



RENEWAL RETROSPECTIVE

IN THE BALANCE



CONTENTS

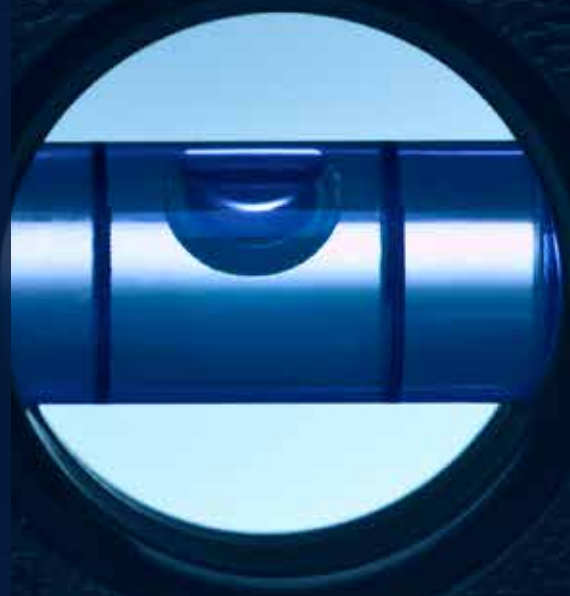
EXECUTIVE SUMMARY
IN THE BALANCE 3

2017 REINSURANCE
RENEWAL 5

OUTLOOK FOR 2017
WEIGHING THE FACTORS 19

At **JLT Re**, our trusted team combines market-leading expertise and proprietary analytical tools with the freedom to challenge conventions. We create new insights and explore innovative capital solutions tailored to meet client needs.

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WE DELIVER RESULTS**



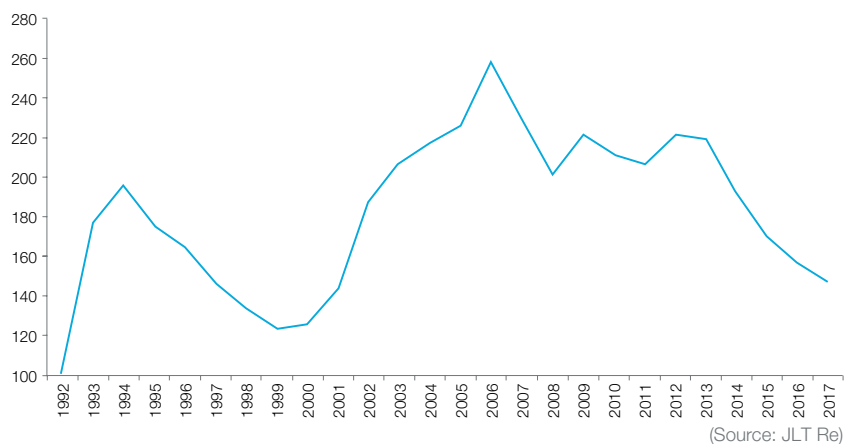
EXECUTIVE SUMMARY: IN THE BALANCE

A degree of balance was restored to the reinsurance market at the 1 January 2017 renewal, as later completions and evidence of further price stabilisation defined outcomes for many lines of business and regions. Whilst renewals twelve months ago were bifurcated between the United States, where single-digit pricing declines were the norm, and the rest of the world, where double-digit falls were not uncommon, there was a broader trend towards moderating price declines in 2017. As a result, programmes across a number of different territories and lines of business generally renewed closer to expiring levels, although some continued to experience more significant downward pricing pressures.

Figure 1 shows that JLT Re's Risk-Adjusted Global Property-Catastrophe Reinsurance Rate-on-Line (ROL) Index fell by 5.7% at 1 January 2017¹. This compares to a decline of 8.2% at 1 January 2016, 11% in 2015 and 12% in 2014. Much of the moderation was driven by relatively stable US property-catastrophe renewals. More marked pricing declines were registered for most international property-catastrophe business, but the magnitude of these reductions was typically less than those of last year.

The moderating trend at 1 January 2017 is related to today's historically low pricing levels. Indeed, global property-catastrophe pricing is now 33% below 2013 levels and approaching the previous cyclical low of the late 1990s. It is becoming clearer that the scope for further price reductions is limited for some classes of business as rates near technical

Figure 1: JLT Re's Risk-Adjusted Global Property-Catastrophe ROL Index – 1992 to 2017



minimums, i.e. the point where expected returns on capital fall below costs of capital.

Increased underwriting discipline was likewise evident across non-catastrophe lines, which also exhibited moderating rate reductions at 1 January 2017. Rates for most casualty

and healthcare classes ranged from flat to moderately down. Specialty classes once again generally saw more substantial rate reductions. Nevertheless, rate declines in certain specialty lines saw moderations compared to last year.

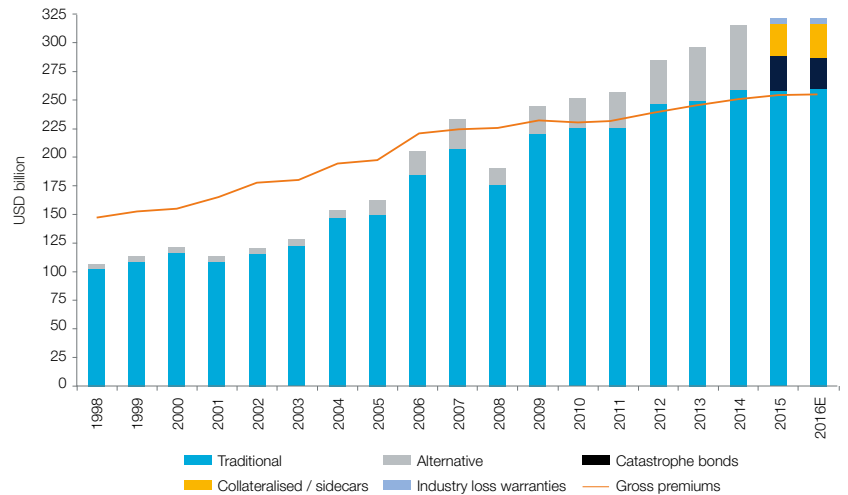
¹ JLT Re's ROL index is *risk-adjusted*, meaning changes in the index reflect variations in exposures as well as premiums.

MARKET DRIVERS

It is therefore clear that the challenging operating environment confronting reinsurers is starting to have a discernible impact as they face the reality of deteriorating results and margin compression. Five other key market dynamics contributed to further price stabilisation at 1 January 2017:

1. Static levels of reinsurance supply (after rapid growth between 2011 and 2014) due to a marked slowdown in the rate of third-party capital entry in particular.
2. Growing demand for reinsurance as cedents recognised that current pricing levels presented opportunities to support growth goals, decrease costs of capital and increase franchise value.
3. Increased loss experiences in 2016, with an uptick in attritional claims and global catastrophe losses (at approximately USD 50 billion) returning to levels closer to historical norms.
4. Growing reserving volatility, with some notable instances of reserve strengthening and evidence that the level of redundancies held by carriers is diminishing.

