Aon Benfield

Reinsurance Market Outlook

April 2017

Risk. Reinsurance. Human Resources.

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Contents

Executive Summary: Strong Capital Provides Reassurance in Uncertain Times

April 1 renewals again concluded with favorable terms for reinsurance buyers. Ceding companies found ample capacity to meet their risk transfer needs and to support geographic and product growth aspirations. Demand for reinsurance remains on a modest upward trend, as buyers increasingly recognize the value of the product in a world of proliferating risk-based capital regimes.

The first quarter of 2017 has been dominated by economic, political and regulatory events that have combined to heighten the general sense of uncertainty. A second rise in US interest rates is positive, in that it may herald an eventual return to a more 'normal' investment environment, albeit with the accompanying risks of higher inflation. However, major tax reforms under consideration in the US could potentially disrupt the way the reinsurance market is structured, adding additional cost to the industry. The same can be said of 'Brexit', which has now been formally triggered, while forthcoming elections in France and Germany will test the foundations of the European Union.

Several issues more specific to the re/insurance sector are worth highlighting. Firstly, the 'covered agreement' finalized in early January by US and EU authorities with the intention of creating a level playing field between their respective markets is currently being evaluated by Congress. Secondly, 'assignment of benefit' abuses and increased litigation continue to impact the Florida market, potentially contributing to decreased demand for reinsurance at the mid-year renewals. Thirdly, an unexpectedly severe 'Ogden' discount rate cut in the UK has required local insurers and their reinsurance partners to increase long-tail reserves for unsettled large bodily injury claims. Finally, the quarter ended with Cyclone Debbie making landfall on the north-east Australian coast, an event which is likely to result in modest losses to the reinsurance market.

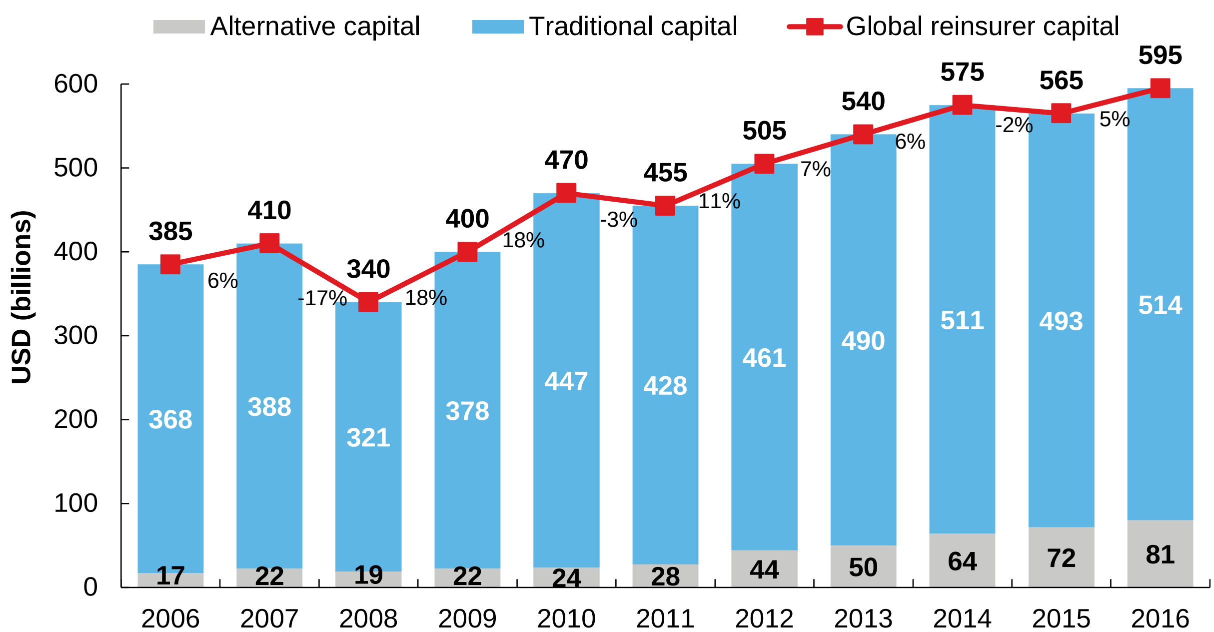
Fortunately, reinsurers are currently strongly capitalized and therefore well positioned to cope with uncertainty. Consequently, our outlook for the June and July 2017 renewals period remains positive, with ceding companies likely to achieve improvements in pricing, terms and conditions.

