BIQ

October 2011

BERMUDA INSURANCE QUARTERLY

BEST OF TIMES TO COME

How the insurance industry faces a "golden age" of opportunity and will rise to the challenges presented by the growth of the burgeoning economies of Brazil, Russia, India and China. *See page 7*

BIQ

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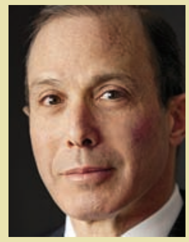
THE QUOTES OF THE QUARTER



"This was another difficult quarter for natural catastrophes, while the challenges of a competitive insurance market globally and sluggish economic conditions in developed markets continue to weigh on growth."

Evan Greenberg, CEO, ACE

"The question of the impact of the Neal bill depends on what it ends up saying, if it does get passed. The most recent version was treating all foreign reinsurers the same, so that wouldn't be damaging to Bermuda's relative competitiveness. However, it would increase costs."

Marty Becker, CEO, Alterra Capital Holdings

"Our transaction fully satisfies the key strategic goals outlined by Transatlantic with greater certainty. We believe that Validus' proposal is inferior. It cannot provide Transatlantic's shareholders with the same value that our merger of equals can. Validus' unsolicited proposal is an attempt to acquire Transatlantic at a significant discount to book value. In addition, the needed reduction to Transatlantic's property catastrophe business in the inferior Validus takeover to a level compliant with Transatlantic's enterprise risk management risk tolerances, would lead to limited property catastrophe writing flexibility."

Scott Carmilani, President & CEO, Allied World

"Through recent renewal periods … we reduced certain catastrophe exposures to bring greater balance to our overall risk portfolio and ultimately maximise the risk-adjusted return potential of the total portfolio … We saw some encouraging signs in the June and July renewals. As we approach the January 1, 2012 renewal, PartnerRe is well positioned to take advantage of market opportunities in shorter-tail lines within a disciplined risk-return framework, and maintain our position in longer-tail lines until pricing momentum improves."

Costas Miranthis, President & CEO, PartnerRe

Sigh of relief after Hurricane Irene slams US

BUT STORM DOES ADD PRESSURE TO PROPERTY/CATASTROPHE REINSURANCE MARKETS

Industry experts say that Bermuda's reinsurers should see little impact from Tropical Storm Irene.

There had been fears that insurers would have to pay out up to $14 billion as the large storm headed up the east coast but, fortunately, the Category 2 hurricane weakened before it hit New York.

Most of the insured losses caused by Hurricane Irene in the US are likely to be borne by primary insurers, meaning that Bermuda's reinsurers should see little impact from the storm.

Industry expert and economist Robert Hartwig, President of the Insurance Information Institute, told *The Royal Gazette*: "Reasonable estimates for insured losses (excluding the federal flood programme) are in the $3 billion to $5 billion range. At this magnitude of loss, Irene is not a 'market turning' event, though it does incrementally add pressure to property insurance rates and property/catastrophe reinsurance markets.

"I don't believe reinsurers will see much impact from Irene. Most of these losses will be retained by primary insurers."

Ratings agency Fitch said: "Insured losses brought on by Hurricane Irene are likely to be material, but manageable, for US property and casualty insurers and reinsurance companies. From the standpoint of rating actions overall, Fitch does not anticipate material rating changes for any insurers tied solely to losses from Hurricane Irene. Insurers most likely to be affected by the storm include those companies who emphasise homeowners and commercial multiperil property insurance."

Catastrophe modelling firm AIR Worldwide estimates insured property losses from Irene are likely between $3 billion and $6 billion.

Catalina signs merger agreement

Catalina Holdings (Bermuda) Ltd's wholly owned subsidiary, Catalina Echo Ltd, has signed a definitive merger agreement to acquire Residential Loss Control Holdings, LLC (RLCH).

Subject to regulatory approval, the acquisition is expected to close in the fourth quarter of 2011. RLCH owns two risk retention groups, National Home Insurance Company (NHIC) and Residential Insurance Company, based respectively in Colorado and Hawaii.

On June 30, and as adjusted for a pre-closing dividend, Catalina said RLCH had total assets of $168.4 million, gross technical reserves of $113.7 million and net assets of $19.4 million. The purchase price was at a discount to net asset value.

Established in 2005, Catalina specialises in "the acquisition and management of non-life insurance and reinsurance companies and portfolios in run-off". The company currently has offices and operations in Bermuda, New York, London and Switzerland.

Chris Fagan, Chairman and Chief Executive of Catalina said: '"RLCH and its management team is well known to Catalina as we are a reinsurer to NHIC and familiar with the business. The acquisition is a good addition to our existing US business.

"We continue to be very acquisitive, and we are seeing an increased flow of run-off acquisition opportunities."

Ariel and DaVinci get Florida green light

FIFTEEN BERMUDA-BASED REINSURERS NOW OPERATING IN SUNSHINE STATE

The Florida Office of Insurance Regulation has signed two consent orders that allow Bermuda-based reinsurers Ariel Reinsurance Co Ltd and DaVinci Reinsurance Ltd to post reduced collateral and operate in Florida as eligible reinsurers.

The orders make the companies the 15th and 16th reinsurers respectively to operate in Florida with similar terms. Fifteen of the 16 are based in Bermuda.

Ariel reported capital and surplus of $1.3 billion, which exceeds the $100 million requirement. DaVinci reported capital and surplus of $1.4 billion. The reinsurers also indicated secure financial strength by demonstrating favourable ratings from two nationally recognised statistical rating organisations.

The other eligible reinsurers in Florida are: Axis Specialty Ltd, Ace Tempest Reinsurance, Allied World Assurance Co Ltd, Alterra Bermuda Ltd, Arch Reinsurance Ltd, Aspen Insurance Ltd, Montpelier Reinsurance Ltd, Hannover Re (Bermuda), Hannover Re (Germany), Hiscox Insurance Co, Partner Reinsurance Co, Renaissance Reinsurance, Tokio Millennium Re Ltd and XL Re Ltd.

Florida's legislature passed sweeping reforms in September 2008 enabling the office to set lower collateral requirements for non-US reinsurers that are deemed financially sound and highly rated.

Argo places cat bond

Argo Group International Holdings Ltd has placed a $100 million catastrophe bond. Loma Reinsurance Capital Ltd Series 2011–1, is listed on the Cayman Islands Stock Exchange and is Argo's first cat bond issuance.

Argo's bond provides protection against the occurrence of two or more US hurricanes, US earthquakes, European windstorms, or Japan earthquakes. For activation the bond establishes per occurrence minimum loss amounts and is triggered by a second and subsequent event that meets specific loss criteria. The bond has been rated BB- by Standard & Poor's.

Benefitting Bermuda

Bermuda could gain more of Britain's insurance business unless the British Government and industry work out how to compete better globally. That's the view of Clement Booth, the Chairman of Allianz's UK unit, who said that in the past two or three decades no global insurance group had returned to make Britain its home again. He also said that no new global group had developed here.

In the meantime, Mr Booth said $65 billion had come across into Bermuda's insurance sector to create an extra 10,000 jobs on the Island.

"In the UK we should try to compete for a bit of that," he told an Association of British Insurers' conference. "We need to reflect as a community ... on the capital that is flowing into Bermuda and Switzerland and even Ireland."

Ironshore to raise underwriting capacity

Ironshore Inc has announced that the company is broadening its relationship with Equinox Global Limited to extend additional underwriting capacity to its trade credit insurance market programme.

Ironshore will provide increased capacity on a facultative basis for all eligible territories to meet the growing insurance demands of Equinox Global, a managing general agent specialising in trade credit. "Ironshore's expanded relationship with Equinox Global allows us to provide greater access to an on-demand, one-stop resource for capacity in an expeditious manner," said Daniel L Sussman, President of Ironshore's Political Risk Unit. "Our continued participation in this enhanced programme signals a mark of confidence in Equinox Global's ability to provide cover to an even larger global client base."

Equinox Global, exclusively dedicated to the trade credit insurance market, was established in November 2010 to offer coverage with first class security in the credit insurance sector throughout various market cycles.

"As our business grows it is appropriate for us to be able to offer increased capacity aligned with increased demand," said Michael Holley, CEO of Equinox Global. "Meeting the needs of our customers is our top priority, and this arrangement with Ironshore sends a clear message to the market that we can respond to the needs of companies of all sizes."

Meanwhile, Ironshore Inc has announced that A M Best has affirmed the financial strength rating of A– (Excellent) and issuer credit ratings of a– for Ironshore's operating subsidiaries.

The operating subsidiaries include Ironshore Insurance Ltd (Bermuda), Ironshore Indemnity Inc (Minnesota), Ironshore Specialty Insurance Company (Arizona) and Ironshore Europe Ltd (Ireland). The outlook for all ratings is stable.

"In its affirmation announcement, A M Best emphasised that the ratings reflect Ironshore's strong risk-adjusted capitalisation, enhanced and developing business profile and highly experienced management team," said Kevin Kelley, Ironshore's CEO.

OBE rewards Butt's role in reinsurance


Michael Butt

A stalwart of the Bermuda reinsurance industry was recognised in the Queen's Birthday Honours List. Michael Butt, who founded the World Insurance Forum, was awarded an OBE.

Mr Butt, the Chairman of Axis since 2002, was recognised for his contributions to Bermuda's reinsurance industry. He has previously chaired Mid Ocean Reinsurance and been a Director of XL.

"This is also an award for Bermuda, and for all those who have, in the last 20 years, helped take Bermuda from an interesting but peripheral part of the world's reinsurance market, to its very centre. Our task now is to keep it there," he said.

Insurers boost local economy by $971m

IORDANOU: 'IN OUR SELF-INTEREST TO HIRE BERMUDIAN EMPLOYEES WITH SKILLS AND TALENTS THAT MATCH NEEDS'

The Island's 22 major reinsurers contributed nearly $971 million to Bermuda's economy last year.

