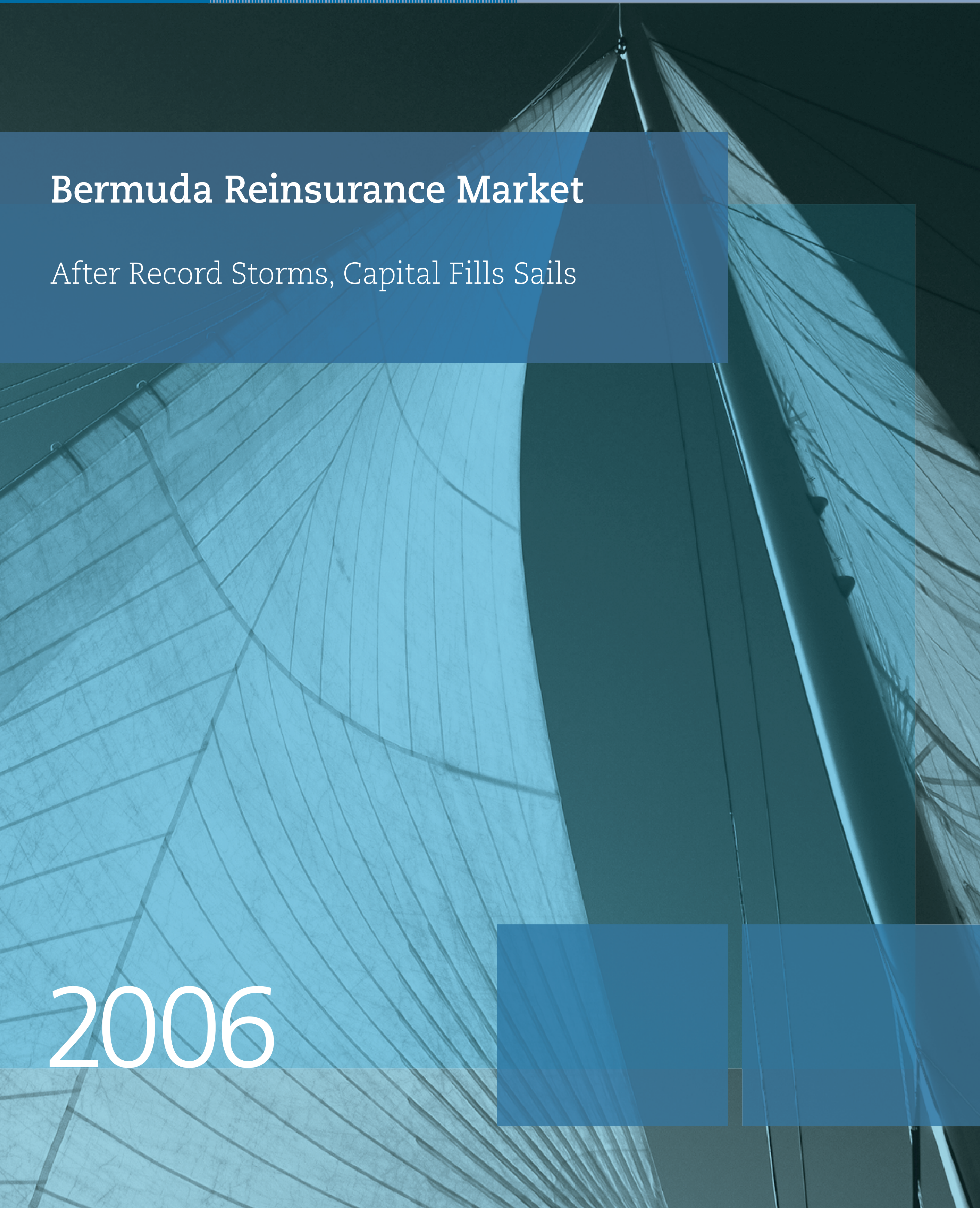
GUY CARPENTER

Bermuda Reinsurance Market

After Record Storms, Capital Fills Sails

2006



Contents

Executive Summary

This report examines the size and security of the Bermuda reinsurance market at the beginning of 2006 as well as regulatory and supervisory issues in the Bermuda marketplace.

> The Bermuda reinsurance market continues to expand rapidly. It tripled in size to $28 billion in 2005, from $9.2 billion in 2001, while gaining market share versus other regions.

> Bermuda reinsurers suffered significant capital outflows in 2005 due to hurricane losses, dividend payments to investors and unrealized capital losses. However, these capital outflows were more than offset by equity capital inflow late in the year, following Hurricane Katrina.

> Despite the Bermuda market's net increase in capital, ratings on average were reduced for incumbent reinsurers in 2005. This is indicative of the rating agencies' view that the world has become a riskier place for property catastrophe reinsurers.

> Bermuda's trademark flexibility and responsiveness was evident following the record hurricane losses of 2005. More than 10 new companies opened for business in the months after the storms. "Sidecars" emerged as a new and efficient way for investors to participate in the Bermuda market. These entities allow an investor to essentially "attach" to an existing reinsurance writer to provide capacity.

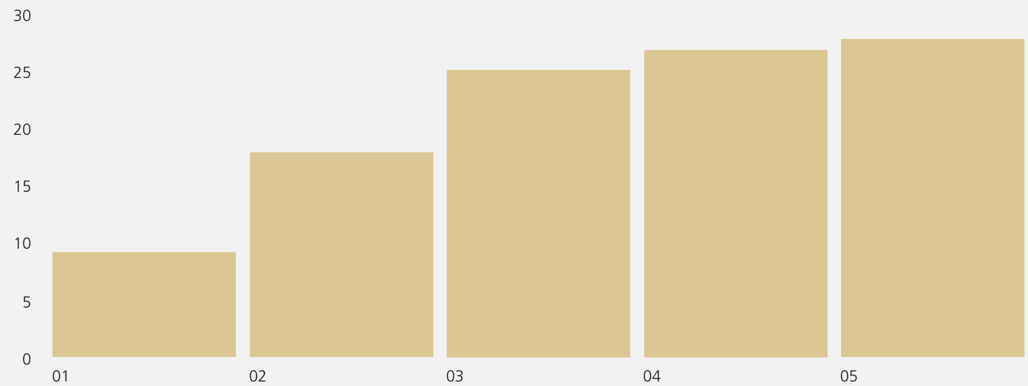
> A January 2004 International Monetary Fund report on the adequacy of the regulatory regime overseeing Bermuda's banking, securities and insurance sectors was largely complimentary but included some key recommendations relevant to insurers and reinsurers.

In 2005 Bermuda strengthened its foothold as the preferred domicile for reinsurers. The island remains a prime destination for capital not only because of its favorable tax and regulatory climate, but also due to its fully developed reinsurance infrastructure, ease of incorporation and simplified regulatory capital and operating guidelines.

Market Size and Growth

Based on our composite of Bermuda reinsurers (defined below), the Bermuda reinsurance industry has veritably exploded in recent years, tripling in size to $28 billion in 2005, from $9.2 billion in 2001. In 2005 the market grew by 4.3 percent. However, this comparatively lower increase should be considered in the context of the decline in global reinsurance premiums, estimated at more than 10 percent, that occurred during the corresponding period.

Figure 1: Bermuda Composite Reinsurance P/C Gross Premiums Written
(US$ BILLIONS)



Defining the Bermuda Composite

The Bermuda composite, as defined by Guy Carpenter, is made up of Bermuda-domiciled holding companies with significant reinsurance writings from non-affiliates. The composite is made up of the following companies:

- ACE Ltd.
- Allied World Assurance Company (AWAC)
- Arch Capital Group
- Aspen Insurance Holdings
- AXIS Capital Holdings
- Catlin Group
- Endurance Specialty Holdings
- Everest Re Group
- IPC Holdings
- Max Re Capital
- Montpelier Re Holdings
- PartnerRe Ltd.
- Platinum Underwriters Holdings
- PXRE Group
- RenaissanceRe Holdings
- White Mountains Insurance Group
- XL Capital

Our definition considers the term “Bermuda reinsurer” in its broadest sense. Users should consider this definition and use discretion when drawing comparisons between reinsurance groups.

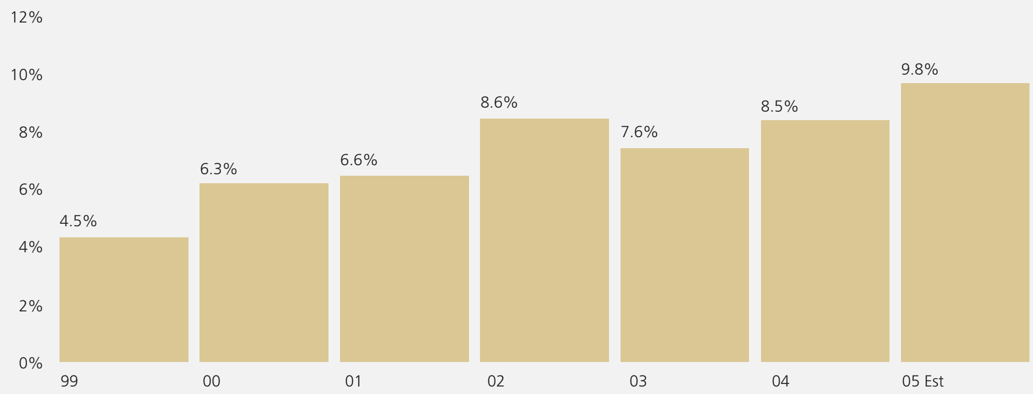
Holding company financial statements were used to compile the information for this report.

Ideally, a report on the Bermuda reinsurance market would contain information on all operating companies domiciled in Bermuda and predominantly writing reinsurance for unaffiliated cedents. However, operating company information lags that of public filings, and the benefit of reporting all company operating statements is outweighed by the need for timely reporting.

