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OVERVIEW OF GLOBAL TRENDS IN REINSURANCE – by Shiamdass Appannah, C.E.O, REINSURANCE SOLUTIONS, Caudan Waterfront, Port-Louis, Mauritius

Mr. Chairman, Distinguished Guests, Ladies & Gentlemen.

When Rudyard Kipling said in his famous Ballad of East and West, way back in the Victorian era, that “East is East, West is West, and never the twain shall meet”, he could never have foreseen the extent to which today’s world would be globalised in all spheres of life although in the same poem, he somehow predicts the future with the words, “But there is neither East nor West, Border, nor Breed, nor birth”. In the same vein, the Chinese, who have long evolved as a great civilization more isolated from the rest of the world than any other power, up to the Mao times, woke up to the global era by acknowledging in the Chinese proverb “may we live in interesting times”, the inter-dependence of different civilizations, a changed mind-set which greatly helped them afterwards in their growing global economic influence, whilst on the other side of the world the often quoted saying “when America sneezes the world catches a cold” is certainly understandable due to the sheer weight of U.S.A’s GDP in proportion to the world GDP, and this could not have been better illustrated than by the “cold” the whole world has really caught from the recent financial turmoils originating from America.

Mr. Chairman, Sir, the reinsurance industry is perhaps the industry which is the most sensitive to global issues than any other industry due its basic four purposes namely:

- Acting like a shock absorber (i.e. provide stability).
- Protecting solvency (using the reinsurer’s capital).
- Providing capacity (offloading large risks).
- Accessing technical services of the reinsurer/reinsurance broker.

all four of which can only be achieved if insurers can without restriction, transcend national boundaries in their reinsurance buying procedure, and similarly if Reinsurers and Reinsurance Brokers operate as global players either through their own network or through their international contacts. It is therefore natural that global trends in the reinsurance markets should concern everyone in our business across the world and more so, in African Insurance markets where our needs for the 4 purposes of reinsurance, i.e. stability, solvency protection, capacity and technical services, are paramount.

Let's see some of the recent global trends which have influenced our business in Africa:

REINSURANCE PRICING

Although we have at least 12 professional Reinsurers operating in Africa, whose ownership is largely held by African interests, this continent remains a significant net purchaser of reinsurance in world markets, and even these 12 Professional Reinsurers are themselves heavily dependent on the world retrocession markets to be able to offer their services in their own regional markets.

Unfortunately this year we have been affected on two fronts: firstly the financial crisis has eroded stock values both in the insurance & reinsurance sectors across the globe as the stock market crash of 2008 and early 2009 took its toll amongst worldwide insurance stocks which are estimated to have lost 25%-30% of their values in 2008, with heavy losses coming from North American firms such as AIG, XL Capital, ACE, Allstate, and others, while other N. American firms such as Chubb, Arch, HCC, were less exposed to the risks in investment products with consequent lower losses, and hence preserving their stock price values. London firms which lost the most were Aviva, Prudential, as well as Lloyds whilst in Europe, Allianz, Axa, Fortis, ING, Generali followed by many others also lost heavily.

Similarly Reinsurance firms are estimated to have lost values in shareholders' equity of about 17% - 20%, with heavy losses coming from firms such as Berkshire Hathaway, Swiss Re, Everest Re, Hannover Re, Max Capital, Munich Re, Korean Re, Transatlantic, while niche players such as IPC Re, Odyssey Re, Platinum, Validus Re and to some extent, SCOR, did not have significant loss exposures.

The erosion of capital caused by such losses increased insurers appetite for reinsurance buying to protect solvency and ratings, while reinsurers reduced their supply due to lesser available capital, the combined effect of these 2 forces drove prices up through the basic law of supply and demand.

These market forces were accentuated in a notorious catastrophe year in the USA, with Hurricanes Ike and Gustav, and other weather related losses and man-made catastrophe losses costing US\$50 billion, with US\$10 billion filtering through to the Reinsurance market.

Fortunately Reinsurers and particularly Lloyds had 2 previous profitable years to cushion their loss, and thus despite combined effect of their capital erosion and the natural catastrophe of 2008, they still had strong balance sheets to weather the storm, which helped to dampen down the increase in property/casualty prices to no more than 10% while marine rates went up by 10% - 15% and Aviation rates stabilized after many years of declining prices, although the recent losses in the Aviation sector have already started driving prices up.

However, the most affected classes were specialty business, namely trade credit insurance following the decline in consumer spending leading to financial difficulties of supermarket chains, and political risk covers, as well as financial D&O Liability, where insurance providers suffered huge losses following the collapse of the sub-prime market, and the financial scandals such as Bernard Madoff, Allen Stanford and Satyam which were uncovered by the flawed financial system. The Madoff \$50bn economic loss alone has already sent shock-waves in the D&O market with insured losses estimated to be near the \$2bn mark and adding as much as 50% points or more to the D&O market loss ratio, driving prices up by 20% - 50% in Financial institutions D&O insurances.

However, in regional markets, D&O and P.I insurance rates remained competitive, and generally we have been looking at not more than 10% rate increases for financial institutions D&O and less for commercial D&O.

