

Willis Re 1st View

Market unity and discipline: managing initial COVID-19 challenges

April 1, 2020



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1st View

This thrice yearly publication delivers the very first view on current market conditions at the key reinsurance renewal seasons: January 1, April 1 and July 1.

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Market unity and discipline

In keeping with prior 1st View reports, this is a retrospective view of the April renewals and is not intended as a forward-looking commentary.

Following the gradual hardening over the past 12 months, reinsurers approached the April 1 renewal season looking to build on the rating increase momentum, which up to this point had continued to be outpaced by the primary market. With the capital strength of the traditional reinsurance industry showing a significant increase as a result of improved 2019 results and only modest reductions in insurance-linked securities (ILS) capacity, primary insurance company buyers were confident that enough capacity would be available to meet their needs, even for those looking to buy more limit, subject to acceptable terms and conditions for both parties.

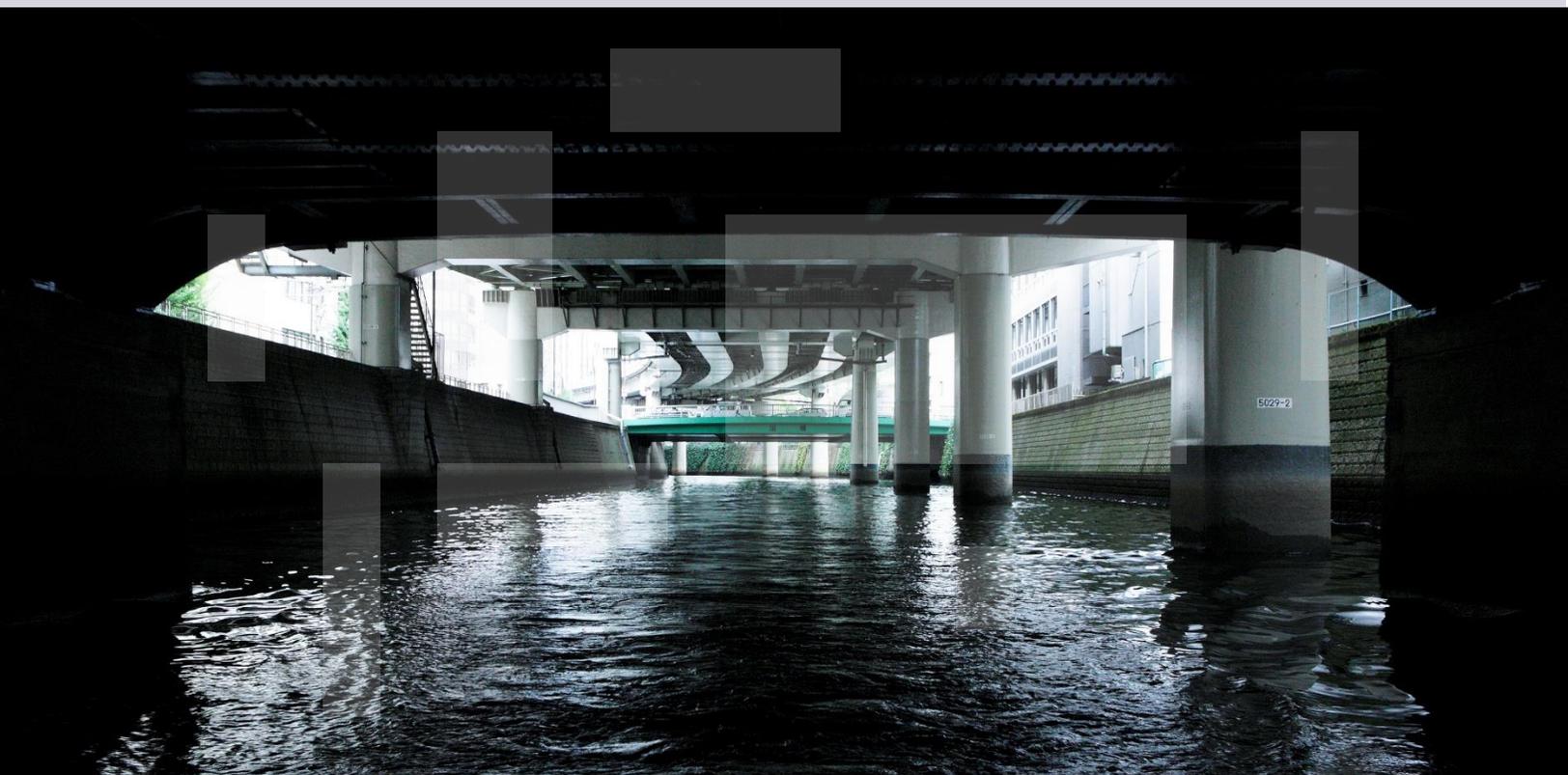
Against this background, reinsurers and buyers reached agreement on renewal terms in a calm and logical fashion, which saw significant rate increases on loss-affected accounts and a measured approach on loss-free contracts and less stressed classes.