In addition, Bermuda statutory information as well as audited GAAP statements for most of the relevant operating companies are not in the public domain. Awaiting this information would further delay our reporting.

The Bermuda composite's share of the global reinsurance market increased from 4.5 percent in 1999 to an estimated 9.8 percent in 2005. Bermuda previously achieved record market share in 2002, reflecting its relatively high orientation toward property catastrophe reinsurance, a line that experienced rate increases at a double-digit pace in the hard market following the events of September 11, 2001.

Figure 2:
Bermuda Market Share
Net Reinsurance
Premiums Written



Source: Standard & Poor's and Guy Carpenter

Bermuda market share considered in terms of surplus (shareholders equity), shown in Appendix A, follows a similar pattern as the chart above. Bermuda is of growing importance to the US primary industry, as discussed in Appendix B.

Classes of 1993, 2001 and 2005

Discussions of the security of Bermuda reinsurance carriers generally encompass ratings, capitalization and commencement of operations, with the latter sometimes placing carriers into three categories: Class of '93, Class of '01 or Class of '05, denoting years that contained or followed a major catastrophic event and triggered a significant infusion of new capital into the marketplace.

This classification is effective, but somewhat simplistic as new entrants have been seen in other years as well. Most of these new players, however, have been connected with already established insurance groups seeking to focus and segregate reinsurance operations and re-domesticate US or UK operations to Bermuda. Operating companies that do not fit neatly into these established "Classes" include:

- XL Re Company Ltd., established in 1995 (although it acquired Mid-Ocean Re, Class of '93);
- Max Re Ltd., Overseas Partners Cat Ltd. and Top Layer Re Ltd., established in 1999;
- Everest Re (Bermuda) Ltd. and Tokio Millennium Re, established in 2000;
- Aspen Insurance Ltd., Catlin Insurance Ltd. and Platinum Underwriters, established in 2002.

New Entrants

Since meaningful information is not yet available on newer start-ups, this report focuses on Bermuda groups established prior to 2005. Due to the importance of new markets, however, key information on Class of 2005 players is contained in the following table, including data on a new phenomenon, "sidecars," which are described below.

"Sidecar" agreements are providing a new and efficient way for carriers to participate in Bermuda's growing reinsurance market. A sidecar carrier attaches itself to an existing reinsurance writer to essentially provide capacity. The sidecar carrier has no stated interest in writing business, seeking a financial strength rating or building business relationships beyond the existing reinsurance writer. Sidecar carriers provide capacity flexibility for the companies with which they directly associate and benefit the industry as a whole by helping to smooth the underwriting cycle.

Benefits for sidecar investors [1]

> limited start-up / infrastructure costs

> capital put to use almost immediately

> a seasoned business and underwriting team

> no near-term need for rating

> expedited entry into a favorable market

> the ability, in theory, to exit the market rapidly

Drawbacks for sidecar investors

> dependence on one carrier for all underwriting services

> a single source of business

> pullout of capital may be circumvented or delayed by agreement terms, regulators and/or the ability of the ceding carrier to handle additional net volume

Benefits for ceding carriers

> additional managed capacity increases offered lines

> revenue (fees and profit commissions)

> ability to maintain market share while replenishing surplus position

> avoids dilution of shareholder ownership since existing shareholders do not have to fund capital replenishment

Drawbacks for sidecar ceding carriers

> many sidecar capital providers appear to have short-term outlooks and high return on equity expectations

> most are not aligned (outside of the sidecar agreement) with the ceding company and/or its management and could become publicly critical of management and damage its reputation and shareholder value

> rating agencies may seek more information on sidecar agreements and carriers from ceding companies before extending full capital credit

> capital may be withdrawn at an inopportune time if the sidecar investors want to pursue other investment opportunities perceived to be more lucrative

[1] This material is not intended as an offer or solicitation for the purchase or sale of a financial instrument. Securities or investments, as applicable, are offered in the (i) United States through MMC Securities Corp., a US registered broker-dealer and member NASD/SIPC, and (ii) European Union through Marsh Advanced Risk Solutions, Ltd. ("MARS LTD"), regulated by the Financial Services Authority for the conduct of investment business in the United Kingdom. Reinsurance products are placed through qualified affiliates of Guy Carpenter. MMC Securities Corp. and MARS Ltd. are affiliates of Guy Carpenter.

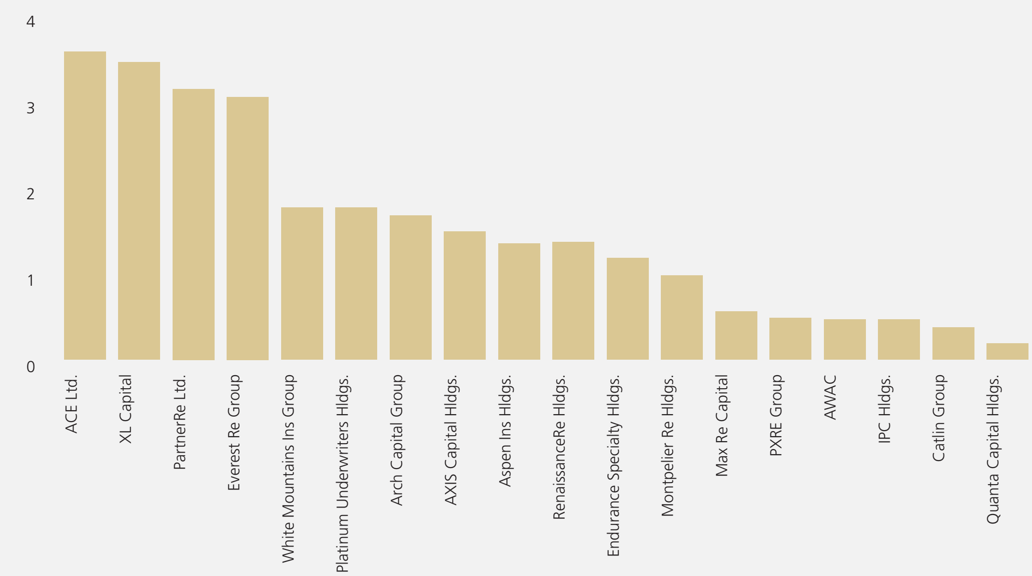
TABLE 1: CLASS OF 2005

COMPANY (1)	PRIMARY SPONSOR	CAPITAL ($ MILLIONS)	BEST RATING (1)	S&P RATING (1)	LICENSED	READY TO WRITE	BUSINESS FOCUS
Amlin Bermuda Ltd	Amlin PLC	1,000	A-	A	11/15/05	12/15/05	Qualified Quota Share; Property; Pro Rata
Ariel Reinsurance Co. Ltd	Blackstone Group; Texas Pacific Group; Thomas H. Lee Group	1,000	A-		11/30/05	12/16/05	Property; Marine & Energy; Reinsurance & Insurance
Arrow Capital Reinsurance Co. Ltd	Goldman Sachs	100			11/15/05	01/01/06	Short-tail Collateralized
Flagstone Reinsurance Ltd	West End Capital	715	A-		11/16/05	12/20/05	Property; Marine & Energy; Short-tail Casualty
Harbor Point Re Ltd	Chubb; Stone Point Capital	1,300	A	A	11/16/05	01/01/06	Multi-line
Hiscox Insurance Co. (Bermuda) Ltd	Hiscox Plc	500	A-		10/26/05	12/06/05	Property Reinsurance; Qualified Quota Share
Lancashire Insurance Co. Ltd	IPO,Cypress; Capital Z	1,000	A-		11/09/05	12/16/05	Marine & Energy; Retrocession; Property Facultative
New Castle Reinsurance Co. Ltd	Citadel	500	A-		11/08/05	11/08/05	Catastrophe business (prefers single territory)
Validus Reinsurance Ltd	Aquiline Capital; Goldman Sachs; Vestar; New Mountain; Merrill Lynch	1,000	A-		11/14/05	12/13/05	Property; Workers Compensation Catastrophe; Marine & Energy; Terrorism; Retrocession
SIDECAR ARRANGEMENTS							
Blue Ocean Reinsurance Ltd	Montpelier and other investors	300			11/09/05	01/04/06	Retrocession
Cyrus Reinsurance Ltd (2)	Highfields Capital; XL Capital	500			Yes	01/01/06	Retrocession of XL book
Flatiron Re Ltd (2)	Arch Capital; Goldman Sachs	900			Yes	01/01/06	Retrocession of Arch Re book
Rockridge Re (2,3)	West End Capital; Montpelier	90			Yes	01/01/06	Retrocession of Montpelier book

(1) - As of May 1, 2006
(2) - Capital Not Confirmed
(3) - Domiciled in the Cayman Islands

Gross Written Premiums

Figure 3: Bermuda Composite 2005 Gross Reinsurance Premiums Written
(US$ BILLIONS)



ACE Ltd. is Bermuda's largest reinsurer, based on gross written premiums, but is followed closely by XL Capital, PartnerRe and Everest Re, which each reported reinsurance premiums slightly less than the $3.6 billion assumed by ACE in 2005. These four groups have led the Bermudian market in assumed premium for at least the past five years, changing their specific rankings year to year. ACE was the fourth largest assumed premium writer in 2004.

These four groups account for nearly 50 percent of the total assumed writings of our Bermuda composite.

