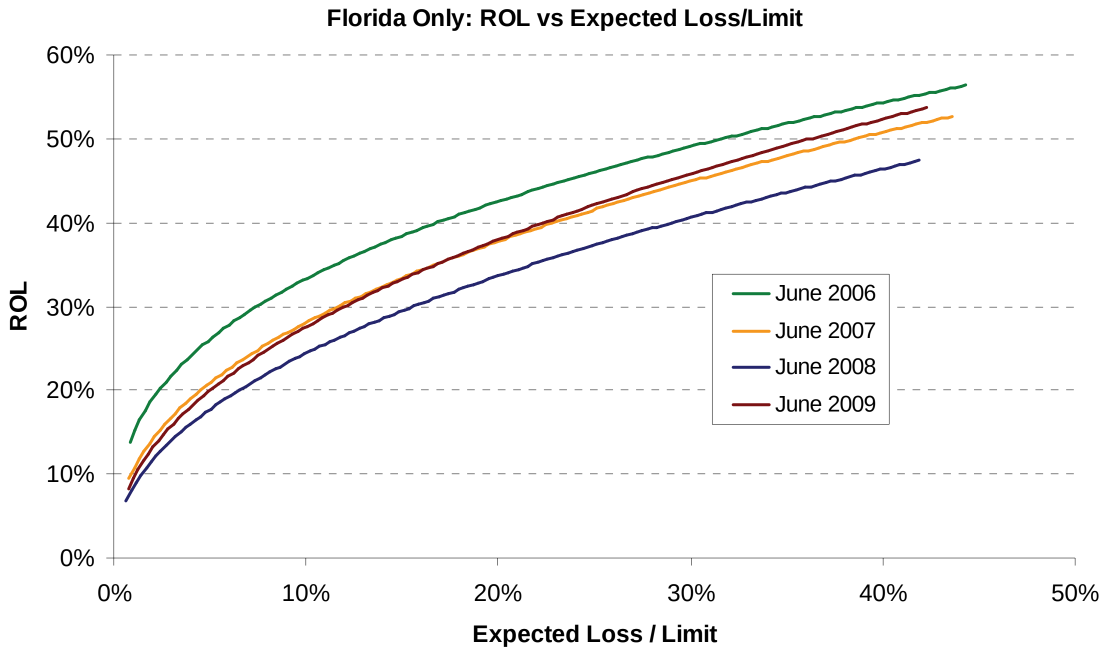
Reinsurance Market Update – June 1 - Florida

Catastrophe reinsurance renewal pricing covering risks in Florida at June 1 increased by 10 to 15 percent. The June 1 renewal date is most significant in the United States as many reinsurance programs that cover significant Florida residential exposures are structured around the substantial loss reimbursements that are projected by the State of Florida through its Florida Hurricane Catastrophe Fund (FHCF). The increases were at the mid to low end of the ranges we had estimated in our April 1 report. The less severe increases occurred for three reasons: (a) the FHCF dramatically increased its estimates of its bonding capacity due to its belief that the municipal bond markets had substantially improved and that it may now be able to fund all of its projected mandatory and optional capacity; (b) insurers' continued investment related challenges in the first quarter of 2009 caused property catastrophe risk reduction strategies to be prioritized above paying substantially higher prices for reinsurance coverage; and (c) reinsurer capacity was generally adequate for the demand that did come to the market. Reinsurer capacity was eased slightly by the decision of Citizens, Florida's state controlled insurer, to not renew its nearly $500 million private reinsurance program because its legislatively suppressed rates would not allow it to pay for both the increased cost of its FHCF reimbursements and a higher cost for its private reinsurance program.

Our expectation for United States July 1 are published below and other global regions remain as projected in our report on January 1st renewals and 2009 outlook.

Reinsurance Price Increases Less Severe

A number of factors affected the supply/demand balance and associated lower than expected price increases for Florida capacity for 2009 June renewals. We estimate that year on year increases are approximately 10 to 15 percent for the United States, largely Florida-influenced programs for 2009 bringing overall pricing back in line with 2007 market conditions – less than the peak witnessed in 2006. The chart below reflects premium to risk comparisons for all Florida-only treaties with 1 at 100 percent reinstatements.