Figure 2: Dedicated Reinsurance Sector Capital and Gross Written Premiums – 1998 to YE 2016 (Provisional)



(Source: JLT Re)

5. A changing macroeconomic environment, including rising inflation expectations in the US, the UK, parts of Europe and some emerging economies, which could compound reserving risks due to higher claims inflation.

However, these factors continue to be offset by near-record levels of dedicated reinsurance sector capital (see Figure 2). Although 2016 was the first year since 2008 in which dedicated reinsurance capital did not grow meaningfully, it is nevertheless

notable that the sector remains over-capitalised. At the end of 2016, JLT Re estimated sector capital to be approximately USD 320 billion (compared to premiums of USD 255 billion). The result is a continued supply and demand imbalance and a market awash with capacity. This abundance of capacity is preventing any meaningful pricing upturn at present.

2017 REINSURANCE RENEWALS

Figure 3: Loss-Free Rate Movements by Line of Business at 1 January 2017²

PROPERTY & CASUALTY

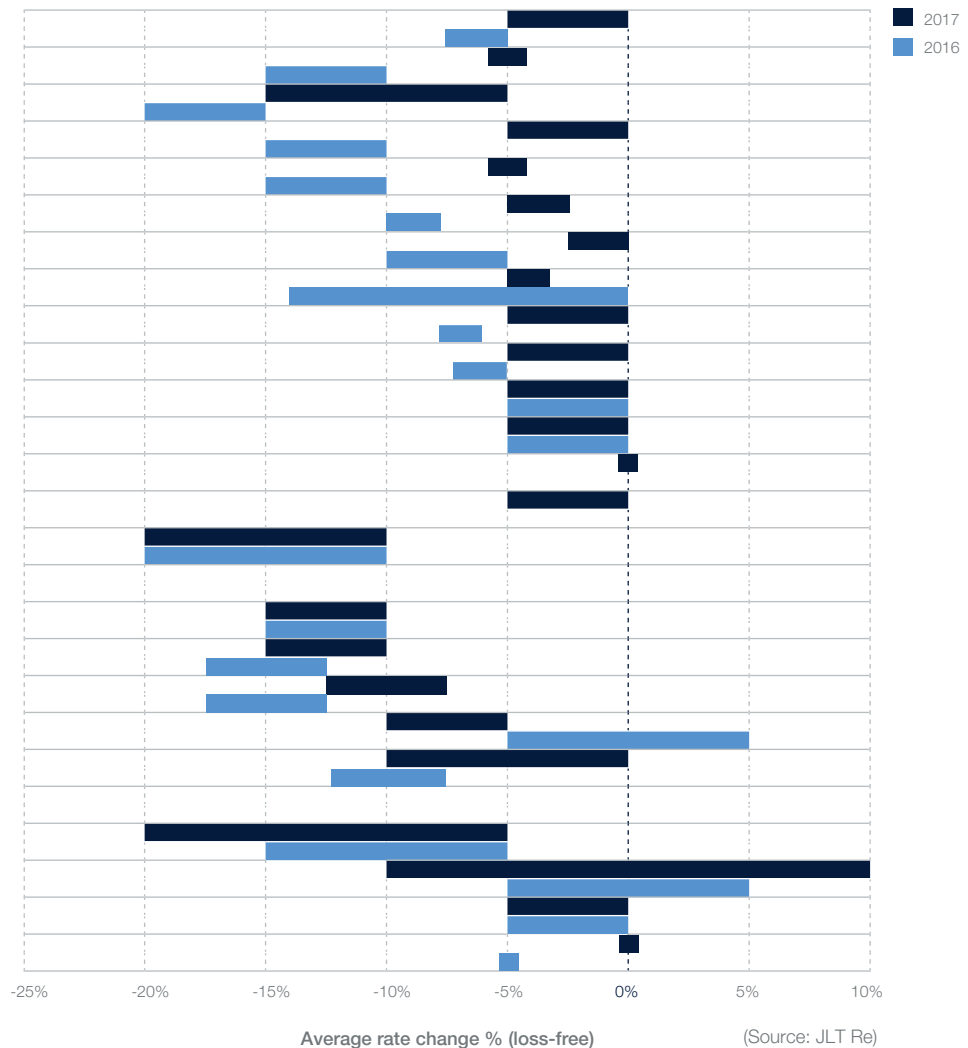
US Property-Cat
 Western Europe Property-Cat
 Asia Pacific Property-Cat
 Middle East Property-Cat
 London Market Global Property
 Retrocession Property-Cat
 Industry Loss Warranties
 US Public Entity
 US Workers' Compensation
 London Market Casualty
 Western Europe GTPL
 Western Europe Motor
 Middle East Motor
 Middle East Engineering
 Global Facultative*

SPECIALTY

Aviation
 Marine & Energy
 Terrorism
 Cyber
 Asia Pacific Agriculture

HEALTHCARE

Accident & Health Catastrophe
 Medical Benefits Per Person
 North America Med Mal (Treaty)
 Australia Med Mal (Treaty)



²Please note that the figures provided in Figure 3 are averages and significant variability exists in individual programmes.

* Rate changes for Global Facultative apply to full year 2016 (light blue) and early 2017 (dark blue).

PROPERTY & CASUALTY (P&C)

US PROPERTY-CATASTROPHE

- Reinsurance rate declines for US property-catastrophe business continued to slow at the 1 January 2017 renewal as pricing fell less sharply compared to the corresponding renewal in 2016.
- Several cedents had losses from Hurricane Matthew which impacted the first (and occasionally second) layers, but this did not have a major impact on pricing for 2017 programmes. Non-loss-affected layers mostly saw moderate rate reductions, whilst pricing generally held firm for loss-affected layers without registering significant price increases.
- Specifically, pricing for loss-free property-catastrophe excess of loss (XoL) programmes typically ranged between flat and down 5% on a risk-adjusted basis at 1 January 2017. It should be noted that this range represents an average across a varied portfolio and individual programmes saw significant variances as historical performance and terms and conditions influenced renewals.
- Modest wind losses hit a number of catastrophe programmes that renewed at 1 January 2017, with lower layers mostly affected. On average, risk-adjusted pricing for these loss-affected layers was flat with no major increases.
- Capacity was more than sufficient, with supply exceeding demand, even in peak zones. This reflected the significant increase in capacity at 1 January 2017, particularly in Lloyd's as a number of new players entered the market.
- Nevertheless, there was also a marked increase in demand, with several cedents purchasing new top layers to take advantage of historically low pricing levels. Proposed changes to A.M. Best's Capital Adequacy Ratio (BCAR) also positively impacted demand at 1 January 2017.
- Terms and conditions were generally stable, with cedents mostly focused on getting the best possible prices. That said, there was increased utilisation of multi-year deals as several markets accommodated cedents' requests by offering more multi-year capacity.