New figures from the Association of Bermuda Insurers and Reinsurers' (ABIR) annual economic impact survey also reveal that the industry employs 1,696 people on the Island — and 66 percent are Bermudian.

And despite the current global economic downturn, Bermudians in the reinsurance industry are earning almost $200,000 a year.

The report shows that the total number of people employed in the industry has fallen slightly from about 1,782 in 2007 to just under 1,700 in 2010, but the number of Bermudian employees has risen from 1,098 in 2007 to 1,128 in 2010.

The ABIR says its members — which include XL Group, ACE and PartnerRe — have increased their workforces in the US, Asia and Europe, employing around 32,000 employees globally.

According to the survey, ABIR members' economic contribution included:

- $737 million ($700 million last year) in aggregate pay to employees based in Bermuda
- $302 million in salary and other compensation paid to just Bermudians
- $116 million ($125 million in the previous year) on construction, real estate, housing, rentals or office leases
- $81 million (previously $82 million) paid to Bermuda-based third party business consulting providers
- $27 million (last year $25 million) on travel and entertainment payments
- $10.6 million (previous year $10 million) in contributions to Bermuda-based charities

ABIR Chairman, Dinos Iordanou, CEO of Arch Capital Group, said: "ABIR's members are integral to a successful economy in Bermuda."

He said the average salary and benefits compensation for ABIR member Bermudian citizens only was $197,000 in 2010, while the median was $127,000. Average salary and compensation for Bermudians has risen substantially — from $108,000 in 2007.

ABIR President Brad Kading

"ABIR members provide good quality jobs for Bermudian citizens and it is in our self interest to hire Bermudian employees with skills and talents that match our needs," Mr Iordanou said.

ABIR President Brad Kading welcomed the government's plans to offer permanent residency status to some 10-year work permit holders, together with other initiatives including plans to identify job categories exempt from term limits.

"We strongly support the government's efforts to create incentives for senior executives with hiring authority to be resident in Bermuda. We are quite encouraged by the Premier's recent announcements on this matter and we are looking forward to the development of the implementing measures.

"The more executives with hiring authority located in Bermuda, the more opportunities there will be for additional Bermudian citizens to find jobs with these employers."

Lancashire to domicile in UK

Bermuda-based insurer Lancashire Holdings Ltd has received approval from its shareholders to go ahead with plans to move to UK tax residency.

Lancashire, which has both UK and Bermuda-based insurance subsidiaries, said its Board of Directors had been reviewing its Bermudian tax residence at regular intervals and, following the publication of the latest proposals for the reform of the UK's Controlled Foreign Companies (CFC) rules, said that it intended to move its tax residence to the UK.

Lancashire, which was founded following Hurricane Katrina in 2005, said the latest proposals for the reform of the UK's CFC rules, had determined its decision to seek shareholder approval to implement "changes in the Company's bye-laws to allow the conduct of board and shareholder business in the UK in anticipation of the Company's move to UK tax residence in 2012."

The shareholders also approved a resolution that "confers authority on the Company to allot and issue common shares for cash in an amount up to 10 percent of the Company's issued share capital at the date of the SGM notice (an aggregate nominal value of $8,430,121) on a non pre-emptive basis."

Lancashire's Chairman Martin Thomas explained that the "vote permitting the issue of up to 10 percent of shares on a non pre-emptive basis, recognises and affirms the approach to capital management that the company has consistently and successfully deployed since its inception in 2005. It gives the company the ability to raise capital rapidly to take best advantage of underwriting opportunities, whilst avoiding the inevitable procedural delay of a UK rights issue."

Lancashire is not required to move its place of incorporation in order to qualify for the temporary period exemption, and currently intends to remain incorporated in Bermuda.

Plans to broaden membership

The Bermuda Insurance Management Association (BIMA) hopes to add more self-managed captives to its membership.

The Association, established more than 30 years ago to represent Bermuda's captive managers, also hopes to change its constitution to allow professional service providers, such as audit firms, banks and legal firms, to become members too, according to a story in the latest Bermuda Insurance Update newsletter.

BIMA president Tom McMahon told the newsletter: "We are quietly confident that more of the self-managed captives will become members. I would like to see our membership over 55 by the end of the year. It is important that BIMA has a strong voice, especially lately with so many issues on the table. That is quite evident this year with all the dialogue we have had with the Bermuda Monetary Authority on the Code of Conduct and Solvency II. It is important that when we are presenting our views on such subjects, we are reflecting a more widespread consensus.

"Self-managed captives are a part of the broader captive industry and they should have a vehicle through which they can make their views known."

Argus records $5.7m year-end loss

CORE EARNINGS ARE HIGHEST IN THE COMPANY'S HISTORY; SHAREHOLDERS' EQUITY AT $82 MILLION

Argus Group Holdings Limited has announced a net loss of $5.7 million for the year ended March 31, 2011, compared to a net loss of $18.4 million in the previous year.

Alison Hill, Chief Executive Officer of the Argus Group, said: "Every one of our seven business units recorded excellent results for the period, generating earnings in the region of $20 million against the backdrop of a continued recession.

"We were disappointed that a further deterioration in the value of certain of our investments, primarily in Bermuda, resulted in a net loss of $5.7 million for the year ended March 31, 2011. Shareholders' Equity stood at $82 million, substantially in excess of the statutory capital required to conduct the Group's various insurance businesses. All business units continue to deliver strong performance, are producing steady cash flows and are well placed to capture growth as the local and global economies start to recover.

"At September 30, 2010, the half year, we reported net earnings of $6.6 million and we were optimistic of meeting our annual earnings target. However, in the second half of the year the further diminution in value of $9 million to our equity portfolio, principally in local investments and $17.5 million against potential non-performing investments in the hospitality sector and local mortgages, have combined to produce negative earnings. The balance sheet now faces substantially less exposure to material risks arising from non-core investments and enables Argus to build on its history of over 60 years of service to Bermuda.

"Without these investment-related losses the earnings would have produced net income in the region of $20 million for the year, generated through the achievement of very high client retention levels and substantially exceeding our new business targets across all business lines.

"The reduction in value of local investments over recent years has led to the diminution in surplus capital available for distribution to shareholders as a dividend. In light of this, and to ensure that we continue to maintain a capital base that is well in excess of minimum statutory requirements, the dividend payment to shareholders will be temporarily suspended.

"During the year Shareholders' Equity was reduced to $82 million by the net loss of $5.7 million, cash dividends of $8.4 million and Other Comprehensive Loss of $1 million.

"Net premiums written increased by four percent arising from new business, and our continuing efforts to achieve acceptable underwriting ratios through appropriate adjustments to premiums. Overall, claims, policy and actuarial benefits decreased by six percent over the prior year due to lower than anticipated claims experience in overseas health care costs and our property and casualty businesses, partially offset by the trend of increasing local healthcare costs."

Conforming to an ill-suited system

ROGER CROMBIE LOOKS AT WHY INSURANCE ACCOUNTING IS A CURIOUS BEAST

The quarterly financial information on which PricewaterhouseCoopers reports in this publication is drawn from a range of sources. Chief among them are the company's unaudited (or, at year-end, audited) results, reports to the US Securities and Exchange Commission and material made public by the company for a range of reasons.

Regulators, industry analysts and rating agencies pour over the same information, basing their calculations and outlook on reported data, as filtered through their market and professional knowledge. Thousands of pages of data are reviewed, chewed over, analysed and tested. Various Generally Accepted Accounting Principles (GAAPs) and International Financial Reporting Standards are brought to bear.

Yet accounting is an odd practice and the truth is that the whole exercise is based not on scientifically proven data, but on estimates. That's a less outrageous assertion than it sounds, especially where insurance companies are concerned.

Let's start with the basic premise on which balance sheets and all derivative data are drawn up. A balance sheet is a snapshot of a company's financial condition at a particular moment. Balance sheets are produced on a number of broad and specific assumptions. An example of the former is the 'going concern basis', which assumes that the company and the world will continue to operate past the balance sheet date much as they did before it, and therefore that the company should be considered a going concern. An example of the latter, in insurance, is loss reserves, but we'll get to that.

Insurance accounting professionals work within narrow tolerances. They must follow the rules of, and answer to, various accounting boards, institutes and governments under whose licences they operate. There are rules, often thousands of pages of rules, and woe betide the individual or company that chooses to ignore any of them.

Public companies are required to produce quarterly financial statements. These three-monthly financial status reports are the lifeblood of the markets. But quarterly reporting is a bad model for an insurance company, and a very bad model indeed for a company with long-tail liabilities.

Insurance is a long game. As the bedrock on which commerce is built, its goal is longevity, to survive until the claims fall due. In certain lines, such as prop cat, consistent forward financial motion, quarter in and quarter out, is neither expected nor possible for even the best-managed company. If you insure cities against the cost of hurricanes, some years the bear will eat you.

Perfect evidence of the impropriety of quarterly balance sheets for insurance companies was provided after March 11, when Japan was hit by earthquake, tsunami and possible nuclear meltdown. Insurers had just 20 days from the first moment, perhaps two weeks once events had settled into a scary norm, to produce definitive financial statements outlining the likely costs they faced as a result of the disasters.

Best guess was all anyone could do. Corporate estimates were scared up based on modelled losses in the context of early estimates from outside agencies. Second quarter results contained more precise estimates, but they, too, will be corrected on a quarterly basis as more information comes to light during the claims process. In some cases, it will be years before liability is settled and a final calculation possible.

Corrections to estimated loss reserves show up in subsequent quarters as "favourable" or "unfavourable" developments in subsequent income statements. The events to which this line item refers occurred before the current reporting period, yet the receipt of new information in the current period qualifies loss development, effectively, as a profit or a loss in the current period.