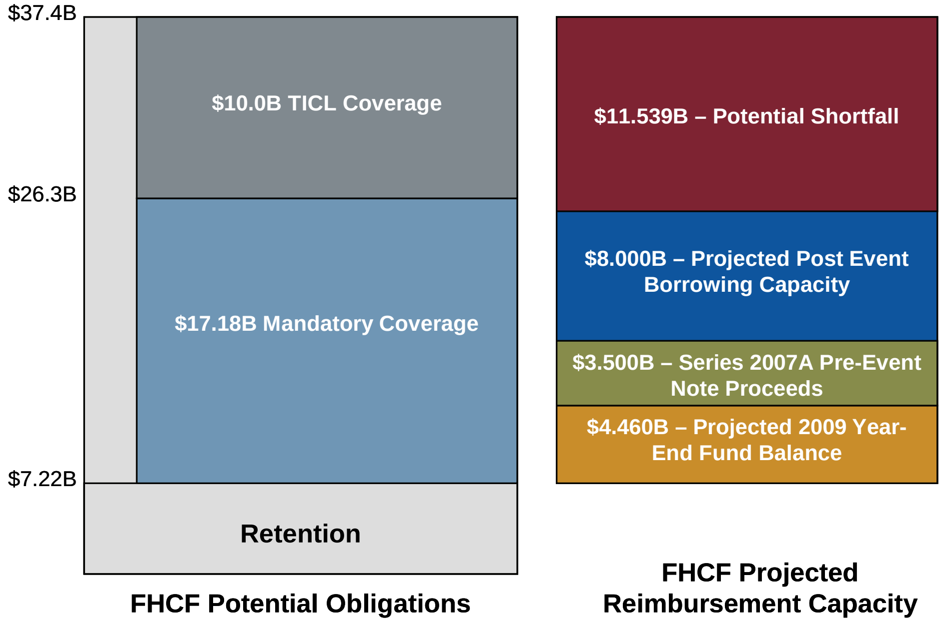
For the first quarter of 2009, reinsurer equity decreased another 3 percent, a rate of decline similar to the insurers. Reinsurers have maintained the core capital necessary to renew substantially all of their capacity. Of course there are exceptions to this broad trend and the exceptions fall into two broad categories: (a) reinsurers that had substantially larger investment or debt leverage and (b) reinsurers that rely more substantially on retrocessions as a source of capacity. Few new sources of capital have emerged thus far in 2009 but the reopening of the catastrophe bond market and limited signs of investor interest in sidecars and industry loss warranties are positive signs for the market. Capacity for substantial new catastrophe programs remains limited.

Original insurance rates for residential risks in Florida allow insurers very limited financial flexibility to replace State of Florida sponsored loss reimbursement capacity provided through the FHCF. Many insurers simply cannot afford to replace the capacity that they, in substance, have been required by the State to rely upon - even if they believe the FHCF may not be able to fully fund its projected capacity. The legislated $2 billion reduction of the FHCF's TICL capacity and the FHCF's increasingly confident claims that they will be able to raise over $20 billion in the municipal bond market (should significant hurricanes occur this year), combined to form what may have been interpreted by some to be a reasonable basis for continued reliance on the FHCF. Insurer net demand for Florida catastrophe coverage from reinsurers is relatively flat. Several insurers would likely desire more catastrophe reinsurance protection if their original rates would allow them to pay for the coverage. Some companies have increased their net risk by purchasing less capacity, increasing retentions, or not as comprehensively covering their potential reinstatement premium exposure.

Florida Legislative Changes

Florida's Governor Crist signed the major insurance package into law late on May 27, 2009. Two noteworthy changes from prior law include the extension with annual decreases in coverage of the TICL layer of the FHCF through 2013, as well as the removal of the rate freeze for Citizens starting in January 2010.

Provisions of the new law incorporate $10 billion of TICL coverage for the 2009 hurricane season (down from $12 billion in 2008) and $2 billion annual reductions in capacity through 2013 in combination with a gradual increase in rapid cash build up factors to both the mandatory and TICL layers of protection throughout the same period. The schematic below illustrates the projected capacity for the FHCF and TICL layers of coverage for 2009 in conjunction with the estimated sources of funding.



*Assumes as much TICL limit purchased as in prior year, subject to legal limit.
** Represents total borrowing capacity. Claims-paying capacity will be less due to costs of issuance, capitalized interest, deposit to debt service reserve fund, etc.

During the May meeting of the FHCF advisory council to provide an estimate of reimbursement capacity, a range of $4.5 to $10.0 billion was provided for post event funding capacity, with $8.0 billion being the best estimate. Many factors impacting insurers, rates, capital, ratings and confidence in the FHCF's ability to finance the program, will influence the actual optional TICL limits purchased. We believe several insurers that purchased the optional TICL for the 2008 hurricane season will not pursue the option in 2009.

Additionally the legislation allows Citizens to increase its rates for the insurance it provides beginning January 2010 by up to 10 percent per policy annually until rates reach an actuarially sound levels. This easing of the previous legislated Citizens rate freeze is an important step to increase the viability of this state run program that competes with private insurers.

In addition to the major property insurance bill signed by Governor Crist, two other bills have not reached the governor for action. HB 1171 (a bill to modify rate regulation in Florida for well capitalized insurers) remains controversial and its fate is not clear at this time. HB 853 (a bill to clarify certain excess and surplus lines issues) also awaits action from the governor.

