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SRA Warns of Hardening Rates This Renewal

Mr Christopher Ho, President of Singapore Reinsurers' Association shares his thoughts on the impact of Hurricane Katrina on the regional reinsurance market and his expectations for the SIRC.

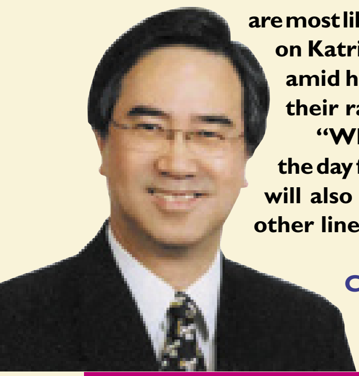
With Hurricane Katrina still fresh in everyone's mind and with loss estimates higher than the S$40 billion (US$24 billion) tab for 9/11, Mr Ho said that the magnitude of these losses mean that many reinsurers will have to adjust their earnings projections for the year. "For some, it means a depletion of the capital surplus and requiring injection of fresh capital. Already, rating agencies have put a number of reinsurers on credit watch with negative implication.

In the wake of increasing natural catastrophe events with higher frequency and severity, reinsurers can be expected to adjust their prices to counter rising exposures. The adjustment of prices will almost be immediate for the coming renewal at 1 January, albeit at (a) different level of severity."

Mr Ho, who is serving his second year as SRA President, anticipates that for the coming renewal, there will be great industry reluctance to provide capacity at anything less than adequate prices, and with the softening market trend in the last two years, many markets are indeed underpriced.

"Renewal is also expected to be late as reinsurers are most likely wanting to analyse their involvement on Katrina and evaluate their protection needs amid hefty increases in retro costs, and review their rating models for the new season.

"While price increases will be the order of the day for catastrophe programmes, reinsurers will also want to see general hardening across other lines of business," he adds.



Cat in Asia

Mr Ho warned that insurers in Asia cannot afford to underestimate catastrophe exposures in Asia, especially in the major markets of Japan, China, India, Taiwan and South Korea. Last year, a record of 10 typhoons made landfall in Japan, including the devastating Typhoon Songda and earlier this year, Mumbai was inundated by one of the worst floods in history.

"In Southeast Asia, the greatest exposure to natural catastrophes has been Indonesia and the Philippines. The Indian Ocean tsunami in December 2004 caused reinsurers to reassess their positions on the Southeast Asian countries, including those previously thought to have negligible exposure.

While catastrophe modeling is gaining much attention and usage in the region, its usefulness is still limited by the fact that many countries do not have the required underwriting data resolution for analysis," he said.

SIRC a Winning Formula

Turning to the SIRC which is in its 8th year and is expected to gather more than 500 delegates from 30 countries, Mr Ho said that SIRC delegates can look forward to the same successful formula of previous gatherings.

"As in the past, the event format is to give delegates sufficient time to interact outside the various indoor sessions. Past participants at the conference have commented favourably at the format, and the bringing together "under one roof" of the buyers, sellers and intermediaries has always been a big draw in this event," he said, adding that the appropriate theme of "Managing the Reinsurance Cycles", will ensure high-level presentations and panel discussions involving distinguished speakers and panelists from the industry.

Mr Richard Austen, Chairman of RBA(S), on the impact of Hurricanes Katrina and Rita and their repercussions on Asia

"The combination of Katrina and now Rita, will undoubtedly affect worldwide catastrophe prices and move the market price curve dramatically north. Clearly reinsurers are bracing themselves for more bad news as the Hurricane and typhoon seasons are only just beginning, and it would not take very much more bad news, be it increases in Katrina loss estimates or new events, to initiate an upward trend in the price cycle.

Looking at Asia, there will be dynamic growth opportunities for some, and despair and potential ruin for others. I guess that the area of greatest concern for Asian insurers has to be the increasing divergence between the domestic prices for the basic P&C and motor business against the profit margins and price expectations of all stake holders. The financial strength of domestic insurers combined with transparent and professional management is finally proving to be a deciding factor to their survival."

SRA and RBA(S) welcome all participants to the 8th SIRC!

Meeting the Renewal Challenges

In an interview with *SIRC Daily*, **Mr Marc Haushofer**, Principal and CEO of Munich Re Singapore Branch, gives his take on Katrina's impact and the 125-year-old reinsurer's strategy in Asia where it has established itself for more than 40 years.

