

Grasping for growth

The outlook for property and casualty markets is likely to remain challenging. Reactions in association with the Qatar Financial Centre Authority brought a high-level panel together at the Monte Carlo Rendez-Vous to ask what opportunities exist for growth.

Michael Loney, Reactions: What is the outlook for the market?

David Flandro, Guy Carpenter: This is a reinsurance market that's different from one that maybe we're used to, where it seems like international loss events are having a big effect on what's happening globally. We think we'll see more of that as the global economy continues to grow and become more versatile.

We think it's about \$75bn of large insured catastrophe losses so far in 2011. That's extraordinary in the first half of the year and we still have half of hurricane season to go, so it's a different world.

There is still excess capital in the sector absolutely, no matter how you measure it we can still find excess capital, but we're starting to find the capacity utilisation rates are changing. Back in 2009 the capacity utilisation by our measure was in the 70s percentile. Now we're in the 90s percentile, and it is significant that there's been \$2bn of new capital come in during 2011. The other thing that's happening in the sector, and this may or may not be meaningful, is reinsurance price to book ratios are at 20 year lows. That creates a higher cost of equity for reinsurers and it means that investors are voting a little bit with their feet and they are starting to get worried about the forward profitability of reinsurance companies and insurance companies too.

It's an extraordinarily tough environment. There are pockets of opportunity both for our clients and for us but it takes a lot of navigating talent to find these opportunities right now in this market. Then you could throw in the worst recession probably since the 1930s to boot.

Bryon Ehrhart, Aon Benfield Analytics: I think we have a world that appreciates reinsurance again. Certainly outside of the US I'd say reinsurers have added tremendous value to the economies and the insurers' capital earnings. That's what reinsurance does: protect capital and earnings. Reinsurance has done a good job and I think the terms and conditions have been appropriate in the response. They've been largely just in affected regions.

There's a lot of focus at these kind of conferences and in the press on price. But what has happened is we've had a lot of value that really wasn't price related. If you look in the loss affected regions, if reinsurance was good business at the beginning of this year it's a hell of a lot better business now. The diversification actually isn't as

bad as it used to be, so if you liked it before you're going to like it a lot better now. You've got sad stories in regions like New Zealand where you have 100%-plus increases and that's really tough for people to deal with but it's coming from a very low base.

James Few, Aspen Re: It's very impressive that reinsurance has worked so well, and thanks for saying so, that's helpful. But I think it would be fair to say in the past 18 months it's probably worked better for the client than it has for the reinsurer. That's reinsurance and I have no complaint about that *per se*, but I do think it means that the reinsurance market will want some kind of recognition of the recent flow of cash in each direction. If you look at just pure returns then the investors are voting with their feet from an industry perspective and that's something that obviously we ought to feel a little bit mindful about.

Bryon Ehrhart, Aon Benfield Analytics: There's a good discussion publicly about the need for more price from western European and US customers. But I'm watching the movie from the other side. I'm getting this feeling from insurance executives that really makes me feel like 2004/2005 again, where we began to lose half of the treaty casualty business, where there was all this discussion about how disciplined reinsurers are about price and how undisciplined insurers are about price, and it just didn't pan out that way. We can all say people were lucky or good, whatever it is, but we lost a lot of commerce.

Jean-Jacques Henchoz, Swiss Re: I think also that the resilience of our industry has been shown again this year and this has not been unnoticed by the C-suite of many insurance companies. What we're seeing is that reinsurance is increasingly perceived as a capital management tool versus risk transfer tool and that transformation in the perspective of reinsurance, particularly because of regulatory developments, means that the value proposition is better understood. This gives me some hope that reinsurance pricing will be put in perspective comparing apples to apples. As a result reinsurance pricing will be considered as very, very attractive and should fuel some increase in rates as well.



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Michael Loney, Reactions: What are your expectations for January 1 2012? Is the market ready to turn?

Jamie Veghte, XL Re: In my experience short-tail losses don't turn long-tail markets. As much as I love the casualty market and would like to see it turn I find it difficult to believe that an earthquake in Japan is going to prop up US D&O [directors' and officers' liability] pricing. I think that the short-tail markets even in geographies that weren't affected by losses are going to be on the way up a year in. But in the long-tail markets, until calendar year combined ratios are more in alignment we've probably got some time before we see it turn.

