

# Are the clouds lifting?

How are global (re)insurers faring in the current climate?  
Sal Zaffino considers the outlook is not as bad as expected.



Sal Zaffino is chief executive of global reinsurance intermediary Guy Carpenter.

Hardly anyone would question that the reinsurance industry has had more than its share of problems in the past few years: a prolonged soft market; a bear market in equity markets globally; the events of 11 September 2001; record low interest rates; the asbestos claim overhang; and substantial adverse loss reserve development for the 1997 through 2001 accident years.

Just look back prior to 11 September 2001. The four largest reinsurance groups in the world had 'AAA' ratings from Standard and Poor's. Currently, only one global player, Berkshire Hathaway, has retained its top rating. It has been a difficult road for the industry.

## A bright forecast

As we move through 2004, there are a number of bright spots on the horizon, implying potential improvements in reinsurer finances.

The first sign is that higher pricing over the last several years should at last result in improved bottom-line profitability. Strong accident year results in 2002 and 2003 enabled reinsurance markets to strengthen reserves for past liabilities over that time.

While some of the loss strengthening can be attributable to asbestos and environmental losses, the great majority were caused by the soft market underwriting of casualty business on the 1997 to 2001 years of account. The strengthening of reserves was accomplished at the expense of calendar year profits. In 2004, barring a significant catastrophe or further adverse development of reserves, reinsurers are expected to record more positive results.

## Improved ratios

The Reinsurance Association of America (RAA) reported a combined ratio of 98.3% for US reinsurers in the first nine months of 2003 — a 16 point improvement from the 114.4 ratio reported for the same period of 2002. However, fourth quarter results in the reinsurance industry are often beset by large year end loss reserve adjustments, as we have just seen from XL Re America.

In addition to improved profitability, reinsurers have taken measures to replenish lost capital. The most prominent participant in capital raising was Munich Re, issuing \$8.4bn in rights and subordinated bond instruments.

Capital initiatives were taken by many other reinsurers, albeit on a smaller scale. Besides the supply of capital to refill depleted coffers, investors have provided funds for start-up reinsurers, particularly in tax advantaged domiciles like Bermuda. One clear indicator of this inflow of capital is that

the share of global reinsurance capital held by Bermudian companies nearly doubled in recent years, rising from 13% in 2000 to 24% at the end of 2002.

The reinsurance industry has also benefited from a moderation of catastrophe losses in recent years. Insured catastrophe losses in 2003 totalled \$17bn, up from \$14bn in 2002. While catastrophe losses are somewhat moderate in comparison with years like 2001 (World Trade Centre) or 1999 (European winter storms), the level of losses are multiples of those experienced in the 1970s and 1980s.

Another positive development is the improvement in stock markets around the world in 2003, following a three-year bear market.

Stock market prices in general have continued to rally in 2004. While we are naturally wary of prognosticating the future performance of stock markets, economic indicators appear to show that equity markets may improve, as we experience renewed economic growth in most regions of the world.

## More good news

More favourable news comes from the interest rate front. The Federal Reserve in the US has signalled a potential upwards shift in the discount rate. Reduced fears of deflation in Germany and Japan also suggest a rise in interest rates. A rise in interest rates can have a double-edged impact for (re)insurer finances.

Higher rates lead to higher investment income, but also imply a lower market value for companies' bond portfolios, impacting GAAP assets and equity. From a rating agency perspective, an increase in interest rates would be viewed as mildly positive, since a key focus of their concern in recent years has been on the earning power of reinsurers.

## Relief for cedants

This positive news spells some relief to cedants concerned about the security of their recoverables. But while some clouds are lifting, there are others on the horizon. Most notably is concern about the adequacy of reserves held by reinsurers. There is also the fear that a softer market will lead to a deterioration in reinsurer finances. And there is always the possibility that a major catastrophe, either natural or man-made, could change the scenario.

With such concerns, the outlook for the reinsurance marketplace can best be described as measured optimism, with careful selection of quality markets essential to future collectability of reinsurance recoverables.

### Editorial

**Editor**  
Isobel McCalman  
**Senior reporter**  
Marc Jones  
**Contributing editor**  
Vic Wyman  
**Sub-editor**  
Deborah Shennan  
**Art director**  
Nicky Brown  
**Editorial director**  
David Worsfold  
**Editorial tel** +44 (0)20 7484 9933  
**Editorial fax** +44 (0)20 7484 9990  
**E-mail addresses**  
name.surname@incisivemedia.com  
rein.editor@incisivemedia.com

### Advertisement sales

**Publisher**  
Michael Blakesley  
**Advertising manager**  
David Kubale  
**Advertising tel**  
+44 (0)20 7484 9979  
**Advertising fax**  
+44 (0)20 7484 9992  
rein.sales@incisivemedia.com

**Managing director**  
James Hanbury  
**Marketing director**  
Rory Brown  
**Marketing manager**  
Ro Osborne  
**Group production manager**  
Daniel Croucher

**Customer services**  
**Tel (UK)** 0870 240 8859  
**Tel (US)** (212) 925 6990  
**Email** customerservices@riskwaters.com

**Subscriptions hotline**  
**Tel** +44 (0)20 8606 7516  
**Fax** +44 (0)20 8606 7303  
**Email** sigs@wdis.co.uk

**Annual subscriptions:** UK £225 Airmail Europe £242 (\$411) Airmail RoW £272 (\$462). Remittances by cheque or international money order to be sent with order and made payable to Timothy Benn Publishing Ltd. Overseas cheques should be drawn in sterling.

**Head office**  
Incisive RWG Ltd, Haymarket House, 28-29 Haymarket, London SW1Y 4RX  
**Tel** +44 (0)20 7484 9700

**US & Canada office**  
Incisive RWG Inc, 270 Lafayette Street, Suite 700, New York, NY 10012, US  
**Tel** (212) 925 6990

**Asia & Pacific office**  
Incisive RWG Ltd, Unit 601B, Sixth Floor, Kinwick Centre, 32 Hollywood Road, Central, Hong Kong, SAR China  
**Tel** (852) 2545 2710



An incisivemedia publication

© Incisive Media Investments Ltd

ISSN 0048-7171  
Reproduction: CTT, London  
Printer: The Grange Press, Southwick  
Member of the Audit Bureau of Circulations