Fortunately, the global market has recognized that while these events have to affect general pricing, they need to consider that it is the USA which has to be the home for the highest catastrophe price increases, with Europe bearing a more moderate increase, whilst Africa with several years experience free of catastrophe losses even in areas exposed to catastrophe perils like Mauritius has experienced more stable to modest price increases.

The reinsurance markets which have been most understanding to favourable local or regional underwriting factors and which have recognized these in their pricing have been the regional professional Reinsurers; however more often than not, their limited capacity has meant that worldwide market capacity still had to be substantially used with consequent transparency in the price that could be achieved, to reflect worldwide trends.

Reinsurance Brokers helped considerably to ensure that market forces worked best for the insurers using their services, to achieve correct pricing, not only by their knowledge of and access to markets, but also by their own technical input in helping reinsurers to understand local market conditions.

FLIGHT TO QUALITY

Fortunately the process of flight to quality of Reinsurers had already began long ago which explains why the catastrophe losses of Hurricanes Andrew in 1992 the losses following the events of September 2001 in USA, Katrina in 2005, and more recently Ike and Gustav, have been promptly paid by Reinsurers, and it is expected that the market will again comfortably weather the storms of 2008 and 2009, although pricing will become under the scrutiny.

Nevertheless, the quality of Reinsurers being used is coming more under watch by all stakeholders including Regulators and Brokers are experiencing that even the client down the line, is asking his insurer to show him the security and quality of Reinsurers on the subject matter insured.

Again, Brokers are playing an increasingly significant role to use the best security in terms of choosing reinsurers who are not only able to pay, but also willing to pay indemnifiable claims. Ratings are of course a useful guide, but brokers as well as other stakeholders have to keep abreast of a fast changing environment where ratings can change materially within a short time. Unrated securities or securities without a superior rating does not necessarily mean that such reinsurers are not secure, but only that it requires the insurer or broker to be more careful and mindful of his own assessment of these reinsurers regarding their quality.

REGULATION

Regulation across the world is coming back to scrutiny, after the recent events, with the principal purpose of protecting the policyholder.

The USA has started reviewing their regulatory practices after having to bail out AIG, and Europe is expected to implement the “Solvency II” regulations on the risk based capital approach to solvency and capital by 2012, giving time to their operators to model their capital requirements to be aligned to risks accepted. Although it is expected that the risk based capital approach will take time to filter through to Africa, some African countries have already started to review their insurance laws towards such an approach, and in fact the Mauritius insurance legislation already provides for solvency and capital to be calculated on this method, which even goes to the extent of influencing insurers to choose Reinsurers on the basis of their international ratings by requiring them to have loadings on their capital requirements and solvency if Reinsurers with lower than internationally acceptable ratings are utilized. This means that it is insurers with lower capital who will feel the pinch, if they use unrated Reinsurers, rather than the well capitalized insurers.

Recent trends indicated that the transaction of reinsurance business became more free globally and even in the USA, a new reinsurance framework was approved by Regulators to reduce or eliminate collateral requirements of non-US Reinsurers, depending on their credit ratings a step which facilitate foreign reinsurers’ business transactions in USA.

In other parts of the world it also became easier for international reinsurers to transact local business, such as in Brazil, where IRB’s monopoly disappeared, whilst in some parts of Africa, Regulating bodies, recognizing the added value of the international market, eased restrictions on placement of facultative business outside national burdens where such restrictions are still in place, and we are also seeing the gradual phasing out of compulsory cessions which were introduced

years ago to allow national reinsurers to have a market share by force of law rather than by business freedom, thus coming to terms with Adam Smith's age-old work in his book "wealth of nations" that free trade increases the wealth of nations whilst restrictions diminishes national wealth.

However a contrary effect to these liberalization trends happened in Nigeria, with the introduction of their "local content" policy, **which is intended to develop the local market.**

NEW PRODUCTS

New risks such as the following have continued to threaten the operations of business, (with consequent demand for insurance coverage):-

- Financial crime.
- Electronic theft by third parties.
- Sabotage & Terrorism risks.
- Political violence
- Political risks on terms of trade
- Credit and supply chain risks on businesses
- Environmental impairment liability.
- Cyber risks.
- Crisis Management risks
- Liabilities putting Director's personal assets at stake.
- "Strict" liabilities imposed by legislation in many parts of the world, such as those imposed by the "Travel Directives" in the E.U.

Many innovative reinsurance markets have been fairly quick to recognize such risks, and offer policies to cover them, and even in many parts of Africa, reinsurance brokers and Underwriters have served the market fairly efficiently to respond to such needs; since there is fairly little capacity locally, most of these risks have had to be reinsured in the international markets which also help to draft wordings and offer technical support and claims assistance services.

MODELLING

The increasing use of models in rating, even for facultative business by international reinsurers has brought a new dimension in our business. However, experience has revealed that these models are fraught with uncertainty, since the mathematics used to build them can only give the right result if the assumptions are right; common uncertainties are:

- Return periods of catastrophe perils.
- Severity of damage for new constructions where there is no experience.
- Legal climate & litigiousness
- New risks.