Jed Rhoads, Alterra: Our cost of capital and our returns have actually converged. The only thing that's important to our

**Panellists** (left to right):

Akshay Randeva, director of strategic development at the Qatar Financial Centre Authority
 David Flandro, global head of business intelligence at Guy Carpenter
 Bryon Ehrhart, chairman of Aon Benfield Analytics
 Hemant Shah, CEO of Risk Management Solutions
 James Few, president of Aspen Re
 Jamie Veghte, CEO of XL Re
 Bill Jewett, president of Endurance
 Jed Rhoads, chief underwriting officer of reinsurance at Alterra
 Jean-Jacques Henchoz, head of Swiss Re's Europe, Middle East and Africa (EMEA) division

Moderator: Michael Loney, managing editor, Reactions

investors and shareholders is what the spread is between the two. We are in a compressed period. We're going to look back at 2009, 2010 and 2011 and say: "Wow, that smelled and looked a lot like 1998/99 and 2000." The casualty results are probably going to look very similar once proper reserving is done on those lines, we're going to say: "What were we thinking in this period of time?"

We are cut pretty thin to the bone right now and my view is we are fairly close to an inflection point in a bifurcated cycle, I'm not sure that property and casualty are going to be on the same cycle in the next few years, and in some ways it's good. The commercial models are providing a little bit more stability to the short-tail side of our business as opposed to the long-tail side and hopefully that will make the market cycle changes slower and longer lasting than what they have been in the past.

Bill Jewett, Endurance: I don't see a systemic market change in the aggregate. I don't think the market *per se* is going to harden at 01/01 or show material signs of hardening. We all see opportunities within various micro cycles within the overall marketplace but I certainly don't see our ships rising with the tide with an overall market return. There are pockets of opportunity out there, however, whether it's losses in specific geographies or lines of business.

James Few, Aspen Re: In cat-exposed property we've seen some good changes in prices, but I would point out that I do also think that the industry has learned some lessons on what the tending price should be.

I think we're going to get a new generation of earthquake models, which will include more recognition of tsunami risk, soil liquefaction, probably magnitude

9.0s on the subduction zones. The old rules about age of crust and speed of movement appear to be questioned by Tohoku so it's likely that all of that science will come together and there will be a new generation of earthquake modelling that will suggest we're not getting as adequate a price as we thought we were. A bit like the effect from version 11 of the RMS [Risk Management Solutions] US wind model but for quakes, so we're trying to anticipate that. Prices have gone up, but maybe the bar has as well.

David Flandro, Guy Carpenter: There's just a lot of moving parts out there right now. Some people feel like RMS really threw a wrench in things. It just means that we have to work a lot harder at the corporate model, which is fine, it's all for the better, and keeps us on our toes. But for many underwriters it changes the exposure, it changes assumptions about exposure and it changes understanding.

Michael Loney, Reactions: James mentioned possible modelling lessons learnt from what we've seen so far this year. Hemant, what have you seen and how do you see that playing out for RMS?

Hemant Shah, RMS: It's on two time scales. There are the new models that we've introduced for North America hurricane and European wind storm, and given the way the market works there's the natural tendency to engage those new models in the context of a trading conversation around a renewal season. That's relevant and part of what models are used for. But there's a more fundamental conversation about risk and capital requirements and Solvency II that really motivates a great deal of our work on models. We encourage everybody in the market to have



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a trading type of conversation about models and model adoption and how models might affect rates and so on but also to look past any one renewal season and think more fundamentally about what the models may be shedding some light in terms of risk and capital.

As far as some of the more recent events, there is a great deal of knowledge now in the pipeline around earthquake risk. A great deal of the activity we're talking about has been earthquakes throughout the world and so we've got a pretty significant R&D pipeline already underway around earthquake risk. Some of the things you've talked about, James, are absolutely in the pipeline right now. It's increasingly important that it's not just about: when's the next model change coming out? But let's start talking about what is being learned well in advance upstream of the mechanical implementation of models so that the industry can start getting its head around some of the lessons learned even before a modeller actually implements some changes in a parameter. I think it's going to be an important part of the discussion in the next two years.

Michael Loney, Reactions: Can you talk us through how you see Version 11 affecting the market? I've heard the term “Hurricane RMS” bandied around a few times in Monte Carlo.

