# BIQ

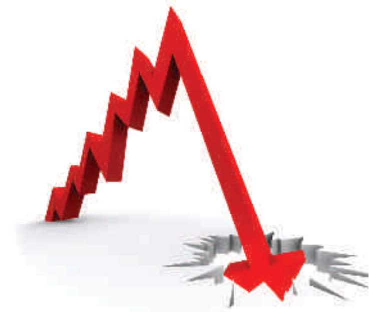
January 2009

# BERMUDA INSURANCE QUARTERLY



ALL THE RESULTS & ANALYSIS Q3 12

CREDIT CRUNCH GLOOM? 14



BERMUDA MARKET LATEST 1


## FRIEND OR FOE?

With the biggest deficit in US history, the new President will be under pressure to raise tax revenue — and Bermuda and other offshore jurisdictions are likely targets: *Page 10*


Fifteen minutes of fame is all that most of us can expect. IPCRe is proudly celebrating 15 years of being famously focused on property catastrophe excess of loss reinsurance. Our clients appreciate specialist advice, common-sense solutions, and exceptional service. We appreciate their business, and we work hard to deserve it. In our business, that's the art.

IPCRe. 15 years of appreciation.

IPCRe LIMITED

**www.ipcre.bm** t: +1 441 298-5100 f: +1 441 292-8085 e: info@ipcre.bm

BIQ
BERMUDA INSURANCE QUARTERLY

Volume 5, Number 1
January 2009

**Editor**
Richard Whitaker

**Art Director**
Paul Shapiro

**Contributing Editor**
Chris Gibbons

**Director of Marketing**
Lissa Fisher

**Publisher**
Ian Coles

Published by Bermuda Media, Suite 310, The International Centre, 26 Bermudiana Road, Hamilton HM 11, Bermuda. Postal address: PO Box HM 2032, Hamilton HM HX, Bermuda. Tel: 292-7279 Fax: 295-3189 Email: submit@bm.bm. Web: bermudamedia.bm. Printed in Canada.

Published four times a year in association with PricewaterhouseCoopers.

*Cover image: gettyimages.com*

# THE QUOTES OF THE QUARTER

"The third quarter [of 2008] has taught the world a great deal about risk. Our industry has been affected in ways that were unimaginable a few months ago. Investment losses and the impact of Hurricanes Ike and Gustav have severely damaged some insurers and reinsurers. Capital in the industry has declined significantly as a result."

**— Kenneth LeStrange, CEO of Endurance Specialty**

"The structure and order of the financial services industry — banking, investment banking, brokerage and insurance — are changing before our eyes. Across the financial services landscape, true credit-related losses, unreasonably exaggerated by fair value accounting, have contributed to a cycle of fear and tight liquidity that has fed on itself, resulting in severe and indiscriminate price declines for all classes of financial assets and near zero liquidity in the lending markets."

**— Evan Greenberg, CEO of ACE Limited**

"While it was a tough quarter by any measure, we are very pleased with the resilience of the XL franchise. Especially noteworthy was the fact that our clients, brokers and people pulled with us through the uncertainty of the Syncora situation, enabling us to have positive sales momentum in the quarter, and positioning us well for the critical 1/1 renewal period."

**— Mike McGavick, CEO of XL Capital**

"There are obviously extraordinary times in the global financial markets, and coupled with the US hurricane loss in the quarter, I think this has been a pretty good test of our strategy, our risk management and our investment portfolio. We feel like we've passed the test with flying colours.

**— Ed Noonan, CEO of Validus Re**

# Bermuda market 'cautious but stable'

## BUT S&P SURVEY SAYS COMPANIES FACE FURTHER EROSION OF CAPITAL IN THE FOURTH QUARTER

Bermuda's reinsurers have so far weathered the global economic downturn, severe price correction across most asset classes, an increase in the number of natural disasters and a soft market, according to ratings agency Standard & Poor's.

S&P gave the Island's industry sector a "cautious but stable" outlook in its November report, *Bermuda Insurers and Reinsurers: The Good, The Bad and The Ugly,* assuming that the market hardens as expected, led by property catastrophe and casualty in the January renewals.

Reviewing data from 17 publicly traded Bermuda-based companies, the group reported around $3 billion in catastrophe losses in the third quarter of 2008, primarily from Hurricanes Gustav and Ike. The group's median combined ratio increased to 83% for the first nine months of 2008, compared with 82.3% for 2007, according to the report.

Through the first nine months of 2008 there were also 36 catastrophes — the highest in a decade — and losses were compounded by other midsize events such as European Windstorm Emma and commercial claims including Anglo American's mine flood/fire in South Africa.

Ike would certainly have been the most significant event of the year for Bermudian reinsurers if not for the global capital market disruptions, says the report. As a result, most Bermudian reinsurers are now facing challenges on two fronts, with catastrophe losses eroding underwriting profits and investment returns plummeting.

According to the report:

"Bermuda insurers and reinsurers have suffered from massive realised and unrealised investment losses that hampered their year-to-date 2008 earnings and weakened their capital position." Net investment income for the group decreased 10% to $6 billion for the first nine months of 2008 compared with the same period last year.

The companies themselves were not immune from the extreme volatility of the capital markets. S&P stated: "Despite the significant decline in the Bermudian reinsurers' market capitalisations, all but three companies outperformed the S&P 500 as of October 31, 2008."

It said companies face further erosion of capital in the fourth quarter leaving "a limited margin for error" especially as turmoil in the financial markets will mean that capital is in short supply and expensive.

"The confluence of all these events leads us to believe that this could be an inflection point in the reinsurance pricing cycle," said S&P. "We expect an increase in underwriting margins which should enable most reinsurers to rebuild their capital over the medium term."

But the report warns: "Failure of this to occur could lead to a widespread re-evaluation of our ratings on the sector."

'Bermuda insurers and reinsurers have suffered from massive realised and unrealised investment losses'

# No shortage of start-up capital

## BUT HISCOX CEO SAYS BERMUDA COMPANIES WILL HESITATE TO TAKE ON MORE RISK

Despite the credit squeeze, industry experts believe there will be no shortage of start-up capital in the wake of another major catastrophe.

Some analysts doubt whether the industry would see a rash of new formations following a significant disaster as happened after 9/11 and Hurricane Katrina, and that sidecars and other vehicles are more efficient than large stand-alone companies.

But Bronek Masojada, CEO of Bermuda-based Hiscox Ltd, told an A M Best conference: "I do not think (sidecars and special-purpose vehicles) are going to do away with new start-ups because that implies that existing players have a monopoly on innovation and new ideas. Sadly I do not believe that we do."

According to insurancenews-net.com, Masojada said that as was the case in 2005 following the devastating Hurricanes Katrina, Rita and Wilma, Bermuda companies would hesitate to take on more risk leaving a shortage of capacity.

"I would predict that many of my (Bermuda) competitors would be more cautious after a big bang, even though they were started up to take advantage of a big bang," he said.

Ian Clark, a partner at London-based Deloitte & Touche, told the conference that although hedge funds had been hard hit by the credit crisis, private equity funds have the cash to invest in start-ups if a major disaster triggers a new capacity crunch.

"Your average private equity fund is sitting there awash with capital that it can't deploy at the moment. The only difference is that before, they were working with a heavy gearing business model. The large private equity houses are now writing large equity cheques, but they are still investing," he said.

And he expected much of that new money to flood in to London as well as Bermuda.

"In Bermuda you can still get capital away and establish vehicles quickly. But you also have a structure within Lloyd's now where the regulator recognises that in extreme scenarios, new capital will want to come into the industry quickly and it has tightened up its processes and timescales appropriately."

He said several vehicles had been established at Lloyd's with minimal capital to exploit the next coverage vacuum and that further mergers and acquisitions of Lloyd's syndicates by Bermuda companies are likely as the latter look to reduce their reliance on property catastrophe business.

> 'I would predict many competitors would be more cautious after a big bang, even though they were started up to take advantage of a big bang'

# Improving fortunes for troubled XL

## WITH $1.62 BILLION LOSS, CEO ADMITS 'A TOUGH QUARTER BY ANY MEASURE'

The Q3 figures may make depressing reading for XL Capital Ltd shareholders — it's hard to be cheerful about a $1.62 billion loss after all — but analysts believe the firm leadership of CEO Mike McGavick is well on the way to putting the Bermuda-based company's problems behind it.

The third quarter loss was largely down to the charge of $1.4 billion it took on its bailout of its troubled former subsidiary, financial guaranty company Syncora Holdings Ltd (formerly Security Capital Assurance Ltd). XL also reported losses of $221.8 million in Hurricanes Gustav and Ike, and a charge of $41.7 million related to the Company's actions to streamline corporate functions and reduce future run-rate operating expenses.

Book value per share, a measure of assets minus liabilities, fell by half in the three months ended September 30 to $21.65, after the insurer sold stock and investment losses depleted capital, XL said. Book value fell from $43.39 per share during the quarter and from $56.29 over 12 months. The firm had $292.9 million in investment losses, and unrealised losses widened by $825.3 million.