Note: This reinsurance market outlook report should be read in conjunction with our firm's views on rate on line, capacity and retention changes for each cedent's market. Our professionals are prepared to discuss variations from our market sector outlook that apply to individual programs due to established trading relationships, capacity needs, loss experience, exposure management, data quality, model fitness, expiring margins and other factors that may cause variations from our reinsurance market outlook

Reinsurance Supply Advances to New Peak

Aon Benfield estimates that global reinsurer capital stood at a peak level of USD595 billion at December 31, 2016, an increase of 5 percent relative to the prior year. This calculation is a broad measure of the capital available for insurers to trade risk with and includes both traditional and alternative forms of reinsurer capital. Ample capacity currently exists to meet expected reinsurance demand.

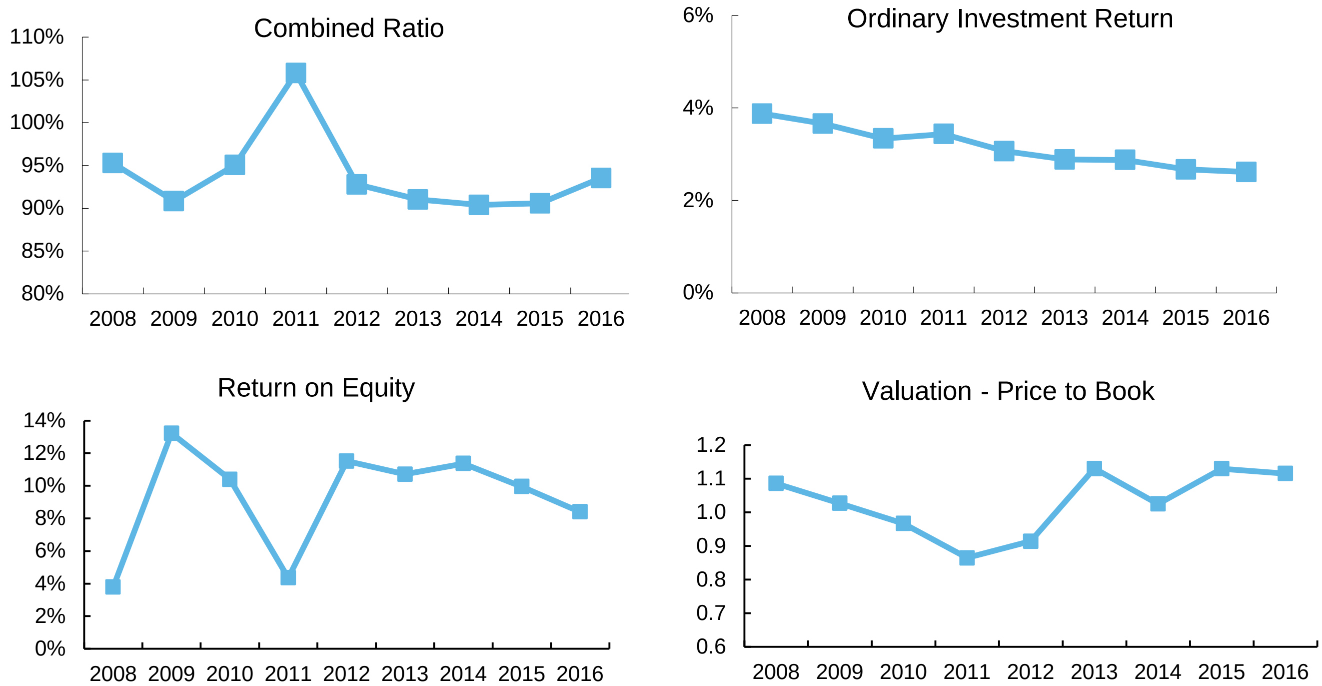
Exhibit 1: Change in Global Reinsurer Capital



Source: Aon Benfield Analytics, individual company records

Traditional capital rose by 4 percent to USD514 billion over the year to December 31, 2016, driven by solid earnings. The 23 global reinsurers forming the Aon Benfield Aggregate (ABA), for example, reported a return on common equity of 8.4 percent for the year, based on a combined ratio of 93.5 percent and an ordinary investment yield of 2.6 percent, as shown in Exhibit 2.