Employees' benefits are often based on performance. An employee might well earn a bonus based on the financial consequences of events that happened before he or she joined the company, ignoring next year's adjustments. With the reality of economic facts about events taking years to unfold, employees receive bonuses based on poor data, but have often left the company with their bonuses in their pockets by the time the correct data becomes available.

The financial statements of insurance companies are estimates. QED.

The human factor

Two insurance industry titans presented themselves for a shared interview some years ago. Both led companies that were having poor years, financially. Each company was, in fact, doing well in its then-current year, but old mistakes and spots of bad luck had dented current year earnings. I asked if the two men were not tempted to put all their troubles into the present year, have a stinker, and then start the following year with clean slates.

> 'Quarterly reporting is a bad model for an insurance company, and a very bad model indeed for a company with long-tail liabilities. Insurance is a long game'

Both replied that they were not allowed to do so, that the rules of engagement precluded any kind of human intervention in the calculation of the numbers. My memory suggests that both men smiled as they said it, as if acknowledging what we all knew, which is that a good degree of wiggle room is not only permitted in, say, estimating loss reserves, but is often relied on.

Since loss development occurs in more or less every quarter, one way or another, it is understood that financial executives are making their best guesses. In so doing, they are expected to act neutrally, eliminating their company's interests in the equation. But no one working for a company can do that, not even internal auditors, ultimately, which is why annual independent audits and rating agencies are required.

Obviously, a better system is needed, but one is not likely to appear any time soon. Investors drive corporations and their representatives insist on quarterly information at a minimum. Lloyd's, that bastion of tradition, until relatively recently had its syndicates draw up financial statements every three years. Now it, too, has succumbed to the widespread British desire for everything American except Americans.

Some Lloyd's practitioners still report formally on an 'interim and final,' i.e. half-yearly, basis, but most offer quarterly advice or commentary, for fear of being noticeable by their omission, the same logic that draws reinsurers to Monte Carlo every year.

All corporate earnings are estimates, not just those of insurance companies. That's just the way it is.

Roger Crombie is a chartered accountant and a Fellow of the Institute of Chartered Accountants in England and Wales

‘Golden age’ for insurance industry

PLUMERI: ‘GLOBAL DEMAND FOR INSURANCE WILL DWARF THE CAPITAL AND CAPACITY OF TODAY’S INSURANCE MARKET’

The insurance industry is facing a “golden age” of opportunity. That was the prediction made by Joe Plumeri, Chairman and CEO of Willis Group Holdings, in his opening keynote address at this year’s Bermuda Insurance Day Summit.

“Over the course of the 21st century, the wealth and insurable value that the exploding global middle class will create will be unprecedented in history,” he said.

“The resulting global demand for insurance will dwarf the capital and capacity of today’s insurance market.”

Discussing the ways that the insurance industry, and in particular Bermuda, stepped up to pay claims after 9/11 and how it innovated to respond to new risks in the past, Mr Plumeri said that the industry would rise to the new challenges presented by the growth of the burgeoning economies of Brazil, Russia, India and China by “harnessing the strength of the global capital markets to provide tailored insurance for home and business.”

“The new middle class will need brokers that understand them and their industries,” he said. “They’ll need carriers who are innovative, financially secure and who are there when they need them — carriers with a reputation for paying legitimate claims quickly.”

The golden age of insurance will also be spurred by developments in the West, Mr Plumeri said, and particularly in the US where economic troubles are reducing the government’s appetite for public insurance.

Citing talk of a scaling back of the terrorism backstop and the unsustainability of the National Flood Insurance Programme, Mr Plumeri said that: “As the public sector inevitably retreats, opportunities will be created for the insurance industry in many areas.”

Joe Plumeri: “The wealth and insurable value that the exploding global middle class will create will be unprecedented in history”

New agreement with Argentina

Bermuda has signed a Tax Information Exchange Agreement (TIEA) with Argentina. It is the 27th such agreement to be signed with Bermuda. Premier Paula Cox said the agreement recognised the growing importance of trade with Latin America.

“This treaty relationship enhances the dealings between the two countries and enables us to pursue more matters of mutual interest. Our TIEA with Mexico has recently come into force and the TIEA with Argentina is also communicating the message that Bermuda recognises the value of opening trade relationships with the Latin American market.”

She added: “Bermuda knows that international business is a key driver of revenue for the country and for our GDP and that the TIEA’s we have signed with our many trading partners around the world contribute to strengthening our international reputation. It is the quality of our international reputation and domestic infrastructure that attracts and retains international business.”

The agreement with Argentina provides for a full exchange of information on criminal and civil tax matters between the two countries and includes provisions to protect the confidentiality of information provided, as well as adhering to public policy and provisions related to protecting legal privilege.

Bermuda signed its first TIEA with the US in 1988, and has since signed TIEAs with a total of 27 countries including Canada, New Zealand, Japan, the UK, China, France, Germany, Ireland, Sweden, Norway, Finland and Denmark.

The Premier said the signing emphasised “that Bermuda’s business model is a positive and well-balanced component of the global financial system.”

The magnitude nine earthquake and subsequent tsunami in Japan in February, left a trail of devastation across vast areas and was felt in Beijing, more than 1,500 miles from the epicentre

Earthquakes shake reinsurers' risk

STUART COLLINS ASKS WHY REASSESSING EARTHQUAKE EXPOSURE IS HIGH ON UNDERWRITING AGENDAS

Underwriters and catastrophe modellers are learning from a string of major earthquake losses, leading some to call for more realistic pricing to better reflect potentially higher exposure levels.

In recent years, insurers and reinsurers have kept a watchful eye on their hurricane exposures after suffering massive losses from Hurricanes Rita, Wilma and Katrina in 2005, and Ike in 2008. But 2010 and 2011 have been a reminder of the potentially huge costs and unpredictable nature of earthquake risks.

After a period of several years in which hurricanes have been grabbing all the headlines, earthquake risk has been the number one catastrophe peril since the beginning of 2010, with quakes in Haiti, Chile, New Zealand and Japan," said Robert Muir-Wood, of catastrophe modelling firm RMS.

More recently, underwriters were reminded of the unpredictable nature of earthquakes when a rare magnitude 6 earthquake shook large swathes of the Eastern US and Canada. The quake, which prompted evacuations in New York, caused damage to buildings in Richmond, Washington DC and Baltimore, as well as triggering the shutdown of two nuclear reactors.

Insured losses from the Virginia quake are thought to be relatively low — less than $100 million — although catastrophe modelling firm EQECAT said losses could have cost insurers $2 billion had the quake been magnitude 7.

The probabilities of the size of loss of the Japan and New Zealand earthquakes were not that extreme, but unique factors meant they proved expensive for insurers and reinsurers, said Dr Jayanta Guin of another catastrophe modelling firm, AIR Worldwide.

The Christchurch New Zealand earthquake in February was a small event of magnitude 6.3. However it proved costly because it occurred on a previously unknown fault close to the city, was shallow and because of the high degree of liquefaction, said Dr Guin.

The losses generally confirmed the expectations of catastrophe models — the Chile earthquake was consistent with modelled predictions — but the losses have also highlighted some key modelling issues, said Mr Muir-Wood.

For example, the September 2010 New Zealand earthquake occurred on a previously unknown fault and itself triggered other highly damaging earthquakes closer to the city of Christchurch over a period of months.

"This kind of behaviour, when one earthquake can trigger a cascade of other main shocks, is by no means unprecedented — and will now need to become a standard element of catastrophe modelling," he said.

Changes will now be made to earthquake models as a result of the New Zealand and Japan earthquakes, said Mr Muir-Wood, and this is likely to change underwriters' view of the risk, he added.

Earthquakes are well and truly back on underwriters radars, with many talking of a need for higher rates and a review of their accumulated earthquake exposure. Surprises, such as the cascade effect, the high cost of settling claims and the degree of liquefaction in New Zealand, as well as the

'This kind of behaviour, when one earthquake can trigger a cascade of other main shocks, is by no means unprecedented — and will now need to become a standard element of catastrophe modelling'

size and location of the Japan earthquake and tsunami, are leading many to reconsider the way they view quake risk in general.

The earthquakes in New Zealand and Japan in the past year have heightened underwriters' awareness of quake risk, even in unaffected zones like California, said Robert Childs, Chief Underwriting Officer at Hamilton-Bermuda-based Hiscox Ltd. For example, catastrophe underwriters are now considering the implications of a tsunami sweeping across the US West Coast, a risk that is not currently reflected in pricing, he added.

Many reinsurers diversified into earthquake exposures after suffering a series of large hurricane losses in the mid to late 2000s. The increased competition for earthquake business put pressure on rates, with some reinsurers suffering disproportionately high losses from recent quakes, said Mr Childs.

Earthquake risk has been at the forefront of catastrophe underwriters' minds following the losses of the past year, he added.

"Underwriters are saying that they cannot continue to write earthquake at low rates on line. The recent losses are a health reminder of the importance of getting the right price for the risk, so there will be pressure on rates in earthquake zones."

International markets in London and Bermuda are likely to take a firm line on earthquake pricing, said Mr Childs. Both markets have a proven appetite for earthquake business and will continue to do so if the price is right, he added.

Underwriters have already responded to the losses with price increases in Japan and New Zealand. According to reinsurance broker Aon Benfield, the July renewals saw price increases for Japanese cedents of between 30 percent and 50 percent, with reinsurance rates in New Zealand as high as 100 percent. However, plentiful capacity continues to hold prices steady in most quake exposed regions, including the US, Latin America, China and Europe.

On-going seismic activity in New Zealand is still a source of concern for reinsurers, Aon Benfield said. "The effects of the ceded losses and heightened seismic activity resulted in a significant reappraisal of the risk with pricing, attachment, reinstatements and capacity all being scrutinised and subject to change."

