

# Dreams and nightmares

**David Spiller** examines the main factors – some positive and some potentially negative - that will have an influence on the upcoming end-of-year renewals discussions



Shares plunged around the globe following the US sub-prime crisis. Will D&O and E&O insurers be impacted?

As summer ends, insurance cedants have their own version of back-to-school jitters to contend with. Many will be wondering what is really in store for their companies as they contemplate market conditions for January renewals?

Collectively, their sweetest dream would no doubt be of smooth sailing for the remainder of 2007. There would be no major catastrophes or other claim or asset surprises.

Following record profits last year, earnings of reinsurers are declining along with rates on most major lines of business. But earnings are still equal to or exceeding market expectations. There is nothing like beating analyst forecasts to put reinsurers in a jolly mood.

One great feature of the market this year was the abundance of capital

readily available to support traditional and non-traditional solutions. Cedants' fervent wish is that this condition persists into 2008.

## AND THEN THERE ARE THE NIGHTMARES...

It's September, so it's storm-watch time. It was a relatively uneventful season in 2006, when no hurricane made landfall in the western hemisphere and there was limited typhoon action in the Pacific. However, insurers are still nervous. We have already had two storms (Hurricane Dean and Hurricane Felix) that reached Category Five status – the highest rating on the Saffir-Simpson scale. This is only the fourth year this has happened since 1950. Meanwhile many believe that the storms and floods that occurred in Europe earlier this year are poor omens for the rest of 2007.

There are also nightmare scenarios that could arise from the global credit crunch. For example, a stock market

collapse could deplete assets of reinsurers, triggering a hard market (memories of the tech bubble in 2000 spring to mind here).

More directly, a severe flight from risk could lead to reduced capital market support for the reinsurance and insurance-linked securities markets.

D&O and E&O insurers and reinsurers are also nervously waiting for the legal storms expected to flow out of the sub-prime mortgage market debacle, and we have yet to see the full impact of this on insurance and reinsurance investments as well.

We could also be surprised by a major insolvency. Adverse economic conditions can expose financial weaknesses, which may not have been apparent in a period of general prosperity.

On a positive note, higher interest rates on corporate and municipal bonds would lead to favourable investment income...softening prices for long-tail business.

## THE REALITY

Reality generally falls somewhere between our optimistic dreams and pessimistic nightmares. One thing is certain: We are a bit smarter and better prepared for many of the worst-case scenarios we could imagine – and that's reason to rest a little easier. Sweet dreams... and here is to an enjoyable Monte Carlo Rendez-Vous.



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## COMING UP TOMORROW

TIM GARDNER reviews the global property market.