For the most part, traditional reinsurers were able to offer increased capacity along with some ILS funds.

Client-centric underwriting was very much at the fore with packages of contracts being offered by buyers to core reinsurers. Reinsurers reacted well to this approach and, in many cases, managed to deepen their relationships with their key clients across diversifying lines of business. It is worth emphasizing at this point that many renewals were well underway before the impact of the COVID-19 virus, which helped support reinsurers reacting in a rational manner with their clients and brokers.

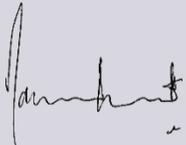
Several buyers sought additional natural catastrophe capacity, some seeking more vertical protection and others looking to buy out coinsurance participations. For the most part, traditional reinsurers were able to offer increased capacity along with some ILS funds, but there were examples of some ILS funds reducing their offered capacity at April 1 with the message that there had been recent redemptions by investors.

Away from the headline loss-affected property catastrophe covers, the underlying themes emerging in the past 12 months continued to play out. Poor property per risk and engineering results led to both pricing and condition improvements across many accounts. Casualty renewals were again under scrutiny in terms of loss development and, for the Japan renewals, the inclusion of difficult risks such as pharmaceutical products liability. Specialty classes with losses also saw reinsurers pushing hard on pricing, with some substantial risk-adjusted movements. The aviation market saw price increases in excess of 20% for the first time in nearly two decades.



Drawing on the lessons of the January 1, 2020 renewal season, most buyers started their renewal negotiations well in advance. This organized approach proved to be prescient in light of the COVID-19 outbreak, which started to challenge the operational model of the market in the last two weeks of March. The global reinsurance market has shown immediate resilience to operating under the challenge of the disruption by smoothly moving to a new working model with underwriters and brokers working from home yet still able to complete and process renewals in a timely fashion, providing unbroken service to their clients. In terms of coverage, April 1 programs which firm ordered in good time were fully placed well in advance of the due date and have been completed without any COVID-19-specific exclusionary language. For those programs that were not completed well in advance, several reinsurers sought to impose COVID-19 exclusions; in some cases, reinsurers achieved these exclusions, but in other cases, buyers have been able to provide comfort that their original policies have no exposure to COVID-19-related losses by issuing letters of understanding to reinsurers.

The extreme gyrations of financial markets have had a significant impact on the assets of reinsurance companies, but fortunately the timing of the COVID-19 disruption has coincided with the global reinsurance market being in a very strong financial position supported by strict regulation. Having demonstrated its ability to manage the operational challenges of COVID-19 so far, the global reinsurance industry is well placed to demonstrate its ability to manage the longer-term financial challenge and continue with its mission of providing support to primary insurance companies and their policyholders.



James Kent, Global CEO, Willis Re
April 1, 2020



Property

Commentary by territory

Caribbean

- Reinsurers focused on wordings and are reluctant to accept any expansions of coverage.
- Some reinsurers were prepared to cut their capacity on programs if original rate movements did not meet their expectations.
- Capacity was still available, but reinsurers were firmer in their demands on terms and conditions.

India

- Frequency and severity of wind/flood events was lower than the average experienced over the past five years notwithstanding Cyclone Fani and monsoon flooding events, which affected most catastrophe programs.
- Majority of buyers suffered risk losses resulting in moderate price increases.
- Continued rate improvement on the underlying business led to renewed interest in pro rata treaties. GIC Re still dominates, but quoting/leading by foreign reinsurers was observed.
- Spread of COVID-19 and consequent social distancing measures prolonged the renewal, but placements were completed on time. Reinsurers showed caution and added the exclusion wording, which was accepted by buyers as primary policies were not exposed.

Japan — Earthquake

- Pricing was generally viewed as adequate by reinsurers.