Munich Re has estimated its exposure to Hurricane Katrina to be 400 million euros, has that estimate changed significantly? What impact will Hurricane Katrina have on the coming renewal for Munich Re?

Munich Re's initial estimates of its exposure were based on its assessment of the situation as at 30 August, before the bursting of the dykes and the flooding of New Orleans.

For now, it is not possible to determine the economic losses resulting from the aftermath of the hurricane, and Munich Re cannot eliminate the possibility that the Group's final gross losses will be higher than the previously estimate of €400 million.

However, we can expect an increase in demand for reinsurance capacity as a consequence of Hurricane Katrina.

What are you expecting in the forthcoming year-end renewal in Asia? What preparations has Munich Re made to meet these challenges?

There are two big question marks: Katrina and the ongoing hurricane and typhoon season. Nevertheless, as mentioned, we expect the demand for reinsurance capacity to stay high on a global level, supported by various factors such as the hurricanes in the US, floods in Central Europe, the series of plane crashes and the drastic increase in costs for pharmaceutical risks.

Reinsurance capacity itself is also expected to augment but on a lesser scale than in previous years. Competition, especially on the primary insurance side, will probably increase whereas investment returns are anticipated to remain moderate.

Munich Re is well-prepared to meet these challenges. We are constantly monitoring our exposure especially on the natural-catastrophe side. In markets where primary rates are not at an adequate level, we are uncoupling our exposure from the direct business.

Besides prices, terms and conditions are of major importance when writing reinsurance business successfully on a long-term basis. Imparting this understanding to our clients will be a major target for the upcoming renewal.

With the constant pressure on prices in Asia, how is Munich Re endeavoring to keep the renewal rates stable & viable?

Munich Re's strategy in Asia is first of all our reinforced commitment to our clients. At the same time, it will stand firm on risk adequate prices, terms and conditions.

For decades, reinsurers have followed the cycles and not managed them. Worse, reinsurers have been guilty of prolonging the soft cycle, and shortening the hard cycle. No one reinsurer can change the cycle from hard to soft or vice versa. However, the major reinsurers can stabilise terms and beat the cycles by insisting on risk adequate pricing. This is our professional duty.

What are the top three efforts undertaken by Munich Re to meet the needs of Asia?

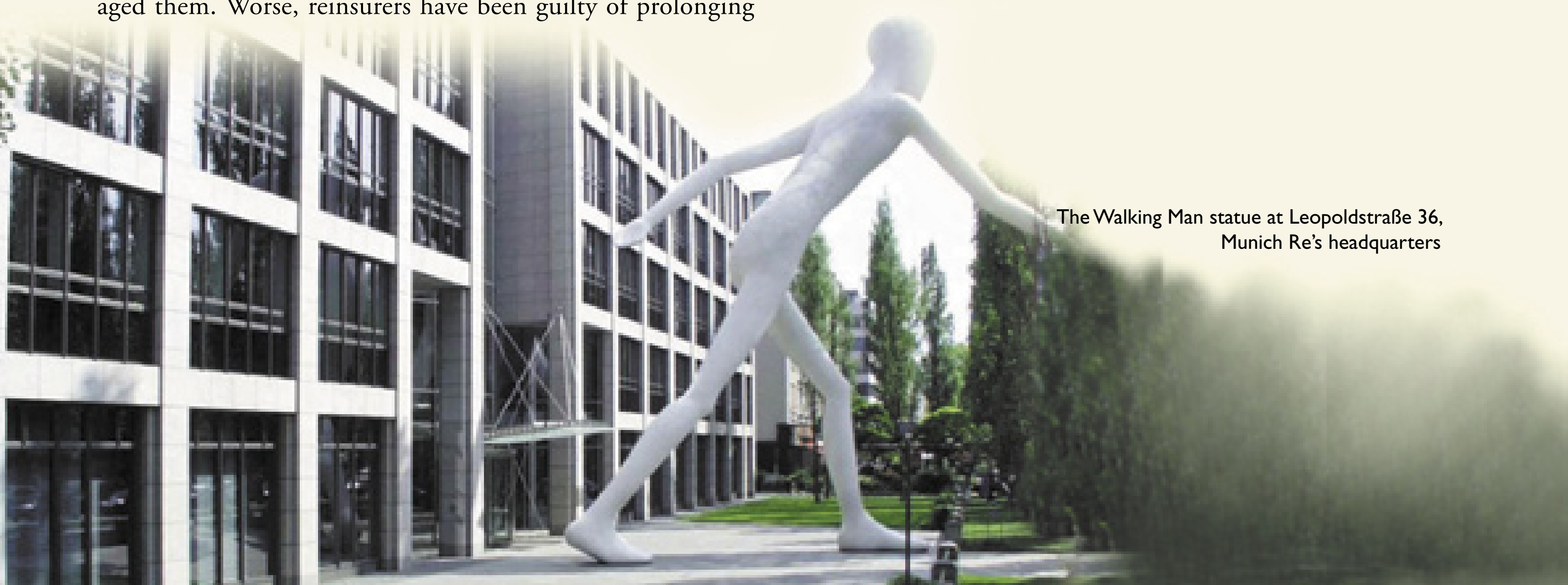
Munich Re has longstanding partnerships with its clients in the Asian markets, some of which go back over many decades. It opened its first Asian business unit in Hong Kong in 1963, and it is now the leading international non-life reinsurer in almost all markets.

