

Guy Carpenter Views

Reprinted from www.guycarp.com

February 2004

The Evolving Role of Today's Reinsurance Intermediary



Dee Megna is Vice Chairman at Guy Carpenter.

Never before in the history of reinsurance has the role of the reinsurance intermediary been tested as it has over the last several years.

In the 1990s, the reinsurance market was soft, rates were affordable, coverage was broad and limits were high. Intermediaries generally did not have much difficulty meeting their insurance company clients' needs for reinsurance protection. In the soft market, intermediaries needed to determine the most appropriate programme for their clients and place that programme at the most advantageous rates, consistent with the clients' wishes on market security.

This cycle began to turn in early 2000. Steady development of historical reinsurance losses, such as asbestos and generally poor economic conditions, slowly pushed reinsurance prices higher until the events of 11 September 2001 caused them to skyrocket. As reinsurers began to shy away from perils that they were unable to quantify, reinsurance terms and conditions became more restrictive.

The assistance of intermediaries is invaluable in this environment. Insurers are seeking coverage for the risks they face. The challenge to intermediaries is to analyse these risks, package them in the most commercially feasible manner, and then seek appropriate risk partners to share these risks.

Through knowledge of new and alternative solutions, and access to capacity around the world, the best intermediaries work to ensure that their clients have the type of reinsurance protection that they need.

New and Evolving Exposures

The events of September 2001 took the insurance industry by surprise.

It showed that terrorism, a relatively low profile risk, was capable of inflicting damage (currently estimated at \$40bn-plus) and loss of life (close to 3000) in multiples of those that occurred during the worst US natural disasters. The claims from the World Trade Centre disaster also highlight the possibility of high exposures aggregated across lines of business arising from other than a natural peril – from life insurance to personal property coverages.

While insurers are dealing with the implications of this disaster, threats are appearing in more areas than ever before. Corporate governance scandals, huge payouts on mass tort lawsuits, new internet risks, and increasing natural and man-made catastrophes have all pushed the industry to look for new ways to quantify and manage their risks and protect their balance sheets. Reinsurance intermediaries have responded by organising themselves into specialty practices.

With pools of risk increasing, and the risks getting larger, accurately measuring them and assessing how they change under a variety of reinsurance scenarios becomes more and more important.

Intermediaries are investing substantially in such consulting services and capabilities as catastrophe and financial modelling, actuarial analysis, portfolio analysis and assistance with ratemaking decisions.

With this focus on modelling risk, we've also seen the emergence of specialised reinsurers in such areas as property catastrophe reinsurance, whose business model is based almost exclusively on a quantitative approach to risk transfer.

Intermediaries who have invested heavily in growing their quantitative services are in a strong position to assist their clients in taking advantage of this new capacity in the market.

Intermediaries are also responding to clients' need for sophisticated products and a more holistic approach to risk. Although conventional reinsurance practices are still important, they are not the only tool. The most effective programmes may involve securitisation as well as a combination of traditional and nontraditional reinsurance. The 21st century intermediary can assist clients in understanding and organising total risk management solutions that comprise the most effective mix of products to respond to their unique risk picture.

Shifting structures

Insurers typically progress from an emphasis on proportional to an increased use of excess-of-loss reinsurance. This evolution is contributing to the expansion of the intermediaries' role as a consultant. Structuring excess-of-loss deals is a complex and time-consuming process, which requires modelling expertise, solid pricing advice and services that are customised to each client's specific needs. This is where intermediaries excel. Many insurers feel more comfortable requesting advice when negotiating excess-of-loss than proportional contracts.

Emerging opportunities

As countries privatise industries, liberalise trade policies, ease barriers to international investment, and deregulate insurance markets, they are encountering unfamiliar risks. The trend by insureds toward higher retentions generates an appetite for alternative risk transfer products to stabilise results.

Newly-liberalised markets need advice as they enter the global market, and intermediaries play a special role in guiding these markets in their use of reinsurance. They also offer foreign entrants into these markets the expertise, product technology, and advisory services to help them operate successfully. There was a time when 'dis-intermediation' was thought possible as technology companies rendered the role of the old intermediary unnecessary. However, as risk managers become more sophisticated, and risks become ever more complex, there is an heightened demand for advice that is informed, experienced, quantitatively based and global in scope. Successful brokers in the coming years will be the ones that effectively satisfy these needs of their clients.

Guy Carpenter & Company, Inc. (Guy Carpenter) provides this publication for general informational purposes only. The data contained herein is based on sources Guy Carpenter believes to be reliable, as of a specified date, but Guy Carpenter in no way guarantees its accuracy. Guy Carpenter makes no representations or warranties, express or implied, concerning the statements made herein or the financial condition or solvency of reinsurers. Past performance does not guarantee future outcome, and readers are cautioned against placing undue reliance upon any forward-looking statements. Guy Carpenter does not undertake any obligation to publicly update or revise the material herein, regardless of new data, future events or otherwise.

This document is not an offer to sell, or a solicitation of an offer to buy any financial instrument or reinsurance program. This report, its data and the methodology utilized are proprietary to Guy Carpenter. The dissemination, reproduction or use of this report without Guy Carpenter's express written permission is prohibited.



Marsh & McLennan Companies