- Upward of US\$1 billion to US\$1.5 billion of new capacity was sought, mainly by Mutuels.
- Capacity on new layers was harder to source than capacity on renewal layers.

Japan — Property Risk

- Buyers typically focused renewal discussions on catastrophe rather than risk.
- Strong client resistance occurred to late requests for cyber and pandemic exclusions.
- Pro rata commission was heavily dependent on results, premium to limit balance and prior year actions.
- Some buyers restricted natural catastrophe coverage from fire pro rata treaties.
- A proactive stance on underlying rate increases were key to securing capacity.

Japan — Wind and Flood

- Renewal of aggregate covers proved a key struggle for buyers; these renewals saw higher rate increases than occurrence layers, with reinsurers applying significant pressure for restructuring.
- The price discovery process was orderly, with a wide range of quotations received and no one reinsurer standing out.
- Traditional European reinsurers were more aggressive in seeking rate increases.
- Reinsurers were typically a little disappointed by the firm order terms, with some reinsurers seeking to move up on programs reflecting a desire to rebalance their portfolios rather than price adequacy.
- Most reinsurers were prepared to support lower layers to secure their share of “payback pricing.”

- Some layers were impacted in 2019 by loss deterioration from Typhoon Jebi in 2018.
- Lost capacity was quickly replaced, with significantly more capacity waiting to support higher pricing.
- There was more churn in reinsurers' participations than historically has been the case.

Korea

- Market suffered a major risk loss — Lotte Chemical (gross loss estimates US\$400 million to US\$600 million) in early March — led to a substantial reduction in capacity for risk and pro rata programs.
- Lotte Chemical's loss drew reinsurers' attention to the potential accumulation issue through coinsurance and the adequacy of underlying risk rates.
- Most buyers preferred to accept separate Loss Additional Premium conditions in order to avoid significant pricing increases.
- Capacity for Event covers was ample, but the market was not as soft as a year ago, as Typhoon Lingling had a modest impact on some covers.

- Some reinsurers sought to impose COVID-19-related exclusion clauses.

United States — Nationwide

- While COVID-19 has made operating conditions more difficult, the industry rose to the challenge and business continued to be transacted with strong communication among all parties.
- Some reinsurers only authorized capacity with COVID-19 or Communicable Disease exclusions; however, this is by no means universally accepted and depends on the scope of the underlying business. Buyers responded with clarification of their intent on original policies.
- Traditional capacity was available, but reinsurers were differentiating among clients in order to position their portfolios with clients they viewed more favorably.
- The market-clearing price of smaller capacity programs was generally less than for those seeking to place significant limits.