WESTERN EUROPE P&C

- The Western European reinsurance market continued to experience some softening across most lines of business at 1 January 2017. Capacity levels were stable but remained plentiful.
- As a result, pricing for loss-free property-catastrophe programmes fell by an average of 5% on a risk-adjusted basis, a moderated decline compared to last year's fall of 10% to 15%. This was mainly due to some markets suffering losses in 2016, with significant flooding in France and Germany and a costly hailstorm in the Netherlands.
- Renewals for other lines, including motor and general third-party liability (GTPL), were very much dependent on historical performance. Renewals typically ranged from flat to down 5% for these lines of business at 1 January 2017.
- For proportional business, ceding commissions were generally stable. Again, historical performance was the key driver here.

MIDDLE EAST P&C

- The Middle East P&C market has been highly competitive in recent years, characterised by ample capacity and consequential downward pressure on rates. Although this has prompted some large reinsurers to withdraw from the market due to stressed profit margins, they have been replaced by smaller regional players.
- Loss activity in 2015/16, especially in the property space with several large payouts for hotel and apartment blocks fires and medium-sized windstorm and flood events in Abu Dhabi and Dubai, mitigated the competitive environment for certain Middle East P&C lines at 1 January 2017.
- Loss-free XoL property-catastrophe programmes saw risk-adjusted pricing fall within a range of flat to down 5% at 1 January 2017. Pricing for loss-free per risk XoL programmes saw reductions of between 5% and 10%.
- Given the elevated losses of 2015/16, loss-affected property programmes typically renewed flat or with moderate price increases of approximately 5% on a risk-adjusted basis.
- Loss-free engineering accounts typically renewed as expiring, reflecting reduced building activity across the region, whilst continued overcapacity in the energy space and comparatively low levels of oil production saw pricing fall by between 10% and 20%.
- In an effort to address poor technical results for motor business, regulators in Saudi Arabia and United Arab Emirates have imposed minimum deductibles and rates in both countries. Increased regulatory action is spreading across the region, with new standards set to be imposed in the property and motors arenas in particular. This is likely to result in rate increases in 2017 and beyond.
- Ceding commissions saw modest changes at 1 January 2017, with some instances of reductions for property and motor casualty programmes in particular. There was also a significant shift from fixed commissions towards sliding scales, and some reinsurers attempted to introduce loss ratio corridors. With pro rata proving to be more difficult to place for some lines of business and certain cedent programmes, more business transitioned to XoL. In addition, profit commissions saw decreases in certain instances.
- Capacity remains plentiful and was relatively stable at 1 January 2017. That said, certain well-rated reinsurers looked to move into new product lines such as cyber, aviation and freight in order to unlock new growth opportunities. Demand for coverage continues to increase across the region.



ASIA PACIFIC PROPERTY-CATASTROPHE

- Pricing for loss-free XoL property-catastrophe programmes fell across the Asia Pacific region at 1 January 2017 for both marine and non-marine business. ROLs were down by an average of between 10% and 15% in most South East Asian countries, with some accounts able to negotiate higher discounts (although these were the exception rather than the rule). There was less downward pricing pressure in China, however, as only small savings were on offer for loss-free (and loss-affected) XoL treaties.
- There were few major natural catastrophes in Asia during 2016, with a powerful earthquake in Taiwan one of the few events to cause meaningful losses. Whilst loss-affected layers in Taiwan saw moderate price increases (in the region of 5%), strong competition across the region typically mitigated the impact of other catastrophe losses in 2016, resulting in loss-affected programmes renewing flat to down 5%. Some markets attempted to raise priorities slightly, but with little effect as an abundance of capacity remained available.
- Most markets in Asia Pacific saw ceding commissions rise by up to 2.5% at 1 January 2017. More marginal increases (in the order of 1% to 2%) were recorded in China, although some reinsurers are becoming increasingly cautious about proportional treaties here due to negligible margins.
- The market softening that transpired at 1 January 2017 was not unexpected, as similar reductions were recorded during the 1 October renewals last year.
- New capacity continues to enter the Asia Pacific market as reinsurers look to strengthen their presence in the region in anticipation of any market upturn. The huge volume of ceded premium (in China especially) also remains valuable to markets looking to boost their top-line performance. Chinese capital is a major feature of this new capacity as it continues to pour into the market.



LONDON MARKET GLOBAL PROPERTY

- The direct and facultative (D&F) market continued to experience some softening at 1 January 2017, albeit at more moderate levels compared to the corresponding renewal in 2016.
- Loss-free D&F property programmes typically saw pricing fall by between 4% and 6% on a risk-adjusted basis in 2017. Long-term relationships were often seen to be an important factor in the renewal, with markets willing to make concessions in order to safeguard profitable and long-standing business.
- Any changes to premium incomes, risk exposures, loss experiences and the structure of programmes were key to the outcome of renewals in 2017. First layer retentions generally remained unchanged where exposures were flat. The trend for increased self-retention levels witnessed last year slowed. Markets tended to unite in pushing back on discounts considered to be excessive. Budget spend was a key driver in most cedents' buying appetite.
- Despite an increase in costly catastrophe losses in 2016 (including Hurricane Matthew, wildfires in Canada, severe weather events in the US and earthquakes in Japan and New Zealand), these losses sat below attachment points for most D&F programmes.
- D&F risk excess business saw some loss activity in lower layers in 2016 due to events such as the Gap warehouse fire in the US. Rates at 1 January 2017 were consequently very much experience driven for first layers. Concessions were seen on loss-free middle layers, and top-layer pricing was considered to be at, or close to, minimum ROL levels by most markets.
- Traditional reinsurers made every effort to be as flexible as possible with a less rigidly model-driven approach in response to the sustained competition from alternative markets witnessed in recent years. Given that pricing levels between traditional and collateralised markets continued to be closely aligned, efforts to accommodate individual client needs by traditional reinsurers often proved to be crucial in securing placements as cedents continue to value the long-term relationships with their core markets.
- Capacity levels remain plentiful in the D&F market when pricing levels are considered to be adequate.



