

Expect no surprises

If current conditions prevail, 2003 looks set to be pretty stable for property catastrophe reinsurance, says Sal Zaffino.



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

I appreciate this opportunity to address issues of concern within the reinsurance market, particularly given the current conditions in the industry. I hope to share with you unique knowledge — specifically on property catastrophe reinsurance — that Guy Carpenter has garnered from our dealings around the world.

Observations of current market conditions indicate that 2003 is shaping up to be a relatively stable year for property catastrophe reinsurance.

The market appears to have absorbed the dramatic impact of the 11 September 2001 attacks and to have made adjustments for emerging losses in areas ranging from corporate governance to asbestos to declines in equity prices.

So far, the industry has also benefited from the relatively few catastrophes this year, thus avoiding another potentially destabilising market influence.

Demand matches supply

Reinsurance demand and supply are essentially balanced, and pricing worldwide is relatively stable for property catastrophe. That is likely to remain so provided that there is no major catastrophe in the coming months.

Industry-wide demand has proven to be consistent from year to year, as cedants are increasingly using sophisticated catastrophe models to determine their programme structure. Consequently, cedants' reinsurance requirements have become fairly constant year-in, year-out, irrespective of any significant change in the exposure base.

Supply, however, is more a function of price. We noted that as prices rose for all forms of reinsurance in 2001, capacity dramatically increased. Following a flurry of activity in late 2001 and early 2002, start-up activity practically disappeared.

The logical explanation for this is that the new capital entering the market had begun to curb price increases. Prices still rose sufficiently to keep the new players in the market, but they were not high enough to continue attracting new market entrants.

A significant question still remains as we head into the 2004 renewal season: will the market retain its current pricing discipline or revert to intense price competition?

Bonds are booming

The 2002 catastrophe bond market had record issuance of \$1.2bn, exceeding the previous high of

\$1.1bn set in 2000. With more than \$700m in bonds issued thus far, 2003 is on track to surpass the 2002 level.

Despite this, experience suggests that these figures understate the impact of catastrophe bonds.

Not only do they offer an important viable alternative to traditional reinsurance, particularly for remote 'super-cat' events, they may also help to stabilise the price of catastrophe reinsurance programmes. The use of catastrophe bonds is likely to increase.

There is already a growing and increasingly sophisticated investor base for these securities; however, note that they require accurate assessments of loss probability.

Some firms currently have the sophisticated tools and experience necessary to effectively model these complex exposures.

Terrorism cover patchy

The global market for terrorism reinsurance can best be described as a patchwork.

On the supply side, reinsurers indicate that they are generally unwilling to take on these huge mega-catastrophic risks. However, they are anxious to respond to their clients' needs and are providing cover in perceived low-risk areas and in sectors with limited exposure.

This intricate quilt pattern is complicated by a variety of government programmes set up to fill the gaps.

On the demand side, our clients have shown little interest in purchasing this protection despite global efforts to ensure its availability. Many independently judge their exposure as minimal, despite terrorism's potentially devastating impact.

Our experience shows that cedants tend not to reinsure these types of risks because they feel that protection is too costly given their relatively low likelihood of loss.

Unimaginable risks

The types of risks we face today are complex in ways that were unimaginable even a decade ago, making it more difficult than ever before to properly identify, assess and prevent potential losses. However, the techniques used to address these complexities are getting better and better.

By accessing the sophisticated tools and specialised market knowledge that is available, cedants can be assured that they are *en route* to effectively addressing and managing all the intricacies of their overall risk picture.

Editorial

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Senior reporter
Marc Jones
Contributing editor
Vic Wyman
Sub-editor
Deborah Shennan
Designer
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

Advertisement sales

Publisher
Michael Blakesley
Senior sales executive
David Kubale
Advertising tel
+44 (0)20 7484 9979
Advertising fax
+44 (0)20 7484 9992

Managing director
James Hanbury
Marketing director
Rory Brown
Marketing manager
Ro Osborne
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 7484 9909
Fax +44 (0)20 7484 9989
Email subs@incisivemedia.com

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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



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