McGavick is committed to streamlining the company. He has earned plaudits for quickly extricating XL from the Syncora mess. XL sold more than $2.8 billion in stock to help rescue the insurance operations of Syncora which faced a wave of claims after collateralised debt obligations it insured, plummeted in value.

Analyst John Appel, writing on investment website Seeking Alpha, said: "Mike McGavick has the skills and experience to lead a successful turnaround and has already made real progress. Meanwhile, premium rates for property, catastrophe and professional lines are already firming and the outlook is very good for XL in 2009."

Admitting in a company statement on Q3 estimate that it was "a tough quarter by any measure" McGavick said he was "very pleased with the resilience of the XL franchise. Especially noteworthy was the fact that our clients, brokers and people pulled with us through the uncertainty of the Syncora situation, enabling us to have positive sales momentum in the quarter, and positioning us well for the critical 1/1 renewal period."

> 'McGavick has the skills and experience to lead a successful turnaround'

He added: "The third quarter has seen real progress in relation to the strategic objectives set out earlier in the year. We eliminated the vast majority of our exposures to Syncora. We have also made demonstrable progress in de-risking the firm, both in our investment portfolios and by demonstrating our attention to managing our traditional property and casualty exposures well. And during all of this we also completed most of the actions necessary to reduce the expense base of the company."

# AIG Bermuda jobs remain safe for now

## ASSET SELL-OFF SHOULDN'T AFFECT THE FIRM'S LOCAL OPERATIONS

Local employees of troubled insurance giant AIG have seen the value of their stock options reduced to pennies — and look likely to go without their annual bonuses. But their jobs are safe — at least for now.

President and Chief Executive Officer George Cubbon has said that he doesn't expect the firm's Bermuda operations — which employ some 205 people in eight licensed entities and deals primarily in property and casualty insurance — to be affected by chairman and CEO Edward Liddy's plan to sell off a large chunk of AIG assets to pay back the company's $150 billion bailout from the US Government, which now owns 79.9% of the company.

AIG saw its stock price freefall from a high of $62.30 to just $1.25 following the disastrous performance of its Financial Products Unit, whose exposure to credit default swaps brought the world's biggest insurer to the brink of collapse. The Bermuda insurance operations, first incorporated here in 1947, are not tied to that unit.

Cubbon told *The Royal Gazette*: "Mr Liddy has not actually announced a list of the entities that will be sold but it seems likely that some of those will be on the life side, particularly in Southeast Asia. Some are likely subsidiaries of companies based in Bermuda and also companies that we do insure. However, in terms of head count, the impact will be minimal."

Liddy has stated that AIG planned to hold on to its US property and casualty and foreign general insurance businesses — such as Bermuda — and to retain a controlling interest in its foreign life operations.

Cubbon said: "There is still going to be a demand for insurance. Insurance is the oil that makes everything happen. There may be a slowdown but essentially insurance will continue and what we have here in Bermuda and what AIG has developed has been in response to demand. That demand, while it would be foolish to say it won't suffer, will continue to be there."

However, Bermuda-based management will feel the effect of a directive from Liddy to eliminate management bonuses. Liddy himself will be paid just $1 — and salary increases for leading executives for 2009 will be blocked.

The directive came as AIG posted its largest-ever quarterly loss — $24.47 billion for the third quarter — as the damage from write-downs on assets related to subprime mortgages continued and losses from catastrophes began to hit home. AIG made a profit of $3.09 billion for Q3 2007.

Axis CEO John Charman said: "I shed no tears for them. I believe that any normalisation of AIG will be beneficial to the marketplace. It will release huge volumes of business throughout insurance portfolios, by product and by geography."

'Insurance is the oil that makes everything happen'

# Vote of confidence on road to Solvency II

## BMA CEO WARNS SOLVENCY II ASSESSMENTS WILL BE MUCH MORE CHALLENGING THAN THE IMF

Armed with a vote of confidence from the International Monetary Fund (IMF), the Bermuda Monetary Authority (BMA) is well on the way to achieving its goal of Solvency II compliance for the Island's reinsurance industry — and CEO Matthew Elderfield says that can only enhance Bermuda's competitive edge.

In recent years, the Island's financial services regulator has beefed up its reporting requirements to ensure Bermuda companies are ready to comply with the European Union directive Solvency II, which will tighten up regulation and set capital requirements for reinsurers, and prepare for a growing global shift away from rules-based supervision to risk-based assessment.

Speaking on a panel on Globalisation of Regulation at the Standard & Poor's/PricewaterhouseCoopers' Bermuda Insurance Conference, Elderfield said: "I think we're at the front of the pack of countries being ready for Solvency II."

He added: "There's a strong consensus [among local insurers] that this is the right thing to do and underlying that is an understanding that there are competitive advantages to recalibrating our regulatory framework. Your reputation as a market is enhanced, the reputation of the firms that operate within it are enhanced, and it certainly benefits you in terms of your interaction with your counter-parties, your investors and with policy holders.

"Internationally we're entering a new phase where regulators are sizing each other up and establishing whether rules are equivalent in other jurisdictions and are acceptable. At the heart of this is that in order for firms to do cross-border business across jurisdictions, regulators are asking, 'Are those rules in Bermuda adequate? If they are equivalent, then are we happy for them to do business in my jurisdiction?' That is a competitive advantage if we can achieve equivalence, which I am confident we will do."

The advantages, he said, would be three-fold:

- Bermuda firms would be able to operate in other jurisdictions without any added burden (such as rules on collateral imposed on US firms)
- Companies would avoid any duplication of regulation and the associated operational costs
- Firms would be able to optimise their group capital structure and hold surplus capital more efficiently without having it tied up in other jurisdictions

Elderfield said the IMF report confirmed that the BMA had established a strong base and that it was "highly observant" of international standards.

The IMF report stated: "Bermuda's insurance supervision, especially for the large commercial reinsurance companies, is highly observant of the Core Principles established by the International Association of Insurance Supervisors."

It also said: "The BMA has instituted a strongly risk-focused supervisory approach in line with the diversified range of insurers in

Bermuda, and the Bermuda insurance regulatory system is based on hands-on risk-sensitive supervision."

But Elderfield warned that European Solvency II assessments — Solvency II is expected to be implemented in early 2013 — would be much more challenging than the IMF.

"We're trying to make sure that the enhancements we adopt are intelligent and not a Xeroxing of overseas rules so we can adapt them to the Bermuda market. The test is that our rules are broadly equivalent, not exactly equivalent, and focuses on the larger commercial insurers."

He said next year the BMA would continue to build out the three Pillars of Solvency II.

"In Pillar I the focus will be on economic capital models and we will be publishing our assessment of the quality of economic and cat modelling in the Bermuda market." He said the BMA would start a pilot programme over the next two years of approval for the models.

"In Pillar II we will be working on the qualitative solvency assessment which is a regulator-mandated enterprise risk management which firms have to undertake and we will check."

In Pillar III he promised more proposals on transparency and disclosure.

He explained: "Europe has had group supervision for some time and it's a very hot topic because of the financial crisis, recognising that groups operate cross-border and you need more effective co-ordination and a more consolidated view of solvency.

"I think the challenges of AIG have really lit a fire under the international regulatory community because you have questions about, 'How could you have an unregulated entity in there that could do damage to the whole group? Who was regulating financial products? Who was regulating securities and lending?'"

Some CEOs fear regulation overkill and the additional costs — fees for Class Four insurers to the BMA are expected to rise to $400,000 from $55,000 just three years ago.

Panel member Simon Rich, Global Controller of XL Capital Ltd, noted: "There's going to be a cost in any serious regulatory regime around the world. Bermuda, as the biggest reinsurance market in the world, needs to have a serious regulatory regime to maintain that position. If I look at why people come to Bermuda — the market, the infrastructure, the people and the ability to relatively get out of the box and start trading — I think that outweighs any cost factor."

A third panel member, Rob Jones, Managing Director of rating agency Standard & Poor's, said: "With global markets opening up, in order to exploit that you have to have strong domestic and group wide supervision. I think the turmoil we've experienced in the financial markets in recent months is just going to focus that more and more.

"For Bermuda it's not a choice, it's a necessity. Bermuda has made impressive progress in the field of insurance supervision and arguably the framework in place is better than that of many European countries."

**Matthew Elderfield**

## 'Bermuda, as the biggest reinsurance market in the world, needs to have a serious regulatory regime'

# Gambling on the cat model

## EXPERT WARNS INSURERS TO TAKE A MORE HOLISTIC VIEW OF RISK

Reinsurers have grown too dependent on models when it comes to assessing catastrophe risk, according to cat modeling expert Karen Clark.

Clark, who developed the first hurricane catastrophe model and in 1987 founded Applied Insurance Research (AIR), the world's first cat modeling company, said models were even less of a certainty than gambling and that the insurance industry should take a more holistic view of risk and recognise models as just one tool to be used.

