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The forecast for reinsurance

Reinsurance has proven a reliable touchstone in a turbulent world, but with the added pressures from this renewal season, the industry will have to be even more resilient if it is to stand firm. By **Garry Booth**

Boring is good in the post-crisis world of the global financial services sector. Reinsurance, once a byword for tedium in the go-getting age of investment banking and hedge funds, is now synonymous with resilience and reliability. The $200 billion sector has been battered by losses on the investment side of the business – but sound risk management meant not a single reinsurance company fell during the financial crisis. On the back of combined ratios below the critical 100 per cent mark, reinsurers continue to provide capacity, pay their claims and still turn a profit during the most turbulent period in recent financial history.

That doesn't mean to say that 2010 renewals will be straightforward for either reinsurance buyers or sellers. There are several reasons for that, according to rating agency analysts. Moody's for example says that insurers' appetite for reinsurance will be constrained by slack demand and soft pricing of their own products. Fitch argues that improved stability in the financial markets has weakened reinsurers' calls for rate rises adding that it would take another Katrina size cat loss (in excess of $40 billion) to justify putting prices up in 2010. That cat event has not happened and the 2009 hurricane season was benign. A M Best believes reinsurers, nicely cushioned now, are still simply too cautious to expose capital that may not be so easily reloaded in the near future.

How will these complex market dynamics translate into action at the coming renewals? Malcolm Payton, Global Practice Leader for Facultative Solutions at JLT Re, agrees that treaty reinsurance capacity remains relatively limited and, according to the rules of supply and demand, pricing will remain stable as a result. "There is still not an awful lot of treaty reinsurance capacity, so reinsurers can stick to their guns at the renewal," he says.

A counterpoint to the perceived squeeze on treaty reinsurance capacity is reduced demand from cedants, who are seeing primary premium volumes shrink. The fall is partly due to the downturn but a persistently soft market isn't helping. In contrast to the reinsurance market, pricing in the primary market continues to fall – a trend attributed to insurers boosting results through early reserve releases. Many insurers are considering increasing risk retentions and/or reducing their limits to keep costs down, Payton believes. "Insurers are reluctant to pay for something they might not actually recover for, when their own margins are tighter," he says.

A squeeze on treaty reinsurance – self-imposed or otherwise – could feed through to fac business. "I can foresee a more buoyant facultative market, probably to counter the perceived lack of flexibility on the treaty side," Payton adds. "Facultative has always been used to fill gaps and take out spikes and that is going to be more apparent next year."

Shipping forecast

The outlook for shipping is no less complex. The marine insurance premium pool dipped by around 4 per cent to $23 billion in 2008, due to falling global trade, while lower oil prices reduced cargo values and vessel values fell. However, capacity is plentiful, as IUMI President Deirdre Littlefield said at the Marine Insurance Association's conference. "The danger now is that many underwriters will be tempted to cut rates and make other concessions in order to maintain market share," she added.

"Rates are low," says Nick Jay, a Partner at JLT Re, "but that's because there have been several years without a major loss event. Marine insurers are broadly in a good position and have an appetite for risk." Pirate activity has grabbed the headlines but has not dented insurer results. Any settlements made by insurers as a result of ships and crew being ransomed have not caused insurers to burn through their retention levels.

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It's relatively plain sailing in the marine secondary market too and Jay says that reinsurers are making sufficient capacity available. "We would expect reinsurers to recognise the likely reduction in exposure affecting their clients and to adjust their pricing to reflect this," he concludes.

Plenty of energy

Conditions in the important offshore energy insurance market can be divided into two pieces: the hurricane-exposed Gulf of Mexico and the rest of the world. According to JLT Re's Managing Director, Alistair Lockhart-Smith, insurance and reinsurance capacity is plentiful for energy risks that are not exposed to windstorms.

But in the Gulf of Mexico, insured losses totaling $15 billion caused by Hurricane Ike in 2008 led insurers to hike prices to the point that their customers walked away from 1 January 2009 renewal discussions. They opted to self insure – or 'go bare' instead.

"It will be interesting to see what happens at renewal in 2010. If the front end terms to the insurance buyers improve we might see the buyers come back strongly," Lockhart-Smith says. "Insurers are unlikely to come back unless they can protect themselves with competitively priced reinsurance, however. And I believe reinsurers will hold their ground and restrict Gulf wind capacity to only the highest levels."

The complicated market dynamics don't bode well for an easy renewal season in any sector, warns Lockhart-Smith. On one hand the reinsurance buying process is a lot more rigorous than it used to be in terms of the volume of information that must be exchanged. On the other hand, the regulatory focus on contract certainty now requires deals to be done by 31 December. "It will build to a crescendo in the week between Christmas and New Year," he says. "But on 2 January the market will be like a battleground: littered with bodies and with smoke hanging over it." RS

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