

The year ahead

Kevin Griffiths examines the prospects across the UK, Continental European and Asian casualty markets over the next 12 months

Rates on motor programmes continue to trend upwards

GENERAL CASUALTY: UK AND CONTINENTAL EUROPE

UK: Conditions in the underlying insurance market for general third party and employers' liability remain soft across all sectors. Small- to medium-sized risks (SME) have seen a number of new carriers and re-entry of the composites. Larger 'target risks' and international risks are also under pressure, both from insurer and placing broker competition.

Loss experience remains benign, with insurers and reinsurers both reporting excellent results. While original rates are an integral part of the rating process, the accumulative rate reductions should be considered against the background of the extreme rate increases of 2002 and 2003. Many risks, particularly the heavier industrial sectors, saw rate increases of 200% or 300%. Employers' liability experienced similar rate increases, with newspapers regularly reporting on the 'liability crisis' in UK industry and the impact that these rate increases were having on the industry.

We do not anticipate a reverse of this trend in 2008. Cedants should benefit from their individual claims experience, which should

counteract rating indices and higher target loss ratios.

While reinsurance capacity has increased, this is not as significant in this market cycle because of the stringent acceptance criteria applied to reinsurers by many insurers. This should also be considered in the light of higher retentions and the increased use of internal/captive arrangements.

In general, rates on UK motor excess of loss programmes continue to trend upwards, although there have been recent occurrences of below-trend or even flat renewals. However, such renewals are usually driven by circumstances specific to the cedant's portfolio.

The incidence of Periodical Payments Orders (PPO) being awarded remains very low, with both sides of most personal injury cases preferring to settle out of court. However, on the few PPOs that have been awarded, the evidence for a likely shift to earnings-based inflationary uplifts has strengthened.

In two recent cases, *Flora vs Wakom (Heathrow) Ltd.* and *Thompson vs Tameside and Glossop*, the courts determined that to base a PPO on movements in the Retail Price Index would lead to under-compensation of accident

victims. Many commentators believe that this will increase the number of plaintiffs who opt for a periodical payment.

In *Flora*, the Court of Appeal determined that the Average Earnings Index should be used as the basis for the PPO calculation. In *Thompson*, the High Court ruled that future care costs should be indexed by the Average Earnings of Home Carers (ASHE 6115). As both of these earnings indices have historically risen faster than retail prices (and are expected to do so in the future), the likely cost of personal injury claims will be increased significantly (particularly on PPOs running for 20 to 30 years).

CONTINENTAL EUROPE:

Renewal rates at January 1, 2007 were stable for general third party programmes. However, since underlying insurance market rates are softening in most areas, this suggests that reinsurers are following prices down. Original rates are nevertheless perceived as continuing to generate a reasonable level of profit, after the strong rating corrections between 2003 and 2005. Greater competition can be expected going forward into 2008 due to new entrants into the primary and excess insurance marketplace being



attracted by the current profitable results.

Motor reinsurance unlimited layers in Europe generally renewed at unchanged rates through 2007, with the exception of France, where further rating increases have been required to compensate for above-average inflation of bodily injury awards. Working-level XOL layers have continued to witness rate increases in line

hurricanes, driven by the desire of reinsurers to diversify their property exposures. While this has not happened in either the UK or Continental Europe, the market has remained stable, with the majority of programmes staying with renewal markets. However, reinsurance capacity for known difficult classes such as pharmaceuticals remains very limited.

- Target risks – original coverage in excess of \$250m
- Asbestos
- US domiciled exposures
- Coverage extensions: E&O, D&O, financial loss.

As in past years, reinsurers vary with regard to required retention levels. Some reinsurers seek premium to limit imbalance and need to participate on a mix of low and high volatility layers, while others are prepared to participate in volatility layers in isolation. A prior understanding of preferences and potential limitations is vital for success.