Exhibit 2: Reinsurance Sector Performance

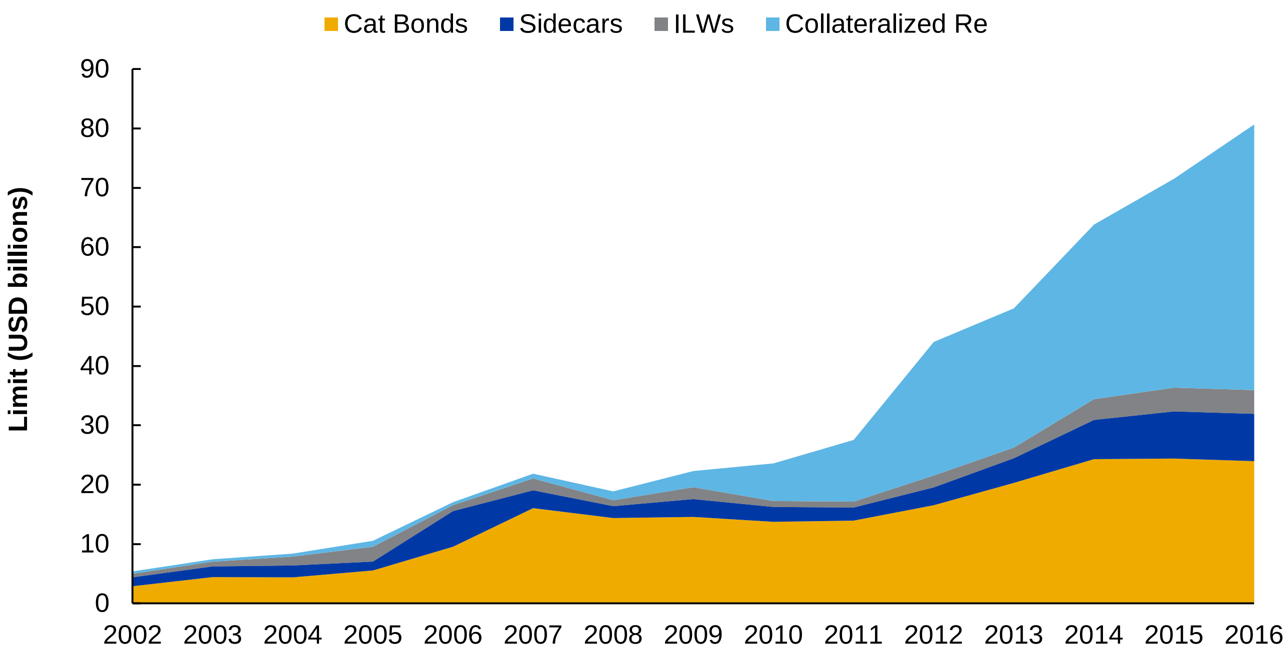


Source: Aon Benfield Analytics, individual company records

Insurance risk continues to attract capital market investors

Alternative capital rose by 13 percent to USD81 billion over the year to December 31, 2016, principally reflecting additional deployment into collateralized reinsurance structures. While expected returns have declined, insurance risk remains attractive to capital markets investors relative to other available opportunities, and low correlation with other asset classes remains a key consideration.

Exhibit 3: Alternative Capital Deployment



Source: Aon Securities, Inc.