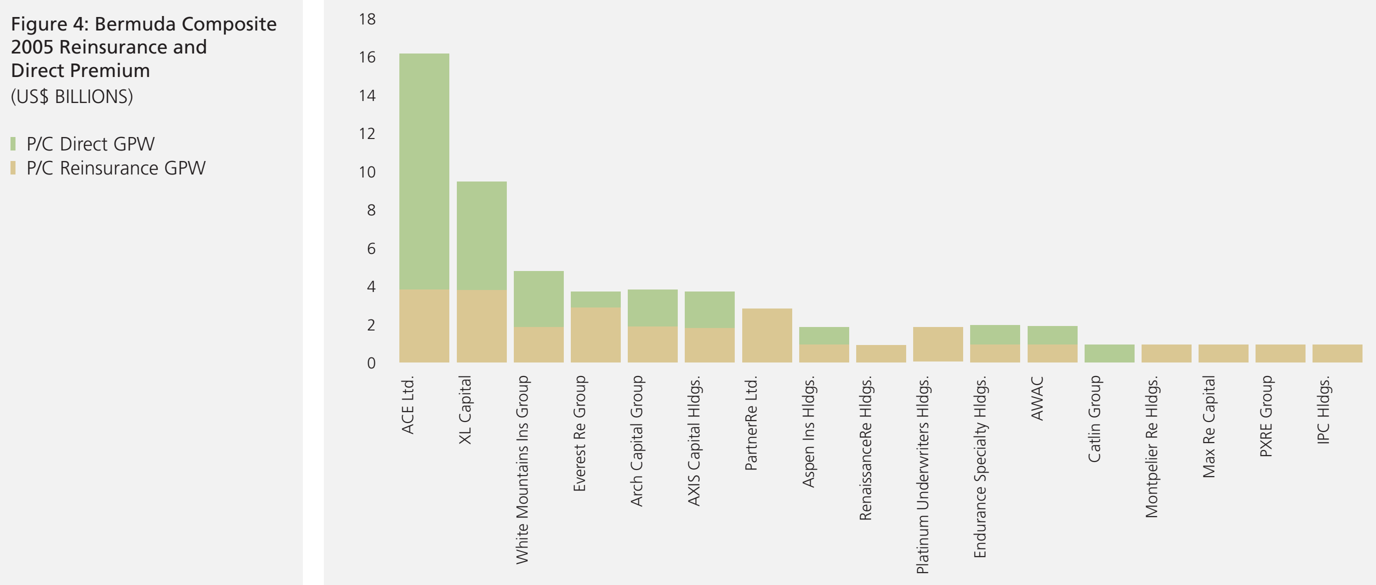
TABLE 2:
SHARE OF BERMUDA REINSURANCE MARKET, 2005

GROUP	PERCENT OF MARKET
ACE	13
XL	12
PartnerRe	12
Everest Re	11
Sub-total, top four	48
All other	52
Total	100

Since most of the data we follow is only available at the holding company level, it is important to know how much direct insurance is written by these Bermuda holding groups. The following chart identifies groups that write predominantly reinsurance, e.g., Platinum and Montpelier Re, versus those writing a broader product mix, notably ACE and XL.

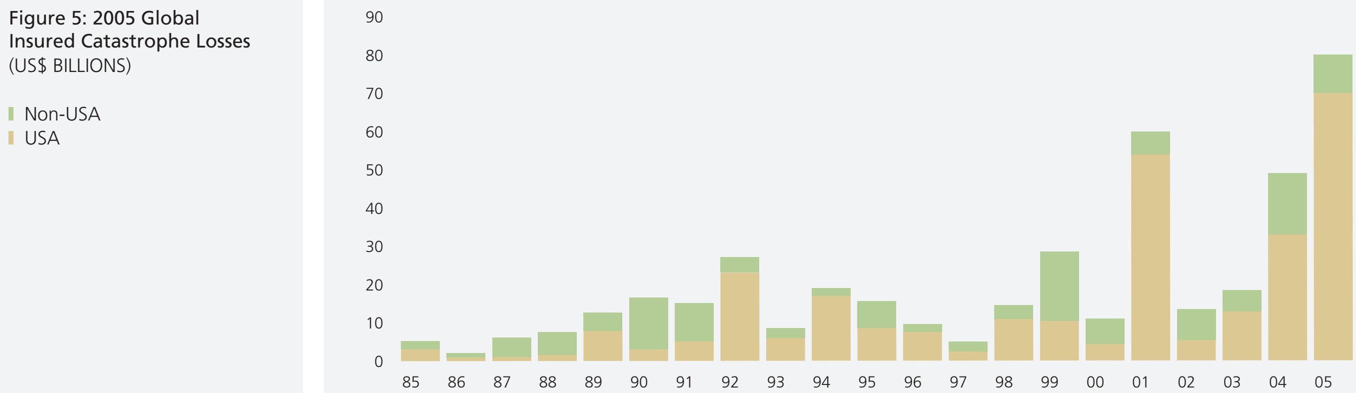
The premium split in the below chart was taken from SEC filings and generally includes only property/casualty business. In actuality, some higher layer direct business reflected in the calculations is more akin to reinsurance than to what is typically thought of as direct business.

Figure 4: Bermuda Composite 2005 Reinsurance and Direct Premium
(US$ BILLIONS)



Profitability

Figure 5: 2005 Global Insured Catastrophe Losses
(US$ BILLIONS)



Source: Swiss Re/Sigma

Catastrophe Losses in 2005

2005 was the costliest year on record for insured natural catastrophes.

Swiss Re/Sigma estimates 2005 worldwide insured property cat losses at $83.4 billion, which represents about one third of total economic catastrophe losses (including non-insured losses) of $230 billion. Insured losses of $72.6 billion occurred in North America. This North American figure could prove conservative, as the upper range of Risk Management Solutions' (RMS) estimated losses from Hurricanes Katrina, Rita and Wilma is $79 billion. Swiss Re estimates that Katrina produced insured losses of $45 billion, with total damages of $135 billion.

As estimated industry losses from Hurricane Katrina spiraled upward in the weeks following the storm, many groups avoided publicly issuing point estimates or even ranges of their potential losses, offering instead a fixed percentage of the total loss incurred by the industry, without speculating as to what that total industry loss would be. Since there were several disparate estimates of the industry's loss, these percentage estimates translated to a wide range of figures. As the extent of losses became better known, criticism was leveled at the probable maximum loss estimates many groups had modeled prior to 2005, which were now viewed as overly optimistic.

The rating agencies are now taking a very cautious approach to assessing the capital and security of reinsurance carriers, particularly those specializing in property reinsurance. Rating agencies have adopted a "belt and suspenders" approach to judging the capital catastrophe reinsurers need to sustain an investment grade rating.

Ironically, more capital may be needed as ceding insurers improve their data and modelers adopt a more conservative and detailed approach that enhances the ability of reinsurers to quantify aggregated risk. This better quantification of risk, combined with the more conservative stress test standards adopted by rating agencies, is putting additional strain on the industry to support catastrophe exposures and on carriers to adopt innovative structural changes.

On March 23, 2006, RMS announced that it was incorporating a forward-looking, five-year view of risk for estimating potential catastrophe losses in its modeling of windstorm risk, rather than continuing to use the long-term historical average as a baseline. The intent was to address what it perceived as a "multi-decadal period of elevated frequency and intensity of storms driven by higher sea surface temperatures in the tropical North Atlantic and by associated changes in atmospheric circulation." As a result, the firm's US hurricane model will "increase modeled annualized insurance losses by 40 percent on average across the Gulf Coast, Florida and the Southeast, and by 25 percent to 30 percent in the mid-Atlantic and Northeast coastal regions, relative to those derived using long-term 1900-2005 historical average hurricane frequencies."

An Industry Problem
Undervaluing Property Risks

"Nine out of 10 commercial properties analyzed had replacement values significantly less than the amount estimated by our construction specialists. The variability in the quality of data among companies was also significant with insurers' average replacement values ranging from 20 to 80 percent of values derived using a standard engineering-based cost estimation process."

- Karen Clark, Chief Executive Officer, AIR, indicating in a company press release that the underestimation of catastrophe exposures goes beyond enhanced data collection and modeling assumptions.

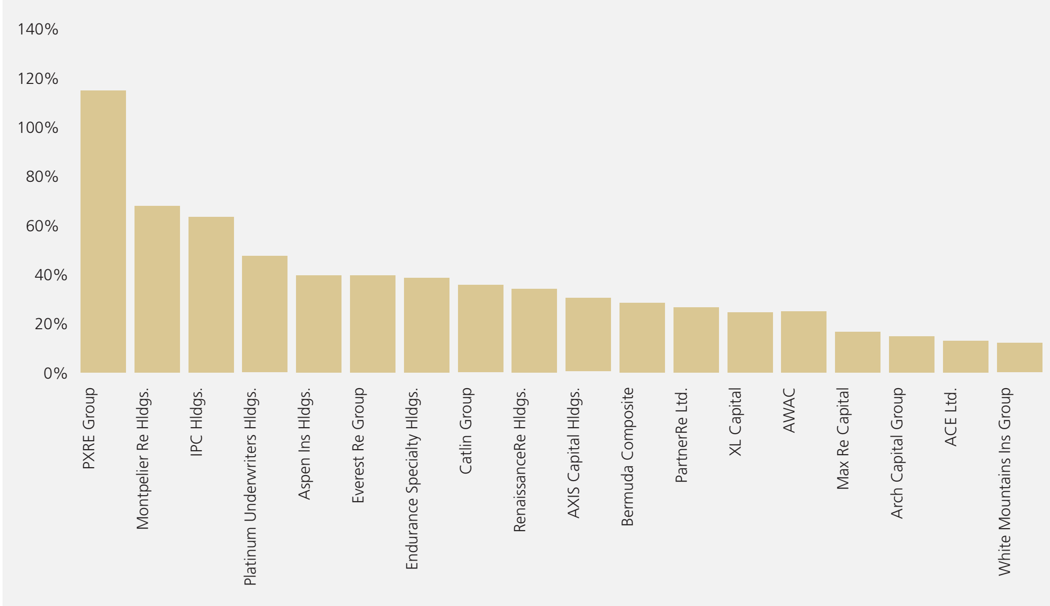
Impact of Catastrophes on Equity

The following chart illustrates the magnitude of catastrophe losses relative to the equity position of each of our Bermuda composite groups at the onset of 2005. As expected, the three groups most affected by 2005 losses were property catastrophe specialists PXRE, Montpelier Re and IPC. Net pre-tax developed losses (after-tax where indicated) as of year-end 2005 from Hurricanes Katrina, Rita and Wilma exceeded PXRE's beginning year capital and surplus, while the losses represented 69 percent and 64 percent of beginning year shareholders' equity of Montpelier Re and IPC, respectively.

