

Data driven

As the January renewals approach, the orders are clear for writers of workers' compensation and life, accident and health risks, says **Kevin Griffiths**. Know your exposure and be prepared and proactive in skilfully negotiating your case in the marketplace



Being prepared and proactive is the mandate in a post-September 11 world in which risks such as workers' compensation and life, accident and health are fully recognised for the potentially catastrophic exposures they have. While there is much talk of the need for cedants to scrutinise the security of reinsurers this renewal season, reinsurers too will be putting cedants under the microscope, seeking to gain a thorough understanding of the company's potential vulnerabilities.

Consequently, in preparing to optimise reinsurance availability and, pricing and decision making, prudent underwriters should be focused on managing accumulations of exposures to both man-made and natural catastrophes, as well as correlations of exposures across multiple lines. To facilitate this, detailed risk data – often drilling down to the buildings in which individual insured's congregate – is needed for occupational exposures.

Even non-occupational writers must consider actively managing accumulations and correlations. While medical and individual life carriers enjoy a natural spread of exposure in their portfolios, it is

not so wide as to negate the possibility of large-scale unexpected losses, particularly in the area of terrorism risk.

Thoroughly understanding portfolio risks is even more urgent as reinsurers that specialise in multiple catastrophe lines will assumingly allocate capital more generously, with more favourable rates and terms, to risks that are quantified and demonstrated to be actively managed in the coming months.

The following discusses these and other issues workers compensation and life, accident and health companies should expect to confront at renewal – and strategies that can position these companies for the most positive reinsurance outcomes.

WORKERS' COMPENSATION

Setting Expectations

Low interest rates, adverse reserve development, escalating medical costs, cost shifting, and the difficult tort environment in certain US jurisdictions are expected to keep pricing firm for working layer workers' compensation reinsurance. However, new capacity, improved accident year results and a saturated market for catastrophe cover might temper firming slightly.

With workers' compensation catastrophe capacity currently exceeding pre-September 11 levels, continued price softening would normally be expected for these layers. However, many lead workers' compensation catastrophe markets also write property and it is uncertain

whether the recent large-scale hurricane losses will affect their cost of capital and, therefore, influence renewal pricing.

One can safely forecast that pricing will remain driven by geographic location and coverage, and close attention will be given to concentrations of exposure within earthquake-exposed regions and urban centres where terror risk is perceived to be greater.

Separate from the Tria coverage provided by the federal government, the third party reinsurance market for workers' compensation terrorism coverage continues to develop. Non-Tria certified acts, excluding nuclear, biological and chemical (NBC) perils are generally covered for a nominal, if any, additional charge. More reinsurers are providing Tria-certified cover, including and excluding NBC coverage and pricing has been decreasing, albeit from a lofty base. Barring unforeseen losses, this trend should continue.

Terrorism reinsurance capacity is limited and may be further taxed by the heightened demand expected in 2005. Cedants' retentions under Tria increase each year, as a

percentage of written commercial premiums and renewal of Tria at year-end 2005 is uncertain. These factors may influence some cedants to 'reserve' capacity now.

Optimising Renewals

Workers' compensation insurers will be expected to have detailed street and building-level knowledge of portfolio exposures, though the workers' compensation industry is generally far along in terms of collecting detailed exposure data. Those using this data to demonstrate active management of accumulations will be best positioned to obtain the capacity they need at the most favourable rates, terms and conditions at renewal.

Detailed data and information should be provided early in the renewal process to allow brokers sufficient time to provide analytical support prior to going to market. Companies should also consider setting clear priorities for desired programme characteristics, such as security, market relationships, price, terms and conditions, as well as any preference for US, Bermuda or London markets.

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ACCIDENT

Setting Expectations

Terrorism will be the major issue during accident reinsurance negotiations. In the London market, most markets will write war and terrorism, including NBC perils though, some will limit exposure in high risk regions (e.g. New York, London). Limited appetite and capacity exists for NBC, but some markets will write it if pricing is considered favourable. However, NBC capacity is allocated at the discretion of senior management, so placing large programmes remains difficult.

