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Reinsurers and Cedants: Partners for better, not worse

Reinsurers seem to be the ones left holding the baby whichever way you look at it. Yet they count for everything in the insurance chain, and now with the move towards risk-based capital, even the quality of reinsurers is becoming paramount. So what does it take for reinsurers to be appreciated as long-term partners, especially since they provide the backing for cedants to take on more risks than allowed by their capital?

Asian reinsurance markets are booming, though the region still accounts for only about 10% of the global reinsurance pie, while holding 26.6% of the world insurance premiums.

The number of reinsurers with an actual physical presence in Asia is increasing as well. Our latest Reinsurance Directory of Asia, launched this week, notes that the number of reinsurance offices in the region has increased to 168 – five more than last year and 45 more than seven years ago. Along with this trend, the number of reinsurance broker offices has more than doubled over the past seven years from 73 in 2004 to 196 in 2011. This is a sign of the times, and by is no means comprehensive as it only covers those who responded to our survey. There is also a brigade of travelling reinsurers and brokers who are stepping up their visits to the region.

Too many cooks

So is it because too many reinsurers are going after too little business? There are some reinsurers who are more than ready to accommodate the business in the name of friendship, partnership and service, and who will stay with a client no matter how bad the terms are. There are also some who still make ex-gratia payments beyond treaty coverage in the name of partnership: "We are in this together and we follow your fortunes". But somehow, the reverse is only true in some markets which truly value reinsurers.

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Bali rattled by 6.8-Mw earthquake

While delegates at the recent Indonesia Rendezvous were listening to the first panel discussion, apples began rolling off the tables, water bottles were toppling and delegates were rocking in their seats.

A 6.8-Mw earthquake jolted Bali just before noon on 13 October – ironically when the panellists were discussing CATs: learning and sharing experiences from the 11 March earthquake and tsunami in Japan.

The epicentre was 145 km southwest of Nusa Dua, where the conference was held, and 10 km deep. In other areas of Bali, about 45 people were injured when building debris dropped onto them. Cars also suffered damage from falling debris. Most people were evacuated from buildings and told to wait in open spaces.

While the delegates were unharmed, most were confused but later caught on to the extent of the earthquake, especially when the hotel announced the magnitude and reassured them that no tsunami warning had been given by the authorities.

Thai Floods: US$3.3 bln in insured losses and rising

Thailand's worst floods in 50 years have seen insurance claims totalling around THB100 billion (US$3.3 billion) filed as of 24 October, according to the Office of the Insurance Commission.

Claims by manufacturers alone are expected to exceed THB10 billion – with plants in the country's seven major industrial estates insured for THB410 billion, representing 2.66% of the Thai property insurance market.

Financial losses to manufacturers could hit THB140 billion, while damages to homes and vehicles could reach THB500 million. Less than 1% of Thai households have flood covers.

The floods have so far affected more than 8 million people in the country. The government expects the floods to cut economic growth this year by between 1% and 1.7%, and the University of the Thai Chamber of Commerce has estimated the cost of the floods to reach around THB150 billion. Moody's Investors Service, though, estimates the damage to cost more than THB200 billion, or equivalent to 2% of GDP.

CAT reinsurance rates are expected to rise, and more effective flood prevention systems and drainage facilities will be required for plants needing flood insurance. Already, some brokers are seeing an increased demand for CAT reinsurance from insurers in the country.

While the current flooding is unusually severe and economically costly, the insured losses are likely to be manageable and will not trigger widespread solvency problems, or undue financial strain, for the country's non-life players, says Fitch Ratings.

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Yet signs of markets are hardening are showing everywhere. And with the spate of Nat CATs hitting home hard, insurers are facing really big claims. Reinsurers have to stay firm on pricing and the basic principle of risk-adequate pricing.

A speaker at a conference warned the local market to increase their primary rates or run the risk of losing all reinsurance support soon. A delegate shot him a killer question: "Then why is your colleague knocking on our doors every time, asking us to give him more business?"

So reinsurers need to walk the talk, and somewhere along the way, without infringing any anti-trust fears, get fellow reinsurers to toe the line.

The burning cost of risk

This leads right back to the illusion of a right price. Do insurers have a good handle on pricing? Is the mantra of risk-adequate pricing becoming a reality? Do practitioners understand the burning cost of a risk? There are just too many variables to the basic cost that gives too much say to the underwriters to deviate wildly. Some cedants even expect investment incomes from reinsurance premiums to be computed into the pricing as part of the sweetener of a long-term partnership. Others work in discounts based on the client's risk profile and style. Consequently, the science of risk adequate pricing goes out of whack.

If the real price is quoted, taking into account the changing risk landscape and increasing frequency of Nat CATs, affordability becomes an issue in the primary market. Then you will have the cacophony from corporate risk managers that reinsurers are pricing themselves out of business. They will rush to set up captives.