Hemant Shah, RMS: There is no good time of the year to implement changes. These R&D pipelines are multi-year development programmes. I can understand the trading context of the conversation and there's a lot of positioning but the reality is that these are significant changes. They're based on significant amounts of R&D – in the hurricane model alone there were 120 man years of pure R&D that went into that single model change and it will take some time for the market to understand the implications, what assumptions are in the models and then take them on board into the decisions they make. That takes a bit of time and it needs to be engaged constructively and transparently. There's certainly a lot of positioning going on right now about the model change and what it may mean for this renewal or not, but the more important conversation is what the models actually say about risk, and do we understand what the implications are at the level of risk. Let's have a conversation about that as opposed to about the positioning on any particular renewal.

Jamie Veghte, XL Re: It would be nice if we had the luxury of a lot of time to consider the impact of these changes. Unfortunately there are stakeholders attached to this industry who don't give us a lot of time, and that would include shareholders, not only around price ramifications for the new model but also risk management decisions. Many companies have published risk appetites relative to probabilistic measures in these models. If they change then the shareholders want to know how we're going to change. So unfortunately there has to be a fairly quick reaction to some of these changes.

Hemant Shah, RMS: These things feel like they happen with a hair trigger of response. Part of it is how can we build in more gearing between improvements in knowledge and science and

how these things work their way through their business systems. I appreciate it's a challenge. When I look at my colleagues, it's an R&D lab, hundreds of people building models, scientists, modellers, engineers looking to improve the quality of our insight on these very complex risks. Then I look over here and there's an expectation that as soon as we announce a new insight it propagates all the way through all kinds of financial conversations. People are phoning up to say: “What does this mean for my rating conversation with rating agency X?” It's the same kind of thing when a hurricane has made landfall and everybody is looking for loss estimates one hour before landfall with a degree of precision. Part of it is finding a way of reconciling those things.

I think what we can do better in a tangible way is try to move some of these conversations upstream so that they're starting to take place before models are mechanically implemented so there's more visibility and transparency into this knowledge pipeline and what the implications might be.

Jed Rhoads, Alterra: At the end of the day RMS did become, at least in the US and I think outside of the US as well, sort of a *de facto* model choice for initial cedants. Cedants don't use multi-models, reinsurers use multi-models, though there are some exceptions on both sides of the fence. It's fair to say that v11 both in Europe and in the US will probably have a broader and more lasting impact on our industry than the recent cat events of this year.

Jean-Jacques Henchoz, Swiss Re: What is more important is to look at the reality. The reality is very clearly that frequency and severity are on the increase and need to be at the centre point of the discussion rather than a discussion about whether the model is the right model or not, this is a side issue. For me it's not about Hurricane RMS, not at all. We should not put RMS at the centre of it, we should put the reality of nat cats across the world. The reality is it's on the increase and needs to be reflected in the modelling process.

James Few, Aspen Re: We did a study on what limits were bought before version 11 came out and what limits have been bought by the industry since it has come out and they have hardly changed. There is hardly any increase in demand yet that model has gone up by \$60bn. Now, we can all argue that we don't rely too much on RMS but I don't think there's too many people who would ignore RMS, and AIR also went up. So in our opinion at some point the industry's going to recognise this increased risk to protect either by charging more price, buying more cover or restricting the amount of exposure you have on your books. That hasn't happened yet but we think it might well.



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Michael Loney, Reactions: It sounds like a fairly downbeat outlook. Where are people seeing any bright spots, by line or by region?

Jean-Jacques Henchoz, Swiss Re: There are always opportunities for any player depending on the strategy. The most significant one to consider for any player is: “How can I diversify my book in a more effective way?” For us it’s obviously more difficult than others given the global scope but emerging markets generally are still an area where we really think we can grow in the next few years. That’s not in terms of business line but in terms of geography.

We are certainly growing very fast in China. Brazil is strong currently and we have a few target Latin American countries where we are trying to step up our efforts, so it’s certainly one area of growth.

The regulatory developments generally, and particularly in Europe, will trigger many thoughts in terms of product strategies and may lead to some adjustments, and these developments will lead us into some transactional growth opportunities, be it players wanting to diversify more or focus on a certain segment and exit some business lines. The dislocation effect that these trends will have will be a source of opportunities for reinsurers on a transactional basis. I think transactional growth is going to be more important than bread and butter business – the renewal treaty business. That’s where I think we will grow significantly in the next two or three years.