The number of intense and costly earthquakes to strike in the past year-and-a-half has led some to suggest there may be an underlying trend toward a period of greater quake activity. However, there is little evidence to support such a theory, said Mr Muir-Wood and Dr Guin. Earthquake activity remains steady, although more quakes have occurred close to populated areas with high levels of insurance penetration, resulting in losses for insurers, they observed.

The recent run of losses — in particular the relatively high cost of a moderate earthquake in New Zealand and the devastation wrought on Japan — have shown large earthquake losses are less uncommon than some may previously have thought.

There is a two-percent chance of a $50 billion or greater accumulated earthquake insured loss worldwide in any one year, said Dr Guin. The combined losses in New Zealand and Japan are likely to be around $50 billion, he said.

"This reminds us that there is a lot of risk out there for underwriters," he added.

Twelve-month delay for Solvency II

SOME INSURERS LOBBY FOR THE OPPORTUNITY TO OPT IN EARLY. BY STUART COLLINS

Implementation of Europe's much-heralded Solvency II regime looks set to be delayed until 2014 — one year later than initially hoped.

While some firms are not happy with the prospect of further delay, the additional lead-in time will give regulators and insurers more time to prepare.

For much of the more than decade-long development of Solvency II, the intended implementation deadline was set for late 2012. However, as the deadline date has drawn closer, it has become apparent that legislators, as well as some regulators and insurers, have much work to do. In particular, legislative delays and wrangling over key outstanding issues have left insurers without a final set of rules to go by.

Talk of a delay surfaced as European legislators hammer out details of Solvency II final implementation measures and the Omnibus II Directive. Both the European Council and Parliament-the two bodies that must reconcile their proposals in order to pass legislation-have proposed a delay to implementation.

Proposals from the European Council and Parliament are similar, said Paul Clarke of PricewaterhouseCoopers. "There is now reasonable certainty that the outcome will be a January 1, 2014 deadline for implementation. Insurers will continue to be regulated until then on a Solvency I basis, although they are likely to be required to supply Solvency II information — a kind of soft launch — in 2013," he said.

The consensus is positive for the industry because it means the end of a distracting debate about whether or not there will be a delay, said Mr Clarke. However, insurers that have spent millions preparing for implementation in 2013 are not happy about the prospect of delay.

"Lloyd's does not want a delay to implementation," said Sean McGovern, General Counsel for the London-based insurance market. "We have been investing very significant amounts of money and management time to ensure we are ready for a 2013 start and are confident we will be ready. A delay will only drive up costs and leave the industry with a continuing cloud of uncertainty hanging over it."

Some insurers that are set to meet requirements on the original deadline are lobbying for an opportunity to "opt-in" to Solvency II early. This would allow them to take advantage of their own internal models, and avoid duplication of reporting, they argue.

The European body representing insurers, the CEA, says that there is support for an approach whereby legal transposition of Solvency II would take place as planned in 2013, but supervisors and industry would have additional time following transposition before full application.

Insurers would like an appropriate period between achieving legal certainty — the issuing of final implementation rules-and the full implementation of Solvency II, said a spokesperson for the CEA. For example, insurers will need at least two years from the adoption of implementing technical standards in order to implement the necessary systems to support quantitative supervisory reporting, the spokesperson said.

The delay should be welcomed by the industry because a lot of the technical detail is still to be finalised — such as capital charges for catastrophe risk — said Mr Clarke. Getting clarity on areas of disagreement is now the most important issue for insurers, although this is not expected until autumn, with final rules not likely until well into 2012, he added.

The delay will also give breathing space for countries like Bermuda and Switzerland that are seeking regulatory equivalence with Solvency II.

Equivalency assessments could potentially be carried out against a final Solvency II rule book, as well as giving non-EU countries extra time to make regulatory changes to secure equivalent status, he added.

The delay is also being welcomed by the Bermudian supervisor, the Bermuda Monetary Authority (BMA), which is seeking regulatory equivalence with The European Union. "This will be viewed as ultimately beneficial, as it will give EU regulators, third country regulators seeking equivalence with the EU, and the market additional time to prepare for equivalence," said a BMA spokesperson.

"Extension of the implementation date for Solvency II is a positive indication that the authorities in Europe have taken into account the input of those who will be making adjustments to comply with Solvency II, and the European Insurance and Occupational Pensions Authority and European Commission are taking a pragmatic view on implementation of the Directive."

On the road to Solvency II: page 18

'Positive' progress on equivalence

Bermuda's bid to reach an agreement with the European Union on the equivalence of insurance regulation is progressing well, with the Island's regulator planning additional changes to meet European requirements.

The Bermuda Monetary Authority (BMA) continues to make changes to the domicile's insurance regulatory regime with Europe's Solvency II in mind.

A European Insurance and Occupational Pensions Authority (EIOPA) consultation document published in August on Bermuda's application for equivalence — which included a preliminary assessment — was generally positive.

EIOPA says that that Bermuda meets the criteria for equivalence assessments under Solvency II for commercial insurers — Classes 3A, 3B and 4 — but with certain caveats. For example, EIOPA highlighted the need for stricter governance and reporting requirements, as well as the need for further development of group supervision.

EIOPA also noted that the regime applicable to insurers of other classes does not meet the criteria.

"For several years we have proactively focused our framework changes in terms of equivalence on the commercial insurance market in Bermuda," the BMA said. "Therefore, the BMA appreciates EIOPA reaching its conclusions regarding our commercial framework while distinguishing Bermuda's captive sector regulations, a position that we expected."

The BMA also said that it already has under active consideration, EIOPA's suggestions or caveats on areas for additional regime enhancements. "Since this assessment is the first phase of a process that will conclude in 2012 with the EU Commission's final decision on equivalence, in the interim period we can conclude work on these areas and the various work streams already in progress," the BMA said.

Issuing of the final Level 2 implementing measures for Solvency II will bring a further level of clarity to the practical implementation of the Directive, said the BMA.

OPERATING RATIOS

QUARTERLY LOSS RATIOS

	Q2 2011	Q2 2010	Q2 2009
ACE	62.9%	58.8%	58.2%
Alterra	60.7%	54.6%	NA
Arch	67.1%	58.3%	57.0%
Aspen	71.0%	57.7%	54.8%
Allied World	66.4%	55.7%	53.3%
Axis	67.3%	54.9%	53.5%
Endurance	74.4%	64.2%	62.4%
Everest Re	70.8%	65.1%	59.2%
Flagstone Re	67.3%	65.4%	30.8%
Hiscox	NA	NA	NA
IPC Holdings	NA	NA	(8.7%)
Max Capital*	NA	NA	65.1%
Montpelier	68.6%	29.4%	23.6%
PartnerRe	71.4%	57.6%	53.6%
Platinum	92.4%	37.3%	53.7%
Renaissance Re	69.6%	14.6%	17.6%
Validus	48.7%	44.5%	38.0%
White Mountains	59.0%	64.6%	58.9%
XL Group	63.1%	61.4%	60.8%

QUARTERLY EXPENSE RATIOS

	Q2 2011	Q2 2010	Q2 2009
ACE	29.7%	30.9%	29.5%
Alterra	33.0%	28.7%	NA
Arch	32.5%	31.7%	30.2%
Aspen	34.0%	29.2%	32.9%
Allied World	31.0%	31.3%	29.8%
Axis	31.6%	31.3%	26.9%
Endurance	27.5%	26.8%	27.2%
Everest Re	27.2%	28.1%	28.7%
Flagstone Re	39.8%	38.0%	37.9%
Hiscox	NA	NA	NA
IPC Holdings	NA	NA	32.3%
Max Capital*	NA	NA	25.7%
Montpelier	34.0%	30.4%	37.9%
PartnerRe	30.3%	32.2%	29.9%
Platinum	27.0%	30.1%	23.2%
Renaissance Re	25.9%	27.7%	26.2%
Validus	34.5%	30.4%	33.9%
White Mountains	46.7%	41.0%	40.7%
XL Group	31.8%	30.8%	32.2%

QUARTERLY COMBINED RATIOS

	Q2 2011	Q2 2010	Q2 2009
ACE	92.6%	89.7%	87.7%
Alterra	93.7%	83.3%	NA
Arch	99.6%	90.0%	87.2%
Aspen	105.0%	86.9%	87.7%
Allied World	97.4%	87.0%	83.1%
Axis	98.9%	86.2%	80.4%
Endurance	101.9%	91.0%	89.6%
Everest Re	98.0%	93.2%	87.9%
Flagstone Re	107.1%	103.4%	68.7%
Hiscox	NA	NA	NA
IPC Holdings	NA	NA	23.6%
Max Capital*	NA	NA	90.8%
Montpelier	102.6%	59.8%	61.5%
PartnerRe	101.7%	89.8%	83.5%
Platinum	119.4%	67.4%	76.9%
Renaissance Re	95.5%	42.3%	43.8%
Validus	83.2%	74.9%	71.9%
White Mountains	105.7%	105.6%	99.6%
XL Group	94.9%	92.2%	93.0%

NA — No data applicable

FINANCIAL STRENGTH RATINGS

	A M BEST RATING		S&P RATING	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
ACE	A+	A+	AA–	A+
Alterra	A	A	A–	A–
Arch	A	A	A+	A+
Aspen	A	A	A	A
Allied World	A	A	A	A–
Axis Specialty	A	A	A+	A+
Endurance	A	A	A	A
Everest Re	A+	A+	A+	A+
Flagstone Re	A–	A–	NR	NR
Hiscox	A	A	A	A
IPC Holdings	NA	NA		NA
Max Capital	NA	NA		NA
Montpelier	A–	A–	A–	A–
PartnerRe	A+	A+	AA–	AA–
Platinum	A	A	A	A
Renaissance Re	A+	A+	AA–	AA–
Validus	A–	A–	A–	NR
White Mountains	A–	A–	A–	A–
XL Group	A	A	A	A

NR — Not rated by S&P NA — No data applicable

ANALYSIS / PWC Q2 2011

Outlook

- Direction of rate increases partially dependent on outcome of wind season plus recalibration of windstorm models.
- Low interest rate environment due to continue and cause additional rate pressure on long-tail lines. Many entities within the group have short duration portfolios that will be reinvested in the near term at low yields.