RETROCESSION

- Pricing for loss-free worldwide property-catastrophe retrocession programmes typically fell by between 2.5% and 5% on a risk-adjusted basis at 1 January 2017. Territory-specific covers, especially those outside the United States, saw reductions in the order of 5% to 7.5%.
- Although catastrophes such as the Fort McMurray wildfires and Hurricane Matthew caused significant losses in 2016, their impact on most retrocession programmes was limited.
- There was continued pressure from cedents to raise ceding commissions for pro rata treaty placements at 1 January 2017, and some increases were agreed.
- Some cedents looked to purchase more occurrence coverage with one reinstatement (at the expense of aggregate cover) during the renewal process. Motivations behind this strategy included the desire to diversify reinsurer panels (by reducing reliance on collateralised markets and using more rated carriers) and securing adequate cover by reducing vulnerabilities to a large second event with a post-loss reinstatement.

INDUSTRY LOSS WARRANTIES

- Although there were very few new major purchases of industry loss warranties (ILWs) at 1 January 2017, a number of sizeable renewals took place.
- Pricing for US earthquake and nationwide wind exposures ranged from flat to down 2.5%. Stable capacity contributed to the outcome, although certain insurance-linked securities (ILS) funds shifted some capacity away from catastrophe bonds to ILWs as catastrophe bond spreads become more challenging.
- Catastrophe modelling changes due in 2017 for US earthquake risks prevented any meaningful price reduction for earthquake exposures at renewal.
- There was also strong reinsurer resistance to any cedents' attempts to negotiate price discounts of more than 5%.

US PUBLIC ENTITY

- The US public entity market continued to experience some softening at 1 January 2017, with most cedents able to achieve further improvements to their reinsurance programmes.
- Loss-free XoL programmes for property and liability business typically saw risk-adjusted pricing range from down 3% to down 5% at 1 January 2017.
- Loss-affected programmes saw limited upward pricing pressure, as liability and property programmes typically renewed flat.
- Ceding commissions were also generally flat at 1 January 2017.
- Capacity was mostly stable at renewal, although less was available for transit business this year. Overall, drops in investment incomes and stable reserve development resulted in overall surplus levels of public entity pools staying relatively flat.

US WORKERS' COMPENSATION

- For loss-free workers' compensation (WC) programmes renewing at 1 January 2017, pricing for working layers ranged from flat to down 5% on a risk-adjusted basis whilst WC catastrophe layers typically saw rate reductions of approximately 5%. However, development on some larger per person claimants, whilst still not penetrating reinsurance layers, caused price adjustments on lower working layers of up to 5% without affecting higher working layers or catastrophe layers.
- Rate changes for loss-free working layers were very much driven by company experience, including losses and exposure changes, rather than external market forces.
- Recent WC loss activity has generally been contained within working layers and pricing for any loss-affected programmes at 1 January 2017 was likewise mostly influenced by company experience.
- Ceding commissions for proportional business were typically flat at 1 January 2017. This actually represented a favourable outcome for buyers, given that underlying rates and loss costs have fallen.
- WC capacity continued to be abundant at renewal. Looking ahead, capacity is expected to remain relatively stable, although a few new market entrants could boost per person and WC catastrophe capacity in 2017.
- Buying behaviours remained generally unchanged at 1 January 2017 despite the market's willingness to offer more favourable terms that could be used as a hedge against continuing underlying pricing deterioration and/or reserve pressures.
- There was an overall trend of loosening terms and conditions at 1 January 2017 that was both demand and supply driven. This included increased Maximum Any One Life (MAOL) provisions, expanded hours clauses and discussions about other coverages that are normally covered elsewhere, including clash, extra-contractual obligations (ECO), excess of policy limits (XPL) and cyber. The take-up rate for nuclear, biological, chemical and radiological (NBCR) terrorism coverage also continued to rise.

LONDON MARKET CASUALTY

- Renewals for London Market Casualty business at 1 January 2017 were completed at a relatively late stage due to a number of factors.
- Firstly, reinsurers expressed growing concerns around material adverse loss development on accounts which have historically received credit for their experience. To compound the issue, some meaningful losses materialised on the 2015 and 2016 years of account.
- Secondly, cedents were slow to provide firm order terms as there was a large disconnect between what buyers felt were satisfactory quotes and what reinsurers were prepared to offer. Recent notifications put considerable pressure on immature programmes at 1 January 2017, particularly those that had previously benefited from heavy experience discounts. As a result, markets took tailored approaches to each programme. Three key overriding themes emerged from this strategy:
 1. Cedents were able to achieve rate reductions if they were able to show that exposure was down (as opposed to reduced rates) whilst also having favourable loss records.
 2. For accounts that were shown to be stable, the result was generally flat to moderate reductions in pricing.
 3. Accounts that experienced losses and/or significant deterioration to back-years were subjected to upward pricing pressure. However, whilst reinsurers were looking to push through increases of between 15% and 30%, these expectations were not always met – a range of up 5% to up 10% was more typical.

GLOBAL FACULTATIVE

- The global facultative market continued to experience significant softening across most lines of business in 2016, as an abundance of capacity was available.
- Rates consequently fell by between 10% and 20% on average for property, terrorism, construction and casualty placements, with renewals very much dependent on industry and loss records. For example, rates were relatively stable for power accounts that sustained losses, as capacity for such business was more limited.
- Market capacity is expected to grow through 2017, with new syndicates due to launch and existing syndicates increasing their capacity (some by double). This is likely to bring more surplus capacity, thereby ensuring that the soft market environment continues.
- Overall, there was high demand for facultative cover in 2016, particularly in areas where cedents sought to reduce exposures (including mining, power and oil and gas). This trend is expected to continue into 2017. Indeed, the soft market environment is likely to encourage additional arbitraging through the shrewd use of surplus capacity on a facultative basis.
- That said, carriers looking to build more effective treaty programmes and assume lower net retentions are likely to pull back in buying facultative cover unless the deal is exceptionally competitive.
- The main obstacle in 2016 was the overcapacity on upfront programmes, often leading to upfront cedent markets being signed back or in many instances failing to get an order at all. As a result, facultative placements were regularly dropped at the eleventh hour.
- The key overriding trends outlined here are expected to continue into 2017. In addition, the consolidation and rationalisation of teams and/or capacity in 2016, following high-profile acquisitions in 2015 (for example, XL Catlin and AS Amlin), look set to be maintained in 2017 given recent M&A activity involving AmTrust and ANV, Liberty and Ironshore, Sompo and Endurance and Fairfax and Allied World Assurance Company.



STRUCTURED REINSURANCE

The structured reinsurance market is split into two main types of transactions: prospective cover (protection for future underwriting) and retroactive cover (protection for existing reserves).

PROSPECTIVE MARKET

- Capacity in the prospective market increased in 2016. The distinction between traditional and structured markets continued to be blurred as an increasing number of traditional players offered capacity on a multi-line and multi-year basis (which is traditionally the domain of structured markets).
- 2016 saw increased demand from cedents, with many looking at whole account covers or seeking to retain portions of outward placements in order to protect them in a more efficient manner.
- The increase in demand reflects the fact that a number of cedents now view reinsurance as a capital optimisation tool, with an increasing focus on products that deliver corporate risk tolerance targets whilst also maximising capital relief. It is also driven by pressure on companies to deliver profitable growth in a market that continues to soften.
- Although prospective placements are difficult to compare, given that they are tailored to each cedent, the market was essentially flat in 2016 as pricing on loss-affected contracts reflected incremental increases in loss costs.