Another field where Munich Re is treading new paths is related to the development and marketing of new insurance products that are aligned with local situations. Munich Re assists its partners in breaking new grounds, enhancing their competitive advantage, developing their young markets and responding successfully to private wealth and insurance needs. Munich Re benefits from an intensified strategic partnership with these clients and from jointly tapping the potential of newly-created business.

Munich Re has also taken the lead in innovation and knowledge management. One example is our recognition of the importance of understanding geoscientific principles long before "climate protection" and "sustainability" became familiar buzzwords. The Geo Risks Research Department was established in 1974 for this purpose.

What in your view are the key markets in Asia in terms of prospects and in terms of challenges?

Munich Re is focusing on clients, not countries. Reinsurance needs vary from client to client. We aim to satisfy those needs wherever possible, at risk-adequate prices. Nevertheless, one can make a rough distinction between developing and established markets. Special attention is paid to the markets with a high growth potential such as China and India, and sophisticated markets such as Japan and Korea.



The Walking Man statue at Leopoldstraße 36,
Munich Re's headquarters

Counting the Co$t of Katrina

As Hurricane Katrina looks set to be the world's costliest insurance loss in history, insurers and reinsurers are still struggling to put a realistic number to their exposures.

Total economic estimates as well as total insured loss estimates were changing almost every day and usually heading north. At press time, the total insured loss estimate by Risk Management Solutions Inc was between US$40 billion to US$60 billion, with US$15 billion to US$25 billion coming from New Orleans. Total economic losses now are being placed at more than US$125 billion, at least half of which is expected to come from New Orleans.)

Here's a sampling of estimates as at press time from various reports, press releases and from the gathering at Monte Carlo Rendezvous as an overview of what the market is saying.

- **Ace Ltd**: from US$450 million to US$550 million.
- **Alea Holdings**: pre-tax net claims from US$20 million to US$30 million.
- **Allianz Group**: €470 million.
- **American International Group Inc (AIG)**: Katrina and other third-quarter catastrophes will cost US$1.1 billion, after tax and reinsurance.
- **Arch Capital Group Ltd**: from US$110 million to US$160 million, after tax.
- **AXA RE**: Total net losses of US$200 million, before tax.
- **AXIS Capital Holdings Ltd**: from US$500 million to US$650 million.
- **Beazley Group Plc**: US$50 million.
- **Berkshire Hathaway**: up to US$3 billion.
- **Catlin Group**: US$274 million gross of reinsurance and US$125 million net of reinsurance.
- **Chaucer Holdings**: £35 million.
- **Converium**: from US$10 million to US$20 million.
- **Hannover Re**: €250 million pretax.
- **Hiscox**: US$100 million.
- **Kiln PLC**: from £30 million to £35 million.
- **Lloyd's**: £1.4billion (US$2.55 billion).
- **Montpelier Re Holdings Ltd**: from US$450 million to US$675 million.
- **Munich Reinsurance**: €400 million (US$490 million).
- **Odyssey Re Holdings Corp**: from US$80 million to US$100 million pretax.
- **PXRE Group Ltd**: from US$235 million to US$300 million after tax.
- **Royal & SunAlliance**: £25 million.
- **SCOR**: from €25 million to €35 million.
- **Swiss Reinsurance**: US$1.2 billion before tax;
- **Transatlantic Holdings Inc**: pre-tax cost, net of reinsurance, US$270 million.
- **White Mountain Insurance Group**: from US$150 to US$300 million before tax.
- **XL Capital**: net loss US$700 million.