"Insurance companies, reinsurance companies and even the rating agencies are relying too heavily on the model output without sufficiently vetting the model input or output," she said during a panel discussion at the Standard & Poor's/PricewaterhouseCoopers' Bermuda Insurance Conference.

"You've heard the phrase 'garbage in, garbage out?' It's actually worse today because it's 'garbage in, gospel out.' Models are tools — they provide you with uncertain estimates. They don't provide an answer and they should be used as such. They should be used as just one source of information.

"They can provide useful information but they are tools — don't bet the house on it, and don't base your business strategy on it."

She added: "I think if some of the experts on Wall Street would have heeded similar insight with the financial models we probably wouldn't be in the mess we're in today.

"I would say cat modelling hasn't gone beyond gambling because there is even less certainty. At least in gambling you do know the true odds. How many cat five hurricanes are going to hit the US coastline over the next 52 years? I don't think you'd be willing to bet too much money on that."

Clark, who sold AIR in 2002, is now President and CEO of Karen Clark & Co, a company she formed specifically to develop tools and processes to help solve two major challenges for the insurance industry over catastrophes — the lack of accurate and sufficient data on insured homes and businesses, and the over-reliance on models to assess cat risk.

She pointed out: "We don't know, believe it or not, how many cat five hurricanes have made landfall in the last 52 years because there is still debate among the scientists about whether Andrew (1985) was a cat four or cat five storm. There is no decision on that yet. It was a cat four but 10 years later they decided it was a cat five and they are still arguing about it.

"It's not really the modellers' fault that the models have so much uncertainty. They do the best they can from the data available but our scientific data is just limited. We learned a lot from Katrina but it didn't help us in terms of predicting how many future cat five hurricanes there will be. What we did learn from the tens of billions of dollars of claims data was something about the damageability of certain types of construction, how well different types performed and that will help with fine tuning our models, but even then you're going to have to be careful because we don't know the exact wind speed at certain locations."

Even the more recent short-term models are unable to accurately predict hurricane frequency and severity over even a one, three or five year period. Clark said one of the first short-term models — developed by RMS — predicted a 40% increase in losses from 2006-2010, but so far losses were 40% below average.

So why were companies so reliant on models? "Everybody wants an answer and nobody likes uncertainty," said Clark. To illustrate the point she told a story about the Northridge, California earthquake on a previously unknown fault in 1994 when an insurance executive seriously asked her team how many unknown faults there were?

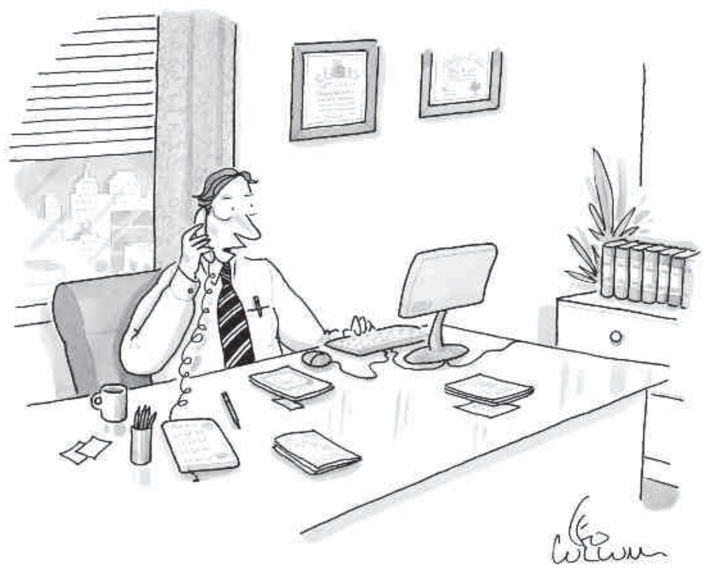
"Our engineer, without batting an eye, said 113!" she quipped. "Uncertainty is a fact and we have to deal with it the best we can. No matter how many model updates there are, we're going to be limited by what we don't know. Our 'unknowledge' in this area is greater than our knowledge.

"The model has gone from using raw aggregate data to companies feeding in information all the way down to street address level. The problem is that there is this misconception that more detail means more accuracy. Of course if you have more detail on your property that's good and you will, within the timeline of the model, get better results, but it doesn't mean that the whole model has become more accurate. In fact there's a problem because at a location level in terms of what policies to cancel, your uncertainty is even more magnified."

Fellow panelist Robin Lang, Assistant Vice President, RenaissanceRe Services Ltd, said: "Most of our problems in property cat in 2005 came from modelling malpractice — just misuse of the models. That comes from all sorts of areas. It can come from a misunderstanding of what they are capable of and applying them to problems they were not built to solve. Models give you an approximation — a range of possible results. It is nothing more than a tool in the toolkit of a risk manager or a capital manger. It's a screwdriver and it's very important to remember that.

"With Katrina we saw some incredible abuses of the model. For example some floating casinos were coded as concrete buildings."

'Models provide you uncertain estimates. They don't provide an answer and they should be used as such'



*"I was spreading some risk around, and apparently it all ended up in your portfolio."*

# Assessing the Obama Factor

## 'EXTREMELY REAL' THREATS OVER TAX REGIMES THAT ARE PUNITIVE TO BERMUDA. CHRIS GIBBONS REPORTS

Bermuda insurers and reinsurers operating in the US are braced for increased taxes and regulations under new President Barack Obama.

He has pledged to close corporate tax loopholes and ensure that offshore companies pay their "fair share" of taxes. Faced with the biggest deficit in US history, the new administration will be under pressure to raise tax revenue, and Bermuda and other offshore jurisdictions will likely be targeted.

XL Capital CEO Mike McGavick warned the annual general meeting of the Association of Bermuda International Companies, that unlike previous threats this one was not mere political rhetoric.

"The threat this time around is extremely real," said McGavick, an American and a former Republican candidate for the Senate.

Unless there was a concerted industry effort over the first year of Obama's presidency, he said, "tax regimes that are punitive to Bermuda and other countries will become law."

Bermuda insurance leaders say any changes in tax policy would be a mistake, as US legislators simply don't understand the business and the vital role it plays in the US economy.

The Island's Premier Dr Ewart Brown, in an official letter of congratulations to the President-Elect, noted that insurance played a critical role in keeping homeowner insurance affordable for Americans living in the path of hurricanes. "Bermuda-based insurance and reinsurance companies have paid out $30 billion in claims to US policyholders between 2001 and 2008 to cover catastrophic events," he said.

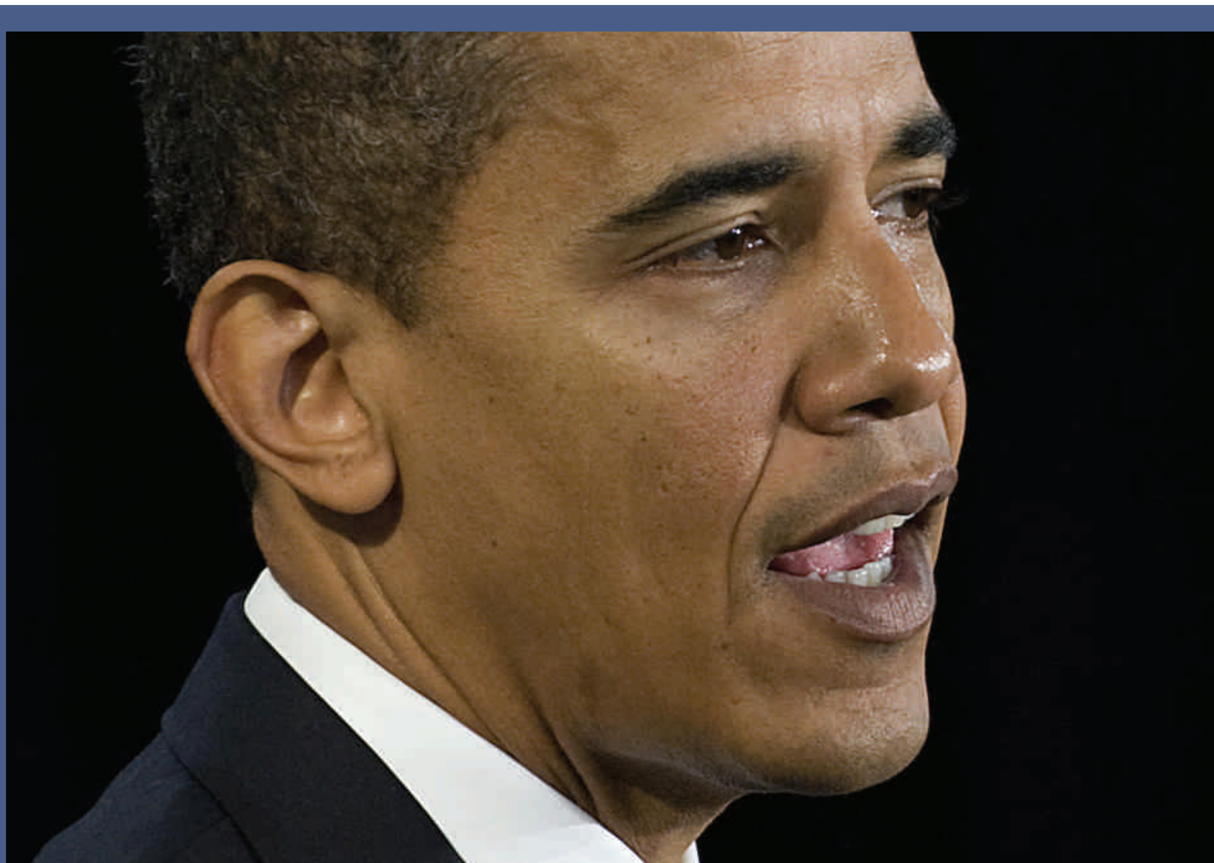
Bermuda is already under threat from two proposed pieces of legislation. The Island is on a list of jurisdictions tagged as "probable locations for US tax evasion" under the Stop Tax Haven Abuse Act introduced by Obama, Democratic Senator Carl Levin and Republican Senator Norman Coleman last year.

