The year of the storms may not whip up prices in the global reinsurance market

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2004 will likely be remembered as one of the most active seasons in the history of tropical storms. Not only did four major hurricanes hit the Caribbean and the United States, but Asia experienced 12 typhoons, some of which hit heavily populated areas in Japan.

Although pressure on insurance and reinsurance rates is likely, we at Guy Carpenter believe that the impact on the global reinsurance market will be relatively small. In our view, renewal conditions in 2005 will fall into four main categories:

- US carriers with large reinsured losses from the storms will likely see rate increases at 2005 renewals.
- Large national carriers, who had sizeable retained losses and no reinsured losses, will seek, and probably be successful in achieving, lower rates. Cedants will be anxious to make up for the losses of 2004, if only to free up money to purchase additional protections, be they vertical or horizontal.
- Regional carriers with no reinsured losses should be successful in negotiating lower rates.
- Carriers outside the US, such as in the Caribbean, with large reinsured losses will see rate increases; otherwise, the decline in rates will continue.

Analysing the impact:

The four major hurricanes (*Charley*, *Frances*, *Ivan* and *Jeanne*) have produced about US$22bn in insured losses (depending on the model vendor and the points within the chosen ranges) to the US. Estimates for insured losses in the Caribbean exceed US$2bn.

While insured loss estimates from typhoons are fragmentary, we estimate that losses are likely to be in excess of US$3bn.

Hurricane *Andrew* in 1992 is commonly used as a point of comparison in measuring the market impact of major catastrophes. Hurricane *Andrew* not only changed the manner that property-catastrophe reinsurance was viewed, priced and ultimately sold, it was a redefining moment for the property-catastrophe reinsurance market.

The total insured loss this year from storms is about equivalent to the *Andrew* loss in today's dollars.

So the question remains, will the 2004 storm activity, which may rival 1992 in terms of aggregate losses to the industry, produce a similar market shift?

The simple answer is 'no', and there are several reasons for the difference:

There are a few very large Florida market players that do not buy meaningful external reinsurance. Citizens Property Insurance Corporation, Allstate and State Farm alone are estimated to represent more than 60% of the homeowner's market.

The Florida Hurricane Catastrophe Fund (FHCF) is the largest reinsurer in the state. Even though the current estimated loss amounts for all the storms appear to fall below the industry attachment for the FHCF, the FHCF pays out based upon individual member company's specific limits and attachments. It appears likely that the FHCF will draw some potential loss out of the reinsurance sector.

Our best estimates indicate that the FHCF will pay US$2bn-3bn in total losses from all four events.

Property-catastrophe programme retentions for the national writers have grown over the last few years to the point where *Charley*, *Frances*, *Ivan* and *Jeanne* will largely be net-retained events. There are a number of Florida-only writers that are in difficult situations as a result of these storms, but in terms of the total impact on the reinsurance market, without the large national writers (and their big limit reinsurance programmes), the impact is less severe. We estimate that 75% of these total losses will be retained net.

When we combine these various factors together, we come up with an estimate of the loss to reinsurers in a range of US$3-6bn. We do not believe that such a loss is sufficient to change the basic downward trend of pricing in the marketplace.

So how we may be wrong?

Losses from the hurricanes may be larger than analysts currently estimate; some believe the loss may exceed US$30bn. Hurricane *Andrew* was initially estimated at less than US$1bn. In a highly politicised state such as Florida, there is a potential for 'demand surge', meaning that reconstruction pricing gets inflated by the demand for the material and services required to repair and rebuild more than a million homes, and also by decisions made by regulators and insurers that go beyond policy language.

On the primary side, losses may be higher than anticipated as a result of multiple deductibles not being enforced. Homeowners who were hit by more than one storm do not want to have the sizeable deductibles in Florida applying to each storm. On the reinsurance side, there are strong incentives for cedants to apply losses to maximise recovery over their retentions. Given that adjusters may not inspect many homes for several weeks, it will be very difficult to assign losses to particular events.

Finally, some carriers may not renew until the middle of 2005, and, by that time, any number of other factors may have impacted the market's direction.

2004 will be remembered for its storm season: there have only been six years since 1900 in which four or more hurricanes made landfall in the US.

The losses flowing from these storms to reinsurers, however, have been modest. At this time, we continue to expect that most cedants will face in January a market characterised by declining rates and adequate capacity for most programmes.

One final point: cedants in 2004 became much more aware of the importance of horizontal protection on top of vertical covers. With high occurrence retentions and minimum or no aggregate covers, a number of cedants suffered collective losses of the order of Hurricane *Andrew*, but without the reinsurance protection normally associated with an event of that magnitude. This is likely to be a key issue in designing and placing catastrophe programmes in 2005.

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