Earnings

- Gross premiums written increased by 5 percent, driven by reinstatements, rate increases and some new business/increases on existing programmes. There were some decreases in individual lines due to unfavourable pricing.
- Mid-year property catastrophe pricing generally positive with reports of Florida rate increases of 5–10 percent and high double digit increases for Australia, New Zealand and Japan.
- The Q2 combined ratio was 100 percent compared with 84 percent in 2010. The increase was caused by US storm activity and adverse development on the New Zealand earthquake, partially offset by favourable prior year reserve development.
- Modest investment income growth was driven by higher invested assets offset by weak alternative investment returns.
- Q2 net income, although significantly improved from Q1, decreased sharply in comparison with the prior year.
- On a year-to-date basis, the group recorded a net loss of $1.1bn compared with net income of $4.3bn in 2010.

Capital Management

- Share repurchase activity down and generally on hold through the remaining hurricane season. Future activity dependent on rate environment approaching January renewals plus impact of recent risk model changes.
- Financial strength ratings were consistent with the prior quarter.

GROSS PREMIUMS WRITTEN $M

	Q2 2011	Q2 2010	Q2 2009
ACE	5,423	5,154	5,117
Alterra	564	399	NA
Arch	912	817	912
Aspen	582	545	534
Allied World	520	494	493
Axis	1,046	940	915
Endurance	503	490	559
Everest Re	988	1,014	974
Flagstone Re	346	370	329
Hiscox	NA	NA	NA
IPC Holdings	NA	NA	128
Max Capital	NA	NA	397
Montpelier	217	200	184
PartnerRe	1,082	1,140	846
Platinum	148	162	215
Renaissance Re	642	507	855
Validus	605	517	425
White Mountains	551	920	957
XL Group	1,863	1,600	1,652

NET PREMIUMS EARNED $M

	Q2 2011	Q2 2010	Q2 2009
ACE	3,757	3,233	3,266
Alterra	349	293	NA
Arch	643	623	699
Aspen	460	480	429
Allied World	355	339	334
Axis	840	735	707
Endurance	487	456	434
Everest Re	1,040	990	957
Flagstone Re	171	232	187
Hiscox	NA	NA	NA
IPC Holdings	NA	NA	96
Max Capital	NA	NA	229
Montpelier	152	148	141
PartnerRe	1,107	1,105	826
Platinum	172	191	232
Renaissance Re	217	212	380
Validus	426	438	328
White Mountains	496	859	898
XL Group	1,398	1,303	1,430

NA — No data applicable

QUARTERLY EARNINGS (LOSS) DATA

	Net income (loss) attributable to common shareholders ($m)			Fully diluted earnings (loss) per share ($)		
	Q2 2011	Q2 2010	Q2 2009	Q2 2011	Q2 2010	Q2 2009
ACE	607	677	535	1.77	1.98	1.58
Alterra	33	103	NA	0.30	1.13	NA
Arch[1]	92	237	152	0.67	1.48	0.81
Aspen	10	103	105	0.06	1.28	1.22
Allied World	94	184	114	2.36	3.47	2.22
Axis	101	205	159	0.79	1.51	1.06
Endurance	37	55	145	0.87	0.97	2.42
Everest Re	131	157	273	2.41	2.70	4.43
Flagstone Re	(20)	13	68	(0.29)	0.17	0.80
Hiscox	NA	NA	N/A	NA	NA	NA
IPC Holdings	NA	NA	174	NA	NA	3.11
Max Capital	NA	NA	44	NA	NA	0.76
Montpelier	21	70	159	0.33	0.96	1.81
PartnerRe	116	182	465	1.69	2.31	8.10
Platinum	(20)	124	98	(0.55)	2.68	1.90
Renaissance Re	25	210	271	0.48	3.66	4.32
Validus	110	180	138	1.05	1.44	1.74
White Mountains	12	3	180	1.48	0.28	20.35
XL Group	226	192	80	0.69	0.56	0.23

NA — No data applicable 1. Where the information is available, Arch share and per share amounts have been restated for the Q2 three for one stock split

CUMULATIVE YTD EARNINGS (LOSS) DATA

	Net income (loss) attributable to common shareholders ($m)			Fully diluted earnings (loss) per share ($)		
	Q2 2011	Q2 2010	Q2 2009	Q2 2011	Q2 2010	Q2 2009
ACE	866	1,432	1,102	2.54	4.21	3.27
Alterra	(14)	140	NA	(0.13)	1.88	NA
Arch[1]	111	448	292	0.80	2.74	4.67
Aspen	(142)	116	221	(2.16)	1.43	2.61
Allied World	102	318	245	2.57	5.98	4.79
Axis	(283)	317	275	(2.38)	2.28	1.84
Endurance	(54)	107	220	(1.36)	1.88	3.65
Everest Re	(185)	134	381	(3.40)	2.28	6.19
Flagstone Re	(181)	45	104	(2.60)	0.55	1.21
Hiscox	(141)	120	NA	(0.37)	0.31	NA
IPC Holdings	NA	NA	182	NA	NA	3.25
Max Capital	NA	N/A	88	NA	NA	1.54
Montpelier	(83)	80	211	(1.34)	1.08	2.42
PartnerRe	(700)	254	599	(10.32)	3.13	10.43
Platinum	(178)	140	182	(4.75)	2.95	3.47
Renaissance Re	(223)	375	368	(4.39)	6.37	5.90
Validus	(62)	61	232	(0.68)	0.46	2.94
White Mountains	(17)	(37)	211	2.06	(4.24)	23.82
XL Group	(2)	320	258	(0.01)	0.93	0.76

NA — No data applicable 1. Where the information is available, Arch share and per share amounts have been restated for the Q2 three for one stock split

MARKET CAPITALISATION

	Q2 2011		Q2 2010		Q2 2009	
	Common shares issued	Market value $	Common shares issued	Market value $	Common shares issued	Market value $
ACE	337,912,324	65.82	338,755,604	51.48	336,097,451	44.23
Alterra	105,794,521	22.30	118,643,363	18.78	NA	NA
Arch[1]	132,771,524	31.92	148,891,720	24.83	182,942,418	19.53
Aspen	70,833,000	25.57	76,700,990	24.74	83,021,860	22.34
Allied World	37,945,043	57.19	49,407,301	45.38	49,524,492	40.83
Axis	125,811,000	30.96	120,254,000	29.72	137,710,000	26.18
Endurance	40,509,263	41.33	52,663,877	37.53	57,090,980	29.30
Everest Re	54,346,000	81.75	56,242,019	70.72	60,852,944	71.57
Flagstone Re	70,058,168	8.43	78,009,113	10.82	84,864,844	10.30
Hiscox	387,050,000	6.70	377,004,000	5.11	374,142,000	4.78
IPC Holdings	NA	NA	NA	NA	56,193,170	27.34
Max Capital	NA	NA	NA	NA	56,598,975	18.46
Montpelier	61,581,768	18.00	73,288,093	14.93	87,448,434	13.29
PartnerRe	67,737,776	68.85	75,349,855	70.14	57,950,306	64.95
Platinum	37,324,000	33.24	41,094,952	36.29	49,778,459	28.59
Renaissance Re	51,753,000	69.95	54,872,000	56.27	62,345,000	46.54
Validus	98,763,928	30.95	111,407,993	24.42	76,151,473	21.98
White Mountains	7,958,589	420.16	8,532,442	324.20	8,857,586	228.91
XL Group	305,233,983	21.98	342,010,919	16.01	342,175,328	11.46

NA — No data applicable 1. Where the information is available, Arch share and per share amounts have been restated for the Q2 three for one stock split

SHAREHOLDERS' EQUITY ($M)

	Q2 2011	Q2 2010	Q2 2009
ACE	24,113	21,410	16,561
Alterra	2,793	2,927	NA
Arch	4,441	4,398	4,030
Aspen	3,105	3,304	2,973
Allied World	3,044	3,469	2,741
Axis	5,333	5,495	4,909
Endurance	2,670	2,844	2,476
Everest Re	6,153	6,036	5,545
Flagstone Re	947	1,304	1,095
Hiscox	1,834	1,803	1,592
IPC Holdings	NA	NA	2,014
Max Capital	NA	NA	1,363
Montpelier	1,620	1,621	1,597
PartnerRe	6,632	7,071	4,768
Platinum	1,696	2,105	1,953
Renaissance Re	3,515	3,775	3,404
Validus	3,543	3,603	2,152
White Mountains	4,216	4,160	3,204
XL Group	10,628	10,507	7,473

NA — No data applicable

Stormy weather in a tough year

WITH THE MOST EXPENSIVE TORNADOES IN HISTORY — AND A SECOND QUAKE IN NEW ZEALAND — THE CLAIMS KEEP COMING. ROGER CROMBIE ANALYSES THE PREVIOUS QUARTER'S FIGURES

With a couple of exceptions, the Bermuda insurance and reinsurance companies that PwC analyses had a profitable second quarter. Under the circumstances, that was pretty good going: like the first, the second quarter of 2011 was remarkable for the frequency and intensity of claims.

The first quarter saw major insured losses from flood damage in Australia from Cyclone Yasi (estimated insured losses $6.5 billion), an earthquake in Christchurch, New Zealand ($12 billion); and the Tohoku earthquake and tsunami ($30 billion). The second quarter was costlier, as discussed below. Then an earthquake in Virginia and Hurricane Irene opened the third quarter, bringing about a majority view that the market had turned. To what extent it has turned will be made clear by the end of the Atlantic hurricane season.