In September, Representative Richard Neal (D-Mass) introduced a bill that would limit deductions for related-party reinsurance cessions to the average percentage of premium ceded to unrelated reinsurers.

During the Presidential campaign, Obama caused outrage in Bermuda by running a TV ad that attacked Republican candidate John McCain's Bermuda links, claiming: "McCain went to Bermuda and while he was there pledged to protect tax breaks for American corporations that hide their profits offshore."

The Neal bill is backed by the 14-member Coalition For a Domestic Insurance Industry, which includes major US-based property/casualty insurers W R Berkley Corp, Berkshire Hathaway and Chubb Corp. The group claims that foreign-based insurers avoid taxes on their US business by reinsuring policies written in the US to Bermuda-based affiliates.

Neal claims the amount of reinsurance ceded to offshore affiliates



## With Barack Obama in the White House, Bermuda insurers and reinsurers operating in the US could face increased taxes and regulations

has grown from $4 billion in 1996 to $34 billion in 2007 of which $19 billion had gone to Bermuda affiliates. Neal says profits are shuttled out of the US and the investment income on those profits is also sheltered from US taxes. US affiliates of foreign-domiciled insurance groups currently pay a 1% excise tax on reinsurance premiums paid from a US member to an offshore affiliate.

"No one wants to impinge upon the free movement of capital. But we don't want people to use the guise of risk-spreading to avoid tax," William Berkeley, CEO of W R Berkely Corp, has said.

A study by Fitch Ratings in March of the Bermuda insurance market found that the Island's insurers and reinsurers had an effective tax-rate advantage of 15% over their US rivals.

Bermuda industry leaders point out the key role the Island plays in stabilising the US economy.

Washington-based Bradley Kading, of the Association of Bermuda Insurers and Reinsurers (ABIR), said that Bermuda's insurers provided 66% of the private property catastrophe reinsurance to Florida home insurers and a similar amount in reinsurance payments for Hurricane Ike to the Texas Windstorm Insurance Association.

He added that offshore reinsurance companies were responsible for 10,000 US jobs which in turn generate a further 100,000 jobs for US service providers.

> 'This industry is not well regarded in the US. We only come into contact with people when they have a loss so our political capital is weak'

"Our members conduct genuine insurance underwriting operations in Bermuda. We're not just a pretty nameplate on the wall — we're actively assuming insuring risk, producing jobs in Bermuda and creating economic value for our global customers."

Donald Kramer, Chairman and CEO of Ariel Re, and an American veteran of the Bermuda market, has accused Neal of "creating a tax concept that is unworkable. He's looking at it in a static sense and not a dynamic sense.

"He's saying, 'Oh my goodness, we could generate $15–18 billion of revenue.' Not only is that outrageous but its completely incorrect," he said during the recent Bermuda Insurance Conference. "It is based on the idea that cessions into companies' reinsurance should only be limited to a ratio based on the industry average and anything else to be non-deductible.

"But the problem is that if you cede premiums you also cede risk and Bermuda gives back to the United States billions of dollars in claims payments that were neither taxed, offset, carried forward or anything else when they paid the lawsuits for Katrina, Rita, Wilma, Ike and Gustav. It's not a simple cut and dried issue."

He added: "It's not just Bermuda. A lot of other jurisdictions are looking at this and wondering what the US is trying to do. Is it trying to create protectionist legislation for Warren Buffet and Bill Berkeley and a bunch of other billionaires or are they really creating a tax policy?"

Matthew Elderfield, CEO of the Bermuda Monetary Authority, said it would be a mistake for the new President to change the tax rules.

Speaking at the Standard & Poor's/PricewaterhouseCoopers' Bermuda Insurance Conference, he said: "I think an important argument the incoming officials will grasp very quickly is that you don't want to be discouraging capital coming into the US economy in this current environment, and Bermuda is a source of risk capital. The lesson of the last six to eight weeks has been that you need more capital in the financial system and tinkering with the tax code in a way that might risk capital leaving the system is highly risky and imprudent and you do it at your peril."

He said Bermuda should not be necessarily pessimistic either. "I don't think too much should be read into then Senator Obama's co-sponsorship of the Stop Tax Haven Abuse Act. A lot of co-sponsorship goes on in the Senate because you're asked to do it and how close it is to his heart remains to be seen."

Nevertheless Bermuda's reinsurers are likely to face an uphill battle to make their case.

As Donald Kramer noted: "This industry is not well regarded in the US. We only come into contact with people when they have a loss so our political capital is weak. Notwithstanding the fact that ABIR makes a real effort to educate and try to make direct contact with members of the legislature and do everything possible to make our case but the polemics outweigh the facts every time, and then they just nail us."

And as Edward Noonan, Chairman and CEO of Validus Re, put it: "Let's face it, if you're a US congressman right now, how many chances do you get to impose a significant tax on a group of companies that have already been demonised as tax exiles, living in an exotic location with not a single constituent vote you have to worry about?"

# ANALYSIS / PRICEWATERHOUSECOOPERS Q3 2008

## OPERATING RATIOS

### QUARTERLY LOSS RATIOS

| | Q3 2008 | Q3 2007 | Q3 2006 |
|---|---|---|---|
| ACE | 69.5% | 62.5% | 60.2% |
| Arch | 74.9% | 54.7% | 58.8% |
| Aspen | 95.2% | 52.4% | 54.0% |
| Allied World | 64.7% | 61.1% | 56.9% |
| Axis | 102.3% | 47.9% | 52.8% |
| Endurance | 87.4% | 46.6% | 46.1% |
| Everest Re | 87.3% | 58.5% | 57.0% |
| Flagstone Re | 105.9% | 27.0% | 15.3% |
| IPC | 86.9% | 31.2% | 7.4% |
| Max Capital | 75.5% | 44.0% | 54.7% |
| Montpelier | 119.9% | 26.8% | 28.5% |
| PartnerRe | 67.8% | 47.1% | 52.1% |
| Platinum | 96.5% | 56.5% | 56.4% |
| Renaissance Re | 141.1% | 35.9% | 11.6% |
| Validus | 93.9% | 29.5% | 12.5% |
| White Mtn | 74.6% | 63.2% | 60.7% |
| XL Capital | 79.3% | 58.1% | 60.4% |

### QUARTERLY EXPENSE RATIOS

| | Q3 2008 | Q3 2007 | Q3 2006 |
|---|---|---|---|
| ACE | 28.4% | 26.0% | 25.8% |
| Arch | 30.4% | 30.1% | 25.5% |
| Aspen | 28.1% | 32.1% | 27.0% |
| Allied World | 25.5% | 23.0% | 20.0% |
| Axis | 25.7% | 26.2% | 24.9% |
| Endurance | 25.2% | 33.0% | 32.0% |
| Everest Re | 27.7% | 28.1% | 26.1% |
| Flagstone Re | 23.2% | 34.9% | 29.2% |
| IPC | 14.2% | 16.0% | 18.8% |
| Max Capital | 23.5% | 25.0% | 19.0% |
| Montpelier | 29.7% | 31.1% | 29.8% |
| PartnerRe | 27.7% | 27.0% | 29.3% |
| Platinum | 26.1% | 24.8% | 28.0% |
| Renaissance Re | 22.3% | 24.7% | 24.9% |
| Validus | 28.4% | 33.5% | 26.3% |
| White Mtn | 39.6% | 35.2% | 39.7% |
| XL Capital | 27.8% | 27.2% | 26.4% |