Cost of partnership

So who wants a long-term partnership if it compels the reinsurer to write risks even if the price is wrong? Reinsurers have invested so much in analytics and training the cedants as part of the long-term partnership, that sometimes they are held captive to that tie. There are many cedants in the game for the best deal of the year, as every year there is more innocent capacity making wild offers.

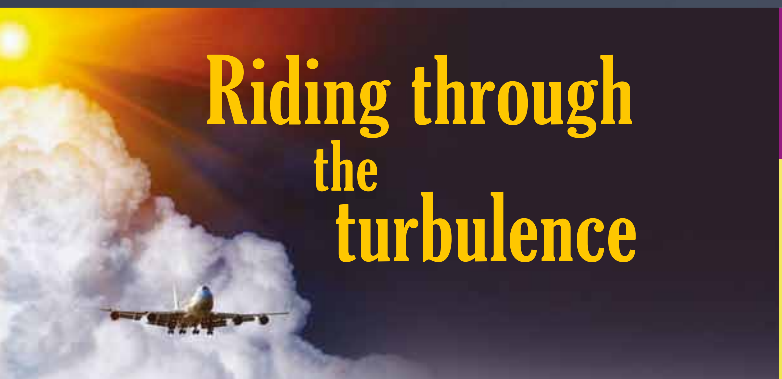
Some cedants also say that too many reinsurers have walked away from the business and lost the moral edge to call in the long-term partnership. In Asia especially, memories of rejections last long.

And so we row on, boats against the currents, borne back ceaselessly into the cycles. And in reinsurance, even friendship and partnership seem to go in cycles.

Winds of change

However, the tides are turning, and reinsurance is in demand again. With the extreme CAT conditions this year, there are many cases where reinsurers are wined and dined, including by the political dignitaries of a country.

Reverence for reinsurers will come only when cedants realise they need reinsurance support. And that is when they start to chase or stalk reinsurers. But that is also when you know that their business is "not as good" and that even brokers could have forsaken them. RBC will make rated reinsurance more in vogue. Go for it!



Riding through the turbulence

The US debt ceiling crisis, the Euro-zone problem, low interest rate environments and the drying up of inter-bank lending had thrown capital markets into disarray this year.

From July to August, S&P500 Index dropped from 1,345.02pts to 1,119.46pts – and there is scarcely any sign of this abating in the current climate, particularly as few corrective actions have been proposed to stop the slide.

The (re)insurance industry, which has been hampered by relentless and costly Nat CATs, has also taken a beating with the market gyrations, putting pressure on players' investment incomes.

At 30 June 2011, the global reinsurance capital from the Aon Benfield Aggregate (ABA), which is made up of 28 of the world's biggest reinsurers, totaled US$445 billion, a reduction of 5% from $470 billion at 31 December 2010.

Total investment return fell 12% to US$18.5 billion, equating to a yield of 2.0%, down from 2.5% in 1H 2010, due to the continued effects of low-interest rates and a marked reduction in realised and unrealised losses.

Among primary players, China Life showed strain. Its 1H 2011 net profits fell 28.1% y-o-y to US$2.03 billion, mainly due to fluctuations in capital markets and distribution of the previous year's cash dividends to equity holders, said VP Liu Jiade at a press conference in August. He expected the stock markets to "continue to fluctuate and be uncertain" in the second half of this year.

Meanwhile at the recent Baden Baden meeting, Dr Ludger Arnoldussen, Board Member of Munich Re, forecast that the reinsurance and primary markets will be further affected by capital market fluctuations. "Strict focus on profitability is more vital than ever in times of major uncertainty," he said.

Dear cedants:

Review your level of protection

This year's unprecedented frequency and severity of natural disasters have caused very significant losses to the (re)insurance industry.

Reinsurers are reviewing their portfolios and two areas that they will closely scrutinise are:

1. Adequate pricing levels, particularly for CAT risks.
   Primary rates have continued to deteriorate over the years, and they now often do not commensurate with the exposures and are unsustainable.

2. Consistent implementation of event limits on proportional treaties in catastrophe-exposed territories. While the imposition of such limits has been discussed in recent years, the implementation has not been consistent, and more needs to be done to vigorously address these challenges.

Given the current environment and sentiment, my renewal message to cedants is: to critically review your level of protection to ensure capital preservation and do it early!

Mr Christopher Ho
Chairman, Singapore Reinsurers' Association

Time to work on your data

With unprecedented natural disasters in 2011 in the Asia Pacific region that comes on the back of a challenging year in 2010, we believe 2012's renewal will be characterised by a level of data scrutiny not previously seen in this region.

Our message is: if you are not already working on your data, this is a good time to start. Begin negotiations via your appointed broker early, and look towards an early completion of your reinsurance arrangements set against a background of achievable ambitions. We would be glad to assist and stand ready to bring our analytical and broking expertise to your assistance.

