressuring life reinsurers to increase or at least maintain yield.

The lack of strong organic market growth reflects, in part, the long-term trend of lower cession rates. A.M. Best estimates cession rates to be in the mid-20% percent range. This compares to rates as high as 60% a decade ago. It's important to note that the current level of cession rates is more of the historical normalized run rate. However, reinsurance companies were enjoying the high cession rates and have had to adjust to the "new reality". One factor that has driven these rates lower is the availability of alternative collateral to back reinsurance for redundant reserves with the use of affiliated captives. While bank letters of credit had been the more common form of collateral, A.M. Best notes the increased use of internal surplus notes and reinsurer-backed credit-enhanced notes. These notes have become more common in recent Regulation XXX reserve financing structures. In addition, some states allow for GAAP reporting for captives, thus lowering reserves that need to be financed.

Actuarial Guideline 48 is setting new rules as to the level of reserves that need to be collateralized with hard assets when ceding business to captives. As companies adjust their balance sheets to the new rules, the amount of redundant reserves financed will likely be reduced, thus presenting an additional headwind to reinsurers that provide collateral support.

Deal Pipeline Robust

In addition to traditional life mortality cover, a number of life reinsurers actively pursue block acquisitions (sometimes referred to as admin reinsurance). Currently, the longer-term market opportunity for block acquisitions for both life and annuity business is highly favorable. This is driven by the sheer number of U.S. life insurance companies that have subscale businesses. Such companies are challenged to grow in a meaningful way, reach new markets or earn acceptable returns, and are looking to unlock trapped capital. In addition, the low interest rate environment is pressuring annuity returns and many smaller- to medium-sized companies are unable or unwilling to take on additional investment risk to earn an acceptable return. As a result, many of these companies, over time, will likely be seeking a full exit or disposal of non-core businesses in order to release capital to deploy elsewhere. Finally, global regulatory uncertainty has led some larger insurers to dispose of business segments seen as volatile or capital-intensive.

While supply is robust and ought to bode well for reinsurers with an appetite for portfolio or whole company acquisitions, competition for business has heated up. There is an unprecedented supply of fresh capital, much of which is backed either by private equity or private investors.

Aggregators such as Apollo Global Management LLC and Guggenheim Partners LLC are clearly focused on asset accumulation and have made serious inroads into the annuity space. Both companies now have meaningful market shares in the traditional and fixed indexed annuity market. Other players include Wilton Re and Global Atlantic Financial Group Limited, which has been active in the acquisition arena since separating from Goldman Sachs, including its purchase of Forethought Life Insurance Company and Accordia Life (the former Aviva USA life division).

Moreover, A.M. Best notes Resolution Life's launch into the U.S. through Lincoln Benefit Life, which purchased a large block of life and annuity business from Allstate Life Insurance Company. Wilton Re completed two major domestic life company acquisitions in 2014 — Conseco Life Insurance Company and Continental Assurance Company — and closed on the purchase of Transamerica Life Canada in August 2015. In addition, Wilton Re has gained access to additional capital resources reflecting its new ownership by Toronto-based Canada Pension Plan Investment Board (CPPIB). Direct writers have also been involved in reinsurance activity. Two notable deals announced in 2014 involved acquisitions by two large mutual companies. Reinsurance Group of America Inc. (RGA) retroceded a block of U.S. individual life business to the retrocession operations of Pacific Life Insurance Company. In July 2015, New York Life completed the previously announced acquisition, through reinsurance, of a net 60% interest in John Hancock Financial's closed individual life insurance block.

Given the spike in acquisition activity funded by alternative capital sources, A.M. Best believes certain traditional reinsurers that have historically looked for acquisitions to complement more traditional reinsurance flows will face strong competition, and thus complete fewer deals than historical trends. This may translate into a heightened focus on traditional reinsurance business, more tailored client financial solutions and other value-added services.