### QUARTERLY COMBINED RATIOS

| | Q3 2008 | Q3 2007 | Q3 2006 |
|---|---|---|---|
| ACE | 97.9% | 88.5% | 86.0% |
| Arch | 105.3% | 84.8% | 84.3% |
| Aspen | 123.3% | 84.5% | 81.0% |
| Allied World | 90.2% | 84.1% | 76.9% |
| Axis | 128.0% | 74.1% | 77.7% |
| Endurance | 112.6% | 79.6% | 78.1% |
| Everest Re | 115.0% | 86.6% | 83.1% |
| Flagstone Re | 129.1% | 61.9% | 44.5% |
| IPC | 101.1% | 47.1% | 26.2% |
| Max Capital | 99.0% | 69.0% | 73.7% |
| Montpelier | 149.6% | 57.9% | 58.3% |
| PartnerRe | 95.5% | 74.1% | 81.4% |
| Platinum | 122.6% | 81.3% | 84.4% |
| Renaissance Re | 163.4% | 60.6% | 36.5% |
| Validus | 122.3% | 63.0% | 38.8% |
| White Mtn | 114.1% | 98.5% | 100.4% |
| XL Capital | 107.1% | 85.3% | 86.8% |

## FINANCIAL STRENGTH RATINGS

| | A M BEST RATING | | S&P RATING | |
|---|---|---|---|---|
| | Nov 12, 2008 | Nov 20, 2007 | Nov 12, 2008 | Nov 20, 2007 |
| ACE | A+ | A+ | A+ | A+ |
| Arch | A | A | A | A |
| Aspen | A | A– | A | A |
| Allied World | A | A | A– | A– |
| Axis | A | A | A | A |
| Endurance | A | A | A | A |
| Everest Re | A+ | A+ | AA– | AA– |
| Flagstone Re | A– | A– | NR | NR |
| IPC | A | A | A– | A– |
| Max Capital | A– | A– | NR | NR |
| Montpelier | A– | A– | A– | A– |
| PartnerRe | A+ | A+ | AA– | AA– |
| Platinum | A | A | NR | NR |
| Renaissance Re | A+ | A | AA– | A+ |
| Validus | A– | A– | NR | NR |
| White Mtn | A– | A– | A– | A– |
| XL Capital | A | A+ | A+ | A+ |

NR — Not rated by S&P

### Outlook

- A challenging quarter for the Bermuda insurance and reinsurance industry due to an active hurricane season combined with significant global capital markets distress.
- Companies reiterated the need to be well capitalised, have diligent risk management and be capable of managing an unprecedented investment environment.
- Continued financial market dislocations led to forecasts of rate hardening for 2009, almost the first time the pricing cycle has been impacted by matters other than insured losses.
- It is expected capital will be much harder to access going forward which will lead to some companies reassessing capital allocation.

### Earnings

- Results were largely impacted by specific catastrophe losses and investment losses. Hurricane Ike industry loss estimates increased significantly from the initial PCS base and is now considered to be the third largest insured landfall event in US history.
- Investment losses resulted from extraordinary volatility and illiquidity in the financial markets. The losses were both realised and unrealised; substantial differences in reported earnings between companies who have/have not adopted income statement treatment for all unrealised value changes.
- Companies with international operations benefited from the strengthening of several major currencies.

### Capital management

- The companies have continued to suffer substantial loss in market capitalisation with a number of insurers witnessing an extremely sharp decline in their share price and price to book ratio. This has continued post quarter end.
- Share repurchases continued for certain Bermuda companies. Most indicate they plan to retain potentially excess capital due to the current state of capital markets and the catastrophe claims being experienced. Other companies from our group are currently in pursuit of further capital injections.

## GROSS PREMIUMS WRITTEN $M

| | Q3 2008 | Q3 2007 | Q2 3006 |
|---|---|---|---|
| ACE | 5,220 | 4,463 | 4,297 |
| Arch | 904 | 999 | 1,105 |
| Aspen | 441 | 374 | 458 |
| Allied World | 291 | 276 | 362 |
| Axis | 725 | 755 | 735 |
| Endurance | 624 | 423 | 476 |
| Everest Re | 999 | 1,075 | 1,048 |
| Flagstone Re | 173 | 124 | 62 |
| IPC | 60 | 43 | 56 |
| Max Capital | 206 | 223 | 178 |
| Montpelier | 103 | 128 | 121 |
| PartnerRe | 869 | 878 | 813 |
| Platinum | 289 | 297 | 320 |
| Renaissance Re | 240 | 209 | 258 |
| Validus | 269 | 245 | 117 |
| White Mtn | 1,033 | 1,037 | 1,077 |
| XL Capital | 2,056 | 1,934 | 2,248 |

## NET PREMIUMS EARNED $M

| | Q3 2008 | Q3 2007 | Q3 3006 |
|---|---|---|---|
| ACE | 3,609 | 3,150 | 3,088 |
| Arch | 733 | 736 | 758 |
| Aspen | 434 | 420 | 429 |
| Allied World | 272 | 284 | 318 |
| Axis | 690 | 686 | 693 |
| Endurance | 510 | 400 | 408 |
| Everest Re | 932 | 997 | 958 |
| Flagstone Re | 189 | 139 | 63 |
| IPC | 113 | 97 | 108 |
| Max Capital | 142 | 178 | 147 |
| Montpelier | 134 | 138 | 151 |
| PartnerRe | 1,078 | 1,056 | 974 |
| Platinum | 281 | 290 | 340 |
| Renaissance Re | 379 | 367 | 367 |
| Validus | 339 | 296 | 92 |
| White Mtn | 936 | 936 | 919 |
| XL Capital | 1,695 | 1,731 | 1,855 |

## QUARTERLY EARNINGS (LOSS) DATA

| | Net income (loss) attributable to common shareholders ($m) | | | Fully diluted earnings (loss) per share ($) | | |
|---|---|---|---|---|---|---|
| | Q3 2008 | Q3 2007 | Q3 2006 | Q3 2008 | Q3 2007 | Q3 2006 |
| **ACE** | 54 | 656 | 578 | 0.16 | 1.95 | 1.73 |
| **Arch** | 26 | 200 | 186 | 0.42 | 2.76 | 2.44 |
| **Aspen** | (126) | 117 | 95 | (1.63) | 1.21 | 0.94 |
| **Allied World** | (46) | 109 | 114 | (0.95) | 1.72 | 1.89 |
| **Axis** | (249) | 270 | 226 | (1.79) | 1.65 | 1.37 |
| **Endurance** | (103) | 128 | 124 | (1.79) | 1.81 | 1.74 |
| **Everest Re** | (233) | 247 | 246 | (3.80) | 3.90 | 3.76 |
| **Flagstone Re** | (187) | 66 | 57 | (2.18) | 0.77 | 0.79 |
| **IPC** | (92) | 109 | 111 | (1.93) | 1.63 | 1.60 |
| **Max Capital** | (163) | 67 | 26 | (2.89) | 1.05 | 0.42 |
| **Montpelier** | (142) | 101 | 83 | (1.69) | 1.06 | 0.86 |
| **PartnerRe** | (160) | 254 | 227 | (3.01) | 4.44 | 3.93 |
| **Platinum** | (48) | 89 | 82 | (0.99) | 1.37 | 1.28 |
| **Renaissance Re** | (231) | 133 | 251 | (3.79) | 1.85 | 3.48 |
| **Validus** | (126) | 137 | 70 | (1.71) | 1.90 | 1.19 |
| **White Mtn** | (277) | 111 | 162 | (26.55) | 10.32 | 15.01 |
| **XL Capital** | (1,649) | 328 | 416 | (6.09) | 1.82 | 2.32 |

## CUMULATIVE YTD EARNINGS (LOSS) DATA

| | Net income (loss) attributable to common shareholders ($m) | | | Fully diluted earnings (loss) per share ($) | | |
|---|---|---|---|---|---|---|
| | Q3 2008 | Q3 2007 | Q3 2006 | Q3 2008 | Q3 2007 | Q3 2006 |
| **ACE** | 1,177 | 2,006 | 1,640 | 3.46 | 5.98 | 4.92 |
| **Arch** | 408 | 598 | 453 | 6.23 | 8.00 | 5.96 |
| **Aspen** | 82 | 354 | 259 | 0.71 | 3.67 | 2.55 |
| **Allied World** | 164 | 346 | 314 | 3.22 | 5.51 | 5.76 |
| **Axis** | 220 | 749 | 645 | 1.40 | 4.53 | 3.94 |
| **Endurance** | 70 | 357 | 288 | 1.10 | 5.02 | 4.03 |
| **Everest Re** | (2) | 827 | 634 | (0.04) | 12.96 | 9.71 |
| **Flagstone Re** | (112) | 117 | 89 | (1.31) | 1.44 | 1.27 |
| **IPC** | 34 | 205 | 273 | (0.65 | 3.06 | 3.99 |
| **Max Re** | (81) | 241 | 122 | (1.43) | 3.77 | 1.91 |
| **Montpelier** | (98) | 225 | 181 | (1.15) | 2.35 | 1.95 |
| **PartnerRe** | (75) | 511 | 481 | (1.38) | 8.83 | 8.33 |
| **Platinum** | 154 | 247 | 236 | 2.81 | 3.79 | 3.68 |
| **Renaissance Re** | 42 | 507 | 561 | 0.65 | 7.02 | 7.79 |
| **Validus** | 16 | 264 | 114 | 0.14 | 4.11 | 1.95 |
| **White Mtn** | (343) | 306 | 374 | (32.69) | 28.35 | 34.61 |
| **XL Capital** | (1,199) | 1,422 | 1,251 | (5.75) | 7.89 | 6.98 |