RETROACTIVE MARKET

- Supply and demand in the retroactive market continued to increase in 2016, as a growing number of markets offered new capacity (or explored the potential of doing so) in reaction to cedent requirements. Many markets, new entrants in particular, are more focused on transactions aimed at capital optimisation.
- The cost of capital required to support long-tailed reserves has been brought into sharp focus by the changing regulatory environment, particularly Solvency II. This has been a key driver of several transactions which focused on capital relief and optimising cedents' capital structures.
- Other motivations behind retroactive covers in 2016 included efforts to limit the impact of legacy business on balance sheets by seeking protection on blocks of reserves.
- The difficulties of comparing structured placements notwithstanding, there was some downward pressure on pricing and terms for retroactive placements in 2016, with rates typically seeing reductions in the low single digits.



SPECIALTY

AVIATION

- Both the insurance and reinsurance aviation markets continued to attract new entrants in 2016. That said, there were some instances of insurance markets exiting the aviation space during the course of the year.
- Abundant capacity and strong competition meant loss-free XoL programmes saw risk-adjusted reductions of up to 15% at the 1 January 2017 renewal.
- The absence of significant aviation losses in 2016 also helped to drive down pricing. For the isolated instances where XoL programmes did suffer small losses, there was essentially no impact on pricing as most layers/programmes have enormous banks.
- Ceding commissions were under pressure at 1 January 2017 as pricing for original business become increasingly marginal.

CREDIT, BOND & POLITICAL RISK

- Market conditions in the credit, bond and political risk space today are noticeably different to those of twelve months ago. There has been a significant increase in credit losses, in particular due to rapidly changing economic and political circumstances around the world.
- Pricing movements for credit, bond and political risk programmes at 1 January 2017 were influenced strongly by the limited number of quoting leaders.
- In the absence of these quoting leaders, pricing trends, particularly in the credit line, reversed dramatically for buyers in 2017. In fact, with most credit lines sustaining losses in 2016, the average price increase of 5% that materialised at 1 January 2017 could have been even more dramatic had the profitable political risk class not been used as make-weight.
- For proportional business, cedents attempted to push for additional coverage and commissions with varying degrees of success. Unlike the specific credit XoL segment, these treaties have ceded good margins in recent years.

MARINE & ENERGY

- Rate reductions for marine and energy programmes at 1 January 2017 were typically lighter than those recorded in the corresponding renewal of 2016. However, once assessed against exposure changes, the impact of the Jubilee oil field loss in Ghana (estimated to be up to USD 1.3 billion) and additional coverages, reductions in 2017 fell within similar ranges to last year's.
- Elevated loss activity in 2016 that included Hanjin's insolvency (of approximately USD 500 million) and the SpaceX rocket explosion (USD 225 million), in addition to the Jubilee oil field disaster, influenced pricing movements for loss-affected programmes.
- Demand was broadly unchanged at 1 January 2017 but some cedents were enticed into tail purchases by historically low pricing levels. Cost remained the key driver behind most cedents' buying strategies, although there were some notable coverage extensions as buyers looked to extract additional value through the inclusion of new specialty lines.
- There was some reinsurer resistance to cedents' attempts to negotiate price discounts that were deemed excessive. Indeed, some markets were prepared to walk away from business they considered to be poorly rated, particularly as renewal deadlines neared.
- Reinsurers were generally also unwilling to pay additional commissions at 1 January 2017, given the thin margins on treaty quota share business.
- Nevertheless, capacity in the marine and energy market remained stable through 2016 with all market leaders remaining in play.

TERRORISM

- Despite a number of high-profile terrorist attacks in 2016 in both advanced and developing countries, the terrorism market continues to be competitive.
- This reflects the fact that insurance has absorbed only a small portion of the economic impacts that have followed most recent terrorist attacks, as groups and individuals look to carry out mass casualty attacks (rather than target high-value properties). Perils such as impacts on people, denial of access and contingent business interruption have therefore replaced property damage as the primary loss driver.
- Given that most traditional terrorism policies are designed to respond to events that cause significant property losses, insured losses in 2016 were modest.
- As a result, pricing for loss-free XoL terrorism programmes at the 1 January 2017 renewal saw average reductions in the order of 10%, with some cedents able to negotiate discounts of up to 15%.
- Very few XoL programmes were loss-affected. Some pro rata programmes did suffer losses, ending the upward trend in ceding commissions seen over the last few years. However, claims were manageable and ceding commissions generally renewed on an as-expiring basis.
- Despite poor underlying rates, terrorism remains a popular class of business and new capacity continues to enter the market. This competitive environment, coupled with the desire (and need) to offer wider coverage, has seen new products become available in recent months for risks such as cyber (from physical damage), loss of attraction and impacts on people (by covering costs for repatriation and medical expenses).

CYBER

- There were several highly publicised cyber-attacks in 2016, with a number grabbing the media headlines as they set new standards in terms of scale. Despite this, cyber-related losses to the (re)insurance sector were moderate.
- Most cedents have been able to achieve increased original income levels due to organic growth, so any decreases in ROLs resulted in significant savings in rates.
- Loss-free XoL cyber programmes typically renewed with ROL reductions of between 5% and 10% at 1 January 2017. Similar discounts were also on offer for stop loss/aggregate stop loss coverages.
- Any loss-affected programmes saw impacts only on lower layers. This mitigated upward pressure on ROLs, meaning most were renewed as expiring, or with manageable 5% to 10% increases.
- Most quota share programmes continued to perform well in 2016, with lower than expected net loss ratios of approximately 65%. As a result, cedents applied some pressure at renewal to moderately increase ceding commissions (which was generally accepted by reinsurers).
- Capacity was relatively stable through 2016, with no significant new players entering the marketplace.

ASIA PACIFIC AGRICULTURE

- Capacity for agriculture business in Asia Pacific remains plentiful.
- As a result, most loss-free XoL programmes outside of China saw rate reductions of between 5% and 10% at 1 January 2017, depending on portfolio size and cedent/reinsurer relationships. Decreases in China were generally less marked, with only marginal savings on offer.
- Loss-affected agriculture programmes typically renewed flat or with moderate price increases. This was despite increased loss activity in the region, illustrating that cedents continued to be able to use soft market conditions to their advantage.
- Most proportional business in China renewed with lower commissions, or on an expiring basis at best.
- Retentions and capacity remained mostly unchanged.