Even the more diversified reinsurers were substantially affected by catastrophe losses, including Endurance (losing 39 percent of equity), Everest (40 percent) and Platinum (47 percent).

While the 2005 losses relative to reinsurers' beginning year capital base were sobering for policyholders and industry analysts, they also ignited investor interest, particularly from hedge funds, which saw short-term opportunities in the marketplace.

Figure 6: Bermuda Composite Net Cat Losses in 2005 as % of Start Year Equity

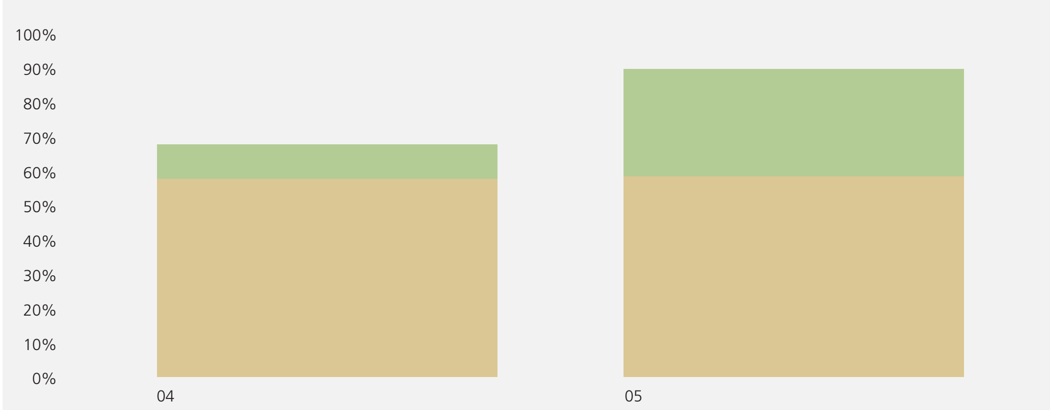


Impact of Storms on Loss Ratios

Looking first at the Bermuda composite average, the impact of 2005 catastrophe losses on current year loss ratio results is illustrated by the following chart.

Figure 7: Bermuda Composite Average Loss Ratio

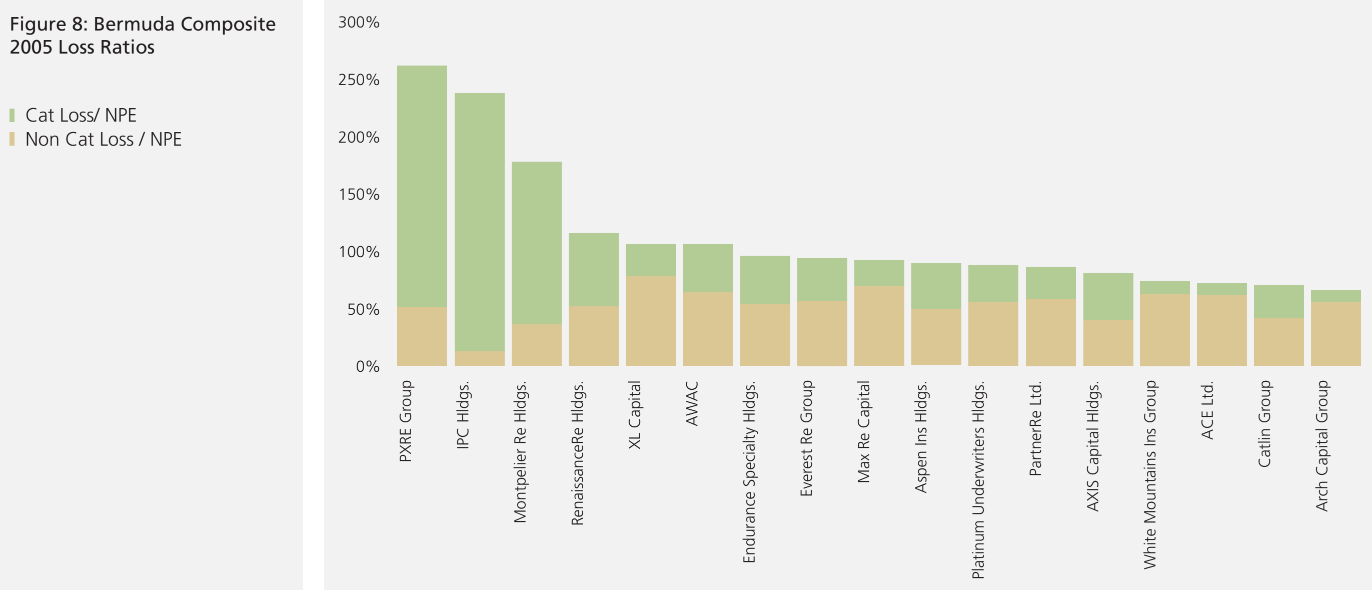
Cat
Non-Cat



Non-catastrophe losses were about equal in relation to premiums in 2004 and 2005, at 58.7 percent and 60.1 percent, respectively. However, the overall loss ratio was above 90 percent in 2005, reflecting the 30.7 percent ratio for catastrophe losses.

Results for many reinsurers were much worse than these averages, as the chart below indicates. PXRE's total loss ratio suffered worst, coming in at over 200 percent. The company is currently operating without an A.M. Best or S&P rating and is reviewing its options.

Figure 8: Bermuda Composite 2005 Loss Ratios



Impact of Storms on Net Income

The impact of the 2005 storms on net income was offset by a number of factors, notably investment income and favorable underwriting results for lines of business not exposed to catastrophe losses. For our Bermuda composite overall, the catastrophe loss of $14.3 billion was reduced to a loss of $2.9 billion. Six of the 17 Bermuda composite members were in the black in 2005 despite heavy catastrophe losses.

TABLE 3: BERMUDA COMPOSITE NET INCOME AFTER 2005 STORMS
(US$ THOUSANDS)

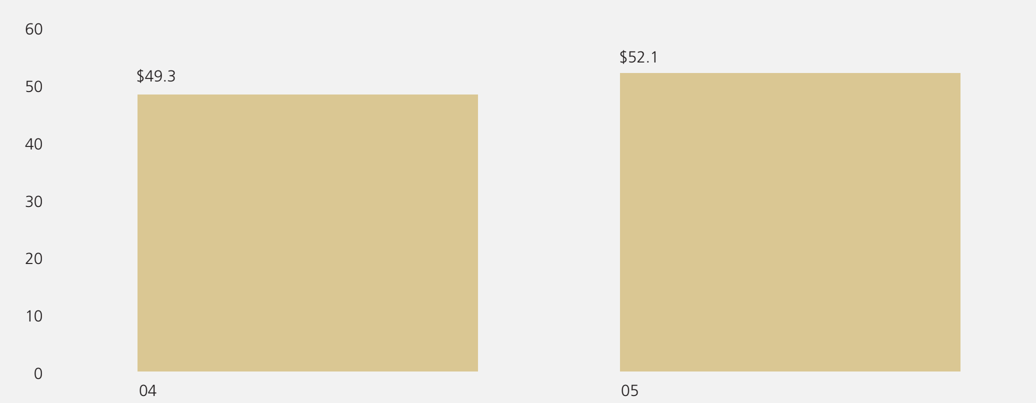
COMPANY	TOTAL CAT LOSSES	NET INCOME
ACE Ltd.	$1,279,000	$1,028,000
AWAC	531,500	(159,800)
Arch Capital Group	333,200	256,500
Aspen Ins Hldgs.	594,600	(177,800)
AXIS Capital Hldgs.	1,019,100	94,400
Catlin Group	350,200	19,700
Endurance Specialty Hldgs	717,800	(200,800)
Everest Re Group	1,485,700	(218,700)
IPC Hldgs.	1,017,500	(623,400)
Max Re Capital	157,400	6,700
Montpelier Re Hldgs.	1,202,800	(752,900)
PartnerRe Ltd.	900,000	(51,100)
Platinum Underwriters Hldgs.	530,000	(137,500)
PXRE Group	806,900	(697,600)
RenaissanceRe Hldgs.	909,300	(246,800)
White Mountains Ins Group	455,000	290,100
XL Capital	1,969,800	(1,252,000)
Bermuda Composite	**$14,347,200**	**($2,929,000)**

Capital

Many balance sheets were hit hard in 2005, with capital outflows totaling about $6.7 billion resulting from hurricane losses, dividend payments to investors and unrealized capital losses.

However, these capital outflows were more than offset by the wave of new capital that flooded the market later in 2005 – an equity capital inflow of $9.5 billion. By year-end 2005, the total equity of the Bermuda composite rose to $52.1 billion, up from $49.3 billion at the end of 2004.

Figure 9: Bermuda Composite 2005 Equity Increases
(US$ BILLIONS)



All of the Bermuda composite's 2005 equity capital was raised following Hurricane Katrina.