## MARKET CAPITALISATION

| | Q3 2008 | | Q3 2007 | | Q3 2006 | |
|---|---|---|---|---|---|---|
| | Common shares issued | Market value $ | Common shares issued | Market value $ | Common shares issued | Market value $ |
| **ACE** | 333,394,608 | 54.13 | 329,460,367 | 60.57 | 323,322,586 | 54.73 |
| **Arch** | 60,173,489 | 73.03 | 69,141,795 | 74.41 | 74,006,652 | 63.49 |
| **Aspen** | 81,450,413 | 27.50 | 87,145,828 | 27.91 | 95,260,798 | 25.83 |
| **Allied World** | 49,022,495 | 35.52 | 60,424,795 | 51.91 | 60,283,040 | 40.40 |
| **Axis** | 137,991,000 | 31.71 | 147,936,000 | 38.91 | 149,994,363 | 34.69 |
| **Endurance** | 57,656,562 | 30.92 | 64,080,540 | 41.55 | 66,196,147 | 35.26 |
| **Everest Re** | 61,408,081 | 86.53 | 62,800,000 | 110.24 | 65,000,000 | 97.53 |
| **Flagstone Re** | 85,346,325 | 10.27 | 85,297,891 | 13.29 | n/a | n/a |
| **IPC** | 46,946,320 | 30.21 | 60,659,489 | 28.85 | 63,703,567 | 30.42 |
| **Max Capital** | 55,970,138 | 23.23 | 58,707,527 | 28.04 | 59,549,893 | 22.96 |
| **Montpelier** | 91,491,059 | 16.51 | 102,617,706 | 17.70 | 111,775,682 | 19.39 |
| **PartnerRe** | 57,684,884 | 68.09 | 57,145,463 | 78.99 | 56,830,493 | 67.57 |
| **Platinum** | 47,706,861 | 35.48 | 57,210,877 | 35.96 | 59,638,834 | 30.83 |
| **Renaissance Re** | 61,694,117 | 52.00 | 71,944,904 | 65.41 | 72,114,675 | 55.60 |
| **Validus** | 74,878,137 | 23.25 | 74,199,837 | 24.24 | n/a | n/a |
| **White Mtn** | 10,441,964 | 469.75 | 10,842,613 | 519.75 | 10,780,053 | 496.96 |
| **XL Capital** | 330,788,403 | 14.92 | 179,697,903 | 79.20 | 180,508,133 | 68.70 |

n/a = data not publicly available

## SHAREHOLDERS' EQUITY ($M)

| | Q3 2008 | Q3 2007 | Q3 2006 |
|---|---|---|---|
| **ACE** | 15,356 | 16,035 | 13,511 |
| **Arch** | 3,517 | 3,875 | 3,346 |
| **Aspen** | 2,638 | 2,733 | 2,315 |
| **Allied World** | 2,273 | 2,613 | 2,095 |
| **Axis** | 4,601 | 4,944 | 4,141 |
| **Endurance** | 2,269 | 2,526 | 2,117 |
| **Everest Re** | 5,037 | 5,612 | 4,824 |
| **Flagstone Re** | 1,084 | 1,159 | 802 |
| **IPC** | 1,818 | 2,063 | 1,883 |
| **Max Capital** | 1,274 | 1,534 | 1,295 |
| **Montpelier** | 1,414 | 1,630 | 1,359 |
| **PartnerRe** | 4,085 | 4,225 | 3,545 |
| **Platinum** | 1,772 | 2,004 | 1,774 |
| **Renaissance Re** | 3,041 | 3,522 | 2,797 |
| **Validus** | 1,917 | 1,789 | 1,122 |
| **White Mtn** | 4,062 | 4,733 | 4,119 |
| **XL Capital** | 8,661 | 11,432 | 9,524 |

# Downturn has silver lining for Bermuda reinsurers

## MANY CATASTROPHE REINSURERS FORECAST TO SHED SOME RISK BECAUSE OF THE SHORTAGE OF CAPITAL

Mike McGavick, CEO of XL Capital Ltd (left), and Brian Duperreault, President and CEO of brokers Marsh & McLennan, at the Bermuda Insurance Conference

The current global financial crisis may prove to be a double-edged sword for many Bermuda reinsurers.

On the one hand it is likely to reduce competition from the capital markets and drive prices up. On the other, the credit squeeze will make it difficult and expensive to recapitalise in the event of further major losses.

Industry experts say not even the projected $20 billion in insured losses from Hurricane Ike — the third biggest loss in history after Hurricanes Katrina and Andrew — would have forced a major hike in prices on their own.

Mike McGavick, CEO of XL Capital Ltd, speaking on a panel at the Standard & Poor's/PricewaterhouseCoopers' Bermuda Insurance Conference, said: "If you look at the reserves companies had going into this hurricane season, I don't think the storms themselves or even the greater frequency of smaller catastrophes would have led to substantial pricing change. What we're seeing is the combination of the two."

Brian Duperreault, the former head of Bermuda-based reinsurer ACE Limited and now President and CEO of brokers Marsh & McLennan, noted: "Through September 30, we estimated that Bermuda firms lost about 12% of their capital. That's about a year and a half of profits. It's bad but not so bad. It would have had to have been twice as bad to have had an effect on pricing."

But whether rate increases will be enough to cover the cost of capital and further loss of investment income remains to seen, said Duperrault, who added that price declines had been "unabated and universal" throughout 2008. He predicted that many catastrophe reinsurers would be forced to shed some risk because of the lack of capital.

"If you're writing business and you've got a per event risk cat exposure, you want to be trading after that," he said. "You have to think 'If there is another event, what would I be left with? Would I be able to continue to trade?' You can't take a chance so I would expect you would have to shed some exposure because you can't get money."

He said: "I've been in business 35 years and I've seen a number of changes and they are never the same. You're always fighting the last war trying to figure out what's going to happen and this one is different because we've never had an asset market change. Before, you could almost always get capital and start trading again. That phenomenon doesn't exist right now. The cost of capital has to drive prices up."

Duperreault added: "The flip side is we have a global recession of significant proportions on a world scale and there is a buyer out there and they are going to react too. They are only going to buy what they need and budget their premiums so the expectation of massive premium increases are less likely."

McGavick noted: "In a recessionary environment we would expect to have less growing insurable activity because by definition we reflect the economy. But at the same time the cost of capital for others has grown very dear too. I have no doubt risk managers will be under terrific pressure to hold the line on their costs at the same time that would be a wise purchase in that environment because their cost of capital is also very dear.

"I would maintain that even if prices do go up — as I expect they will — the absolute cost of reinsurance capital relative to other capital would still be a favourable transaction. With retentions coming down that means more demand for reinsurance. At the same time reinsurers will view their capital as more dear — that's a nice combination of demand and supply moving in a better price direction."

McGavick said the turmoil in the financial markets had effectively put alternative competitors from the cat bond market and hedge funds "out of the game".

Lehman Brothers, the failed investment bank, pioneered cat bonds and McGavick said: "The cat bond market is going to have some really negative effects from what is going on in Wall Street. We're going to see changes in how derivatives are regulated in future."

He added: "Hedge funds in essence were writing layers of insurance forcing downward pressure on pricing by their capacity and they were backing it with these instruments that are now under such pressure. My view is that whole category of competitor is probably out of the game for a period of time.

"You take two categories of competition out and you increase demand and you've got reinsurers viewing their own capital as more precious. I don't see how that doesn't yield a real increase in price."

'If prices do go up — as I expect they will — the absolute cost of reinsurance capital relative to other capital would still be a favourable transaction'

# Lack of capital will restrict mergers

## CEOS DON'T EXPECT A RUSH FOR START-UPS IN THE CURRENT FINANCIAL CLIMATE

A soft market with companies trading at far below true value would normally signal a frenzy of mergers and acquisitions but the credit crunch will almost certainly mean it will be all quiet on that front for the immediate future, according to industry veterans Don Kramer and Edward Noonan.

Kramer, CEO of Ariel Re, speaking on a panel at the Bermuda Insurance Conference, said: "You'd think there would be opportunities with so many companies selling at less than 80% of book value. The fact is that even at 75–80% of the book, the cost of capital is so high that it's very difficult.