Rating Agency Update

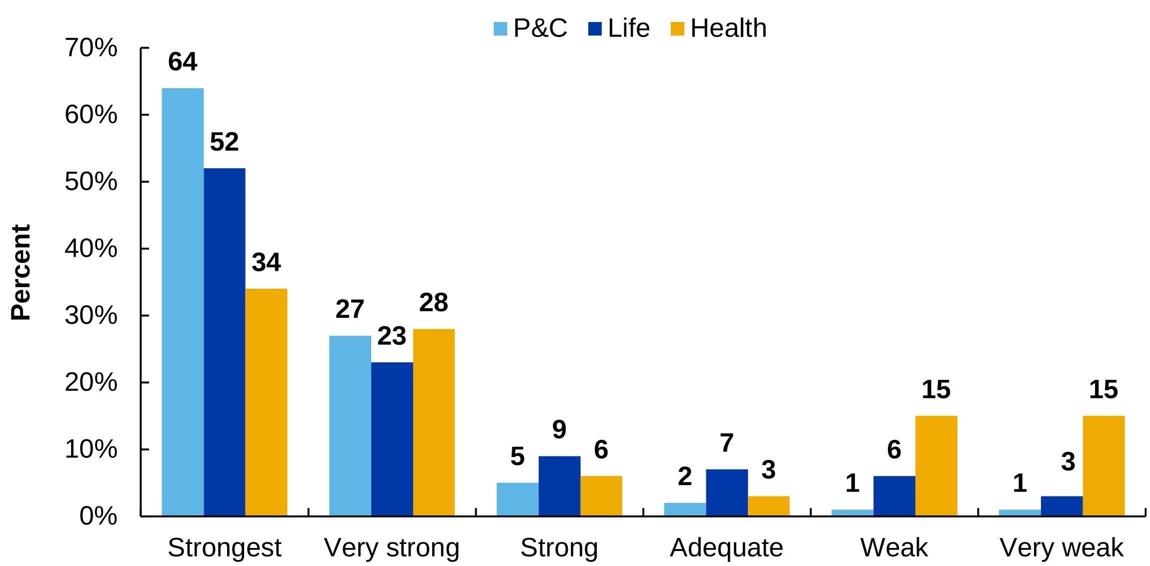
A.M. Best hosted their annual conference from March 20 to 22 and provided updates regarding their draft criteria for the stochastic-based BCAR model and Best's Credit Rating Methodology (BCRM). After reviewing feedback from the industry, A.M. Best is considering the changes listed below.

- **Tax treatment of catastrophe stress PML:** Currently, the catastrophe stress event is on a pre-tax basis, consistent with the B8 risk charge. However, this treatment is inconsistent with other surplus adjustments, such as UPR equity, reserve equity, and fixed income equity, which are calculated on a post-tax basis. As a result, A.M. Best is considering a post-tax reduction to surplus for the catastrophe stress test.

- **Combined business profile and ERM adjustment:** A.M. Best is considering capping the combined assessments of business profile and ERM to a maximum positive adjustment of +2 notches.

A.M. Best detailed its indicated balance sheet assessment from using stochastic-based 2015 BCAR output for industry sectors shown in the chart below. Overall, the P&C sector has the strongest balance sheet assessment and there is wider variation in the health sector, with 30 percent of the sector at weak or very weak.

Exhibit 4: A.M. Best Indicated Balance Sheet Assessment



Source: A.M. Best's Review & Preview Materials
* Companies with < 20 million USD in capital & surplus cannot score in strongest category

A.M. Best plans to finalize criteria by late 2017 and will release specialty criteria over the next several months. This will include criteria for start-ups, surety, and title companies. These updates will focus on differences between the analysis of the specialty insurer and the standard process outlined with BCRM.