For an exhaustive list of the changes in Florida's insurance laws during the 2009 session, please contact your Aon Benfield reinsurance broker.

Rating Agency Response is Mixed

Last October, the FHCF estimated that it would have a $14.5 billion shortfall should a full limit occurrence or series of hurricane occur during the remainder of the 2008 hurricane season. The shortfall was due to the unprecedented municipal bond market conditions in the midst of the global credit crisis. A.M. Best responded by not giving any credit for TICL recoveries and a 15 percent haircut on the mandatory layer recoveries in its capital adequacy tests for catastrophe risk (BCAR). Six companies were placed under review with negative implications for the remainder of the 2008 hurricane season

As the credit market conditions have improved, the FHCF is estimating a range of post-event bonding capacity, with a best estimate of $8 billion within the 12 months following an event.

A.M. Best is currently reviewing the updated estimates and may revise the criteria used in the fall. We expect that the credit given by A.M. Best will be no worse than last year and potentially slightly more favorable. While it is unlikely that credit will be given for the TICL layer, it is possible that a lesser haircut will be applied to the mandatory layer.

If the stressed BCAR is below the company's minimum required target BCAR (which is company specific and does not necessarily equal the minimum BCAR for the rating category or the company's published BCAR score, and is available from their A.M. Best Analyst), A.M. Best will determine what action will be taken on a case by case basis. While last year's rating actions of "under review with negative implications" occurred at the end of hurricane season, companies falling below the required threshold at the beginning of hurricane season may face downgrade. Companies will be analyzed to determine their sources of financial flexibility, including any letters of credit or parental guarantees. If companies are facing a downgrade, they will be given the opportunity to respond with a corrective action plan

Companies with low financial flexibility and whose BCAR scores are near the minimum target for their rating category should consider other alternative sources of protection, including reinsurance. The reinsurance solutions may include replacing their TICL layer with private reinsurers. Aon Benfield's Rating Agency Advisory group can help determine which solutions would be optimal for individual clients

Demotech, an agency that rates many Florida property writers and for many is the sole rating of their company, is currently in the process of updating their ratings. As of May 26, Demotech has upgraded five companies, affirmed 26 companies and alerted five companies that their ratings would be removed in the coming weeks a result of both their inadequacy in responding to the "short-term liquidity issues" associated with the FHCF's potential inability to raise all funds subsequent a significant event, as well as poor overall financial results. Twenty two companies are still being reviewed.

Demotech is reconsidering how it analyzes catastrophe exposures and may revise its criteria in 2010; Demotech has not yet undertaken this analysis and such information will not be available until the fall at the earliest.

Expectations for Upcoming July Renewals

Our expectation for July 2009 renewals have changed slightly but remain in line with our January and April 2009 publications. The complete Reinsurance Market Outlook report issued in January is available here.

United States: July 2009 Renewals

	ROL CHANGES	CAPACITY CHANGES	RETENTION CHANGES
Personal lines national	+5 to +20%	Stable to -10%	+10 to +15%
Personal lines regional	-5 to +20%	Stable to -5%	+5 to +15%
Standard commercial lines	+5 to +20%	Stable to -5%	+10 to +25%
Complex commercial lines	+5 to +25%	Stable to -10%	+10 to +25%

Rest of World: July 2009 Renewals

	ROL CHANGES	CAPACITY CHANGES	RETENTION CHANGES
Europe			
Northern (wind dominating)	Stable to +5%	Stable to -5%	Stable
Southern (quake dominating)	Stable to -5%	Stable	Stable
United Kingdom	Stable to +5%	Stable	Stable
Asia Pacific (excluding Japan)	Stable to -5%	Stable to +10%	Stable
Japan	Stable to +10%	Stable	Stable
Australia / New Zealand	Stable to +10%	Stable	Stable
Canada	Stable to +5%	Stable	Stable
South America	Stable to +5%	Stable	Stable
Mexico	Stable to +5%	Stable	Stable
Caribbean	Stable to +5%	Stable	Stable

Assumptions: No changes in insured catastrophe exposures. No significant catastrophe model changes. No significant catastrophe losses occur before negotiations are completed. Rate of change measured from the expiring June through July, 2008 terms.

About Aon Benfield

Aon Benfield provides clients with integrated capital solutions and services through a world-class network of experts in more than 50 offices. Clients are better able to differentiate and meet their business objectives with Aon Benfield's treaty and facultative reinsurance placement services, capital markets expertise, and relevant analytics and technical expertise, including catastrophe management, actuarial and rating agency counsel. Please visit aonbenfield.com or contact your Aon Benfield broker for additional information.