In the US, companies can generally obtain full terrorism coverage, including NBC, albeit for a significant price.

Canadian cedants have shown an interest in full terrorism coverage, but generally do not want to pay the price quoted by reinsurers for this exposure. Primary writers and reinsurers differ in their perception of the magnitude of terrorism exposure and the value of covering it.

One Canadian reinsurer is limiting terrorism coverage to events occurring within Canada only. Thus, if an event occurring in the US impacts one of their Canadian treaties, the losses would not be covered. This is a significant issue as the majority

of Canada's population (and insured values) are within 100 miles of the US border.

The following discusses other developments anticipated in accident reinsurance by geographic region:

UK

Overall, rates are expected to remain flat, although downward pressure may be exerted on reinsurance pricing for certain programmes. The UK company market will be more aggressive and flexible on pricing, terms and conditions as its appetite for personal accident (PA) business increases. Lloyd's may remain somewhat less aggressive in pricing, but generally tends to follow favourable terms on desirable programmes.

Along with war and terrorism, exposure to California earthquake will be a major influencer of PA catastrophe pricing and participation since many markets carry this exposure on the property side. Approximately 12 UK company markets and 13 Lloyd's Syndicates now write PA catastrophe reinsurance, with available per programme capacity of about \$100 million from each sector.

Increasing amounts of capacity are being allocated to facultative

reinsurance and surplus lines where markets can track exposures more effectively.

US

Rates for accident reinsurance have generally been steady, although some cedants, particularly those with poor loss experience, may see increases at renewal. Expect no more than one reinstatement on catastrophe business. Cedants continue to explore separately reinsuring the accidental death portion of group and individual life books of business with carve out products.

Canada

Rates, terms and conditions are expected to change little at renewal. Pricing for life catastrophe treaties may rise modestly (excluding NBC) for smaller companies with purely Canadian exposures. Larger companies may face a higher rate of increase, depending on their share of the group market and the spread of risk in their international portfolios.

Volatility may be greatest for Canadian-based exposures in layers below \$50m, where rates may rise more significantly. Canadian life insurers are not fully convinced of the benefits of life catastrophe reinsurance; most carry sizeable retentions.



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Optimising Renewal

In all regions, urban accumulation modelling of terror risk is essential to help markets and cedants reach agreement on fair pricing for the peril. It is particularly important for accident exposures in major North American and European cities. Providing detailed location information on portfolio exposure, including street and building-specific data, is quickly becoming the norm for exposed accident risks.

Reinsurers will also be looking for information on underwriting changes that could favourably impact future results. In Canada, initiation of data collection, modelling and analytics will improve understanding of lower layer exposure and enable companies and reinsurers to develop a common understanding of the value of reinsurance cover.

LIFE AND ANNUITY

Setting Expectations

Companies placing programmes will find a life and annuity reinsurance market in transition. Reduced capacity is expected in the primary reinsurance and retrocessional markets as mergers, acquisitions and run-off companies have left fewer players. Also per-life capacity has decreased as reinsurers have become wary of larger lines. At the time of writing there is one new confirmed entrant to the life and annuity reinsurance market. Rumours of other new entrants persist.

In the US and UK, tightening of treaty language is evident, primarily in clauses related to negligent underwriting and the reinsurer's right to deny claims or increase prices if it disagrees with underwriting or believes blocks of business are not compliant with underwriting

guidelines. However, these changes may be communicated by reinsurers as unilateral, but this is not always the case.

Prices appear to be increasing significantly on coinsured products. In addition, reinsurers are concerned about mortality falling short of expected levels, primarily in preferred and super-preferred classes, and are focusing on this during underwriting audits.