Severe Weather Peril Leads Global First Quarter Catastrophe Losses

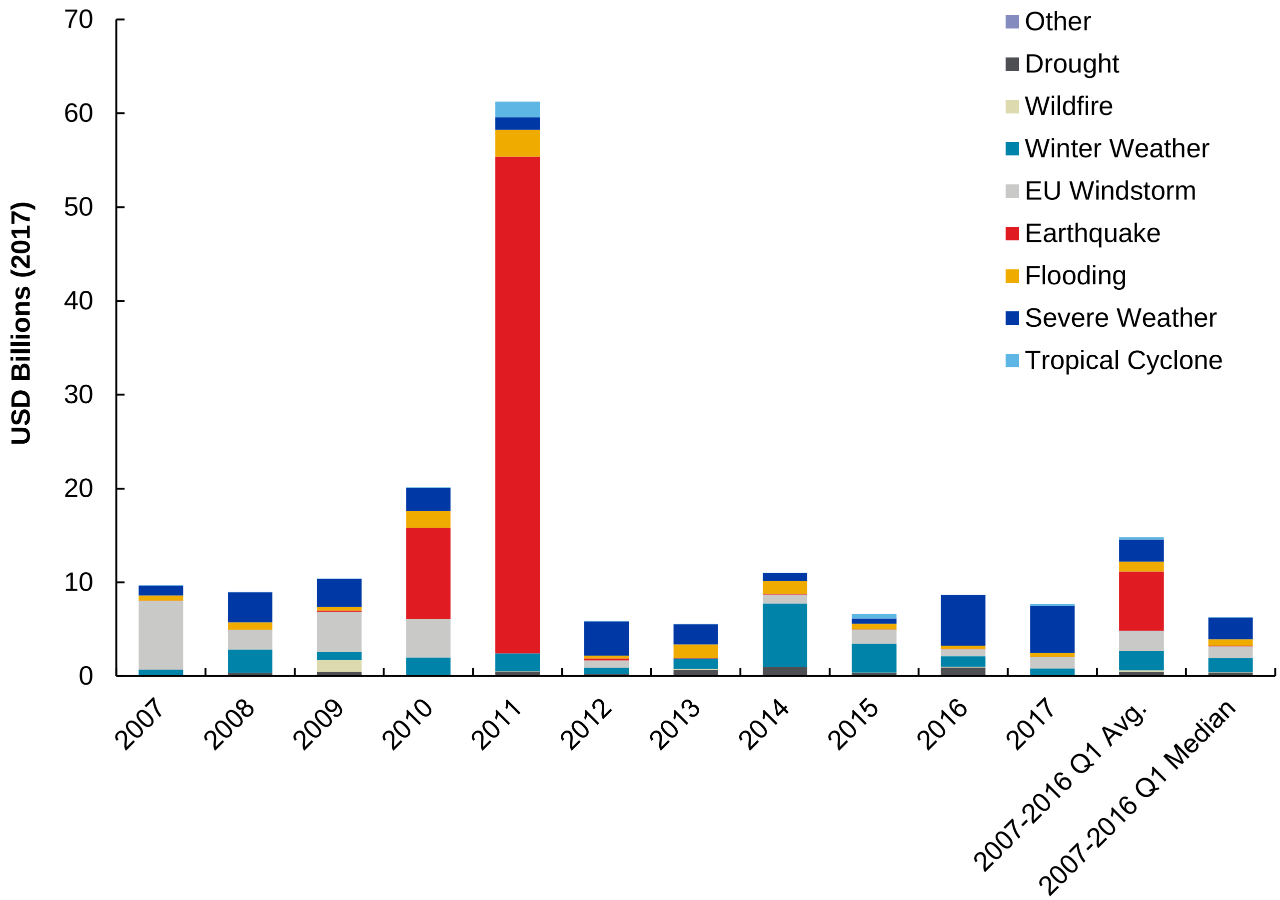
Preliminary data for the first quarter of 2017 indicates that the global insurance industry endured an active, yet below ten-year average level of payouts. Through the first three months, the industry has tentatively sustained losses of roughly USD7.6 billion. This estimate is subject to change as event losses are further realized. This is 48 percent below the recent ten-year average of USD14.8 billion. However, when analyzing the losses on a median basis (USD9.3 billion), the 2017 losses were 18 percent lower. The median comparison was actually 15 percent higher if looking at first quarter insured losses dating to the year 2000 (USD6.6 billion). Using a median analysis helps to provide a more accurate depiction of losses and eliminates any potential skew of outlier years.

Nearly three-quarters of the insured losses were sustained in the United States; with six of the ten costliest Q1 events recorded in the country. Most of the losses were attributed to a very active start to the severe weather season that was marked by elevated numbers of tornadoes, large hail, and damaging straight-line wind events across the Plains, Southeast, and Midwest. The early season severe weather in the US was attributed to one of the mildest winters on record and well above normal sea surface temperatures in the Gulf of Mexico that helped fuel developing storm systems in the central and eastern US. Other notable events included a stream of prolific atmospheric river events that led to extensive flooding and mudslides across California and the Intermountain West.

Outside of the United States, a significant hail event left severe damage in the greater Sydney, Australia metro region in mid-February. That event minimally caused USD305 million in claims payouts. Australian insurers additionally continue to receive claims following Cyclone Debbie's landfall in late March.

A series of strong European Windstorms additionally left widespread wind and flood damage in western and northern Europe. Storms Zeus, Thomas, Egon, and Dieter combined to cause an estimated USD1.0 billion in insurable loss; the highest for the peril since 2015.