HEALTHCARE

ACCIDENT & HEALTH

- Rate movements for loss-free XoL medical programmes varied by geography at 1 January 2017. Depending on the level of the deductible, US accounts saw risk-adjusted pricing range from up 7.5% to down 6%, whilst reductions for Asian programmes were more marked, averaging between down 5% and down 10%. Due to high medical trend, renewals in Brazil saw greater upward pricing pressure, with risk-adjusted pricing falling within a range of flat to up 10%.
- Pricing for personal accident (PA) business also varied by region, as cedents in mature markets saw pricing decline by between 5% and 7.5% whilst those operating in developing markets achieved rate reductions of between 5% and 20%.
- Loss-affected programmes for both medical and accident lines typically renewed within a range of up 10% to down 5%. In circumstances where renewals fell towards the lower end of this range (i.e. with rate reductions), it was mainly a consequence of significant growth in premium income bases and/or losses only impacting the bottom layer.
- Nevertheless, it became known just before the New Year that one Lloyd's PA facility picked up two losses in the last week of 2016. Whilst details remain unconfirmed, the size of one of the claims is likely to have impacted 2016 results of some participating syndicates. In addition, reinsurers on any programme which had not been placed before 25 December are likely to have requested, at the very least, additional premium dependent on the amount of any loss to layers.
- Ceding commissions for proportional business renewing at 1 January 2017 varied depending on historical performance. Increases were achieved for personal accident pro rata programmes with better than average loss ratios whilst commissions were mostly stable for medical accounts.
- Pressure for looser terms and conditions continued during the renewal process as cedents sought more reinstatements and the removal of certain exclusions. Some cedents also altered their buying strategies by dropping their bottoms layers. In Asia (China especially), certain cedents grew their premium income bases by more than 50%. Chinese carriers' retentions generally remain low compared to their Western counterparts (as low as 0.5% of total programme limits).
- There were no significant developments that impacted capacity availability at 1 January 2017. There continues to be an abundance of capacity in both the European and US markets. In addition, there is growing local competition from South East Asian, Indian and Chinese reinsurers for Asian business.
- Although the election of Donald Trump in the United States did not directly affect renewal terms at 1 January 2017, it has created some uncertainty in the US medical market given that he has vowed to repeal the Affordable Care Act (ACA).

NORTH AMERICA MEDICAL MALPRACTICE (TREATY)

- Medical professional liability continues typically to make up a significant portion of reinsurers' casualty treaty portfolios. However, there was the beginning of a perceptible shift in sentiment for North American medical malpractice business at 1 January 2017 amongst several markets. Accounts that modelled poorly attracted far greater scrutiny than in previous years, prompting some reinsurers to reduce authorisations or withdraw capacity if pricing was deemed to be inadequate as a consequence of loss activity. Greater adverse loss development also had an impact.
- A number of more recent market entrants in particular struggled to justify renewing more marginal business as, unlike more established players, they lack redundant reserves accrued from strong results in the early 2000s from this line of business. Cedents whose reinsurance panels have changed in recent years therefore had the potential for greater pricing variations at this year's renewal.
- Loss-free XoL accounts typically fell within a range of flat to down 5% at 1 January 2017. Most programmes that renewed at expiring prices saw some level of coverage enhancement as reinsurers were more willing to offer more favourable terms than to reduce rates.
- Rate movements for loss-affected programmes were very much dependent on the overall level of loss. Given some expensive payouts in 2016, loss-affected programmes saw rate increases of between 5% and 25%.
- Ceding commissions were generally flat for proportional business.
- Overall, physician programmes exhibited greater pricing stability/softness than hospital treaties, which delivered more volatile results as a result of lower ceded premiums and increased frequency of high-severity losses.

AUSTRALIA MEDICAL MALPRACTICE (TREATY)

- After agreeing to significant pricing declines for Australian medical malpractice programmes in 2015 and 2016, markets generally held firm against cedent attempts to negotiate further rate reductions at 1 January 2017.
- All medical malpractice treaties in Australia are placed on an XoL basis and pricing is therefore primarily driven by loss experience.
- With no major losses in the medical defence organisation (MDO) space through 2016, loss-free XoL programmes typically renewed flat at 1 January 2017 on a risk-adjusted basis.
- However, there was an uptick in loss activity in the public sector arena (including a record claim of AUD 30 million), reflecting rising demand for health services, low pay levels for health providers and historical underinvestment in the medical sector.

OUTLOOK FOR 2017: WEIGHING THE FACTORS

Multiple, competing factors drive today's reinsurance market. Prices are still softening, although the degree of softening is itself lessening. Moderating capital inflows, increasing cessions at the margin, the prospect of higher insured catastrophe losses, reserving volatility, inflationary and interest rate concerns and declining forward reinsurer returns are coalescing to counteract price declines. Against these factors must be weighed continuing excess sector capital levels as well as historically low cession rates. Figure 4 endeavours to show how these factors are interacting to create a softening, but moderating market.

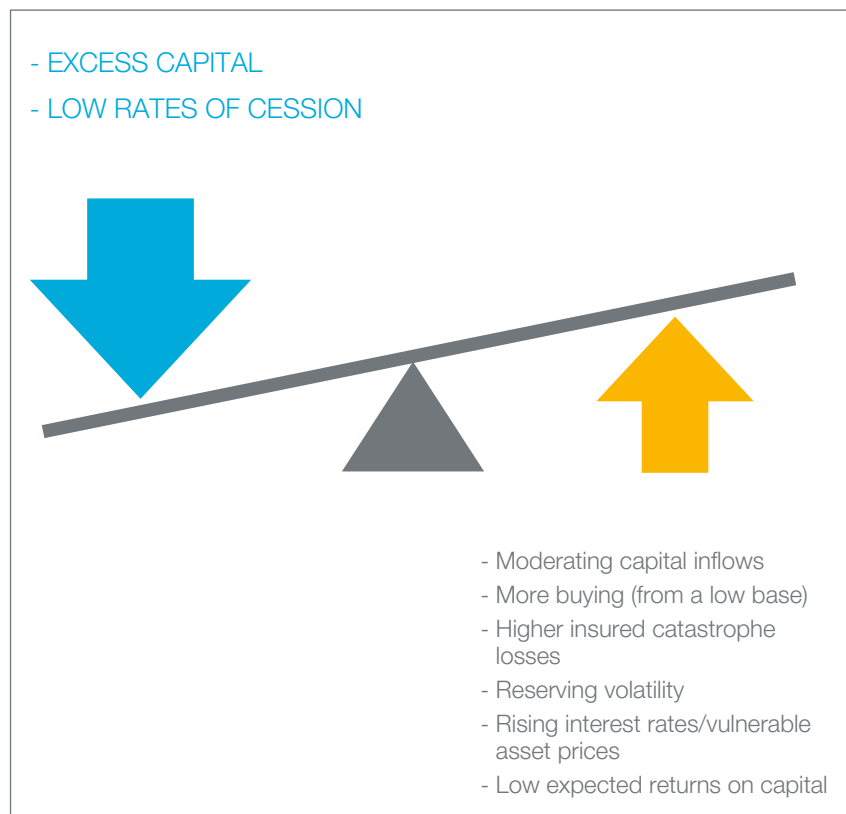
Evidently, excess capital and historically low rates of cession are currently outweighing the sum total of other offsetting factors. This has been the case for eight of the last ten years. The question is: for how long will this remain the case?