Jamie Veghte, XL Re: I also think there is an opportunity for growth in some of the emerging markets. But we have never really believed that geographical product diversification for its own sake is wise for a company of our scale. There are indeed big growth opportunities in some of these markets. Brazil is a perfect example of an excellent market for all of us over time. But there have certainly been some teething issues around the opening of the market, so you have to be careful about growth.

Jed Rhoads, Alterra: I want to take a slightly contrary view to it. I don’t think there’s any pot of gold in the emerging markets. We talk about emerging markets as sort of one entity. They’re not, they are very different regional markets with very different personalities in return times and data quality and so forth. There are opportunities in some areas but I’m not sure that it’s the panacea.

Michael Loney, Reactions: Akshay, you have a slightly more regional perspective: how has the Middle East been performing for reinsurers?

Akshay Randeve, Qatar Financial Centre Authority: As a region there have been some uncertainties but if you think about it as an economic block it’s a very big block growing very quickly. Qatar alone is growing at 16% real rates, which in the rest of the world seems almost other-worldly. And the proclivity towards nat cat exposures or losses is much lower, so though it’s a much softer market it’s still a profitable market. It’s an interesting place

to think about diversifying right now considering an increased amount of nat cat events on international markets.

We conduct a barometer, which is a survey of the reinsurance rates around the region. From the first one in March to the second in September there has been a definite increase in optimism towards hardening of rates, but we have to see how much of the hardening actually takes place.

James Few, Aspen Re: We do think there are some opportunities in the emerging markets. The growth in the size of the middle classes in this part of the world leads to more opportunity to sell insurance products, which we are looking at. The scale at which you can take advantage of that we would argue given current data standards is not sufficient to offset how much we’re giving up in more mature markets where we’re concerned about future problems. But there are opportunities. We entered trade credit on the back of the 2008 crisis and that’s been very good for us. That’s starting to come back down again, but that was a nice opportunity while it lasted. Agriculture internationally is an increasingly interesting area.

But maybe there are a couple of other things that happened recently that mean there’s some opportunity within the US. The floods that have occurred through Hurricane Irene I think make it pretty obvious the NFIP [National Flood Insurance Program] is not in a happy place. The US government is not going to find it easy to pay for NFIP losses or the potential for even more NFIP losses going forward. I think there’s a private market solution. I appreciate that it’s politically difficult but with the right kind of industry action there’s a possibility there that perhaps we could provide a good product for the consumer. And then perhaps even more so quake risk on the mortgage portfolios, which is currently not protected. I’m not sure the governments of the world are as well capitalised as they used to be and I believe there is a private market solution there.

So there are perhaps some opportunities within more mature markets as well, but it’s getting harder and harder and I think the overriding message for me is that future returns will be less than they are today – and they’re not that good today – unless we do something about it.

Bryon Ehrhart, Aon Benfield Analytics: The emerging markets are interesting but I would say emerging risk is more interesting. Deepwater Horizon is a really interesting example where BP has sued its partners for about \$46bn worth of liability. So uninsured losses and that mega liability cat is something we should try to work together because I know reinsurers have capital to help us address it and the clients do.

Hemant Shah, RMS: Opportunity comes from innovation. It’s hard to turn on a dime but if you don’t invest in innovative ideas to grow the market, the tranche of opportunities will never present themselves because you won’t have done the homework. There are many areas of fundamental opportunity to actually extend the market. The amount of uninsured developed markets like the US, the amount of uninsured property exposure from perils like earthquake and flood is extraordinary. That’s a significant opportunity, and I don’t mean just innovation in a narrow sense speaking parochially as a modeller.

There’s real opportunity to think strategically about how the industry can fundamentally innovate its offering to be more relevant to the 80% or 90% of global risks that are not in the marketplace right now. They will never become short-term opportunities unless we start investing in that kind of innovation cycle and then bring those into reaching distance. So there’s no shortage of opportunities. It’s looking at the 80% of the problem that we don’t deal with where all those opportunities are, not tinkering around with that 20% works, which is we’re doing right now. ●