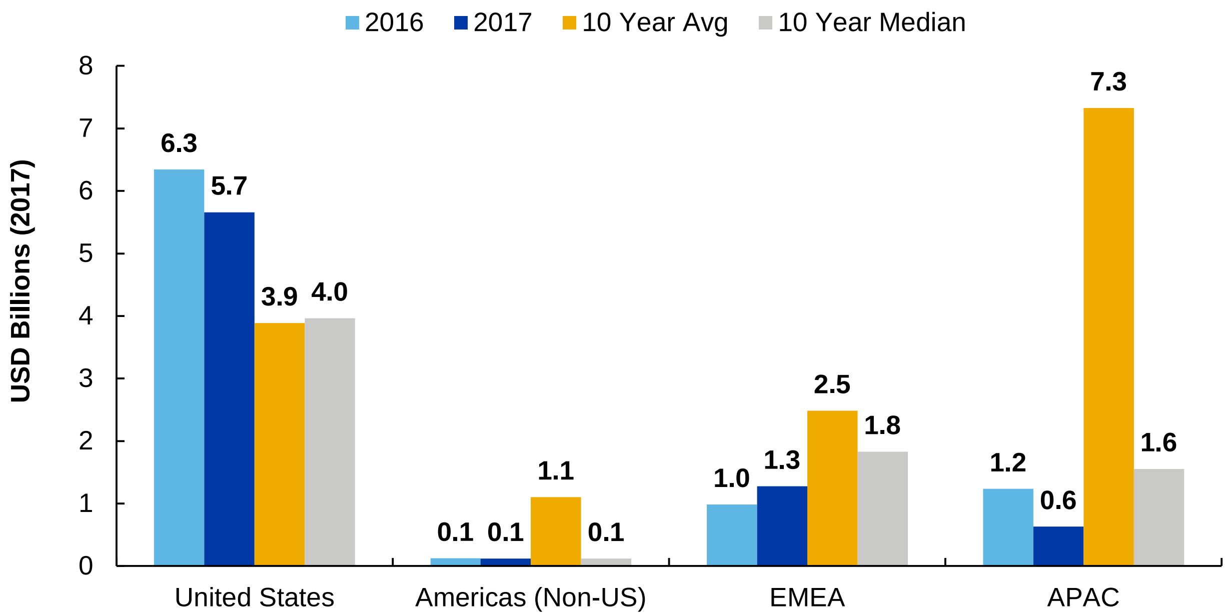
Exhibit 5: Q1 Global Insured Losses



Source: Aon Benfield Analytics

First quarter global catastrophe losses are usually the lightest of the year, with the outlier exception of 2011 given the historic Asia-Pacific earthquake losses. Exhibit 6 shows that preliminary first quarter insured losses were above the recent 2007-2016 average and median in the United States, but tentatively below the losses incurred in 2016. Public and private insurance entities in the US are estimated to have paid out more than USD5.7 billion in claims, which comprised 74 percent of the global total. EMEA represented 17 percent of the first quarter loss, with APAC equaling just 8 percent. The Americas incurred 2 percent. The US was the only region to be above its ten-year mean and median.

Exhibit 6: Q1 Insured Losses by Region



In a forward thinking comment regarding the rest of 2017, there is growing consensus that El Niño will officially return during the second half of the calendar year. Sea surface temperatures continue to warm in the central and eastern Pacific Ocean—which has led to catastrophic flooding in Peru during the first quarter—and the El Niño phenomenon should have an influence on the peak months of the Atlantic Hurricane Season (August, September, and October). El Niño typically has a negative influence on cyclogenesis in the Atlantic Ocean given cooler sea surface temperatures and increased wind shear. Warm phases of ENSO (El Niño—Southern Oscillation) have also historically often led to drier conditions in southern Asia, Oceania, and parts of South America and Africa. Wetter conditions during boreal winter are more prevalent in parts of the southern United States, western Europe, and western and southern South America.

To find the most up-to-date global catastrophe loss data for 2017, and other historical loss and climate data, please visit Aon Benfield's Catastrophe Insight website: www.aonbenfield.com/catastropheinsight

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About Aon Benfield

Aon Benfield, a division of Aon plc (NYSE: AON), is the world's leading reinsurance intermediary and full-service capital advisor. We empower our clients to better understand, manage and transfer risk through innovative solutions and personalized access to all forms of global reinsurance capital across treaty, facultative and capital markets. As a trusted advocate, we deliver local reach to the world's markets, an unparalleled investment in innovative analytics, including catastrophe management, actuarial and rating agency advisory. Through our professionals' expertise and experience, we advise clients in making optimal capital choices that will empower results and improve operational effectiveness for their business. With more than 80 offices in 50 countries, our worldwide client base has access to the broadest portfolio of integrated capital solutions and services. To learn how Aon Benfield helps empower results, please visit aonbenfield.com.

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