TABLE 4: BERMUDA COMPOSITE: CHANGES TO EQUITY IN 2005
(US$ BILLIONS)

Equity at Year-End 2004			$49.3
Net Earnings After Tax	-$2.9		
Dividends	-$2.3		
Unrealized Capital Losses	-$1.5		
Sub-total		-$6.7	
New Equity Additions		+$9.5	
Equity at Year-End 2005			$52.1

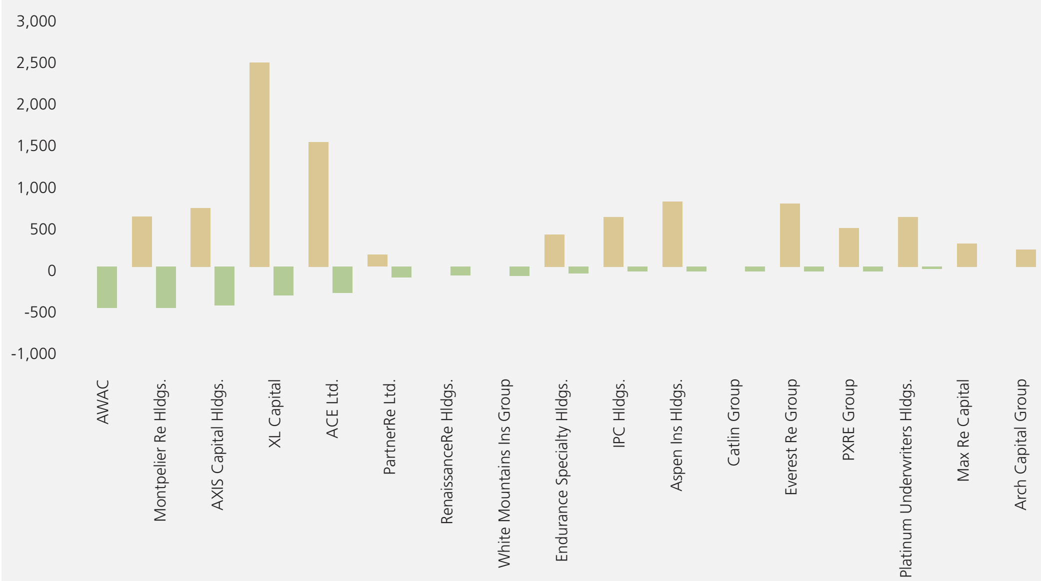
Capital Return Programs

Faced with a softening market and challenged to maintain an acceptable return on equity, a number of Bermuda composite reinsurers returned capital to investors in 2005, replacing costly equity capital with cheaper debt.

Most of the larger amounts were declared or paid prior to the cat losses, most notably in the cases of Montpelier Re and AWAC, with the understanding that there was excess capital supporting the current book of business. While these actions at the time boosted confidence in the resolve of management to return capital to shareholders rather than compete for under-priced business, they proved premature in hindsight. The following chart ranks companies by their capital return programs in 2005. The chart also includes the data by company on equity raised in 2005.

Figure 10: Bermuda Composite Capitalization
(US$ MILLIONS)

Equity Raised in '05
Dividends and Share Repurchase in '05



Capital Raising Programs

Companies offset capital outflows by raising capital through the equity market in 2005. Montpelier Re quickly raised $620 million through a common share offering following Katrina, after paying out $470 million in dividends during the year. Montpelier Re's managed capital was also boosted by two sidecar companies, Blue Ocean Re and Rockridge Reinsurance, which are supporting more volatile categories of business, such as retrocessional catastrophe coverage. Approximately $230 million of the capital in those two sidecar companies is not reflected in Montpelier Re's year-end 2005 consolidated equity figure of $1.06 billion. Montpelier Re also completed a $100 million preferred offering in early 2006.

AWAC, a privately held company whose principal shareholders include AIG, Chubb, the Goldman Sachs Funds and the Securitas Capital Fund, paid out a special dividend of $500 million early in 2005, funded by debt capital of the same amount.

About a year later, in March 2006, the company registered with the SEC for an IPO that is expected to raise roughly $400 million.

PXRE, meanwhile, raised about $474 million from the issuance of common and preferred shares in October 2005, with the preferred shares later converted to common. This amount nearly matched PXRE's cat loss estimates at the time from Hurricanes Katrina, Rita and Wilma, but an updated estimate released in February 2006 added another $300 million to incurred losses.

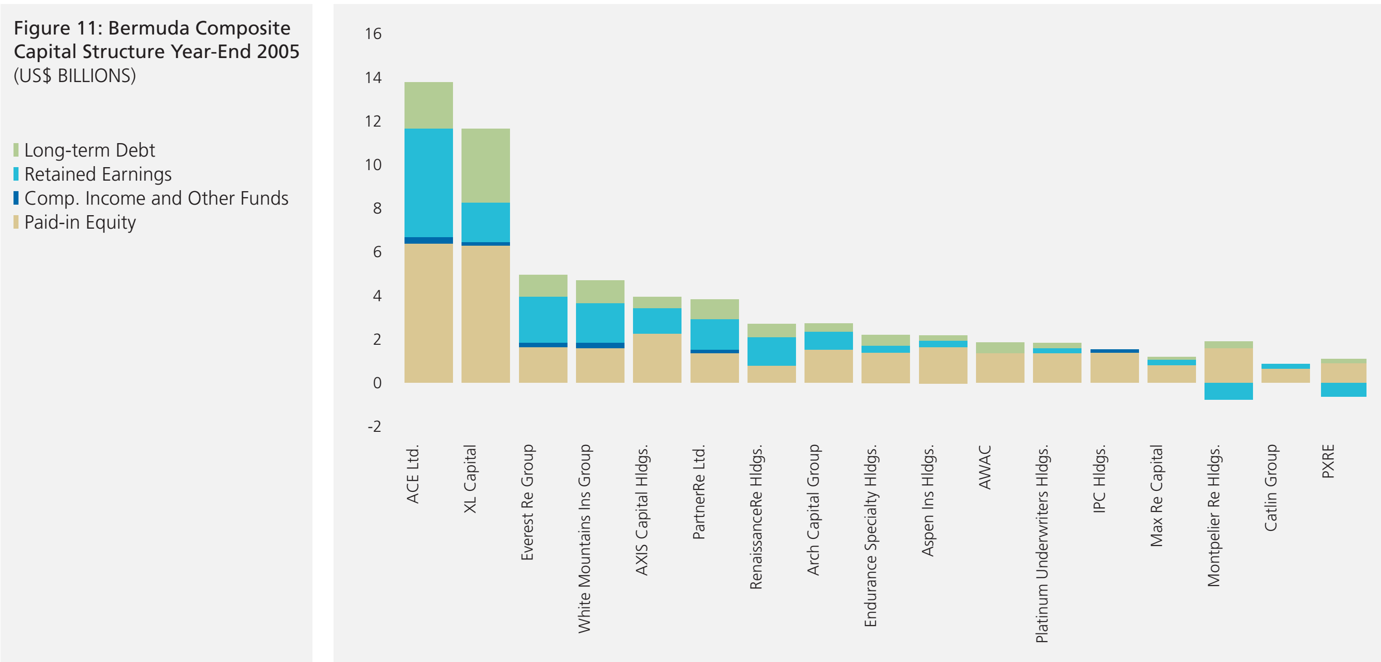
XL Capital had the largest capital raising effort by far in 2005, with a $2.4 billion equity issuance to replace capital from losses during the 2005 Atlantic hurricane season and an $834.2 million loss arising from a settlement related to an actuarial dispute with Winterthur Swiss Insurance Company.

Capital Structure

The capital structure of the Bermuda composite has changed little over the last two years. Retained earnings for the composite declined slightly in 2005, while long-term debt increased.

After paying out sizable dividends early in the year and incurring heavy losses from hurricanes, several individual markets experienced a decline in retained earnings at year-end 2005. AWAC, Montpelier Re and PXRE finished the year with negative retained earnings. IPC, which had one of the largest retained earnings positions of the property catastrophe specialists going into 2003, reported that its retained earnings balance declined by almost 93 percent by year-end 2005. As would be expected, markets that were more diversified and less exposed to catastrophes, notably Arch, AXIS, Catlin and Max Re, added to retained earnings over the same period.

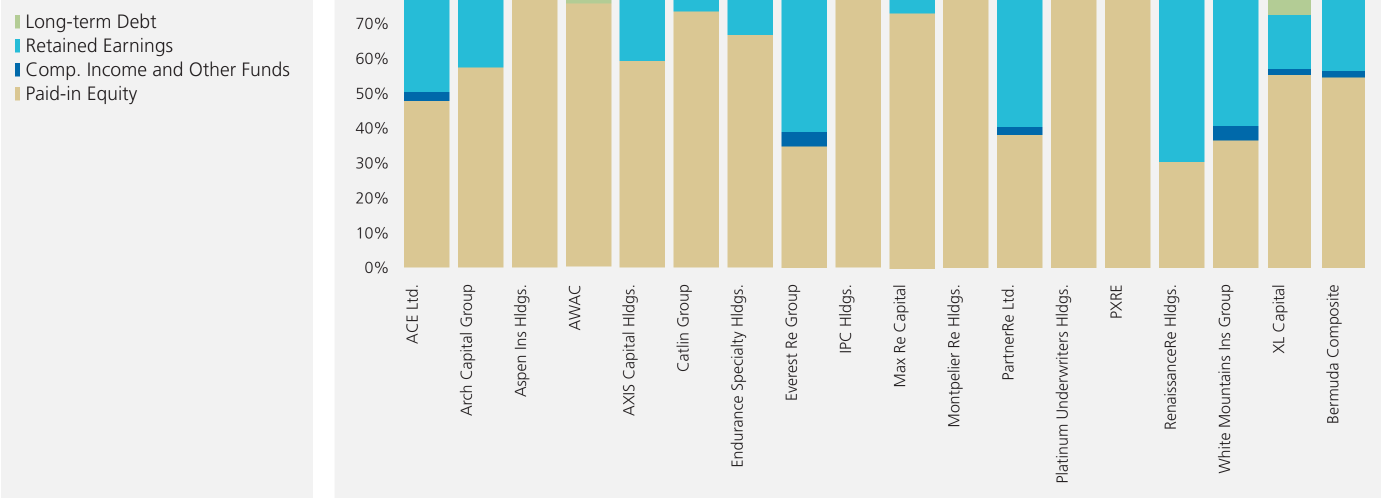
Figure 11: Bermuda Composite Capital Structure Year-End 2005
(US$ BILLIONS)