The Rating Agencies' Word on Global Reinsurance

Pre-Katrina: "Unanimous" Thumbs Up

In their latest reports on the outlook for the global reinsurance industry, all the international rating agencies have maintained that the outlook for the sector is stable despite the market softening.

Moody's said the stable outlook reflects the strength of reinsurers' earnings over the past several years, owing largely to the exceptional profitability in property business. Moody's, however, gave a mixed outlook for the Asia Pacific, reflecting the differing trends in the premium rates as well as varying reinsurance needs in each of these markets. Property reinsurance premium rates are largely driven by catastrophic events, while compulsory auto liability coverage is driven by rate trends in the underlying direct insurance exposures as well as market competition.

Differing from Moody's on the Asia Pacific, Standard & Poor's expects the financial strength of local insurers in this region to remain stable in the coming year, even as market conditions soften. This assessment was prompted by the local reinsurers' relatively conservative underwriting, reasonably earnings, and adequate capitalisation.

In its mid-year global review, Fitch says the sector's underwriting, operating and capital trends over the next 12 to 24 months will remain consistent with outlook being stable.

Post-Katrina: Toll on the Industry

Disruption and devastation to human lives aside, Katrina will have an unprecedented level of losses for the insurance industry. S&P was the first rating agency to place its ratings on 10 interactively rated insurance and reinsurance groups on CreditWatch as early as 9 September, with negative implications due to their possible "exposure to the catastrophic and unparalleled losses stemming from Hurricane Katrina." The list included major international brands like: ACE; Lloyd's; Oil Casualty Insurance; PXRE Corp; and Swiss Re, whose subsidiaries even those without direct US exposure. The four US companies – United Fire Group, Allmerica, Allstate Corp, and State Farm were also on the list.

On 20 September, Montpelier Re was removed from CreditWatch due to capital benefit derived from the company's successful raising of US$600 million of equity capital. However, XL Capital Group was placed on CreditWatch with negative implications.

Fitch said it will reconsider its stable outlook for the reinsurance sector if Katrina-related-losses reach the upper-end of industry estimates. On 13 September, Fitch placed the ratings of five North American property/casualty insurance and reinsurance organisations – The Allstate Corp, Horace Mann Educators Corp, Montpelier Re, PXRE Group and State Farm Mutual Automobile Insurance – on Rating Watch Negative based on potential large loss exposures to Katrina.

Due to the evolving effects of Katrina, AM Best has been aggregating public and private information in order to assess the financial impact it will have on insurers. Based on existing known information, it has placed 16 insurance and reinsurance groups, including PartnerRe Group, Odyssey Re, PXRE, Montpelier Re and XL Capital, under review with negative implications. Companies which were previously under review for other reasons continue to remain so, and these include: Munich Re; Transatlantic Re; America Re; and Alea Group. AM Best is continuing to gather information on all primary insurance and reinsurance companies with losses stemming from Katrina, and may take further rating actions in the future.

Moody's expects that most large reinsurers have managed their Gulf-Coast exposures prudently, enabling them to absorb their losses from Hurricane Katrina and sustain their ratings. However, firms with outsized exposure to the affected region, or to hard-hit industries such as energy or gaming, could face rating downgrades, particularly if they do not recapitalisze quickly.

On 19 September, Moody's said that it does not expect significant rating activity for individual Lloyd's Syndicates as a result of Hurricane Katrina.

And the Future?

While Fitch anticipates 2005 to show reasonable underlying profitability for many reinsurers, 2006 is likely to be more competitive, and 2007 will reach the point at which cycle-management strategies truly begin to be tested. Moody's says that to maintain their credit ratings and outlooks, reinsurers need to demonstrate continued restoration of balance-sheet strength over the near term, as well as commitment to adequate risk-adjusted pricing beyond the recent hard market.

AM Best believes that the stability of ratings will largely depend on reinsurers' ability to effectively manage their exposure to more frequent natural catastrophe risks. They will be expected to generate sufficient earnings to absorb potential adverse loss developments from previous as well as current underwriting years while continuing to build their risk-adjusted capitalisation to withstand any potential sharp falls in the underwriting cycle.

S&P says there remains a possibility that a small number of downgrades and upgrades may occur during the remainder of 2005 and 2006, but the ratings are unlikely to change for the majority of the industry's constituents. However, if by 2006 it becomes clear that rate reductions are accelerating and the old familiar boom and bust cycles is to be repeated, a further review of ratings in the industry will be required.

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