



Global Reinsurance Market Review

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The 1 July 2000 renewals showed the first signs of sustained rate increases across most classes though the quantum of increase varied by class, client and territory. The only glimmer of light for embattled property catastrophe underwriters is that to date the 2000 underwriting year has been free of any major catastrophe losses. However, even if this unusually good run continues to the end of the year it will not be sufficient to offset reinsurers' demands for rate increases, particularly bearing in mind the disastrous European losses in December 1999.

Against this hardening market cycle a number of new investments are being made in the reinsurance industry from investors who are seeking to benefit from the anticipated upturn in rates. Notable examples are the planned increase in capacity of some Lloyds syndicates and the start up of some entirely new syndicates for the 2001 underwriting year. Outside Lloyds some insurance groups are allocating increased capital to their reinsurance operations and some reinsurers such as Alea Group (ex Rhine Re) have been able to obtain additional investment from their parent companies.

An additional factor driving the increases in market rates is the reduction in the maximum capacity of many reinsurers. Over the last few years many reinsurers have built up considerable additional capacity primarily as a marketing tool to allow them to attract the better quality business, particularly on their single risk portfolios. This increase was largely built up through the use of retrocession capacity; with the hardening of the retrocession market many reinsurers are no longer willing to pay excessive premiums for this capacity and are electing to accept reduced limits. Whilst this reduction will doubtless add pressure on rating levels the impact in capacity terms may be illusory as most reinsurers have struggled to use their maximum capacity on any but a very few risks.

Property

In closing off their accounts at 31 December 1999 reinsurers have had to face the extent of their very poor property results. Unfortunately with the further deterioration of some major catastrophe losses, notably the Lothar and Martin Storms, these poor results have been carried over into the 2000 accounting year. Against this background reinsurers have been relieved to see some signs of a rating upturn at 1 July 2000 and are working hard to ensure that these green shoots blossom into sustained general rate increases at the forthcoming 1 January 2001 renewals.

For many reinsurers the rating levels they can obtain at 1 January 2001 will be crucial, since many major programmes have been placed on a multi year basis and will be renewing for the first time in 24 months. At the same time, most reinsurers are now resigned to their 2000 underwriting year results being indifferent, irrespective of any other major losses during the remainder of the year. This is due to the low rating levels and the increases in reserves for the 1999 losses. Faced with this background, many reinsurers fully appreciate that 2001 is the year where they must start demonstrating to their long suffering capital suppliers that they can earn a reasonable return on the capital they are employing. The recent Monte Carlo Conference saw the leaders of all the major reinsurers clearly articulate the requirement for rate increases on their property portfolios in the hope that their clients will be able to accept their quotations later in the year. Whilst there can be no doubt that some reinsurance buyers have produced substantial losses to their reinsurers and can justifiably be expected to pay large increases at 1 January 2001, other buyers with good records may find reinsurers' requests difficult to accept against this background, existing reinsurers will have to tread carefully to retain long-term relationships with their core clients who may be tempted to terminate connections if they feel the rate increases being requested are excessive.

Property per Risk excess of loss

Viewed as a whole most reinsurers' property per risk portfolios have performed very poorly during 1999. This is due to a number of losses and perhaps, more importantly, to insufficient rates and low deductibles.

The competition in per risk covers over the last few years has been more severe than for catastrophe business as reinsurers vied with each other for what they saw as attractive non-catastrophe exposed business. Sadly they have reaped the reward of their excessive zeal. For buyers with poor results we



can expect that their reinsurers will aggressively seek to obtain improvements in both rates and deductibles at the 1 January 2001. For buyers with good records, renewal negotiations over deductible levels should be easier, though it is unlikely that they will be able to fend off at least some modest rate increases

Retrocession

The March 2000 Market Review stated that the retrocession market was about to enter a phase of rising prices and capacity shortages.