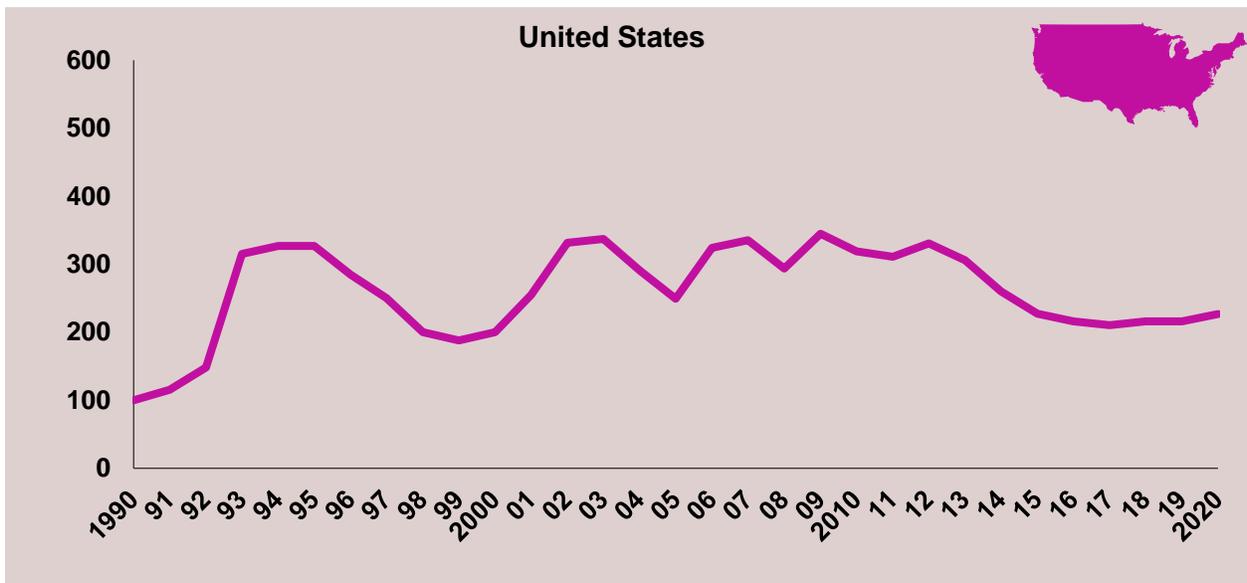
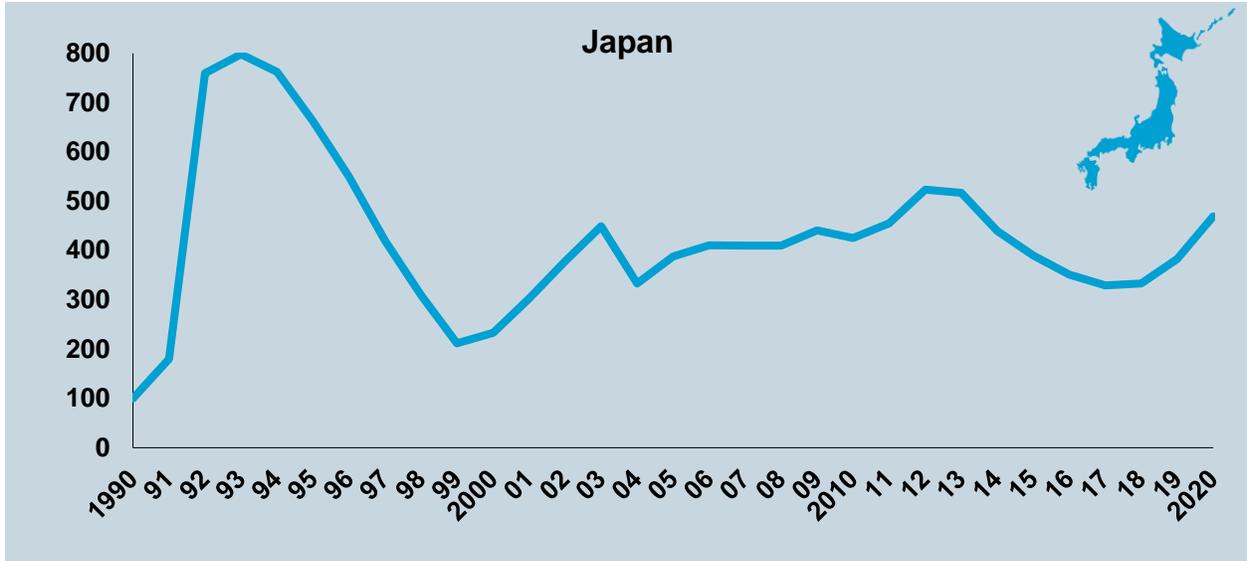
Property rate movements

Territory	Pro rata commission	Risk loss free % change	Risk loss hit % change	Catastrophe loss free % change	Catastrophe loss hit % change
Caribbean	0%	0% to +5%	+5% to +15%	0% to +5%	+5% to +15%
India	+3% to +8%	-2.5% to 0%	+5% to +10%	-5% to 0%	0% to +5%
Japan — EQ	0%	N/A	N/A	0% to +5%	N/A
Japan — Property Risk	-10% to -2.5%	0% to +5%	+5% to +15%	N/A	N/A
Japan — Wind and Flood	N/A	N/A	N/A	+10% to +35%	+30% to +50%
Korea	N/A	N/A	+40% to +90%	0%	0% to +15%
United States — Nationwide	-2.5% to 0%	0% to +10%	+10% to +50%	0% to +10%	+10% to +30%

Note: Movements are risk adjusted.

Property catastrophe pricing trends

The charts on these pages display estimated year-over-year property catastrophe rate movement, using 100 in 1990 as a baseline.



Casualty

Commentary grouped by territory

Global — Cyber

- Increased application of cyber exclusions in other lines fueled premium growth in stand-alone cyber.
- Lloyd's market was looking to underwrite cyber exposure before deciding whether to apply exclusions in other lines of business.
- Signs of tightening in reinsurance capacity, particularly for aggregate stop loss, led to a hardening in pricing conditions.
- All of the above occurred before the impact of COVID-19 and how reinsurers may view exposure to systemic risk going forward.

