reinsurance

Enjoying the ride

Geoffrey Bromley analyses the recent movements of capital within the reinsurance markets.

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Following the events of 11 September 2001, several (re)insurers and Lloyd's syndicates were formed in anticipation of the market upturn that was predicted. Additionally, existing players sought to consolidate or replenish their capital bases. Capital entered the market in rapid time — the majority, some \$20bn, was raised in the last three months of 2001.

Reinsurers returned to the capital markets with renewed vigour during 2003. Significant amounts of capital have been raised for various reasons, including: reserve strengthening; to maximise opportunities to write highly profitable business; and protection against the actions of rating agencies.

Notable among the list of players raising Capital were Munich Re (€7.6bn), Scor (€750m) and several Bermudian operations, including Arch, Endurance, XL, Montpelier, Aspen Re, Axis and Renaissance Re (approximately \$3.5bn between them). New capital flowing to Bermuda comes to approximately \$10bn raised since the events of 11 September.

A number of players have left the reinsurance market, including CNA, Hart Re, and Trenwick. Some new companies have been formed, the most recent being the Bermuda-based Quanta Capital. Capital, however, continues to be eroded, especially due to prior year liability problems. But it does not seem unreasonable to suggest that each additional dollar of capital raised is adding to market capacity.

The Bermuda effect

Although several of the new companies set up in Bermuda originated with a broad business line strategy including multi-line (re)insurance, a number of them commenced business by writing property non-proportional treaty business as their major focus. Such business provided a quick and easy entry into the reinsurance business for several reasons.

Firstly, it can be modelled. Following 11 September, the market had a need for clean capital (not burdened by historical claims). Secondly, it provided a rapid income stream and, thirdly, it is not resource intensive.

As the new Bermudian market's treaty portfolio matures, it has and is likely to continue to prove impossible for the companies to maintain the growth that they enjoyed in their formative years from reinsurance alone. They have been increasingly willing to focus on other lines of business, including the primary property insurance market, in which they are now a major force. This book of business has necessarily taken longer to build up than the treaty portfolio.

The Bermudian companies' additional focus on primary insurance has had two effects: the additional capacity has caused primary property rates to fall quicker; and the multi-line approach has permitted these reinsurers to adopt a harder stance on reinsurance treaty business.

For reinsurers, retrocession placements can function in a similar manner to capital, particularly in a hard market. It allows players to write more business.

Overall, the retro market has proven itself to be relatively stable through the period from September 2001. However, there have been significant changes in the constitution of the market. Axa Re, a dominant element of the retrocessional market until 2001, has continued its withdrawal from the business. Elsewhere, Berkshire and Renaissance Re continue to play major roles in this area of business and other elements of the Bermudian market, which were not traditional supporters of retro business, are showing an increasing interest to provide retrocessional capacity.

The industry loss warranty market has increased in available capacity with a broader availability of capacity from (re)insurers and an increasing involvement by certain hedge funds. Pricing for this form of capacity has reduced significantly, unlike the cost of traditional capacity which has remained relatively stable in recent years. Structured or finite covers continue to play an important role in the retrocessional area. However, the continued availability of traditional and ILW capacity has meant demand for structured retrocessional solutions has not increased markedly

The catastrophe bond market

A final and important source of capital for risk transfer is the catastrophe bond market.

The catastrophe bond market witnessed yet another record year during 2003 with a total issuance of \$1.73bn. The record year for 2003 improved upon last year's performance of \$1.22bn. During the year there were eight transactions completed with three originating from first-time issuers.

Reinsurer sponsored transactions outpaced insurer sponsored transactions by two to one in 2003. The year also featured the first European corporate sponsored transaction. Globally there have now been three corporate-sponsored issuances. Electricite de France, the largest electric utility in Europe, has issued catastrophe bonds to address a portion of the risks facing its properties from French windstorms. This was the first transaction denominated in euros. Interestingly, Vivendi, which became the second corporate (the first US issuer) to use a catastrophe bond to insure itself against Californian earthquake risk, has recently exercised its right to call its issuance as of 20 November 2003.

Capital flows into the reinsurance market have been on a roller coaster since September 2001. Capital charged into the industry in late 2001, then followed a quiet period, before the flood gates opened again in 2003. As we move into 2004 and beyond, our expectation is for a reduced inflow of capital, particularly as prices level off and the expectations for above average returns in the future are reduced.

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