Debt to Total Capital

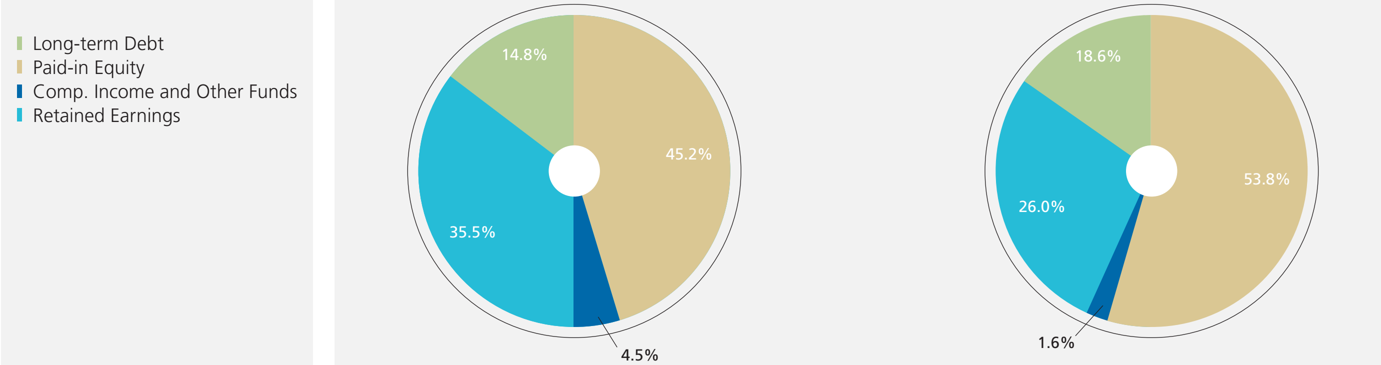
Every market in the Bermuda composite, with the exception of IPC, now has an element of long-term debt in its capital structure. As noted earlier, many members of the Class of 2001 (i.e., AWAC, AXIS, Endurance, Aspen) replaced some equity with debt in 2004 and 2005. Some older markets, notably ACE, PartnerRe and White Mountains, have managed to build retained earnings and were less dependent on long-term debt at year-end 2005 than they were in the period immediately following the events of September 11, 2001, despite the substantially lower cost of debt capital that was prevalent during the earlier period.

Fugure 12: Bermuda Composite Capital Structure Year-End 2005



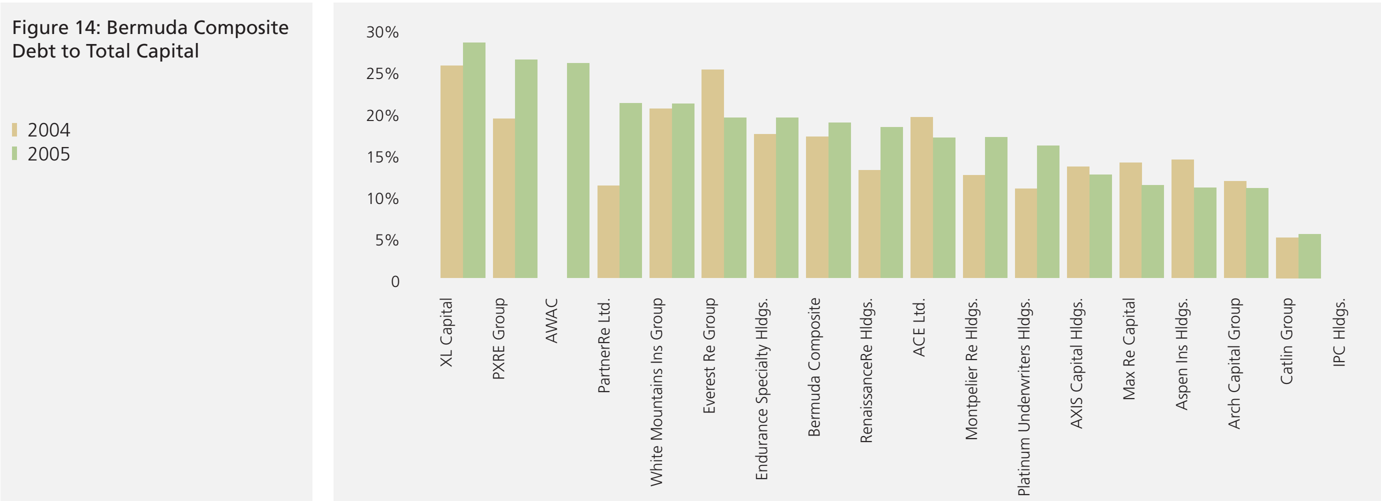
While the overall debt to total capital ratio for the Bermuda composite increased to 18.6 percent at year-end 2005 from 14.8 percent in 2004, debt levels still appear manageable for all of the ongoing markets.

Figure 13: Bermuda Composite Average Capital Structure



XL Capital's new debt issues of approximately $745 million in 2005 moved its proportion of debt to total capital to 28.5 percent at year-end 2005, compared to 25.1 percent at year-end 2004. PXRE's proportion of debt to total capital increased due to negative retained earnings of $527 million at year-end 2005. AWAC has entered into a new 7-year loan with a consortium of banks to fund a special dividend of the same amount. Notably, IPC has zero debt.

Figure 14: Bermuda Composite Debt to Total Capital

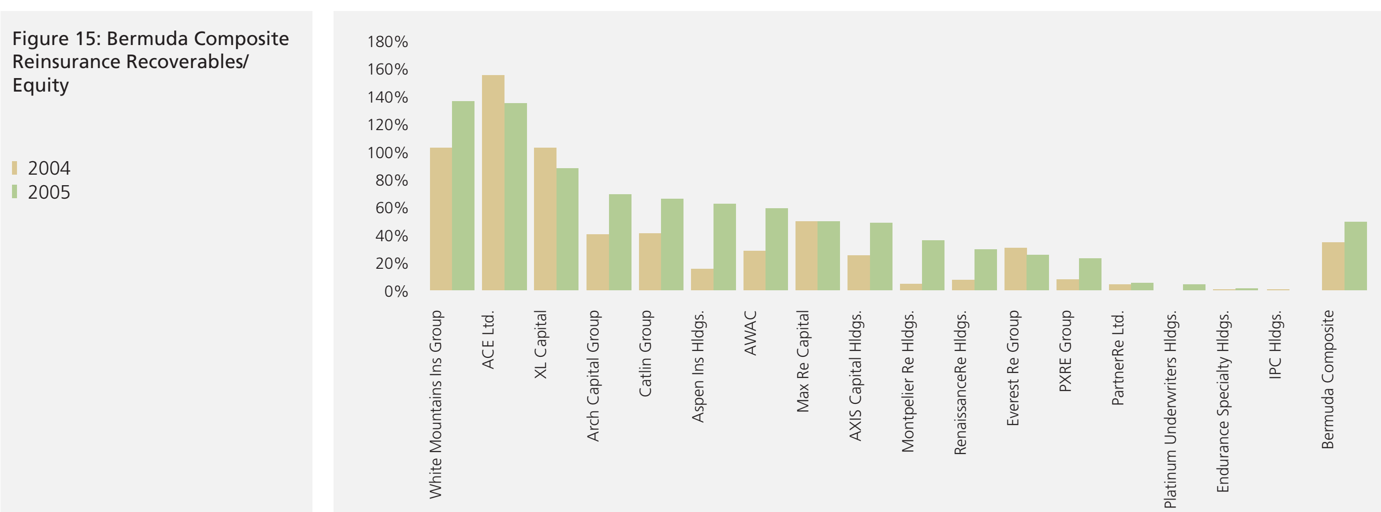


Reinsurance Recoverables

Of the Bermuda composite companies, the three largest based on year-end equity – White Mountains, ACE and XL – also had the highest percentage of their equity due from third parties.

This at first seems counterintuitive because larger, well-capitalized companies would be expected to use less reinsurance due to the scale and diversity of their writings. There are two possible reasons for this seemingly incongruous result. First, these three companies have significant primary operations, with outstanding claims for legacy liability exposures such as asbestos and environmental liabilities. The second is that all three companies grew largely by acquisition and have in their recoverable positions substantial amounts due from reinsurance contracts that were used in lieu of seller guarantees of loss and loss adjustment reserves at the time of the purchase. White Mountains, for instance, acquired One Beacon, ACE acquired CIGNA and XL acquired Winterthur International.