1. SUPPLY/DEMAND DYNAMICS

As outlined earlier in the report, near-record levels of capital currently remain the dominant force in determining the direction of reinsurance pricing, as excess supply chases relatively muted demand.

P&C premiums ceded as a percentage of gross premiums written remain near cyclical lows. Of course, supply/demand dynamics are constantly evolving and there are early signs of a slight shift as capital levels have started to flatten (as shown in Figure 2 on page 4), whilst strategic reinsurance purchasing by some

Figure 4: Factors Affecting the Reinsurance Market



(Source: JLT Re)

buyers has led to a subtle but notable uptick in demand in recent years (see Figure 5).

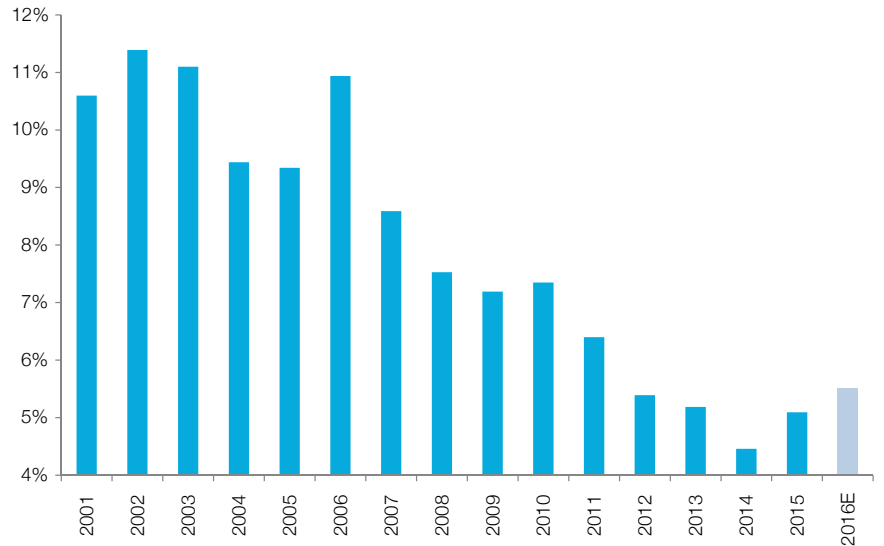
It is particularly notable that the average cession rate rose in 2015, and is expected to do so again in 2016 in an environment of still-falling reinsurance pricing. Buyers are realising that reinsurance is now more competitive than other forms of capital, especially where it can protect franchise value, lower earnings volatility and help to meet regulatory and rating agency requirements. With lower prices and better coverage, the amount of protection purchased has increased.

2. NORMALISING CATASTROPHE LOSSES

After several years of subnormal catastrophe losses, it is easy to forget what an ‘average’ catastrophe year looks like. 2016 brought this back into sharp focus as insured catastrophe losses rose to approximately USD 50 billion, close to the 10-year, inflation-adjusted moving average (see Figure 6).

Reinsurers have produced returns well in excess of expectations over the last three years, due in large part to a sustained period of good fortune with low insured catastrophe losses. 2016 was a reminder that higher levels of catastrophe losses are likely in future, in spite of recent experience.

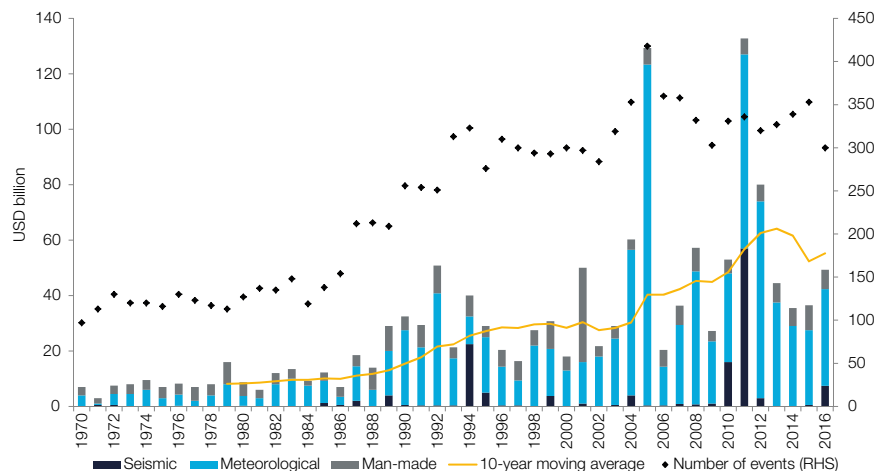
Figure 5: Simple Average Cession Rate of the Top 20 Global P&C Carriers – 2001 to 2016 (Provisional)



(Source: JLT Re)

“ 2016 was a reminder that higher levels of catastrophe losses are likely in future, in spite of recent experience. ”

Figure 6: Global Insured Inflation-Adjusted Catastrophe Losses – 1970 to 2016



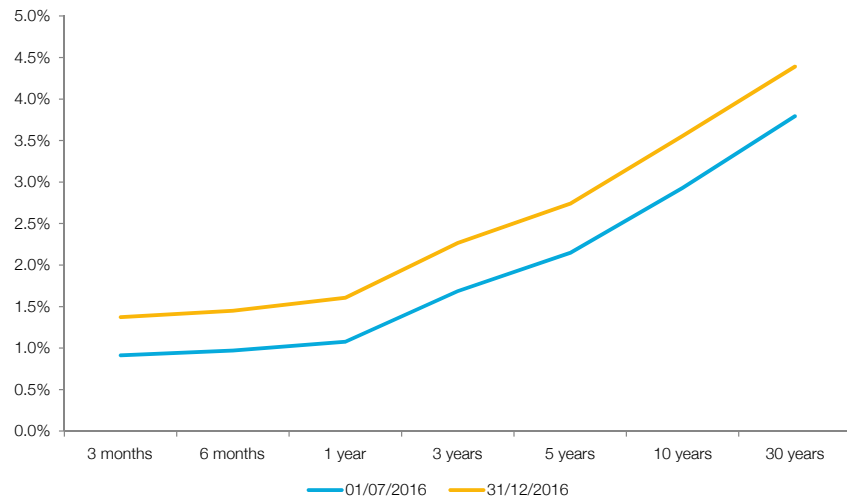
(Source: JLT Re, Swiss Re)

3. INFLATION AND RESERVING

Favourable reserve development during this period has also supported carriers' returns. However, (re)insurers are now likely to have released most of their reserve redundancies and there are growing concerns that the sector is likely to be entering a reserving danger phase in which reserves are being released faster than accident year experience would dictate³. These fears are compounded by the prospect of higher inflation in 2017.