CONTINENTAL EUROPE:

Reinsurers remain concerned about issues surrounding the tail of liability classes. In some cases in France, reinsurers are taking steps to limit their exposure to IBNR on bodily injury losses under working-level excess of loss layers; cedants here are being encouraged to agree to a full and final commutation after three years in return for a profit commission.

In pricing liability programmes, in addition to the special issues referred to above, we anticipate that reinsurers will focus once more on:



with loss experience, and some cedants are absorbing these layers into their retention in order to reduce reinsurance costs.

CAPACITY

Two years ago, there was speculation that additional capacity might flow into casualty lines after the 2005 US

SPECIAL ISSUES

UK: The usual issues remain for general third party programmes:

- Terrorism, although the primary market has either deleted the exclusion or has opted to remain silent
- Pharmaceuticals – ‘top 75’
- Blood products

- Retention levels
- Original rate indices
- Delegated underwriting authority
- Target loss ratios.

Motor programmes are likely to see the biggest general increases, largely driven by inflation in bodily injury awards.

PROFESSIONAL LIABILITY

UK: Renewals have remained relatively flat during 2007, however, reinsurers are seeing an increased frequency of claims and a deterioration of prior year results. Despite the claims-made nature of the original policies, the ‘tail’ remains, and this class continues to be viewed with caution.

Gross results for insurers tend to be more favourable than net loss ratios, with many claims falling within retentions and limited effective systemic loss reinsurance solutions. Sub-prime has drawn renewed attention to ‘clash/systemic’ loss protections, with current reinsurers immediately advising that they do not consider this to be an ‘event.’

For 2008 we do not anticipate increased softening, although reinsurers will of course continue to view each case on its merits.

CONTINENTAL EUROPE:

For the second year in a row, primary D&O insurance rates are experiencing overall average rate decreases of 10% to 20%,

As insurers look for ways to differentiate themselves from other carriers, expect reinsurers to come under pressure to support the broader programmes being introduced by their cedants

with greater reductions in the middle market and average reductions on larger risks in the region of 10%. There are many new entrants into the D&O market, as established US

domiciled D&O markets look to geographically diversify their portfolios. The influx of new entrants is not only influencing pricing, but is also introducing coverage enhancements, such as reduced deductibles and no more co-insurance clause for security claims.

Other coverage areas where there has been some movement is in the Extended Reporting Periods, which are being further lengthened or in specific cases are being given on an unlimited basis. Additionally, D&O has become particularly competitive as insurance markets try to move their attachments up and down the programme in an effort to find the optimum risk versus reward scenario.

SPECIAL ISSUES

The effect of US sub-prime lending on European risks is a frequently discussed topic. While it is widely thought that most of the sub-prime exposure will be confined to the US, several European financial institutions have had to suspend a handful of investment funds due to the sub-prime crisis, and it is possible that more exposure could surface.

As a result, European insurers and reinsurers are ▶

monitoring the situation carefully. Additionally, the sub-prime issue has led to a liquidity crunch which has had a direct effect on some banks, notably Northern Rock. It seems unlikely that there will be more examples of European banks like Northern Rock or any professional indemnity contagion claims or D&O claims arising from such impact, but it remains unknown at this time.

and a downgrade clause which may result in reallocation of premium and attachment point for excess insurers in the event of a downgrade of another insurer. Reinsurers have been reluctant to accept cessions of such policies to treaties they support, and indeed there are insurers who suggest that manuscripts policies for individual risks may be the only proper way to capture the spirit of the Basel II Accord.

Reinsurance terms and conditions are softening, but reinsurers are limiting the reductions. D&O programmes remain mostly on a quota share basis, but the larger carriers are showing some interest in moving to an XOL structure, if not already pursuing an XOL structure. Pressure is on ceding commissions, as original acquisition costs are creeping up.

CAPACITY

Reinsurance capacity for professional lines has been very stable. No new players have entered the market, and to some extent, this has allowed reinsurers to maintain reinsurance terms and conditions.