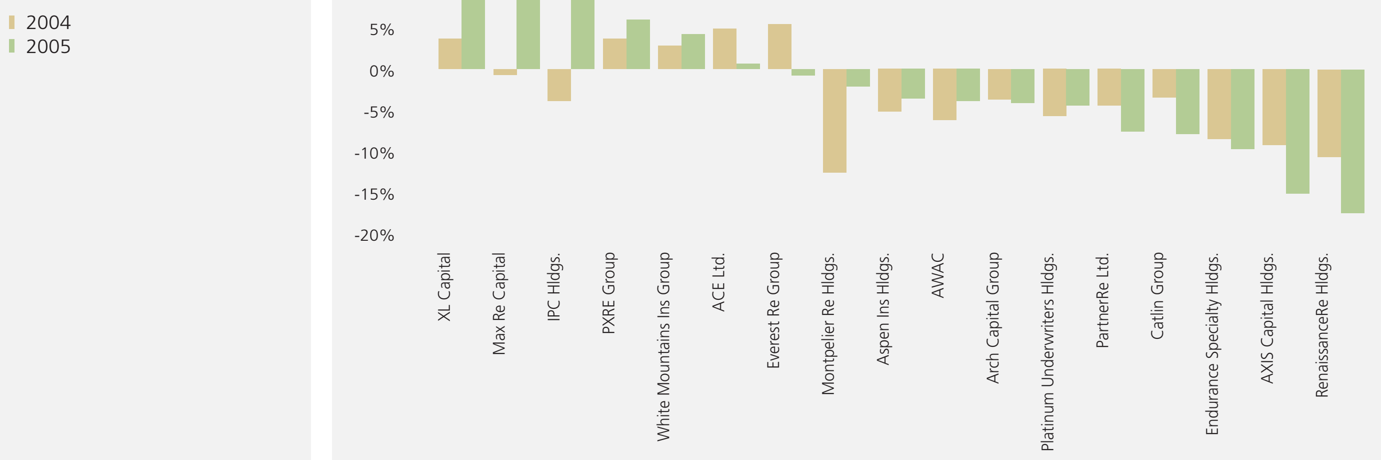
Figure 15: Bermuda Composite Reinsurance Recoverables/ Equity



Movement in Loss Reserves

In 2004 – with their most mature books of business still less than three years old – the class of 2001 released prior year reserves of $777 million. This adjustment offset nearly half of the $1.6 billion in net property catastrophe losses incurred by these newer markets in 2004. Most notable were two of the more diversified markets, AXIS and Endurance. AXIS released reserves of $182 million relative to net catastrophe losses of $266 million, and Endurance released reserves of $137 million relative to net catastrophe losses of $135 million. RenaissanceRe released reserves of $140 million compared to substantially higher net catastrophe losses of $550 million.

Figure 16: Bermuda Composite Loss Reserve Development/NPE



In contrast, the established multi-line writers, with the exception of PartnerRe, recognized net adverse reserve development of $1.3 billion in 2004 as it continued to add to reserves, primarily for US casualty business written during the 1999-2001 accident years.

In 2005, the Bermuda composite strengthened prior year loss reserves by a net $111 million, compared with $117 million in 2004. Individual market patterns were also similar year-to-year, with a few exceptions.

While the Class of 2001, as well as RenaissanceRe, PartnerRe and Everest Re, released prior year reserves in 2005 totaling $1.4 billion, this was offset by net reserve development of $1.56 billion reported by XL, Max Re, IPC, PXRE, White Mountains and ACE.

XL accounted for $1.1 billion. Most of this amount was recognized following the conclusion of arbitration proceedings with Winterthur Swiss in which liabilities of $834 million previously booked as reinsurance recoverables were deemed uncollectible in 2005 and thus accrued to incurred losses.

Especially significant among the more established carriers was RenaissanceRe, which released reserves totaling $242 million, related primarily to property catastrophe reinsurance, and PartnerRe, which released reserves of $232 million, related primarily to its worldwide specialty business. AXIS and Endurance released reserves of $383 million and $163 million, respectively. These redundancies were related primarily to property business written in the 2003 and 2004 accident years.

Companies reporting adverse development on 2004 hurricane losses included Everest ($119 million), AWAC ($57 million), IPC ($55 million), Montpelier Re ($18 million) and PXRE ($17 million).

Ratings

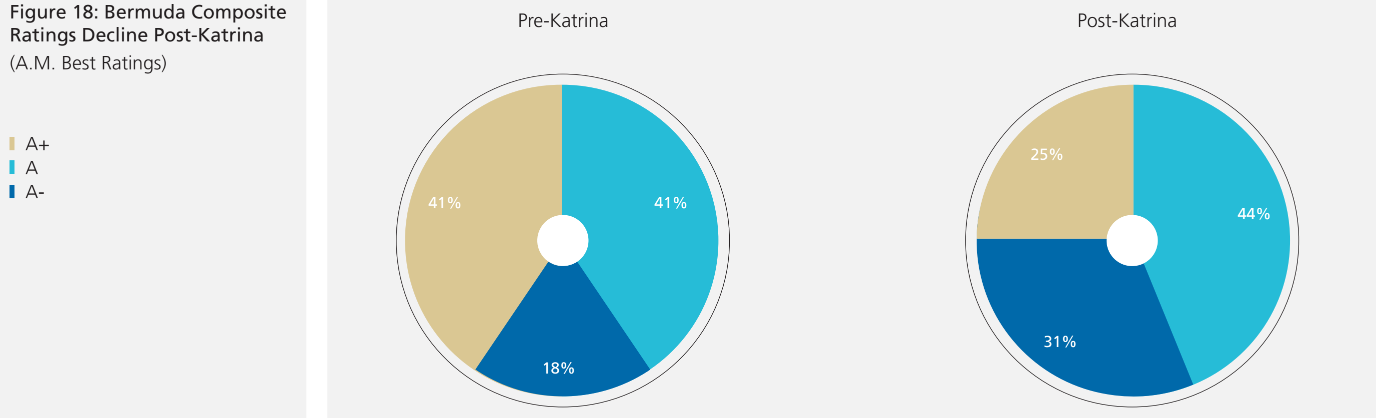
As might be expected, losses from the 2005 storms led directly to ratings reductions in several cases. Pre-Katrina, seven reinsurers in the Bermuda composite were listed as “A+” by A.M. Best. That figure dropped to four post-Katrina.

TABLE 5:
BERMUDA COMPOSITE RATINGS AS OF MAY 1, 2006

LEAD REINSURANCE OPERATING ENTITY	A.M. BEST RATING				S&P RATING			
	PRE-KATRINA		POST-KATRINA		PRE-KATRINA		POST-KATRINA	
ACE (Ace Tempest Re)	A+	S	A+	S	A+	N	A+	S
Allied World Assurance	A+	S	A u	N	NR		NR	
Arch Re	A-	S	A-	S	NR		A-	S
Aspen Bermuda	A-	P	A-	S	A	S	A	N
AXIS Specialty	A	S	A	S	A	S	A	S
Catlin Ins (Bermuda)	A	S	A	S	NR		NR	
Endurance Specialty	A	S	A-	S	A-	P	A-	P
Everest Re (Bermuda)	A+	S	A+	S	AA-	S	AA-	S
IPCRe	A+	S	A	S	A+	S	A	N
Max Re	A-	S	A-	S	NR		NR	
Montpelier Re	A	S	A-	N	A-	P	A-	N
Partner Re (Bermuda)	A+	S	A+	S	AA-	S	AA-	S
Platinum Underwriters (Bmd)	A	S	A	S	NR		NR	
PXRE (Bermuda)	A	S	NR		A	N	NR	
Renaissance Re (Bermuda)	A+	S	A u	N	AA- CW	N	A+	S
White Mountain (Folksamerica Re)	A	S	A	S	A-	P	A-	P
XL Re (Bermuda)	A+	N	A+	S	AA-	S	A+	S

As illustrated in the chart below, 41 percent of the Bermuda composite companies received the top rating of A+ from A.M. Best before Katrina. This ratio dropped to 25 percent after Katrina. The S&P ratings for the composite show a similar mild downturn after Katrina.

Figure 18: Bermuda Composite Ratings Decline Post-Katrina
(A.M. Best Ratings)



The downward movement in ratings is not necessarily indicative of a capital issue since the equity of Bermuda composite carriers increased on average in 2005. Instead, rating agencies are concerned with the ability of reinsurers to quantify their catastrophe exposure and manage it to a level consistent with the earnings stability expected of a company assigned an upper investment grade rating.

Regulation and Supervision

Bermuda has gained a reputation for attracting insurance capital, in part, because of its income tax free advantage as well as its reputation for having a hands-off regulatory environment, at least as compared to that of the United States.

In addition, Bermuda has distinguished itself as a global reinsurance center because of its ease of incorporation, lack of bureaucracy and simplified capital and operating guidelines that are intended to bring basic ground rules and legitimacy to a sophisticated market. In addition, while Bermuda's history as a reinsurance center is short compared with that of London, New York and other markets, Bermuda has long been the leading host for the captive insurance company market.

The International Monetary Fund (IMF) sought to measure the adequacy and performance of the Bermuda regulatory regime, and published the findings from this "mission" in January 2004. The paper, titled "Assessment of the Supervision and Regulation of the Financial Sector," covered the banking, securities and insurance sectors, with the latter sector's examination based on the International Association of Insurance Supervisors' Insurance Core Principles. The IMF pointed out that those core principles are applicable more to insurance than to reinsurance (the dominant force in the Bermuda market), but since Bermuda does not make a distinction between the two sectors, the principles were applied to both.

The IMF report was largely complimentary. It commended the "flexibility" of the Bermuda Monetary Authority (BMA), which oversees insurance regulation under a system that relies heavily on the work of independent auditors and an industry-supported screening process for entry. The report also noted some deficiencies in oversight of the insurance sector and included the following key recommendations:

1. The flow of information from auditors to the BMA should be more detailed and more frequent.
This point was initially not pressing for most of the companies given their large and – at the time the report was issued – underutilized capital bases and lack of legacy issues. As 2005 unfolded, however, unprecedented catastrophe losses affected all property catastrophe markets and took a particularly heavy toll on a few reinsurance writers.

The lack of interim reporting was particularly vexing in the aftermath of Hurricane Katrina. The condition of Bermuda operating companies could not be discerned except through inference from the reported condition and actions of their publicly traded holding companies. Even this was virtually useless when an operating company represented an insignificant share of its holding company's operations and, of course, it was not an option at all in the case of privately held companies.

Because of this uncertainty, some cedents wanted to cancel and replace their reinsurance writers. Just prior to 2005, many reinsurance contracts were written with a cancellation provision (trigger) that allowed, among other stipulations, the cedent the option of canceling the policy if the capital and surplus position of the reinsurer fell below a certain percentage (usually 15- 20 percent) of the last published figure.