Many of our property risks in Africa tend to be rated and placed facultatively in regional markets with rates influenced by the market forces, but we as brokers have often found that when such risks are referred to the international market, they always go through the rating models before a rate is offered and if the Underwriter does not have experience of the local market conditions, the rates coming out of the models would be way out of line with market rates.

As one modeller puts it “models are not the world: you must start with models and then overlay them with common sense and experience.”

Other than rating models, various other models are common place in the reinsurance world, such as catastrophe models, financial models, value-at-risk models etc. It has to be acknowledged however that the use of models has served to put a lot of discipline in our business, and serve to remind us to think back to the basics that it is mathematics and statistics which are the primary determinants of our pricing strategy, and before we can build other variables on top, to arrive at a price.

Reinsurance Brokers have a crucial role to play in the general information gathering process to feed to these models so that Reinsurers come up with the right price.

WHERE DO SMALL BROKERS FIT?

The recent past has seen a wave of mergers and acquisitions in the reinsurance broking world:

- AON acquired Benfield, after having earlier picked up Gallagher Re, ensuring that the merged entity AON Benfield Re becomes by far the largest world reinsurance broker, with combined revenue estimated at over \$1.6 bn, just for reinsurance.
- Guy Carpenter Re, the 2nd largest broker, acquired John Collins Associates of USA (the World’s 7th largest) and together will have estimated revenue of \$1bn.
- Willis Re remained the world’s 3rd largest, with revenue of \$600M , while its parent Willis acquired US broker Hilb Royal Hobbs.

These three are the world’s mega-brokers controlling together over 80% world reinsurance broker revenues, whilst others like Towers Perrin, Cooper Gay, BMS and Lockton trail behind with no one of them having more than 4% of world’s market share.

Whilst being big certainly gives advantages of economies of scale and more resources to develop technology, what matters most to the client down the line is service, price and technical support.

Smaller brokers continue to do well and remain bullish about their role in the market, namely due to:

- Being niche players or servicing niche markets.
- Having special relationships with certain Reinsurers.
- Proximity to clients.
- Ability to offer specialist products.
- Commitment to the client due to being shareholder-owned
- Ability to work with lower costs and hence offer services at a lower fee.
- Being more focused on clients’ needs and hence able to give quality service.

Despite the presence of these mega reinsurance brokers in Africa, niche and boutique reinsurance brokers continue to play a vital role and can choose where they want to compete with the megas, and where they choose to leave them alone. In effect, in some regions, these reinsurance brokers have become so successful that they have larger market share than the megas.

NEW HUBS

There is an increasing trend for Reinsurers and Brokers to open offices in new business centres thus creating new reinsurance business hubs, or even strengthening previous hubs.

Singapore has seen a few new Lloyds players after Catlin such as Liberty, Watkins, New Line and Ascot and while Chubb has made Singapore their hub for their Far Eastern operations. Lloyds has now opened in China, and is also following in India. Brazil has opened its reinsurance market, as a result of which, companies such as Munich Re, GIC and Lloyds are making their entry there. Dubai has seen a lot of interest following the opening of its Dubai International Financial Centre, with about 10 Reinsurers having set up recently there.

Nearer home Mauritius has seen 2 additional reinsurers namely Arig and Best Re expecting shortly announce its opening, in addition to Munich Re and Africa Re who have been there for many years, and Nairobi has witnessed the opening of Continental Re, in addition to long time operators Kenya Re, Africa Re, Zep Re and East Africa Re. Johannesburg has Lloyds, Munich Re, Swiss Re (which has recently moved out), Hannover Re, Flagstone Re, TransAtlantic Re, SCOR, whilst other hubs like Cairo, Dakar, Casablanca, Tunis, etc continue to be important local reinsurance hubs.

We believe that regional hubs will become more common places and they demonstrate commitment by Reinsurers in those hubs to the region, which help in attracting support from the local markets to such reinsurers.

On a different note, Bermuda which rose to become one of the world's most important reinsurance hubs over the last 20 years is showing signs of losing attraction since Bermudan domiciled Reinsurers are coming under pressure as the current US Government examines the tax loopholes in its system of reinsurance. In fact Willis is the most recent company which announced plans to move their global headquarters away from Bermuda (they plan to move to Ireland), after at least 10 multinational companies have already left that low tax Caribbean Island to other domiciles such as Switzerland and Ireland, since US President Barrack Obama and his team in the US Government began to take a tougher line on tax havens, to the extent of saying that their widespread use by American businesses was "the biggest tax scam in the world", according to a recent issue of the Financial Times.

LADIES & GENTLEMEN

Just as in his book "The World is flat", Thomas Friedman demonstrates that no business operator in today's world can successfully operate without thinking global, Reinsurers even in the most remote part of the world, the least in Africa, cannot afford to be unaware of global trends if they are to achieve the purpose of serving their stakeholders whether they be clients, regulators, shareholders, staff or the community at large. These global trends, whether in form of pricing, capital requirements, regulation, products, markets and distribution channels, will affect the Reinsurers in their everyday operations and they must be able to move with the changing environment to continue to operate successfully.

THANK YOU