Mr Chris Kershaw
Chief Operating Officer, Asia Reinsurance Brokers Pte Ltd

The key to capitalising on Asia's growth

Answering questions about the key issues besetting the reinsurance industry in Asia Pacific, **Mr Malcolm Steingold**, CEO of **Aon Benfield Asia Pacific**, notes a growing demand for catastrophe reinsurance in certain markets, and says that reinsurers should focus on doing an environmental audit and developing talent to capitalise on the region's growth.

How should reinsurers capitalise on Asia's growth?

To capitalise on Asia's growth, companies should focus on doing an environmental audit on available and future opportunities. This is to clearly understand where the growth opportunities are. I have seen many investments made with very little return because of a poor assessment of specific growth opportunities. You should understand where you are going to get the best return on your investment, and in order to do this, you really need to spend a lot of time listening to clients in the region so you can appreciate their needs and develop products to meet those needs.

At Aon Benfield, we spend much time gaining an understanding of our clients' growth aspirations, and our service offering is focused on partnering them to achieve their objectives rather than merely providing transactional capability on reinsurance contracts.

More fundamental than doing an environmental audit is developing appropriate talent. You cannot expect to take advantage of the growth opportunities in the region without having the right people. The biggest challenge for insurers and reinsurers is having sufficient talent and developing that talent quickly.

At Aon Benfield, we are investing heavily in talent. Our approach in Asia Pacific is not only to ensure we have sufficient talent to serve clients' current needs, but to anticipate their future needs as well. This requires investment over and above the people resources we require to manage our current business.

You need to take a long-term view in investing in people. I believe it is too late to commence developing people immediately when opportunities arise. You need to anticipate opportunities and commence the development of people now for opportunities that will arise in the near to medium term.

How have the recent catastrophes in the region shown the importance of reinsurance?

What the catastrophes this year have shown is the disparity in levels of reinsurance penetration in the region. For example, the reinsurance penetration level for earthquake in Japan is, in relative terms, significantly lower than that in New Zealand. The recent catastrophes in both these countries have, however, certainly shown not only the importance of reinsurance, but also its value.

We cannot however generalise that these catastrophes have led to a realisation of the value of reinsurance across the whole region. Low penetration rates for catastrophe reinsurance in the region suggest there is substantial opportunity to develop this line of business. For example, our analysis suggests many insurers in China are not buying sufficient catastrophe reinsurance. Many companies buy to less than "one-in-100-year return periods" whereas regulators in more developed markets require insurers' minimum event retentions to be at least at the "one-in-250-year return period" level. This suggests that there is scope to increase the amount of catastrophe cover purchased by the Chinese insurance market.

The reinsurance industry has to spend more time educating insurers on catastrophe reinsurance and demonstrating to them the implications of the levels of cover they currently purchase. Their current purchases should be benchmarked against global standards to highlight the insufficiency of cover. Aon Benfield is continuing to invest in its ability to assist clients in gaining a deeper understanding of their catastrophe risk profiles.

Have you seen an increased demand for CAT reinsurance this year?

We are seeing an increased demand for catastrophe reinsurance in New Zealand and Japan. We would not say the same could be said for the rest of Asia Pacific at this point in time. We expect to see an increased demand in Thailand following the recent floods and are already experiencing more interest from some clients.

How would you assess the level of reinsurance capital available in the region?

There is adequate capital available to service the current demand in Asia Pacific. This is the reason pricing is still very competitive on loss-free programmes. The markets hit by major catastrophes this year have been adequately served by the reinsurance industry, and there certainly has been sufficient capital to support their demands.

Looking to next year, we anticipate that, barring some market-changing events, there will be sufficient capital to meet clients' needs, the caveat being there may be a premium on capital for markets that have been hit by major catastrophes.

What topics will influence the discussions at the coming renewals?

Reinsurers will no doubt focus on the quality of insurers' data. Insurers who are able to provide robust data and demonstrate higher underwriting standards will be differentiated from those who do not and can expect more competitive terms than insurers who are unable to provide sufficient transparency.

What is your outlook for the reinsurance industry in the region?

The industry is entering a very exciting period. Singapore, as a reinsurance centre for the region, has developed exponentially over the last five years, and I do not expect this development to slow down.

The most exciting part of the industry's development is that it is offering employment opportunities for talented young people coming out of universities. I certainly encourage those with analytical, financial or economics background to consider insurance and reinsurance as a career choice.

A pictorial lookback at SIRC 2009

Roaring CATs: Asia counts the costs in 2011

Insured losses from the 11 March Japanese catastrophe are estimated to reach US$30bln.

Sources: Swiss Re, Guy Carpenter

Insured losses from the floods in Queensland, Australia in January, a continuation from December 2010, totalled up to around US$2.6bln.

Cyclone Yasi roared into northern Queensland, Australia in February and left insured losses exceeding US$1bln.

Earthquakes hit New Zealand twice this year & once last year, racking up to US$12bln. in insured losses.

Floods in Thailand had seen insured claims totalling around THB100bln (US$3.3bln), filed as of 24 October.

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