Matters of concern

Sal Zaffino examines the problems facing US casualty reinsurers.

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

The casualty reinsurance market in the US has seen turbulent times in recent years, and there has been wide variation in conditions among the various casualty segments and lines of business.

In the workers compensation area, there is ample capacity in the catastrophe layers and an unstable market in the per person exposed layers, which are typically below $5m. The average severity of both the medical and indemnity portions of workers compensation claims has increased. This should not have a major impact on workers compensation catastrophe business, where capacity of more that $500m is currently available, but it certainly affects reinsurance layers that are per person exposed.

Consequently, reinsurers have reduced their overall workers compensation capacity in the layers below $5m, maintaining that associated loss costs are very difficult to predict and have a high level of uncertainty for many years. Rather than deploy capital in these layers, reinsurers are supporting workers compensation catastrophe business or other reinsurance lines of business, which they feel produce better returns. As the results of prior accident years begin to stabilise and margins even out, additional reinsurance capacity should become available in these layers, although this may take six to 18 months.

Key drivers

The key drivers of workers compensation rates and availability continue to be Californian exposures. Heavy concentrations of employees in urban areas may also influence price. The overall cost of workers compensation catastrophe is down about 10% in 2003, with larger decreases in regional business. Further reductions are anticipated for 2004.

The professional liability reinsurance market has stabilised, although directors' and officers' (D&O) aggregations and a shortage of capacity could occur if reinsurers reduce their participation at signs of a softening market. The D&O liability reinsurance market has seen massive changes in the past few years. The key driver of current market conditions is the increase in Securities and Exchange Commission class action lawsuits, the settlement values of which now average $23.3m. With an estimated 1200 open claims still in the courts, future loss potential is significant.

In response, many reinsurers have decreased their overall limits and are controlling their aggregates by participating in fewer ceding company portfolios.

Reinsurance terms remain steady for existing clients but have tightened for start-up companies. Pricing has increased dramatically. Many ceding companies are looking to increase net retentions and are pursuing more leveraged treaty structures.

The medical professional liability (MPL) reinsurance line remains under stress. The average MPL jury award has increased more than 400% in the past ten years, and the pricing and availability of this coverage have shown extreme fluctuations.

The 1 January 2003 renewals saw double to triple-digit rate increases and restrictions in terms and coverages. As the underlying business improves, reinsurance terms may ratchet down accordingly; however, this could take some time.

Fluctuations in this market have led to an increased interest in alternative reinsurance products. The size of the alternative medical professional liability market — which includes such products as captives and trust funds — is estimated to be almost 70% as large as the traditional marketplace.

Several new players entered the medical professional market on or around 1 July 2002, with most carriers emphasising excess hospital professional liability business as a target class, due to ease of market entry and high premiums per transaction. However, the increased competition has started to slow the rate of increase for the excess layers.

The errors and omissions (E&O) reinsurance market is much more diverse than other professional liability reinsurance lines, and a definite segmentation exists based on the size of the exposures in the treaty. Rate increases have been in the 10–50% range, class dependent, which lag behind those for D&O and MPL coverages. For treaties covering large accounts or higher hazard classes, terms have remained steady, but available capacity has shrunk. If historical results deteriorate, adjustments will continue to be made.

For pro rata treaties covering smaller accounts, ceding companies are seeking commissions that allow them to adequately cover their expenses. Other terms and conditions have remained largely unchanged. There is not the sort of capacity crunch in this area as there is for larger accounts such as large law and accounting firms.

Bermuda's role

Bermuda has played a key role in providing workers compensation catastrophe capacity, and in 2003 some Bermuda markets began considering layers below the catastrophe level. In addition, Bermuda actively participated in medical malpractice placements during 2003 and began providing support on D&O business. As Bermuda reinsurers continue to expand their role in the global market and look for diversification, casualty business will possibly become a more meaningful percentage of their portfolio.

Many distressed lines of casualty business have had historically poor financial results and, as outlined above, although they are improving, these segments still have significant obstacles to overcome. For example, certain lines face capacity issues and uncertainty in predicting future results, which has led to a spread between asking and offered pricing, and to variations in terms and conditions. Consequently, we expect that the US casualty reinsurance segment will face numerous challenges in 2004.

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