Japan — Motor Liability/General Third-Party Liability/Employers' Liability/Professional Liability

- Reinsurers were largely satisfied that opioid exposures are now contained.
- A small number of reinsurers were restricting capacity in the absence of exclusions.
- Reinsurer concern was growing on reserving practices, U.S. exposures and U.S. pharmaceutical risks.

Japan — Personal Accident

- Generally a quiet renewal, though some competition remained among reinsurers.
- Some serious pandemic concerns were allayed by buyers; no widespread restrictions were imposed.

Casualty rate movements

Territory	Pro rata commission	XL — no loss emergence % change	XL — with loss emergence % change
Cyber	-2% to 0%	+5% to +15%	N/A
Japan	N/A	0% to +10%	+5% to +20%
Japan — Personal Accident	N/A	-5% to 0%	N/A

Note: Movements are risk adjusted.

Specialty

Commentary by line of business

Capital Markets

- Record-breaking volume of primary issuance has occurred in natural catastrophe issuance.
- Issuance volume has been driven by a continued increase of retrocession industry index covers.
- Increasing spreads had been observed following increased global catastrophe activity and loss development from 2017 to 2019.
- COVID-19 impact observed in the secondary market in March with a further widening of pricing.
- Offsetting that, a historically large number of cat bonds will redeem in Q2 (US\$4.6 billion), which should create reinvestment needs in the next few weeks.
- Very small number of catastrophe bonds face loss exposure to COVID-19.
- ILS performance in the past few weeks has fared much better than the broader financial markets, re-evidencing the value of diversification.

Global — Marine

- Reinsurer aggregate restraints continue on peak energy assets (i.e., Sleipner, Gjoa, Johan Svedrup), translating through to increased vertical limits needing to be purchased and consequently some reinsurers having to reduce percentage lines.
- Well-performing accounts received favorable terms while loss-affected business generally saw increases, although not to the extent anticipated.
- Challenging renewals saw reinsurers reduce lines, as opposed to decline

programs in order to maintain relationships.

- Growing trend emerged to reduce retention and limit volatility.
- The Golden Ray grounded and capsized off of the coast of Georgia in the U.S. in September 2019. The case is complex, comprising a blend of pollution prevention and salvage costs as well as cargo claims (International Group, US\$440 million).
- Impacts of contraction in ILS market through continued trapped collateral was beginning to impact reinsurers, as well as apparent historic reliance on CatCo pillared-style product, further compiling reinsurer restrictions.

Global — Non-Marine Retrocession

- Pricing kept pace with the first quarter renewal.
- Reinsurers continued to differentiate among clients based on past performance and depth of relationship.
- Additional coverage was predominantly purchased at higher attachments to protect the tail as a result of internal and regulatory requirements.
- Ongoing and evolving COVID-19 situation has not impacted pricing or available capacity at this moment in time.

Global — Aerospace

- Lack of air travel and associated manufacturing will reduce incomes and put more pressure on rates.
- General excess of loss retentions is reducing, and some are buying more vertical cover.

- Capacity remains abundant, although there is an unwillingness to quote against incumbent leads.
 - QS commissions are reducing for some in light of poor results and cession levels
- debated in light of rapidly improving market.
- Retro capacity is becoming tighter with pricing generally in line with underlying products.