Managing capital remains a challenge in the life industry, particularly as it relates to reserving requirements (XXX, AXXX) and certain annuity risks, primarily non-US longevity exposures.

As pricing hardens, and terms and conditions become more onerous, more companies will explore stop loss/spread loss reinsurance options to replace or supplement quota share reinsurance.

Health insurance premiums are increasing at a rate that far outpaces the Consumer Price Index and average wage increases



Optimising Renewals

To support the most positive programme outcomes, despite hardening conditions, individual life carriers should develop a better understanding of their portfolio-level exposure and approach multiple markets with detailed data and analytics. Companies should also consider initiating reinsurance reviews now, before prices increase further. A broker that has broad, proven market knowledge and relationships is best situated to help a company generate the information and analytics required – and ensure that a company's exposure is assessed on its own merits, not automatically subject to tightening language and rate increases.

GROUP DISABILITY

Setting Expectations

A major disconnect exists between what primary disability markets need and what traditional reinsurers are currently willing to provide. Growth of the US group disability market remains slow, with most short and long-term disability sales coming from takeover business. Low customer

awareness of disability products and the failure of distributors to access new buyers have made organic growth difficult.

Economic trends exacerbate the challenges for primary companies. Health insurance premiums are increasing at a rate that far outpaces the Consumer Price Index and average wage increases, making it difficult for disability carriers to compete with medical products for limited employee benefit dollars. The current environment of increased unemployment and lacklustre consumer confidence typically spurs adverse claims experience. Low interest rates and investment income are hurting long-term disability carriers heavily reliant on investment income. These trends, coupled with the aging of America and a shrinking labour pool, puts substantial pressure on the profitability of group disability writers.

Primary carriers are seeking creative reinsurance solutions – from swing plans to structured reinsurance products, to reserve buyouts – and traditional reinsurance markets have been slow to respond. Primary insurers

also want financial stability, reasonable prices and value-added services. Many request protracted rate guarantees, guaranteed service days, and web-based administration.

However, reinsurers are burdened by many of the same economic and market pressures as the primary writers. RoE is expected to remain in the mid single-digits for the foreseeable future and both lead and retrocessional disability reinsurance capacity is retracting. While declining retrocessional capacity is a serious issue, it may enable the reinsurers remaining in the marketplace to firm up pricing and risk management requirements.

Consequently, rates, terms, and conditions offered by incumbent disability reinsurance markets may harden in 2005 and beyond. Traditional group disability reinsurance markets will probably be conservative in managing their in-force books of business.

Optimising Renewals

Diversifying disability reinsurance programmes with both traditional and new/emerging markets is likely to prove beneficial at

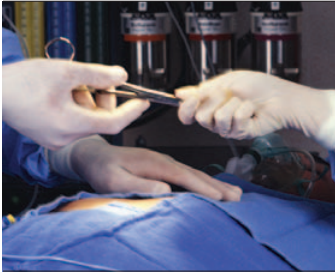
renewal. Negotiations that include presentation of detailed data and provides reinsurers with a clear picture of portfolio exposures will better position a carrier, optimise rates, terms, and conditions, as well as available value-added

pace than in the recent past. The frequency of claims above \$1m has levelled off after pronounced increases from 2000 to 2001 and 2002 to 2003.

Large losses continue to be driven by neonatal treatments,

Optimising Renewals

A company should be prepared to present a comprehensive package of information detailing operations, care management capabilities, and any programme improvements that may allow



Large losses continue to be driven by neonatal treatments, transplants and intravenous prescription drug therapies

services, such as actuarial, claims management, underwriting, product development, research and training.

MEDICAL

Portfolio Medical XOL Programmes Setting Expectations

Low barriers to market entry, coupled with increased pressure on specific and aggregate stop-loss margins, has reinsurers actively seeking new Portfolio Medical excess-of-loss (XOL) opportunities. Incumbent reinsurers are expected to seek rate increases in 2005, but the anticipated rise in competition may mitigate any rate increases. The competitive environment may also afford an opportunity for cedants to improve profit commission, swing rate and corridor terms and conditions.