"If Company A, selling at 80% of book, wants to buy Company B and Company B's expectations are inflated and looking for book value or more, to sell stock to buy something at book, the deal is highly diluted.

"The other thing is that we had the recent high watermark of Tokio Millennium's deal to buy Philadelphia Consolidated at three times book ($4.7 billion) and that's inflated the views of the prospective sellers, so it just makes it a very difficult market."

Noonan, CEO of Validus Re, noted: "In an ordinary environment this would lead to a lot of activity but the lack of capital means there probably won't be any deals for a while and the next one will probably not even be in our sector. There's probably going to be much better opportunities in the managing sector like financial services."

He added that with pricing expected to firm up going into the January renewals, many CEOs were adopting a more cautious approach.

"Bermuda is a short tail market and 2009 is starting to look pretty attractive to us. Companies that might have thought about growing by acquisition are looking at their business plans and saying, 'It's looking like a good year. I don't need to make any bold strategic moves because I can do very well in this pricing environment.'"

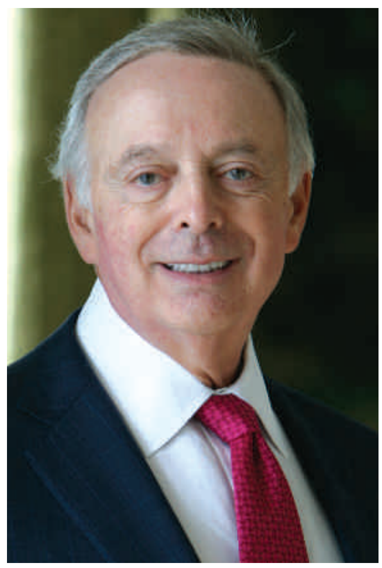
John Marra, Partner at PricewaterhouseCoopers, said the volatility of the markets was also inhibiting M&A activity because with insurance deals typically taking three to six months to complete due to regulatory requirements, it was difficult for buyers to assess what fair value was for any stock transactions.

Noonan said he was already seeing signs that the problems of big companies like AIG and XL were causing some buyers to think more carefully about placing all their programmes with one megaline insurer.

"We are seeing the early indications from buyers that maybe spreading smaller lines among more smaller companies is a better strategy that having several hundred million dollar lines from single companies because no one knows what might happen to that company in the next 12 months."

Neither Kramer nor Noonan expected to see any rush of start-ups in the current financial climate.

"The ticket to the dance in 2005 was $1 billion and that hasn't changed. No one is going to put up that sort of money to start a company today," said Kramer. "It was a slam dunk years ago. You'd put up the money, the company would earn 20% return in its first year.



**Don Kramer: High-cost capital**

Why would anyone today put up $1 billion to start a company and have it trading at 80% of book a year later?"

Added to that was the uncertainty concerning increasing global regulation and the new US administration.

"It's such an uncertain time," said Noonan. "You have the need to revamp the global regulatory regime of the financial services industry and the need for the United States government to capture more tax revenue. It's difficult to plan ahead and say Bermuda, Dublin or Switzerland is the perfect spot.

"Bermuda is such a major financial centre with a highly developed technical underwriting model and it is not going to go away because of what the United States does, but you will see companies look to redomicile if US tax policy changes in some deleterious way to the Island. That could well lead to acquisitions. If you're talking about maybe having to give up 20–30% of your returns in your taxes, then you redomicile. It's pretty cut and dried."

However both CEOs expected to see an increase in the trend for hybrid insurance-reinsurance companies as well as reinsurers looking to acquire primary insurers and vice versa.

Noonan explained: "Our business is 56% reinsurance and 44% insurance. There are points in time where it's far preferable to be a reinsurer than an insurer and it varies by class of business."

Kramer added: "In times like this where we are in a financial crisis, being the financial agent for the insurance industry becomes very valuable and I think you're going to see reinsurance demand increase. Mutual fund companies in the US have lost significant equity and their ability to retain risk is probably much more limited than it was three or four months ago and so you'll see reinsurance demand escalating."

# Why ERM matters more than ever

## COMPANIES URGED TO THINK MORE CREATIVELY ABOUT WHAT CAN GO WRONG

Enterprise Risk Management — or ERM — matters more than ever in the wake of the crisis in the financial markets and the reinsurance industry needs to be better equipped to assess its own risks.

That was the opinion of panelists at the recent Bermuda Insurance Conference and the conclusion of a recent global study by PricewaterhouseCoopers.

The turmoil in the financial markets shows that insurance companies are not immune to severe investment risks and other emerging threats, and that the role of an objective Chief Risk Officer (CRO) was critical going forward. Rating agencies are increasingly evaluating risk management in their financial strength assessments and risk-based assessment will be a key feature of the European Union's forthcoming Solvency II regulations for the financial services industry.

Tim Aman, CRO for Bermuda-based Montpelier Re, told the Bermuda Insurance Conference: "It's always dangerous, given human nature, to be limited by history and not consider the full range of possibilities. As insurers and reinsurers, when we price business we're pretty good at thinking about things that are small and outside the range of history. But when it comes to managing our own portfolios and our own risk — the correlations across classes or between assets and liabilities — we've got a ways to go.

"Going forward, because of this current crisis we have a bit more respect for what is possible and maybe we can use a little more imagination and creativity in thinking about what can go wrong and how it could go wrong.

'Because of this current crisis we have a bit more respect for what is possible'

"Diversification is a two-edged sword. It can add stability and capital efficiency but on the other hand, in very extreme cases, the more things you get involved with, the more ways there are to experience volatility and correlation and you have to be aware of that. There's the inherent risk of moving outside your area of expertise."

Mark Puccia, Managing Director, Standard & Poor's, said over-concentration in one risk was fatal and that companies needed to give CROs authority within the company culture. "Risk managers at many of these firms that are in trouble actually did identify the problems in advance. They weren't given sufficient stature at the time key strategic decisions were made."

William Panning, Executive Vice President at Willis Re, said it was critical that ERM advocates got buy-in from key decision makers. "For executives who have focused the firm on maximising profits it is a relatively new thing to try and bring risk into the picture and I'm not sure directors have a clear idea how to do that. It's not particularly easy and I do think that people who are advocates of ERM have not done a very good job of describing just how it should be done."

Aman agreed that ERM is a board responsibility. "Shareholders expect them to take it seriously in all strategic decisions they make. It's about trade offs between risk and reward. They need to be presented with a fair view of what the risks are associated with various course of action and need to be able to understand what those are and quantify at least in terms of ranges. That should be driven by the CRO."

Puccia said: "It must start at board level and it must require a substantial education of board members what their job is in establishing risk tolerance and risk appetite."

**Tim Aman, CRO for Bermuda-based Montpelier Re**

In its recent global study of 53 insurers, *Does ERM Matter?* PricewaterhouseCoopers stated that less than 50% were confident that ERM had been integrated into their company's decision making and frontline risk taking. Around 70% said risk management considerations were not integrated into their strategic planning, while only about 30% consider their risk assessment to a 'great extent' in setting underwriting policy. Only 30%, for example, had early warning systems to detect when volumes were nearing maximum thresholds. The report noted that only 3% of the ERM capabilities of 274 insurance companies reviewed by S&P in 2008 were rated as 'Excellent'. Just 10% were rated 'Strong'.

'Risk managers at many of these firms in trouble actually did identify the problems in advance. They weren't given sufficient stature at the time key strategic decisions were made'

William Panning said a major issue with ERM was that there was too much focus on measurement and not enough on the "psychology of decision-making." He said: "It's been very misleading because it focuses on what is the single number that is going to best express our risk so we can orientate everything towards that. I think that's a futile exercise. The more important thing is that if you look at most directors and executives, they have 30 years or 40 years experience of looking at very simple measures for what they do, like creating surplus ratios. If you tell them your tail value risk is 'Y' they have nothing to compare it with. We need much more attention to try and develop tools that link to the psychology of decision-making. I think scenario analysis is much better."

He also said: "I think we're at a very very primitive level where we don't have the vocabulary for board members to have an intelligent discussion about risk where the term 'risk' is being used in precisely the same way by all the people involved in the conversation. I think people talk about risk and mean totally different things."

Aman said it was important to understand that risk management was not about avoiding risk but about taking the right risk and to "go in with your eyes open, know what you're doing, do what you're good at and avoid the things that you don't know and to facilitate consensus on that.

"It's about understanding how bad things can be and knowing that is what you're in business to do."

# No bailout for insurance industry

## ACE BOSS SAYS INSURANCE WRITERS CAN WEATHER THE CURRENT FINANCIAL MARKET CRISIS

The insurance industry does not need a handout from the US Government, according to Evan Greenberg, Chairman and CEO of the Bermuda-based ACE Group and Chairman of the American Insurance Association (AIA).

Greenberg told the US Treasury Department that "the substantial majority of the insurers represented by AIA do not support the inclusion of property-casualty insurers in Treasury's Capital Purchase Programme (CPP). If made available they will not elect to participate.