Specialty rate movements

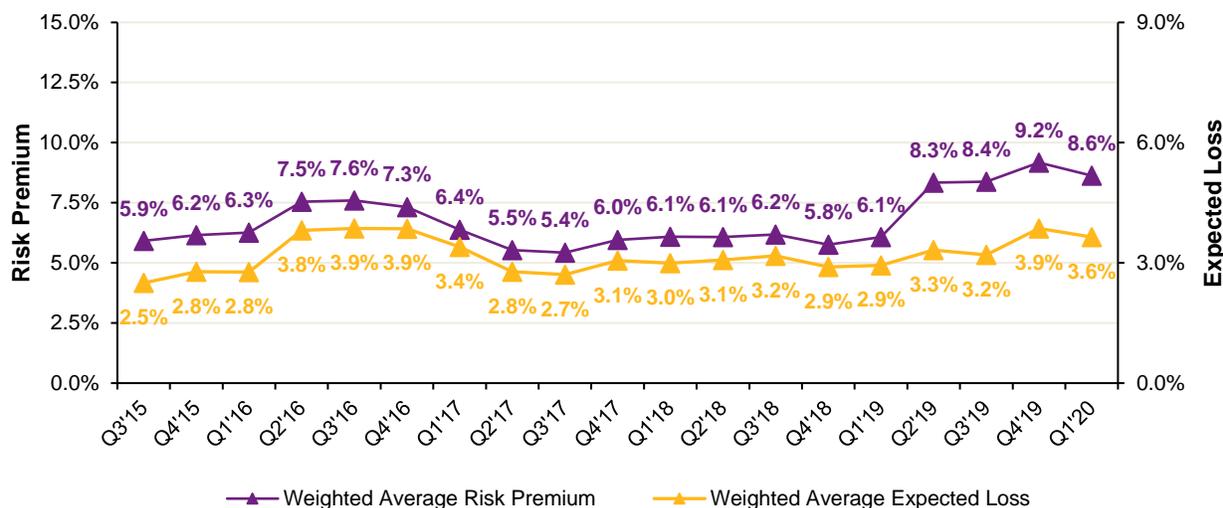
Territory	Pro rata commission	Risk loss free % change	Risk loss hit % change	Catastrophe loss free % change	Catastrophe loss hit % change
Non-Marine Retrocession	-2.5% to 0%	+5% to +10%	+10% to +25%	+5% to +25%	+15% to +35%
Aerospace	-3% to -1%	+20% to +25%	+30% to +50%	+15% to +20%	N/A

Note: Movements are risk adjusted.

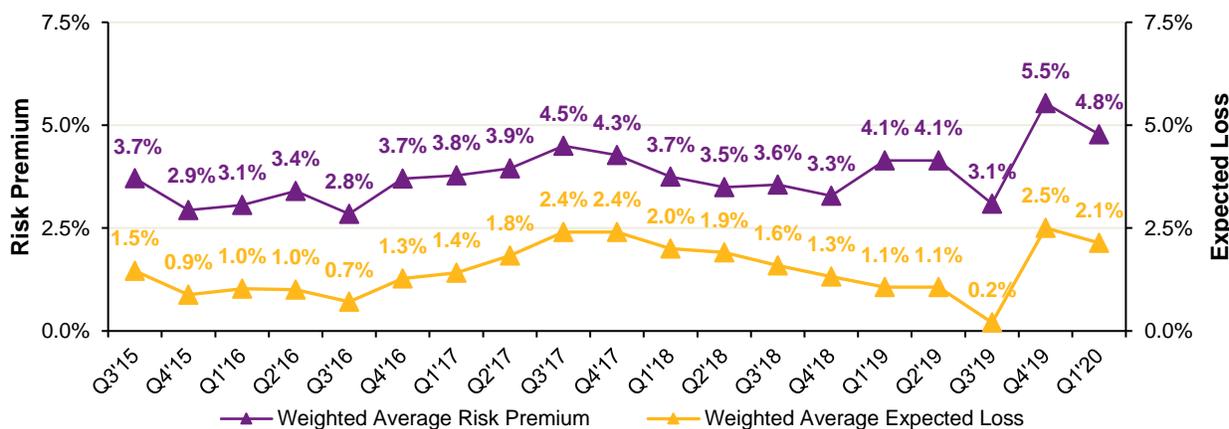
ILS Update

The charts below show the changes in the average risk premium and expected loss for both U.S. wind and non-U.S. wind publicly traded cat bonds, along with the capacity development of the cat bond market, and a comparison of the yield on cat bonds as against two other comparable investment classes.

Quarterly long-term U.S. wind exposed weighted average risk premium and expected loss



Quarterly long-term non-U.S. wind exposed weighted average risk premium and expected loss¹