This has proved to be the case. The price increases, which were witnessed during the January renewal season have continued on an upward trend throughout the first half of the year. The reasons for this are twofold. Firstly, the full impact of the European storms Lothar and Martin at the end of 1999 is becoming clear, and secondly because of a recent contraction in capacity, which is for the most part directly related to these storms and also the other catastrophe losses which occurred during 1999. Programmes that have not suffered a loss have had on average a 20% increase in price, and those which have been hit with a loss have gone up in price by anything up to 50%. In respect of capacity shortage, even though due to increasing rates there have been a number of new reinsurers attracted to the retrocession market, adding valuable capacity, there have also been some significant fall outs.

As in the past the increased retrocession rates are finally having an impact on original reinsurance rates, although the increase is considerably less. Also, due to the large number of multi-year covers that exist in the direct reinsurance market, there is often a time lag before any increases take effect.

In conclusion, we are entering an extremely hard retrocession market, and there is little sign that the environment will ease in the short term. Many programmes that were renewed last year before the European storms had occurred will be subjected to substantial rate increases, and unless some new lead markets emerge, placement of retrocession programmes will be increasingly difficult to complete.

Facultative

The predictions that last year would be the turning point of the international insurance and reinsurance markets have proved correct. The international markets were already experiencing losses accumulating from previous years, leading to a move to increase rates and, sometimes for buyers with poor loss records, deductibles. Surplus capacity and good, cheap reinsurance protections had, however, kept the changes to modest levels.

The international insurance and reinsurance markets rely to a greater or lesser extent on their own treaty protections, so trends can be predicted by the reactions of treaty renewals. The renewals that took place on 1 January 2000 were already demanding increases in premium and changes in cover. By 1 July 2000 these changes had become universal as the full impact of results was felt.

Cheap capacity at low level, something that the markets had become used to, is becoming very expensive. This change in the treaty market has had a dramatic effect on the facultative reinsurance markets. Market capacity, although continuing to remain at healthy levels, is being squeezed as investors and shareholders demand profitable returns.

The immediate results of this have been as follows:

- ➔ The market is seeking across-the-board increases in rates: no longer is it just buyers with poor loss records who are being penalized, increases are now much more widespread with the largest increases being targeted at those with poor loss records and/or perceived poor risk management
- ➔ The market is now looking carefully at levels of deductibles: for many years these remained unchanged or decreased and now they are coming under scrutiny and increases are being demanded, particularly where there are natural perils, such as earthquake and windstorm.
- ➔ Policy conditions are being reviewed: gone are the days where insurers and reinsurers accepted their leaders opinion on the merits of a policy wording.
- ➔ Capacity is being used more judiciously: although there remains considerable capacity in the market, with reductions and restrictions being imposed by treaty reinsurers and a more conservative approach being taken by management, this has led to a reduction in individual commitments.
- ➔ Greater attention being paid to limits for major perils, such as earthquake, flood and windstorm.
- ➔ Non-cancelable two or three year programme, except in very exceptional circumstances, are no longer possible to obtain.



In the foreseeable future, current market conditions will continue to harden and buyers will have to become more flexible, allowing more time to consider renewal options and the placement of their programmes. Given time, however, as the increases in terms and restrictions in conditions begin to take effect and a level of profitability returns, the market will level out. There are, indeed, already signs of some new capacity entering the market in the expectation of being able to take advantage of increased rates.

It is now apparent that those who locked in to long-term arrangements in 1998 and 1999 made the right decision. Multi-year programmes will be difficult to extend or to renew on a multi-year basis. Apart from re-marketing with new carriers, those policyholders whose programmes renew in the second half of this year can expect renewal rate increases in the area of 10 to 20%, if their loss ratios are acceptable (50% or less). Those with unfavorable loss experience can expect a drive to increase rates from 30% upward.

Marine

The unbalanced nature of a traditional marine account puts great reliance on the availability and financial viability of reinsurance.

On the facultative side, total loss only reinsurance and primary (low-level) reinsurance coverages, particularly for energy building projects, are seeing sharp price increases.

Both proportional and non-proportional (excess of loss) treaty coverages are witnessing a contraction of capacity for non-core coverages. Proportional treaties, as one would expect, are showing results, which are in line with the direct markets experience. Reinsurers are under pressure from their capital providers and management to produce profitable returns. Continuity for the sake of continuity is no longer an acceptable reason to support marine insurers.