Without tangible proof of a fall in capital, this part of the cancellation provision was difficult to activate – and hence, a less than ideal safeguard against a potential insolvency.

2. Independent reviewers should verify information received from companies.

This recommendation raised the issue of whether the BMA is overly reliant on actuaries and independent auditors employed by the insurance companies. To lessen this dependence and increase detection of carrier problems, the IMF pointed to the need for the BMA to hire additional staff to review data and working papers and conduct on-site inspections. At the time of the mission, there were 17 people supervising the insurance sector, three of them administrative. The number increased to 25 by the time the report was finalized. It was also recommended that the BMA's authority to intervene in a company's operation be strengthened in cases when insurers were operating in hazardous condition. Suggested solutions included giving the BMA the ability to enforce changes in the company's board and /or senior management or, alternatively, to intervene more directly.

3. Authorities should set minimum rules for calculating liabilities and for the adequate cover of technical provisions by secure assets.

The third point includes the application of "stricter prudential rules" to assets and liabilities. The IMF noted that capital adequacy and solvency "appear more strictly regulated, but this is undermined by the deficiencies of asset and liability regulation."

4. Reporting should be more detailed, with distinctions made between direct and assumed business, lines of business and types of reinsurance contracts, and generally more relevant data gathered from the industry.

This fourth recommendation is particularly pointed, as it cites the lack of loss reserve information – even the basic liquidation of prior year reserves – and the lack of segmentation of losses and reserves by lines of business. This is becoming more of an issue as groups seek to write more balanced books of business in order to mitigate future catastrophe losses. They also seek premium growth by flowing liability related business through the reinsuring of admitted US affiliates.

5. Procedures should be established to permit the individual and small corporate policyholder to receive meaningful and understandable information in a timely manner.

The BMA has long refused to share statutory insurance reports with the general public. Any interested third party, therefore, must approach a Bermuda insurance carrier directly to request its Bermuda statutory statement. Accommodation of the request depends largely upon the business purpose involved. The non-disclosure of data is understandable for Class 1, 2 and even 3 companies, but public disclosure of operating company data should be a required condition for operating a Class 4 carrier. (See Appendix C for descriptions.)

A Final Word

The Bermuda market weathered 2005 well, expanding as new capital entered the market in the wake of Hurricanes Katrina, Rita and Wilma.

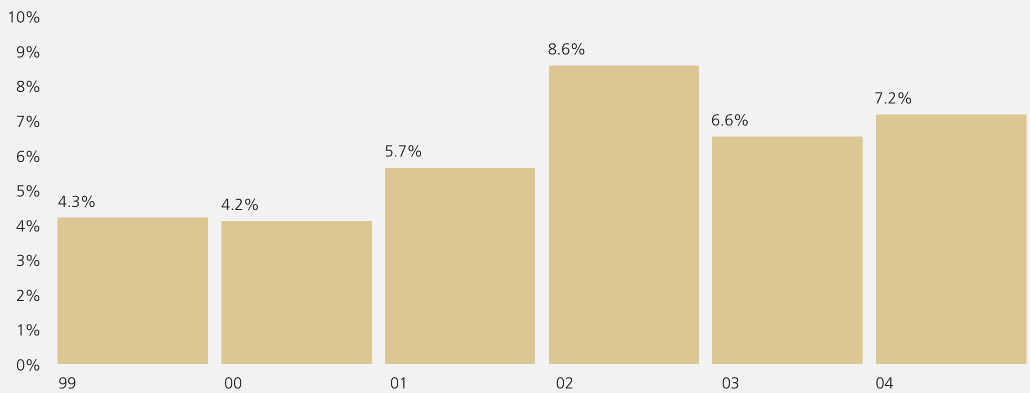
New capital flowed to both existing and start-up entities, attracted apparently by prior year returns and higher rates in property catastrophe lines. Some of the new capital came from hedge funds through direct investment and through sidecar agreements. Although incumbent players were hit hard by the 2005 storms, total equity for the Bermuda composite increased as a result of this capital inflow.

As the door opens on another hurricane season and more catastrophes undoubtedly lie ahead, Bermuda stands at the forefront of the global reinsurance market. Yet a key question looms. Will the risk management strategies recently adopted by the Bermuda property catastrophe market be enough to mitigate extreme catastrophe losses on future equity positions and operating results? Or, is there more to be done?

Appendices

Appendix A

Bermuda Market Share
Total Adjusted
Shareholders' Funds



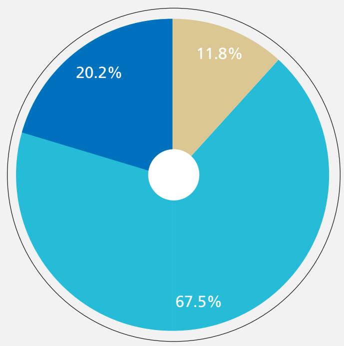
Source: Standard & Poor's

Appendix B

Bermuda's Share of US Ceded Premiums

During 2004, the US property/casualty insurance industry ceded approximately $67.8 billion to non-affiliated carriers, compared to $77.7 billion in 2003, according to A.M. Best's Aggregates & Averages - Property/Casualty 2005 Edition. The premium retention rate, or net premiums to adjusted gross premiums written, of the US property/casualty industry increased to 82.4 percent in 2004 from 80.7 percent in 2003. A Schedule F analysis using Highline Data's 2004 US Insurance data indicates that even though total ceded premiums declined, the share ceded to non-affiliated Bermuda based carriers actually increased to $8.0 billion in 2004 from $7.1 billion in 2003 with the percentage of Bermuda-bound premium increasing to 11.8 percent from 9.2 percent of the total non-affiliated ceded premiums.

2004 Premiums Ceded to Unaffiliated Reinsurers



Affiliated transactions represent an even larger share of premiums flowing to the Bermuda market. US companies ceded premiums of $16.8 billion (2003: $14.3 billion) to Bermuda affiliates in 2004, accounting for about two thirds of the total premium ceded to Bermuda markets (excluding captive cessions). This larger share of ceded premiums to Bermuda is attributable to the many Bermuda-based groups using admitted affiliated US subsidiaries, primarily for casualty lines, to issue policies to US cedents and then retroceding the majority of the business to larger Bermuda-based affiliates. These arrangements, predominantly executed under quota share treaties, are used to better manage the collateralization of reinsurance balances in the state where the US-admitted affiliated carrier is domiciled and to maximize the favorable tax advantage of investing the premium and loss reserves through a Bermuda-based vehicle.

US COMPANIES	STATED Q/S
Arch Re	90 percent
AXIS Re	50 percent
Endurance	50 percent
PartnerRe	25 percent
Platinum	80 percent
XL	75 percent

Appendix C

Brief Overview of Bermuda Classifications and Regulations

The Insurance Department of the Bermuda Monetary Authority (BMA) derives its authority from the Insurance Act 1978 and related provisions. The Insurance Act sets minimum guidelines for solvency, liquidity, auditing and reporting requirements as well as grants power to the BMA to supervise, investigate and intervene in the affairs of insurance carriers.

Regulatory Classifications

There are four general business (as contrasted to long-term business, otherwise referred to as life) classifications of insurers:

1) Class 1 - single parent captives that only write risks of the parent and its affiliates

2) Class 2 - a multi-owner captive insuring the risks of its owners or affiliates of the owners or a single/multi-owner captive where up to 20 percent of the net business is unrelated

3) Class 3 - commercial insurers and reinsurers not included in the other Classes, such as carriers writing more than 20 percent of unrelated business, finite reinsurers and rent-a-captives

4) Class 4 - explicitly excludes captives that could fall into Classes 1 or 2 and includes all reinsurers writing excess liability or property catastrophe reinsurance

Minimum Solvency Margin

The minimum solvency is checked on an annual basis. The minimum solvency margin is equal to the greatest amount indicated by the three following measures:

MINIMUM CAPITAL AND SURPLUS

CLASS 1	CLASS 2	CLASS 3	CLASS 4
$120,000	$250,000	$1,000,000	$100,000,000

PREMIUM TEST (CAPITAL AND SURPLUS TO NET PREMIUMS WRITTEN)

NPW	CLASS 1	CLASS 2	CLASS 3	CLASS 4
Up to $6 million	20 percent	20 percent	20 percent	50 percent
Excess of $6 million	10 percent	10 percent	15 percent	50 percent

Maximum deduction for reinsurance limited to 25 percent of GPW

NET LOSS RESERVES (CAPITAL AND SURPLUS AS A PERCENT OF NET LOSS AND LOSS ADJUSTMENT EXPENSES RESERVES)

CLASS 1	CLASS 2	CLASS 3	CLASS 4
10 percent	10 percent	15 percent	15 percent

While the Bermuda regulatory regime has some pointed weaknesses in relation to the United States, it has been moving to correct deficiencies discovered by the IMF and appears to be actively seeking counsel and strengthening its relationship with other regulatory bodies, such as the International Association of Insurance Supervisors and the National Association of Insurance Commissioners. The IMF mission pre-dated the introduction of the Insurance Amendment Act of 2004 and the related publication of Guidance Notes on different standards and requirements of the Act. The regulatory regime should be expected to remain far less bureaucratic and invasive than that found in the United States and the UK as it carefully balances increased regulation against sensitivity to the participants in the Bermuda reinsurance market.

Minimum Liquidity Ratio

An insurer engaged in general business is required to maintain relevant assets at no less than 75 percent of the amount of relevant liabilities. Relevant assets include cash and time deposits, quoted investments, unquoted bonds and debentures, first liens on real estate, investment income due and accrued, account and premiums receivable and reinsurance balances receivable. Other assets may be permitted if specifically allowed by the BMA, including unquoted equity securities, investments in and advances to affiliates and real estate and collateral loans. Relevant liabilities are total general business insurance reserves and total other liabilities less deferred income tax and sundry liabilities.

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