Rates for layers excess of \$1m will probably continue upward, albeit at a slightly more moderate

transplants and intravenous prescription drug therapies and reinsurers will be aggressive in assessing a company's ability to manage the costs of these claims. Some will provide catastrophic claim management services to help. Reinsurers will want to identify known claimants at the point of sale and re-underwrite these risks at higher attachments or rates.

Pricing mechanics will be scrutinised as reinsurers question rate adequacy on portfolio medical excess over specific/aggregate stop-loss contracts. Reinsurers will attempt to capture premium or individual self-insured retention for known claimants medically underwritten by cedants to garner the appropriate share of an impaired risk. Several reinsurers will write and issue their own contract wordings and may appear to offer little flexibility on these wordings.

reinsurers to judge their programme more favourably. In addition, anticipate questions about changes in business mix (by state, class, size of account, etc.).

Many reinsurers use a model to develop a manual rate. Understanding the factors that drive the modelling calculations – such as inpatient hospital days, in/out network use, and PPO efficiency ratings – and how reinsurers blend the manual rate with trended burning costs will be valuable in managing rate negotiations.

Brokers that specialise in these types of reinsurance can assist companies in preparing appropriate data and analytics for renewal presentation and negotiating favourable wordings and rates.

First Dollar Medical

Setting Expectations

The two leading first dollar medical reinsurers appear to be optimistic about their current

relationships and under less financial pressure than their peers in the specific/aggregate stop-loss market. They will likely remain highly selective in utilising capacity and seek carriers that partner with quality programme administrators to pay claims and manage marketing, medical underwriting, utilisation management/case management, and a solid PPO network.

Other reinsurers may seek first dollar programmes to diversify their portfolios heavily weighted with stop-loss business. These reinsurers may be interested in diversifying with other first dollar opportunities, such as short term medical, mini-med and Health Savings Accounts programmes as well as Medicare and Medicaid demonstration projects.

Reinsurers may continue to attempt to provide risk-sharing structures like slides and corridors.

Optimising Renewals

Reinsurers will probably want the programmes they support to be administratively advanced, have medical underwriting competency, and a solid distribution plan. Cognisant that many PPO networks lag behind their peers, reinsurers will also seek evidence of a quality network.

A cedant should be prepared to provide prospective reinsurers with a detailed, analytical plan for their operations for at least the next two years. Proof of innovative plan designs that give a programme a competitive advantage in attracting new risks – and thus maintaining a healthy pool of risks



– is important. A company should also show that its programme administrator operates in states with reasonably positive regulatory climates for individual and small group products.

While managing accumulations is probably not as urgent for medical exposures as it is for occupational risks, the potential for large-scale losses resulting from events such as a terrorist attack makes it prudent for companies to track and understand potential vulnerabilities in this area.

Finally, plan to meet with current and potential reinsurers throughout the next year to discuss programme ideas, especially ways to improve areas the programme administrator deems weak.

A FINAL NOTE

Efforts of workers' compensation, life, accident and health companies to understand and quantify exposures will continue to advance. Sound risk management, reinsurers, and reinsurance decisions will require it. Fortunately,

the tools to support in-depth knowledge and analysis of these exposures, virtually nonexistent before September 11 2001, have become robust for carriers with the requisite data available.

Guy Carpenter works closely with workers' compensation, life, accident and health clients to help them better understand their exposures so that they can make better-informed underwriting and portfolio management decisions. As a result, risk management tools like accumulation mapping and urban accumulation analysis are now widely used and new tools and techniques are continually being developed and applied.

By being resolute in understanding and tracking vulnerability, and deploying the best tools available to manage accumulations of exposure, insurers can make informed risk and reinsurance management decisions. They will also be better positioned for positive outcomes this renewal season – and for peace of mind in the years to come.