"Those members believe that as property-casualty insurance writers they are well-capitalised and well-positioned to weather the current financial market crisis without the assistance of the CPP."

The CPP is part of the $700-plus billion emergency Troubled Asset Relief Programme (TARP) approved by Congress to inject capital into credit markets and to prevent counterparty failure of such a magnitude as to pose a systemic risk to the financial system.

In a letter to Treasury Secretary Henry J Paulson, he wrote: "The public effects of financial difficulties for insurers are, generally speaking, more limited, and they are already ameliorated by the highly regulated nature of the insurance industry in America and throughout the world. Although it is possible to imagine potential systemic financial risk in the form of a widespread failure to make claim payments to policyholders, claimants are already protected in all 50 States by priority rules and capitalisation requirements imposed on operating insurance companies throughout the land."

He pointed out that the AIG crisis was an exception as it resulted from "problems at the holding company level pertaining to sophisticated financial instruments that placed the entire organisation at risk."

He added: "AIG was acting not as a traditional insurance company but using its holding company as a seeming guarantor of credit worldwide, obligations that have now fallen to the Government. We are informed that its operating insurance companies remain well capitalised."

In the *Wall Street Journal*, Greenberg wrote: "Yes insurers have been buffeted by the current financial market turmoil. But this is not a crisis, nor does it threaten a run on the bank. Insurers are not generally lenders, and the availability of credit is not meaningfully affected by insurers' financial issues. Nor will delivering capital to insurers unfreeze any credit markets.

"Even in the current environment, private capital is available to insurers at market prices — the capital is just more expensive than taxpayer money. In the absence of a broken market and a public crisis, we should reward those companies that make prudent decisions and not subsidise those that do not."

He concluded: "Insurers have rowed their own boats for centuries. CPP capital should be deployed elsewhere to curtail a crisis, not used as a prop for weaker insurers."

# Market events justify Darwin move

## ALLIED WORLD DOUBLES ITS FOOTPRINT IN THE US FOR PRODUCTS AND SERVICES

Bermuda-based Allied World Assurance Co says its recently completed acquisition of Darwin Professional Underwriters, based in Farmington, Connecticut, has been justified by recent market events.

Speaking in an earnings conference call, CEO Scott Carmilani said the deal has doubled its footprint in the US for products and services and expanded its staff to enable Allied World to meet the opportunities developing in the market.

"In my view the recent market events validate the importance of this acquisition," he said. "The acquisition immediately doubles our footprint in the US for products and services and now gives us a much needed primary platform from this offering.

"Darwin also further expands our special liability and they are known for product and technological innovation. One example you can see is the small business technology platform for writing primary professional liability via the Internet called i-bind. We have made significant investments throughout the year and not just the acquisition of Darwin. We significantly added to our administrative infrastructure, our IT system support staff and our claim professionals. We are now some 555 strong — all prepared to better meet the developing opportunities being presented in the market."

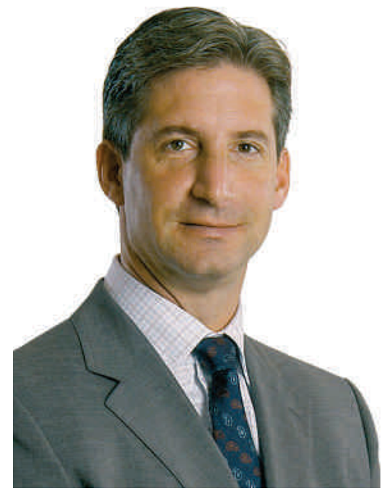
Allied World acquired Darwin, a specialty insurer focusing on professional liability insurance, from Alleghany Corp of New York for $550 million.

In a company statement marking the completion of the deal, Carmilani said: "[The] acquisition is an important strategic initiative for the company that increases our specialty casualty focus in the US and significantly expands our access to the US primary healthcare and E&O markets, which are target markets for Allied World."

Allied World posted a net loss of $46.4 million for 3Q 2008, mainly caused by net investment losses of $151.9 million and losses of $71.6 million related to Hurricanes Ike and Gustav.

Despite the losses, Allied World delivered an annual operating ROE of 19% year to date and Carmilani believes the turmoil in the insurance and reinsurance markets has generated great interest in Allied World's excess products — a trend he expects will accelerate in early 2009.

'We have made significant investments throughout the year'



**Carmilani: Company better prepared to meet opportunities**

# Making lemonade out of lemons

"What has happened to AIG recently is sad, but we should always remember what this giant of a company meant to Bermuda in not only reinsurance, but they were also the catalyst for many companies setting up business in Bermuda and providing capital to fuel the Island's growth."

— *former Premier* **Sir John Swan** *in* The Royal Gazette

"One of the fundamental reasons we come to Bermuda and other jurisdictions is because US regulation on a state basis is completely dysfunctional. Before we acquired an American company I had to do 40 sets of fingerprints. I never thought I'd get my hands clean. It's insane."

— *Ariel Re CEO* **Don Kramer** *at the S&P's/PwC Bermuda Insurance Conference*

"Talent is more mobile than it has ever been. The world is in geographical competition. It's about finding a competitive advantage and to bring together human and financial capital to make it valuable."

— *XL Capital CEO* **Mike McGavick** *speaking at the AGM of the Association of Bermuda International Companies, in* The Royal Gazette

"We believe the property/casualty insurance industry is unique in the ability to make lemonade out of lemons, or to put it another way, the worse the results, the better the potential for an improving-rate environment."

— *KeyBanc Capital Markets, Investors' Soapbox on barrons.com*

"I think companies will be happy to have any investment income in the next year."

— *President and CEO of Marsh & McLennan* **Brian Duperrault** *at the S&P/PwC Bermuda Insurance Conference*

## WHAT'S ON

**ONSHORE**

**April 5–7**
*Spring IRU Conference*
Fairmont Southampton
www.irua.com

**May 18–19**
*Casualty Actuarial Society Seminar on Reinsurance*
Fairmont Hamilton Princess
www.casact.org

**June 16–17**
*Insurance Day Summit*
Fairmont Hamilton Princess
www.insurancedaysummit.com

**June 21–24**
*Bermuda Captive Conference*
Fairmont Southampton
www.bcoa.bm

**OFFSHORE**

**February 17–20**
*Reinsurance Association of America — Cat Modelling in Uncertain Times*
Tampa, Florida
www.reinsurance.org

**February 23**
*P&C Technology Conference*
Toronto, Canada
www.insurance-canada.ca/seminars/icsem.php

**April 19–23**
*RIMS Annual Conference & Exhibition*
Orlando, Florida
www.rims.org

# Rosengarten joins XL, Morrison retires

**XL CAPITAL LTD** has appointed **Jacob D Rosengarten** as Executive Vice President and Chief Enterprise Risk Officer of the XL group of companies. Rosengarten, a Managing Director of Goldman Sachs, will be responsible for ensuring the efficient identification, assessment, monitoring and reporting of key risks across the XL group.

Rosengarten and Morrison

During his 30 year career he has held several leadership roles in risk management including Managing Director of Risk Management and Analytics for Goldman Sachs Asset Management (GSAM) for the past 10 years. He began his career as an Auditor at Arthur Young & Company in 1979. Commenting on Rosengarten's appointment, XL CEO Mike McGavick said: "This appointment demonstrates XL's commitment to excellence in enterprise risk management. This has been a core pillar of XL's business and while much progress has been made at XL, we know we can do better, and working with Jacob, this remains one of my top key areas of focus."

Founding CEO **Michael I D Morrison** has retired from the **ALLIED WORLD** Board of Directors. Morrison has been one of Allied World's Directors since the company's inception in November 2001, from which time he served as President and Chief Executive Officer until January 2004 and as Vice Chairman from January 2004 to October 2004. He served as Chairman of the Board from July 2006 through December 2007. **John J Gauthier** has joined Allied World as Senior Vice President and Chief Investment Officer. **John Telenko** is Allied World's new Vice President, Healthcare, based in Bermuda.

**Sean Ringsted** has been appointed Chief Risk Officer for the **ACE GROUP OF COMPANIES**. In this role, which will be in addition to his current responsibilities as Chief Actuary, he will be responsible for the continued development and implementation of ACE's risk management strategy and processes.

Start-up specialist energy insurer **TORUS INSURANCE** has appointed **Clive Tobin** as the Bermuda-based group's CEO. He will succeed interim CEO David Hope who will continue as Chief Underwriting Officer. Tobin was most recently Chief Executive of XL Capital's Global Insurance Operations. Another former XL executive, **Bob Klepper**, has joined Torus as President and Chief Underwriting Officer – Global Property. Klepper will also be President of Torus Specialty Insurance Inc, a US excess and surplus lines insurer.

**Tony Latham** has joined the Board at **FLAGSTONE REINSURANCE HOLDINGS LIMITED**. Latham is a former member of the Group Executive of international insurance firm RSA Group plc.