Non-proportional treaties are costing more and retentions are going up. The non-proportional reinsurers have been reporting losses in 1997, 1998 and 1999 as both premiums and retentions have reduced. In adverse times, the excess of loss market is in a position to react fast and decisively. This upturn started in January 2000 and terms will continue to harden in 2001.

These factors will combine to put yet more pressure on the bottom line of marine insurers, particularly those insurers who have balance sheets, which are heavily dependent on reinsurance.

Cargo

On the cargo side there are signs that this market is hardening also. A number of underwriters are taking a stance on renewals with no reductions being given. In an increasing number of cases, rises are being quoted. The changes are beginning to be felt as underwriters start the process of planning for their own excess of loss reinsurance protections for 2001 and beyond. As capacity on the reinsurance side is contracting, it inevitably puts upward pressures on reinsurance pricing structure for cargo underwriters 2001 renewals.

Hull

With regard to direct marine hull business, the proliferation of long-term deals offered in the late 1990s is now coming to their natural expiry. Underwriters will no doubt, take this opportunity to insist on some form of annual review, if indeed, long-term deals are offered. They will also seek to impose what they consider to be long overdue increases on loss making accounts. Direct marine hull underwriters have reported some very poor results for the past few years and most hull underwriters are expecting 2000 to be another thoroughly unprofitable year.

Apart from underwriters attempting to (talk up) the market, other developments are taking place which



may well see the manifestation of these intentions. Some of these developments include the withdrawal of certain Lloyds and company underwriters from writing direct marine business. Additionally, while capacity for the Lloyds market overall is expected to be upon this years level of Sterling Pound10 billion (11.1 billion estimated for 2001) the reduction in the number of syndicates with this capacity will be of concern to clients and brokers.

Aviation

As reported earlier this year the turnaround required to bring the direct aviation market back towards potential profitability did not materialize during the last quarter of 1999.

During the first half of 2000, however, expectation was that the market would finally show the first signs of recovery and, to a certain extent, the last few months have been witness to an element of collective resolve that appears to be finally taking hold of the market place with direct underwriters, at last, seeking to impose rate increases across the board.

The resulting increase in the underlying premium into the market is, of course, long overdue with underwriters finally waking to the realization that their management/capital providers would no longer be prepared to absorb a further period of poor results as seen over the last three years.

By comparison, the Aviation Reinsurance market has shown a far greater degree of hardening and expectations of a much changed market place have already started to materialize.

The majority of mainstream (general) reinsurance programmes were, at 1 January 2000, in the midst of long term policies which bridged the Y2K divide. Those that renewed on the whole experienced a market raising of either prices or attachment points or combinations of the two, wherever possible. The degree to which this was achieved was naturally a function of circumstances, including the Reinsureds past record, level of exposures, and whether or not there was genuine competition for the risk.

The real test of course will be at 1 January 2001 as to whether or not this process will be sustained.

The economic facts point to a continuation There has been a fallout of retrocessional capacity, particularly in the more primary areas (USD50 million to USD300 million original loss). This has naturally coincided with a frequency of severity of losses excess of USD50 million original loss over the last few years. This position is further deteriorated by the fact that during this period there have been a number of losses incorporating a significant early paid element (Hulls etc).

This situation has caused a drain on cash flow, which is an integral element of the current Aviation Reinsurance climate A further consideration is, the deterioration in results in both the marine and Non-marine Reinsurance markets. As with the Aviation Market there has been a period of soft rates combined with a run of losses. This is likely to result in non-specialist Aviation capacity providers retrenching to their core business lines, since the (balancing) effect normally associated with spread has temporarily at least been lost.

In summary, it is highly likely that the Aviation Excess of Loss Market will continue to harden through the course of 2000. While there are still reinsurers who require market share, there are far more who believe that the present rating levels are unsustainable and that in order to re-establish a stable market place incorporating a requisite spread of good quality reinsurers, then the current trend is likely to continue. Though nothing is certain in a market as volatile as Aviation, all of the rational economic indicators would point towards a continuance of the current trend