At the start of the second quarter, the insurance markets Bermuda serves were essentially in equilibrium, give or take a few percentage points. Rate increases in cat-related lines at July 1 were widespread, in part because the effect of the windstorm model upgrades this spring has yet to be fully calibrated in real time.

As ever, the end of this soft market has been accompanied by appalling events and catastrophic losses that work their way through to the companies in the PwC group, where the buck stops.

Earnings

That the Bermuda companies met second quarter claims largely out of earnings is a more than creditable showing. As a group, performance in the second quarter of 2011 was down from a year earlier, but that's not the relevant yardstick this year. Making money in the face of the worst tornadoes in history; adverse loss developments from Q1 events, notably New Zealand and Japan; a combined ratio of 100 percent for the second quarter; and a continuing essentially zero interest rate environment, is not to be sniffed at.

For the six months to June 30, most of the companies remain in loss. Second quarter profits were not enough to plug the hole dug by an awful Q1, although a few companies were ahead at June 30, or within striking distance of break-even. That may not sound like much, but this year it represents solid performance.

That tells us that a number of the companies have reached the stage in their development when only a very, very bad year indeed would be looked at as a balance sheet, rather than an income statement, event. That's a good place to be in business terms, en route to the sort of permanence all insurance and reinsurance companies set out to achieve.

Time was that a quarter's gross and net premiums written told the tale almost by themselves. With the market at a neutral point, however, most of the difficult business has been priced reasonably, perhaps after being turned away elsewhere. Gross premiums are up for the PwC group by five percent year on year, but many of the companies have increased writings by 10 to 15 percent. Even with these increases, the ratio of gross premiums to capital remains conservative for the group.

Balance sheets

A quick look at the table of shareholders' equity shows that, in most cases, the large Bermuda companies have grown — some quite significantly — in the past two years, the end of the soft market era. Shareholders' equity is up by almost half at market leaders ACE and XL Group in the two years. At ACE, Evan Greenberg already has a great name; at XL, Mike McGavick is making himself something of a legend. He turned Safeco around and now, it may be said, has done the same at XL.

In the second quarter of 2011, across the group, share repurchase activity fell as claims mounted and the hurricane season approached. The companies' financial strength ratings were consistent with the prior quarter. Balance sheets have been de-risked and have returned to what Willis CEO Joe Plumeri refers to as "boring", i.e. on the asset side, uneventful investment portfolios that return more or less what's expected and let insurers concentrate on the liability side of the business.

Managing clients' risk, after all, is the core competence; investment management is mostly farmed out. It looks as if 2011 will be the acid test (is there an alkaline test?) for underwriting discipline, the core itself.

By June 30, most of the companies' loss provisions for the year had been reached or exceeded. It'll be fingers crossed for the second half of the year, for which the loss experience will dictate the next stage of development of many of the mid-sized Bermuda companies. A major cat loss in the second half of the year would probably set off a cycle of sidecars, recharged capital and all the excitement that entails. With the incidence of disasters seemingly rising, and with Allied World, Validus and Berkshire Hathaway already slugging it out for control of Transatlantic, how much more excitement could we stand?

Killer storms

The most significant claims in the second quarter of 2011 arose from wind, hail and quake. A string of tornadoes across the US was the most devastating and expensive in history. Hail events in the Midwest and Southern US and a second Christchurch, New Zealand earthquake rounded out a quarter that saw an estimated $20.8 billion in US cat losses alone.

April had an active weather pattern across the 48 contiguous states, with strong storms moving through the centre of the country, tapping into moisture from the Gulf of Mexico as they matured across the mid-Mississippi Valley. La Niña conditions in the Pacific Ocean, unusually warm ocean temperatures in the Gulf of Mexico, and the increase of moisture in the atmosphere caused by the warming climate, contributed to events.

The majority of the quarter's losses, in lives as well as dollars, were due to devastating tornadoes in parts of the US Midwest and Southeast in April (estimated cost of insured losses $6 billion) and May ($7 billion). April's US storm activity was the busiest month since records were first kept in 1950. The final April count was 753 tornadoes, easily beating the previous record of 543 in May 2003. The previous April record was 267 in 1974.

'It'll be fingers crossed for the second half of the year, for which the loss experience will dictate the next stage of development of many of the mid-sized Bermuda companies'

Two particularly vicious storm clusters accounted for most of the losses. The period from April 25 to 28 saw an acute string of tornadoes that killed more than 300 people in the South and Midwest. The four days are being referred to as the "Dixie Outbreak." A sad record was set on April 27 when more than 330 people died in and around Tuscaloosa, Alabama. It was the highest one-day tornado death toll in history, as 173 tornadoes were recorded, a record for a single storm system in modern times. Risk Management Solutions estimates that in the Dixie Outbreak, about 70 percent of the losses were in Alabama.

On May 22, the city of Joplin, Missouri took a direct hit from a tornado more than half a mile wide. An American Red Cross official stated that three-quarters of the city had been damaged. The Joplin event may cost insurers $3 billion. The weather system that devastated Joplin went on to cause another half a billion dollars in insured losses in Ohio.

Christchurch, New Zealand was then struck by a 6.0 magnitude earthquake on June 13, the second major event in that area this year ($5 billion in damage). This quarter also saw major uninsured losses from events such as the flooding of the Mississippi River from Illinois to Louisiana ($2 billion) and drought and wildfires in the Southwest ($3 billion).

The US National Weather Service estimates that weather disasters have cost more than $35 billion this year, based on insurance estimates. "The nation is increasingly vulnerable to extreme weather," National Weather Service Director Jack Hayes said. "The year has been marked by floods, drought and tornadoes. Meanwhile, a Texas heat wave has cost $5.2 billion in crop and livestock losses so far. It doesn't take a wizard to predict that 2011 will go down in history."

Now for the third quarter…

Insurance executives who might have been hoping for a little breathing space in the third quarter had their hopes dashed on August 23, when a 5.9 magnitude earthquake hit Virginia, its effects felt from Washington DC up to New England. Insured losses will not exceed $100 million, which makes it a minor event in this year's context.

Not so Hurricane Irene, which headed menacingly for, but then spared, New York City. Irene pushed on into Canada to become one of the 10 costliest storms in history. 2011 will without doubt be remembered in the insurance industry as a tough, tough year; those words were written before the Monte Carlo Rendezvous, when something dramatic, terrible, deadly and expensive quite often happens.

Transatlantic takeover uncertain

Plans to take over Transatlantic Holdings Inc continue apace. In June, Transatlantic Holdings Inc board rejected a hostile takeover bid from fellow insurer Validus Holdings Ltd, and remained committed to plans to combine the company with Switzerland-based Allied World Assurance Co Holdings AG, in an all-stock deal that is now worth $2.96 billion.

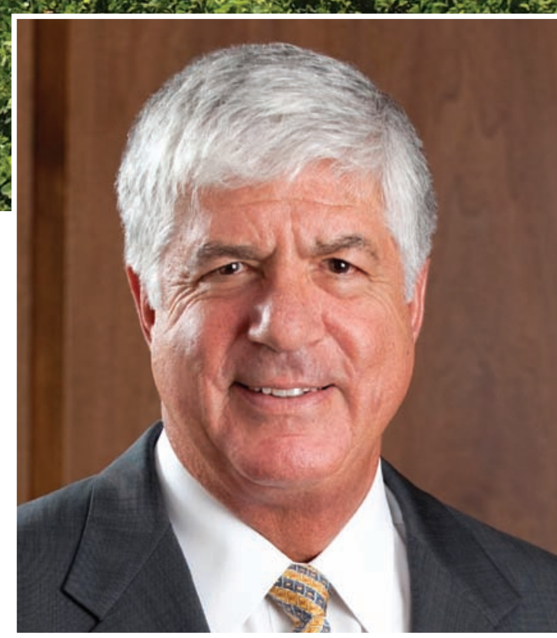
The board also adopted a one-year stockholder rights plan, commonly called a "poison pill," a move used to avoid hostile takeovers.

Bermuda-based Validus claimed its target was "spreading misinformation" about its offer and maintained Transatlantic's board would not take part in good-faith discussions.

Transatlantic said it believed that the deal to combine with Allied World "will provide greater long-term value potential to Transatlantic's stockholders". The deal was described as a merger of equals.

A Standard and Poor's equity analyst has been quoted as saying that they "would not rule out additional overtures from other parties."

Growing vines in Croatia was a retirement dream for Robert Benmosche — but the insurance world soon enticed back the AIG President and CEO



Message in a bottle!

THE WINEMAKING RETIRED INDUSTRY LEADER LURED BACK INTO BUSINESS BY AN IRRESISTIBLE CHALLENGE

When insurance industry giant Robert Benmosche retired in 2006, a lifetime dream of winemaking in Croatia beckoned.

The relentless daily diet of high pressure executive board meetings and global travel were replaced by quiet contemplation tending his vines as a hobby.

"In 2009 I am having a great time. You get to be my age, you retire, and you go to Croatia. I'm single and, you know, as a teenager you wanted all of that freedom but you just didn't have the money to do what you wanted to do. Can you imagine having the money and the freedom to do it and I was having a wonderful time with my life of irresponsibility; a dream that came true."

Then things changed — dramatically.

"I remember sitting and watching television and I remember Hank Paulson coming on television saying that we have a problem and that it is a big problem and the US Government is going to provide financing to American International Group (AIG)," he told the recent Bermuda Captive Conference.

Over the years, AIG had built upon its premier global franchises in life and general insurance by expanding into a range of financial services businesses. One of these, created in 1987, was AIG Financial Products Corp (AIGFP), a company that engaged as principal in a wide variety of financial transactions for a global client base.