While challenges to growth are not likely to abate anytime soon, there are some opportunities as well. International expansion represents an area that is quite viable in terms of added growth potential. RGA, the only U.S.-based life reinsurer among the Top 5, already reports one-third of its net premium income outside of North America. Longevity business, including pension risk transfer deals, represents another area offering growth potential and is well-suited for reinsurers given their expertise in pricing mortality.

Finally, progress continues in the review of collateral requirements for unauthorized reinsurers approved by states as certified reinsurers that are domiciled in qualified jurisdictions. Bermuda, Germany, Switzerland and the United Kingdom are currently conditionally deemed qualified jurisdictions by the NAIC. The ability to post reduced collateral would be a positive for those approved reinsurers.

Appendix 1

Global Reinsurance Market - US/Bermuda, European "Big 4" and Lloyd's

Trend Summary

USD in billions

	5-Yr Avg	1H 2015*	2014	2013	2012	2011	2010
NPW (Non-Life only)	145.1	62.0	156.1	158.0	146.6	137.0	128.0
Net Earned Premiums (Non-Life only)	141.6	59.6	152.5	151.5	143.7	133.4	126.7
Net Investment Income	25.6	11.1	25.2	25.3	27.3	26.0	24.3
Realized Investment Gains / (Losses)	6.7	3.8	11.3	1.3	7.6	2.4	10.6
Total Revenue	**239.0**	**101.2**	**240.2**	**250.3**	**250.4**	**226.4**	**227.9**
Net Income	**20.9**	**10.8**	**25.7**	**28.5**	**24.9**	**4.9**	**20.3**
Shareholders' Equity (End of Period)	212.2	194.3	235.3	218.9	218.4	194.3	193.9
Loss Ratio	62.7%	58.8%	56.4%	56.5%	60.7%	76.1%	63.8%
Expense Ratio	31.9%	32.0%	33.1%	32.2%	31.3%	31.3%	31.6%
Combined Ratio	94.6%	90.8%	89.5%	88.6%	92.0%	107.4%	95.4%
Favorable Loss Reserve Development	-5.7%	-4.1%	-5.3%	-5.7%	-6.1%	-6.3%	-4.9%
Net Investment Ratio[1]	18.2%	18.7%	16.5%	16.7%	19.0%	19.5%	19.2%
Operating Ratio	76.4%	72.1%	73.0%	71.9%	72.9%	87.9%	76.2%
Return on Equity (annualized)	9.9%	11.3%	11.4%	13.1%	12.1%	2.5%	10.6%
Return on Revenue (annualized)	8.6%	10.6%	10.7%	11.4%	9.9%	2.2%	8.9%
NPW (Non-Life only/annualized) to Equity (End of Period)	68.4%	63.8%	66.3%	72.2%	67.1%	70.5%	66.0%
Net Reserves to Equity (End of Period)	272.2%	255.5%	237.1%	268.4%	264.2%	298.4%	292.8%
Gross Reserves to Equity (End of Period)	300.6%	277.4%	260.3%	296.0%	293.5%	326.6%	326.6%

[1] Net Investment Ratio based on Non-Life NPE

*1H 2015 data excludes Lloyd's

Note: "Big 4" includes Munich Re, Swiss Re, Hannover Re and SCOR.

