TIME TO TALK

As renewals get underway, Jon Guy, reporting from the annual gathering in Monte Carlo, finds the market once again hard hit from the hurricane season

The reinsurance market's desire to recoup the capital expended on the US hurricane season has already become evident as the 2005 renewals season gets underway.

What is abundantly clear at this stage is that the impact of hurricanes Katrina and Rita has already started to change the fundamental shape of the market.

As the industry continues to count the cost of the hurricanes, the reinsurers have been publicly talking up rates – saying the earlier predictions of a softening market have been washed away by the events on the US gulf coast.

Predictions of thumping rate increases have abounded since the rendez-vous in Monte Carlo, where the reinsurers were talking tough, with only a few honest enough to say they were previously considering rate reductions as the cycle began to head south.

However, if the worst case scenarios are to be believed, the industry got a $60bn wake up call and it had the underwriters revising rates with both cedants and brokers fearing the worst.

While the public talk has been over the cost of cover, in the meetings leading up to Baden Baden there has been much discussion about the shape of the future market, in terms of capital, composition and capacity.

The World Trade Centre was proved to have been a market-changing event. The fall-out was not only a period of significant price increases but also a root and branch overhaul of the terrorism market and how cover was offered.

The retrocessional market was hard hit by the events of 9/11 and had only painstakingly replenished its capacity by 2004. The impact of Katrina is set to return the retrocessional market back to its 2001 levels and the question remains whether the appetite for the capital market remains for the sector which rarely suffers losses, but when they come they tend to be significant.

While there has been much talk of the reinsurance market's reaction to the events of the past quarter it is the cedants which have the most to say, and potentially the biggest changes to face.

Season's change

It has been a tale of two hurricane seasons for the market. In 2004 there were four significant hurricanes which made landfall combining to deliver an estimated $21bn of insured damage and business interruption for the industry. For the reinsurers the season was not as stormy as many would have thought given the fact that four separate storms saw four separate retention payments from the primary market which left the cost of the four split 70 to 30 per cent with the lion's share from the primary carriers.

However, Katrina has become the most costly natural catastrophe in history in a brutal four day period. The debate over whether the damage is funded from the storm or flood cover is set to continue and the deluge of class actions which have been filed in the weeks following will further muddy the claims picture. It may well be this time next year before a truly accurate figure for the effect of Katrina is produced.

There have already been casualties. Rosemont Re the Bermudan reinsurance company which is part of the Goshawk Group failed in its bid to find a buyer and is set to go into run off, and there are those in the market who believe that there will be further casualties as the cost of the storms increases.

Reinsurance strategy consultant at Donald MacDonald, Nick Golden, believes that the future strategy for reinsurers will be a different one to that envisage prior to the summer.

REINSURANCE PREDICTIONS & STRATEGIES

Speaking to the Chartered Insurance Institute's London Market Faculty Mr Golden said: "There will be a new model for the reinsurer of the future as they look to change their strategies following the 2005 hurricane season.

"The new model will see reinsurers taking smaller exposures and having a greater degree of risk diversification. Given the fact that there will be a demand for high yields from capital providers, there will have to be higher rates charged for the cover provided.

"I believe that the accent will also be on removing the costs of doing business and that could well lead to reinsurers going direct to the clients. It would also deliver greater transparency in the face of the demands of the regulators."

Golden explains that such a new model would also enhance the attractiveness of mutual pools and captives as some risks become simply too big to handle.

"Catastrophe risk may well become too big or too uncertain for the insurance market to cope with and we may well see CAT cover provided by the state or mutual pool in future," he adds. "Under the new model the question has to be asked whether we as an industry can deliver a product which meets the demands of the client."

Mr Golden says the impact on the US should also force a change in terms of the US demand for collateral from "alien" reinsurance entities such as Lloyd's.

"The only positive comment I have seen come out of the media coverage of Katrina has been that this may prompt a review of capital requirements," he explains. "Yet again the Lloyd's market comes to the rescue and is still treated as a second class citizen and required to hold huge assets of capital there [US]."

The broking fraternity have taken a cautious view. Such is the state of flux in the market that few will put their head above the parapet and predict with any great level of certainty the direction the market will take.

Michael Handler, Guy Carpenter's managing director and regional manager for Continental Europe says he believes there were clear concerns which are adding direction to the market as the renewal season continues.

"Firstly is the issue of security," he explains. "The hurricanes have used up a great deal of capacity and the market will be looking at the security of the remaining capital.

"Secondly the reinsurance market is trying to replace the capital which has been lost. Pricing has been changed in an effort to regain the lost capital, and the local pricing looks to be the major concern at present. In Europe there has long been a feeling that the cedants pay for their own claims and not subsidise the claims of other areas of the world. Therefore there will be some resistance in Europe to any attempts for significant price increase on local risks.

"I think at the end of the day it will be the clients who end up the perceived winners.

"The large global entities will look at the issue and fall back on their diversified programme of risks. Those larger companies which operate in one or two regions or countries will be reluctant to pay more for their coverage if they are not involved in the Gulf of Mexico and the smaller local carriers will look to get the best deals possible but will not expect to pay significant increases."

Miller Insurance Brokers' director of reinsurance, Robert Stewart, says the marine market remains a case in point for the issues which face the reinsurers.

"If you look at the Gulf of Mexico, in marine terms, the annual premium is circa £500m a year and it has faced claims of $10bn in the past 15 months," he explains. "There will have to be some adjustments in the future."

He adds, "The hurricane losses are looking likely to be viewed as management losses as compared to Ivan which were underwriting losses, and as such, will have a significant impact on the direct market and will prompt a review of future strategy."

Mr Stewart believes that the realistic disaster scenarios of $50bn property and $10bn marine look set to be close to the final cost for the hurricane season and as such would give regulators a tangible example of a catastrophic loss and could provide pressure for greater solvency and capital requirements.

"There is the potential for some companies to go into run-off in the future," he explains. "Underwriters buying reinsurance will be required to present strategy papers over and above their business plan to look at how they approach various occurrences in order to obtain reinsurance cover."

Deputy chairman of Guy Carpenter's UK operations market, Mark Hewett, says the interesting trend has been the fact that new capital has entered the market post Katrina, but it has gone to existing operations rather than a round of start up which were evident post-WTC.

"The capital has gone to the existing players and I think that may be because it takes the view those players have got their models and exposure right."

He adds that hedge funds are set to play an increasing role – whether as a reinsurance option or as a capital provider, remains to be seen.