In 1998, AIGFP began to sell credit default swaps to other financial institutions to protect against the default of certain securities. At the time, many of these securities were rated AAA, the highest rating possible.

However, in late 2007 as the US residential mortgage market began to deteriorate, the valuation of these securities declined severely. As a result, AIG recorded significant unrealised market valuation losses, especially on AIGFP's credit default swap portfolio, which led to substantial cash requirements.

At the same time, AIG reported large unrealised losses in its securities lending programme that made short-term loans of certain securities it owned to generate revenues by investing in high-grade residential mortgage-backed securities.

The collapse of respected financial institutions such as Bear Stearns and Lehman

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Brothers sent shock waves throughout the world economy. The crises at the US-sponsored mortgage companies Fannie Mae and Freddie Mac added to the financial disruption. Credit markets deteriorated rapidly, making it virtually impossible to access capital.

AIG's credit ratings were downgraded, triggering additional collateral calls and cash requirements in excess of $20 billion. Although solvent, AIG suddenly faced an acute liquidity crisis.

To stabilise AIG and prevent reverberations throughout the economy, the Federal Reserve Bank of New York (FRBNY) extended a two-year emergency secured loan of up to $85 billion to AIG on September 16, 2008.

With the loan in place, the management team developed a plan to sell many of AIG's leading businesses around the world to pay back the FRBNY loan with interest. However, AIG still had to address its two principal liquidity issues: the multi-sector credit default swap portfolio and the securities lending programme.

In November 2008, AIG and the FRBNY announced a comprehensive plan to address AIG's liquidity issues and provide more time and greater flexibility to sell assets and repay the government. The plan included the creation by FRBNY of two financing entities, Maiden Lane II and Maiden Lane III, to acquire AIG's securities lending assets and the multi-sector collateralised debt obligations that were guaranteed by AIGFP's credit default swaps. The entities were funded primarily by the FRBNY, with a subordinated capital contribution by AIG.

Under the terms of the agreements, the majority of any appreciation in the securities held by the entities would go to the FRBNY, but a portion would be retained by AIG.

In addition, the US Treasury purchased, through the Troubled Asset Relief Programme, $40 billion of newly issued AIG perpetual preferred shares. The proceeds were used to pay down a portion of amounts then outstanding of the FRBNY loan. The perpetual preferred shares carried cumulative compound dividends at 10 percent per year.

Although Maiden Lane II and III and the government's equity injection significantly relieved AIG's liquidity pressures, the world economy in general and the financial industry in particular continued to falter. Asset valuations continued to decline and AIG's losses increased through the end of the year, taking a heavy toll on fourth quarter results.

"I get this phone call in January 2009," explained Mr Benmosche. "It is from Hank Greenberg who says that I need to do him a favour. I said 'what is it?' and I felt pretty badly about what happened with AIG. You can imagine 40 years of your life as CEO just about and you watch the thing crumble before you eyes.

"He said that they needed a CEO and he wanted me to consider the job. I said 'Hank, you can't offer that to me anymore, you just can't' and he says to me, 'Listen to me, this is going to get worse, there might be nothing left and this industry can not afford to have AIG fall apart in any of its parts. You just can't afford it; we've got to get this fixed. I want you to consider it, we have a new president coming in, we have a new secretary of treasury, I need you to tell me you will consider it.'

"I said 'You know what Hank, for you I will consider it. So I will get back to you. I will give it some thought' and I left and stupid me, I thought he would never remember.

"He calls me three weeks later. 'When are you coming back to New York?' I said I would be there next week. He said, 'Good, we have to have lunch. You haven't given me your answer' and so I came back, had lunch, and Hank said 'You have to, you are the only guy I know that can do this' and I said that it was really terrific that he said that, but that I really didn't want to give up my retirement but said that if you can succeed I am happy to do it for you but only for a short period of time. Trouble is nothing ever happened with that. It never went anywhere."

Up to his retirement in 2006, Mr Benmosche was Chairman and CEO at MetLife. During his tenure he oversaw MetLife's acquisition of General American Travels Life and Annuity and New England Mutual as well as heading MetLife's sales force in retail product development.

Before joining MetLife he spent 13 years at PaineWebber holding a number of positions including Senior Vice President of Marketing, CFO of the retail brokers division, Executive Vice President of Operations and Technology, Director and Sales Manager for over 1,500 investment advisors, and managed the merger of Kidder Peabody into PaineWebber. Prior to that, he worked at Chase Manhattan Bank.

A native of Brooklyn, his first job was driving a truck for Coca-Cola selling their beverages.

"March came. I remember the big bonuses and the thing before Congress and so on. My frustration of watching on television; I was yelling at the television it didn't do me any good. I said, 'Tell them that they earned the bonus, tell them.' I was screaming at the television but they weren't listening to me they just went on and on about the bonuses AIG shouldn't have paid. It was wrong and of course the company went into a tailspin.

"Then, at the end of June I get a call initiated by the US Treasury to see if I will come in and take the job. I considered it and didn't want to do it, but in the end I realised that as a major shareholder of MetLife, having devoted a lot of time to building that company up to where it is, if AIG were to fail, this industry would take a decade to recover because everyone would begin to start seizing their assets.

"We really had to start building the company right from that point of time, and change the direction, which is why I choose to take the job. If you want to sell out the company, I was not the right guy. If you want to build it, get it right, sell off enough to be able to pay off the government, then I am the one that can do the job and that is pretty much how we got to where we are today."

He said that AIG had survived because of the 'incredible talent' of the company's staff.

"We have our people. It is unbelievable that they are here and they take enormous pride because the fact is they work for AIG and they have a career here, and if we can pull this off they actually have a history that they can be proud of. So it is really something that is very emotional for a lot of people."

"We went out and did a survey of how they felt in September as a reinforcement about the people of AIG, and 92 percent of 63,000 people at the time responded to the survey in two-and-a-half weeks. There is no company that I have ever worked with or for that has ever had that kind of response rate and there was overwhelmingly positivity about all the things that I just described."

He added: "Some of you who are in the industry [in Bermuda] came from AIG. We helped train you in the industry, so the strength is still here, the feelings are still here, the core is still here, and the clients are still here. We don't have the risk profile that got us into trouble, we are back to being a really strong solid insurance company."

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On the road to Solvency II

ANDREW SMITH, PWC DIRECTOR – INSURANCE ADVISORY, ASKS SHOULD WE RIDE IN THE BACKSEAT OR ALTER DIRECTION?

As the strategic consequences of Solvency II become more immediate, many senior executives are re-examining their path to Solvency II compliance.

Why revisit the road map now?

Impacted companies have things to do and limited time remaining in which to do them. In light of recent economic volatility and current economic, political and competitive landscapes, many senior executives are re-examining the Solvency II road map. New directions include changing the way companies are responding internally as well as applying greater influence externally.

How can a senior executive change the direction?

Shape your landscape. Key issues remain unresolved and the European Insurance and Occupational Pensions Authority (EIOPA) continue to invite consultative input. Those wanting to shape the landscape still have that opportunity. Lobbying efforts warrant consideration, provided the consequences are thought through. Groups can also think about how to maximise the effectiveness of their lobbying — alone, with wider industry groupings or from specific jurisdictions. EIOPA should not be the only target of lobbying, local and foreign regulators also have an important role in shaping the landscape.

Customise your route

Companies can organise their group structure to enhance compliance efficiency. For example, companies may benefit from group structures that facilitate supervision of non-European operations by equivalent jurisdictions or by using reinsurance arrangements in equivalent jurisdictions.

Capital requirements will also vary between Europe and equivalent jurisdictions, particularly where some form of standard formula is used rather than a company's own model, with knock-on effects on the company's return on capital. On the road to Solvency II, considering a customised group structure may provide a more scenic route than simply travelling along the existing path.

Know where you've been

Differing timelines between Lloyd's managing agents and companies in different jurisdictions have left some groups racing for subsidiary compliance while leaving cohesive, top down, group-wide approaches behind. This can bring senior executives to the intersection of duplicated effort and increased cost.

The best-prepared companies have leveraged the learning gained in one jurisdiction across others. They have policies written in a way that allows a common core approach to be applied globally, based around a common internal model, consistent governance structures, similar management information, and common documentation and evidencing frameworks. Opportunities to manage the cost of compliance by looking in the rear-view mirror should not be overlooked.

Keep your eyes on the road

The regulatory environment is a significant influence on cost, access to markets and ease of doing business. More than ever, senior executives who plan wisely and keep their eyes on the road ahead will get the greatest mileage.

Asking the right questions about equivalence

Areas that senior executives may consider acting on, and those in governance positions should ask about, are:

Uncertainty about equivalence

The August draft report of the European Insurance and Occupational Pensions Authority (EIOPA's) equivalence assessment of Bermuda's supervisory system (the EIOPA inspection report) was greeted with cautious optimism by commentators. The draft suggests Bermuda is equivalent with caveats, many of which relate to areas where the Bermuda Monetary Authority (BMA) already has work in progress.

Market participants who wish to influence the equivalence debate should visit https://eiopa.europa.eu/consultations/consultation-papers/index.html during the consultation period.

The consequences of equivalence are generally significant for large Bermuda-headquartered insurers or those headquartered outside the European Economic Area with Bermuda-based operations providing reinsurance to EEA insurers.

Treatment of Captives

The EIOPA inspection report draws an interesting distinction between Class I, II and III insurers from Class IIIA, IIIB and IV insurers – possibly reopening a discussion around whether Captives may be carved out from equivalence.

While many would welcome such a move, some large captives may be disadvantaged without equivalence. Captives providing reinsurance to affiliated commercial insurers or other captives may wish to lobby for an ability to 'opt in' in the event they would not otherwise be considered equivalent.

Group supervision

The EIOPA inspection report highlighted uncertainties in Bermuda's progress on group supervision. Many would say the BMA is leading the thinking on group supervision, albeit a work in progress, having already engaged with companies and other supervisors and provided draft industry guidance.