Source: A.M. Best data and research

Appendix 2

U.S. & Bermuda Reinsurance Market

Trend Summary

USD in billions

	5-Yr Avg	1H 2015	2014	2013	2012	2011	2010
NPW (Non-Life only)	57.5	34.8	63.6	59.8	56.7	55.0	52.6
Net Earned Premiums (Non-Life only)	56.1	30.5	61.7	56.6	55.5	54.4	52.4
Net Investment Income	7.4	3.2	7.3	6.8	7.1	7.6	8.1
Realized Investment Gains / (Losses)	1.4	0.2	1.0	1.4	2.2	(0.1)	2.2
Total Revenue	**68.4**	**35.9**	**73.6**	**69.6**	**68.6**	**64.6**	**65.7**
Net Income	**9.2**	**5.5**	**11.6**	**12.1**	**10.1**	**0.9**	**11.2**
Shareholders' Equity (End of Period)	100.5	110.9	110.4	101.4	101.7	93.7	95.1
Loss Ratio	62.6%	56.2%	54.9%	55.3%	63.4%	77.3%	61.8%
Expense Ratio	30.9%	32.4%	32.6%	31.4%	29.8%	30.0%	30.9%
Combined Ratio	93.5%	88.6%	87.5%	86.7%	93.1%	107.3%	92.7%
Favorable Loss Reserve Development	-6.0%	-5.7%	-5.8%	-6.5%	-5.8%	-6.0%	-6.2%
Net Investment Ratio[1]	13.2%	10.6%	11.8%	12.0%	12.7%	14.0%	15.4%
Operating Ratio	80.3%	78.0%	75.7%	74.7%	80.4%	93.3%	77.3%
Return on Equity (annualized)	9.2%	9.9%	10.6%	12.1%	10.6%	1.0%	11.9%
Return on Revenue (annualized)	13.3%	15.2%	15.7%	17.4%	14.8%	1.5%	17.1%
NPW (Non-Life only/annualized) to Equity (End of Period)	57.3%	62.7%	57.6%	59.0%	55.7%	58.7%	55.3%
Net Reserves to Equity (End of Period)	127.6%	119.4%	116.8%	125.6%	130.3%	137.5%	127.9%
Gross Reserves to Equity (End of Period)	154.6%	143.0%	138.2%	150.4%	157.7%	168.9%	158.0%

[1] Net Investment Ratio based on Non-Life NPE

Source: A.M. Best data and research

Appendix 3
European "Big 4"
Trend Summary
USD in billions

	5-Yr Avg	1H 2015	2014	2013	2012	2011	2010
NPW (Non-Life only)	57.3	27.2	61.4	64.8	58.5	53.4	48.1
Net Earned Premiums (Non-Life only)	55.9	29.1	60.4	62.4	58.1	51.0	47.8
Net Investment Income	16.7	7.9	16.3	17.1	18.6	17.0	14.3
Realized Investment Gains / (Losses)	5.3	3.6	10.1	0.4	5.2	2.4	8.3
Total Revenue	**139.2**	**65.3**	**134.6**	**147.2**	**149.4**	**132.3**	**132.7**
Net Income	**8.2**	**5.3**	**9.3**	**11.1**	**10.2**	**4.7**	**5.7**
Shareholders' Equity (End of Period)	80.4	83.4	89.9	83.9	85.0	72.4	70.7
Loss Ratio	66.2%	61.5%	61.7%	61.6%	61.6%	77.5%	68.8%
Expense Ratio	29.9%	31.7%	30.7%	29.8%	29.7%	29.5%	30.0%
Combined Ratio	96.2%	93.2%	92.4%	91.4%	91.3%	107.0%	98.8%
Favorable Loss Reserve Development	-4.5%	-2.4%	-3.3%	-3.7%	-5.8%	-6.5%	-3.1%
Net Investment Ratio[1]	30.0%	27.2%	27.0%	27.5%	32.1%	33.3%	29.9%
Operating Ratio	66.2%	66.0%	65.3%	63.9%	59.2%	73.7%	68.9%
Return on Equity (annualized)	10.4%	13.2%	11.0%	13.1%	13.0%	6.6%	8.3%
Return on Revenue (annualized)	5.8%	8.1%	6.9%	7.5%	6.8%	3.6%	4.3%
NPW (Non-Life only/annualized) to Equity (End of Period)	71.3%	65.2%	68.4%	77.3%	68.8%	73.8%	68.1%
Net Reserves to Equity (End of Period)	502.9%	436.5%	426.9%	492.7%	467.0%	557.1%	571.0%
Gross Reserves to Equity (End of Period)	524.9%	456.2%	446.0%	515.9%	489.1%	569.5%	604.0%

[1] Net Investment Ratio based on Non-Life NPE
Source: A.M. Best data and research

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