We expect to see a continuing trend of reduced price and expanded coverage in 2008. As insurers look for ways to differentiate themselves from other carriers, we expect reinsurers to come under pressure to support the broader programmes being introduced by their cedants. Insurers are asking for increased capacity, and we expect certain main reinsurers to offer this additional coverage on a very selective and restrictive basis. In some instances demand for capacity will outweigh the supply.



European re/insurers are closely monitoring the Northern Rock crisis in the UK

Basel II 'compliant' policies are starting to be introduced in Europe, particularly in France, where regulators seem to have embraced the Basel II recommendations more easily than other jurisdictions. Up to this point, Basel II policies have some terms and conditions that are not found in most policies, such as 24-month durations

Commercial professional indemnity has been lagging behind D&O and [FIPI] in terms of rate reduction over the last few years. Several areas that saw rate reductions in past years, such as France and Nordic countries, have stabilised. Large accounts and UK risks have seen reductions of 5% to 10% in 2007.

ASIA PACIFIC CASUALTY

Despite the growing interest in Asian business, there has been no significant change in the existing reinsurance panel, although Asian Capital Re (domiciled in Singapore) has been welcomed by many Asian clients as an Asian alternative to the mainly overseas reinsurance markets.

While Japan – still the major casualty market in Asia – has been stagnant for years, China and India have grown at a breathtaking pace. Abolition of tariffs, change of law (such as the introduction of the Passengers' Liability Regulation in China) and growing wealth continue to stimulate the demand for protection.

The noticeable trend to shift to non-proportional structures may provide an easier path for entry for the London market, which is traditionally less amendable to proportional treaties.

To the extent that the equity markets remain bullish, financial lines will likely continue to be of major interest. Many domestic carriers indicate a desire to enter this line of business, which previously was the domain of overseas insurers.

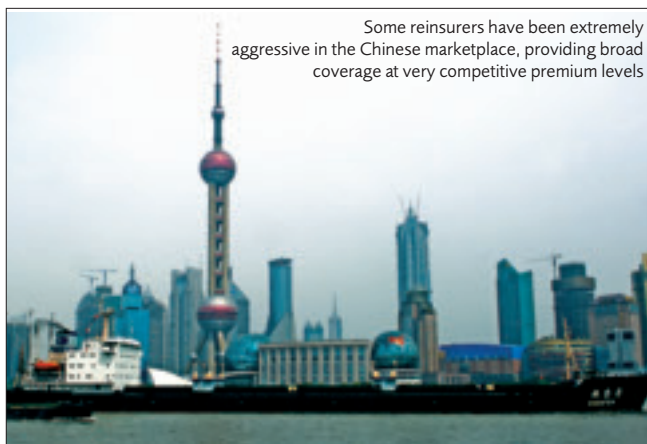
Rates in Australia continue to deteriorate, forcing insurers

to look for attractive business elsewhere in the Asia/Pacific region.

PRICING

In general, liability programmes have been renewed at stable or slightly increased rates in 2007 (up 5% to 10%). Subject to no drastic market changes, this trend will likely continue in 2008. Perhaps as a sign of strong commitment to emerging markets, some reinsurers have

cover for overseas listings was mainly the domain of a limited number of overseas insurers. To the extent that the stock market continues to perform well, and if penetration remains at low levels, the combination should constitute a huge business opportunity. The traditionally strong local business relationship of the domestic insurer may prove to be a business advantage over foreign insurers. However,



Some reinsurers have been extremely aggressive in the Chinese marketplace, providing broad coverage at very competitive premium levels

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LIABILITY IN CHINA

Overseas stock markets have lost their allure for China's leading companies, the main buyers of D&O, due to high liquidity in the region. D&O

foreign carriers may be able to enter the domestic market indirectly by way of strategic alliance with a local carrier. This concept previously has been successful in Japan and Korea. ®

Kevin Griffiths is leader of Guy Carpenter's global casualty specialty practice.