Indeed, the situation today is similar to, if less pronounced than, the last liability crisis in the late 1990s, with the insurance sector coming off several years of favourable underwriting results and low loss inflation and frequency. This, however, may be about to change, as claims costs could potentially rise in 2017, bringing an end to a benign inflation environment that has existed since 2008. The change could have important implications for future reserve development and profitability. Moreover, pressure on reserve adequacy is only likely to intensify, given the strong historical relationship between soft pricing environments and deficient loss reserves.

Figure 7: Changes to US Investment-Grade Industrials Yield Curve – 1 July 2016 to 31 December 2016



(Source: JLT Re, Bloomberg)

4. RISING INTEREST RATES AND VULNERABLE ASSET PRICES

The macroeconomic and political climate is likely to be crucial in shaping the (re)insurance market throughout 2017. The new US political landscape, the anticipated triggering of Article 50 in the UK, unpredictable European elections and changing Asian geopolitics will all have important implications for interest rates this year.

Reinsurance sector capital has benefited significantly since the financial crisis as high-grade, fixed-income securities, reinsurers' largest single asset, have been in a long bull market. It is therefore important to note that as the yield curve begins to shift, these securities are more sensitive to sudden and sharp movements in interest rates. Should pronounced volatility in fixed-income securities markets occur in

2017, carriers could see the value of bond portfolios decline, thereby further stressing balance sheets and potentially creating liquidity problems for certain companies. Figure 7 shows changes in the US investment-grade industrials yield curve since mid-year 2016.

5. PRICE SUSTAINABILITY AND RETURNS ON CAPITAL

An additional factor behind the moderating trend at 1 January 2017 is pricing itself. As shown by Figure 1 on page 3, global property-catastrophe pricing is now 33% below 2013 levels and approaching the previous cyclical lows of the late 1990s. If normalised expected losses and fewer reserve redundancies are assumed, expected returns on equity (RoE) do not cover costs of equity for a majority of the top 25 reinsurers (Figure 8).

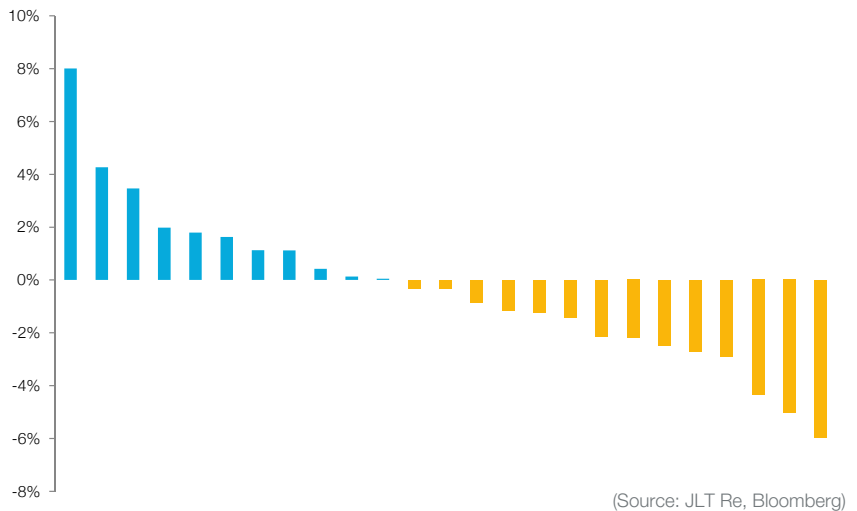
³ JLT Re Viewpoint report: *Enough in Reserve?*, September 2016.

FINDING AN EQUILIBRIUM

The myriad of challenges that characterise today's risk landscape, whether they be reserving volatility, macroeconomic shocks or major losses (or a combination of all three), have the potential to alter the sector's operating environment. As reinsurance pricing remains at historically low levels, these risks reinforce the value and efficiency of reinsurance capital in the current marketplace, with regard not only to earnings protection but also value creation. Indeed, recent analysis carried out by JLT Re shows that reinsurance is today typically the most cost-effective form of capital when measured against debt, equity and cedents' own capital⁵.

Given that cession rates remain at historically low levels, now is the time for insurance carriers to re-examine reinsurance as a form of contingent capital. Evidence emerged in 2016 that this had started to happen as insurance carriers bought new quota share programmes, aggregate

Figure 8: Top 25 Reinsurers' Forward RoEs Less Costs of Equity⁴



covers, excess of loss buy-downs and adverse developments covers (ADCs). Moreover, interest in structured reinsurance products is also growing as cedents look to work with trusted markets to develop alternative and tailored solutions that minimise earnings volatility and secure competitive advantages.

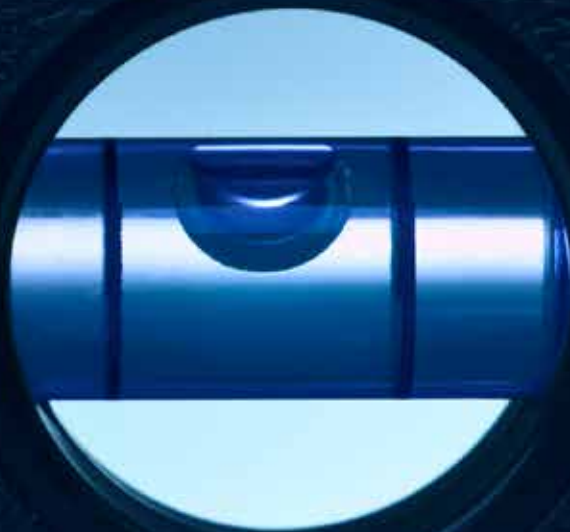
JLT Re looks forward to assisting clients with further strategic reinsurance purchases in 2017 in order to help increase franchise value, support new growth initiatives, grow profitably and, ultimately, deliver future success.

⁴ Calculated using the capital asset pricing model (100-week β using relevant regional index). Where company-specific market data are unavailable, a market-implied cost of equity is imputed using a regression.-

⁵ JLT Re Viewpoint report: Reinsurance: *The Price is Right*, July 2016.

WE SEE OPPORTUNITIES THAT OTHERS DON'T

At **JLT Re**, our deep specialist knowledge and extensive experience of both the reinsurance market and our clients' own industries and sectors enables us to ask smarter questions, innovate and deliver better results.



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