Truly meaningful group supervision leads to sensible, coordinated and proportionate regulation rather than simply implementing an additional layer of scrutiny. Group supervision will be most successful with the support and trust of regulated entities and other supervisors. To shape this, companies can exert influence over their group supervisor and, importantly, other supervisors having a regulatory interest.

Re-calibration of standard capital requirements

Recent economic turmoil highlights the importance of updating models to reflect the ever-changing world. Standard formulae used by regulators to set regulatory capital for those companies who have not obtained model approval will be re-calibrated at various points in the future.

Many companies decided whether or not to seek model approval based on regulatory model requirements. Keeping in mind that these models are not constant, companies should analyse the sensitivity of their capital requirements to potential changes in regulatory models as well as to changes in the economic and competitive landscape.

Will model approval matter?

Internal model approval is required for companies operating at Lloyd's and desirable for many within Europe. For many Bermuda companies, the Bermuda Solvency Capital Requirement is less than driven by rating agency requirements, leading to questionable value in model approval.

However, rating agencies reportedly anticipate that Solvency II compliance will be needed to maintain favourable ratings or commentary on risk management. Gaining model approval could signal an endorsement of the risk management within an organisation. If this proves to be the case, companies that are unprepared could find themselves as outliers.

Bermuda: a one-stop insurance shop

"It's well-known, it's well regulated, it has continued to weather the storms that have battered offshore jurisdictions through the years. Bermuda provides a one-stop shop in as much that the underwriters, companies and service providers are all here."

— Partner at Appleby, **David Lines**, speaking at the 10th Insurance Linked Securities Summit at the Fairmont Southampton, about Bermuda as an insurance market (*The Royal Gazette*)

"The banking sector failed and as a result of what happened in the banking sector, they want to impose upon the insurance sector higher capital requirements. During that same, really singular crisis, the insurance industry performed quite well. I continue to believe that the banks would do well to learn from us, instead of us from them."

— XL Group CEO **Mike McGavick** on increased capital requirements necessary for some companies under Solvency II (*The Royal Gazette*)

"I see no current threat to Bermuda so great that redomiciling makes sense and in the longer run I see no strategic advantage that accrues from being quick off the mark to make such a change. In fact, quite the converse. I think there is a chance that companies that have already redomiciled may ultimately wish they had not done so."

— Endurance Specialty Holdings CEO **David Cash** on the benefits of doing business in Bermuda (*The Royal Gazette*)

WHAT'S ON

ONSHORE

October 18
Sedgwick's Ninth Annual Hot Topics Seminar
Bermuda Underwater Exploration Institute

November 15
Goldman Sachs Asset Management's 8th Annual Conference
Hamilton
charles.fuller@gs.com

June 3–6
Bermuda Captive Conference 2012
Fairmont Southampton
www.bermudacaptive.bm

OFFSHORE

October 16–19
American Society for Healthcare Risk Management (ASHRM)
Phoenix Convention Centre, Arizona
www.ashrm.org

October 23–26
Property Casualty Insurers Association of America
New Orleans, Louisiana
www.pciaa.org

January 30–February 1
World Captive Forum
Doral Golf Resort, Miami, Florida
www.worldcaptiveforum.com

Porrino is XL Group's new CFO

XL GROUP has appointed **Peter R Porrino** as Executive Vice President and Chief Financial Officer. Mr Porrino, who has more than 30 years of experience working in and advising the insurance industry, including considerable property and casualty insurance and reinsurance experience, will report to XL's CEO, **Mike McGavick**, and will serve on XL's Leadership Team. XL Group has also announced the appointment of **Paolo Ribotta** as Head of Global Distribution.

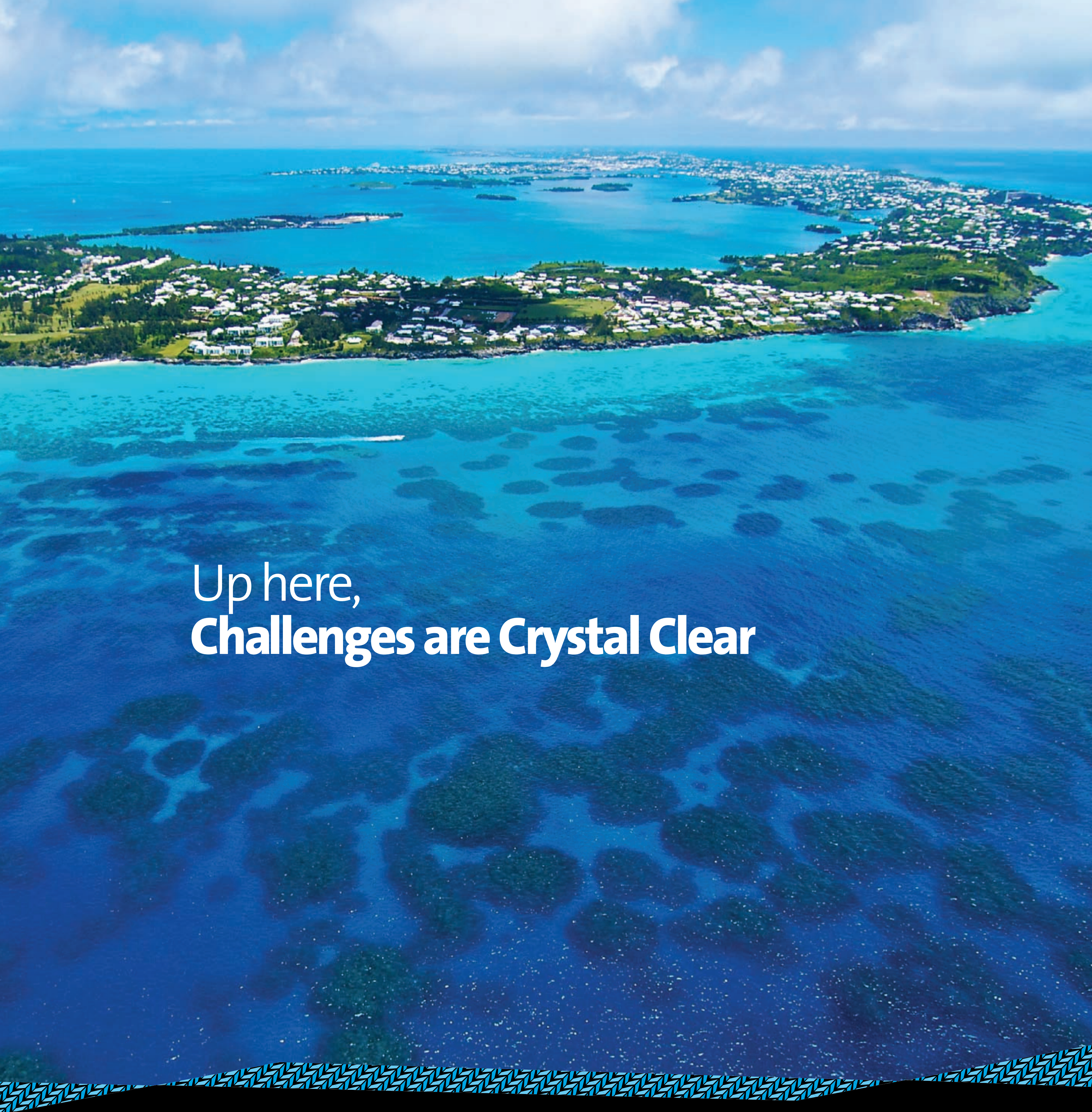
ALTERRA CAPITAL HOLDINGS LTD has announced that **John Berger**, CEO of Reinsurance and a member of Alterra's Board of Directors, is leaving to pursue a new opportunity. **Thomas C 'Tom' Wafer**, formerly the President of Alterra Reinsurance USA, has been appointed to take over from Mr Berger, who has more than 30 years of reinsurance industry experience and has been President of Alterra Reinsurance USA since November 2009. From 2005 to 2009, he was Managing Director of International Underwriting for Harbor Point Re Limited and New Point Re Limited in Bermuda. **Bret Hilgart** has been appointed as Vice President, Underwriter of Alterra USA. He has more than 11 years of executive liability experience, most recently as a Vice President of IronPro, a division of Ironshore, overseeing management liability and related lines for its Central Region.

EVEREST RE GROUP LTD has announced the promotion of **Dominic Addesso** to the role of President. Mr Addesso joined Everest two years ago as Executive Vice President and Chief Financial Officer. **Joseph Taranto,** Chairman and CEO of Everest Re, said: "It is rare to have an executive with such a wealth of experience on both the financial and operational sides of our business. Dom is an outstanding leader with the highest integrity. I look forward to working with him as President." **John Doucette** has also been promoted to Chief Underwriting Officer for Everest's Worldwide Reinsurance. Mr Doucette joined Everest three years ago as Executive Vice President.

ACE LTD has announced that **John Keogh**, Vice Chairman, ACE Ltd, and Chairman, ACE Overseas General, has been appointed to the additional position of Chief Operating Officer, ACE Ltd.

TOKIO MILLENNIUM RE LTD has appointed **Stephen O'Flynn** as Senior Vice President, Underwriting. Mr O'Flynn is responsible for initiating the firm's professional lines portfolio of business. He joins Tokio from Allied World Reinsurance Company.

FLAGSTONE REINSURANCE HOLDINGS has announced that **Gary Prestia** has been appointed CEO of Flagstone Representatives (US) Inc and Chairman of Mosaic NY. **Guy Swayne** has been named Executive Vice President of Flagstone Réassurance Suisse SA, with executive responsibility for underwriting in Bermuda as well as oversight of all international underwriting centres, including Lloyd's where he currently serves as Chairman of Flagstone Syndicate Management Limited.


Up here,
Challenges are Crystal Clear