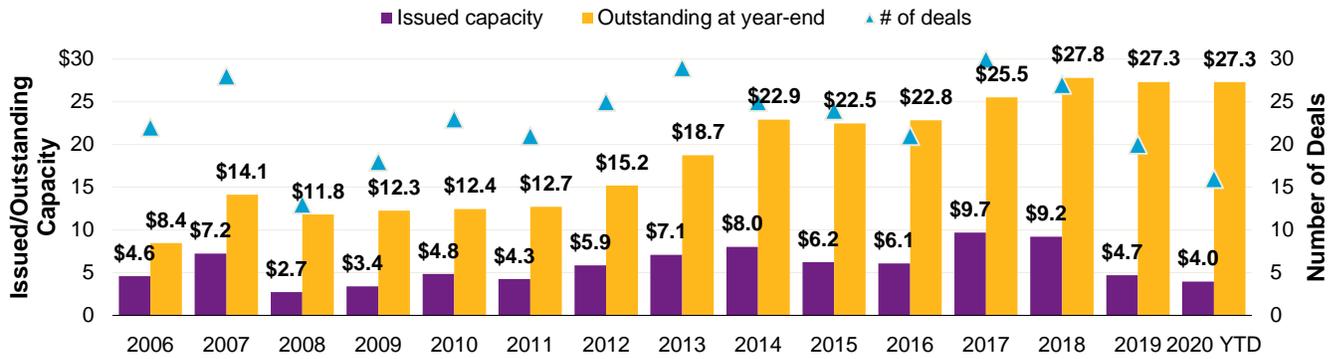


Source: Willis Re Securities Transaction Database as of 3/31/2020. Aggregate data exclude private ILS deals.

LTM = Last 12 months. Aggregate data are for primary issuance and do not reflect secondary trading.

¹ Note that the sharp decline in Q3 2019 expected loss and risk premium is caused by a lack of non-U.S. wind issuances since Q4 2018. Of those that were issued, size, expected loss and spread were relatively low, causing the drop-off in measurement.

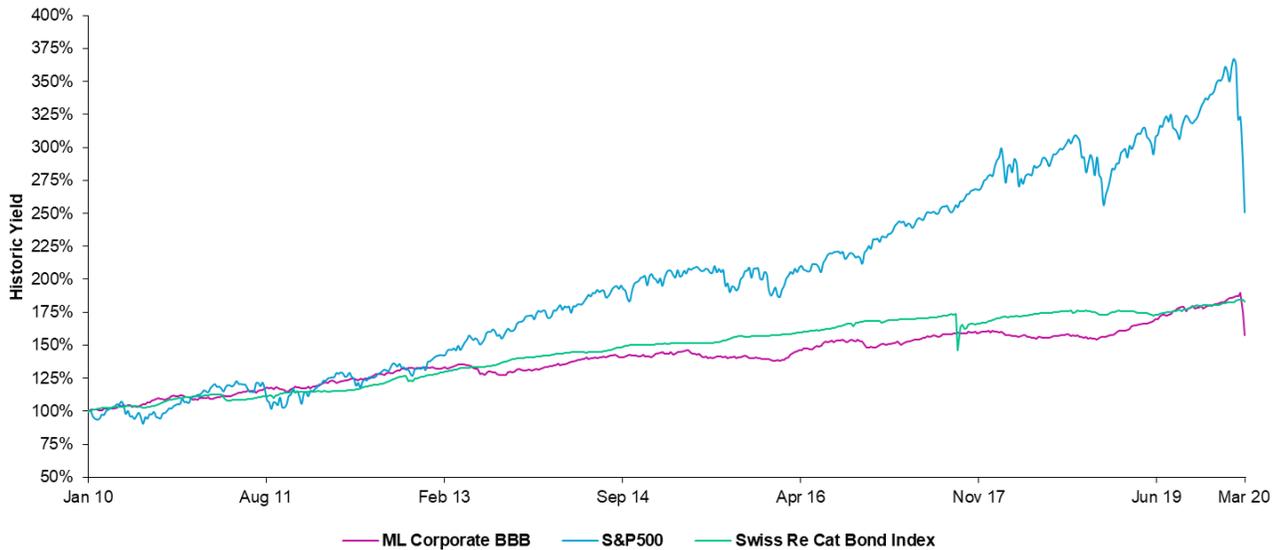
Non-life catastrophe bond capacity issued and outstanding by year²



Source: Willis Re Securities Transaction Database as of 3/31/2020. Aggregate data exclude private ILS deals.

² All issuance amounts reported in or converted to USD on date of issuance. Outstanding amounts adjusted for actual principal losses.

Historic yield



Global and local reinsurance

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For more information, visit willisre.com or contact your local office.

Inquiries

Annie Roberts
Global PR Leader
Investment, Risk & Reinsurance
+44 (0)20 3124 7080
annie.roberts@willistowerswatson.com

Chiara Conley
Reinsurance Broker, VP
Investment, Risk & Reinsurance
+1 206 343 6053
chiara.conley@willistowerswatson.com

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