Centralisation of reinsurance buying

It should come as no surprise that there is a general trend among larger cedants to centralise reinsurance buying decisions and retentions and to bundle homogeneous products. This has become possible with the improvement of available portfolio data.

This practice has some obvious advantages for buyers, such as reduced spend, reduced administration, improved control over counterparty credit risks and, possibly, retention of additional profits that would otherwise be ceded to reinsurers.

Diversification allows a cedant to increase its retention up to the appetite level of the entire group as opposed to that of a single subsidiary company. Whether the approach is "top down" or "bottom up," the result is the same and it makes perfect sense. We have seen few exceptions to this trend despite the soft market.

This development has resulted in a shift in the quality of demand for reinsurance from the "old", more opportunistic approach, to a more strategic and long-term view. It has also removed a substantial amount of premium from the market and has therefore increased the relative amount of volatility ceded to reinsurers. Some argue there is no longer sufficient premium in the market to pay for the losses and to generate the returns to which the industry has been accustomed.

Reinsurers are increasingly pushed to write global programmes, and as their pricing has been kept in check with the arrival of new forms of capital, they have had to adjust their strategies and appetites. The result is different strategies for different reinsurers, with variations according to their size, capital structure, individual appetites and beliefs.

Differing approaches

Increasingly, reinsurers' approaches are falling into several distinct categories. One is the old, traditional approach where the reinsurer relies primarily on a fast-disappearing "personal relationship" with clients.

The second is the development of a new, sophisticated approach to the relationship that is much more effective. One example of this sophisticated relationship is the "market share approach," which often is combined with cycle management. Here, the belief is that diversification can turn a large portfolio of underpriced risks into an overall profitable proposition.

Another strategy is the "portfolio approach", where a client is deemed profitable over the cycle irrespective of whether its programmes are priced slightly more or slightly little less than what they should be, according to the reinsurer's technical view.

A third example of this sophisticated relationship involves the "specialists" – reinsurers that are able to propose and provide complicated, but sometimes very efficient solutions. The final category encompasses the reinsurers "of last resort" – some of them willingly and opportunistically so.

> "Future demand will be shaped by the global buyers and the market needs to respond"

While reinsurers continue to sort out their approach to cedants, what is certain is that the market must succeed in its quest to innovate. Future demand will be shaped by the global buyers and the market needs to respond.

In all of this, the reinsurance intermediary's role has also changed and continues to change. The ability to match the client's needs with innovative offerings; the use and development of the best tools to analyse and represent the client's portfolio; and offering the most efficient reinsurance and capital solutions – in sum, the advisory capabilities – will determine the intermediary's future success or failure.

Guy Carpenter has developed specific capabilities and continues to invest in people and technologies in order to become our clients' most efficient, most innovative, most effective and most trusted adviser.

Our Strategic Advisory practice and our Property and Casualty Specialty Groups, together with our network of local offices, have been successful in assisting our clients with some of their most complex projects, such as centralisation of reinsurance.

However, the job is not finished. The vast majority of large insurers have now centralised their treaty buying, but facultative cessions, which are often bigger in terms of premiums ceded, are still largely decentralised.

Fac challenge

Centralisation of facultative reinsurance presents very different questions and operational challenges. We are working with some of our clients to assist them in this transition.

As a starting point, many feel the role of line underwriters in deciding whether or not to buy facultative reinsurance on a risk is of paramount importance. The issues that worry our clients the most seem to concern control of the buying strategy, the choice of carriers and brokers, the counterparty credit risk and, of course, the potential loss of profits ceded to reinsurers. Reduction in administration costs, reduced exposure to potential errors and omissions and gaps in coverage are also considered priorities.

Facultative reinsurance remains a flexible and valuable tool to manage volatility and market positioning. It is also a very effective way to stay in touch with the market, absorb knowledge and understand trends, but reinsurers will have to come up with better solutions to safeguard the very large amount of premiums currently ceded on a facultative reinsurance basis. Guy Carpenter is working with them and with our clients to find the optimum balance in this challenging issue.

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