The curse of choice

Peter Zaffino argues that just because our industry is cyclical, it doesn't mean that we should assume that the successful strategies of the past will be our best option for today

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Today, we have choices. The current market requires that we make informed decisions about risk and capital management issues that simply would not arise if conditions were different. The ubiquity of capital makes retention attractive, but lower pricing can entice (re)insurers to transfer risk and allow unencumbered capital to support aggressive growth programs. Internal initiatives that require substantial investment and can lead to greater efficiency start to garner some attention, and merger and acquisition activity can become more common.

The scope of options

Decision-making has been considerably less complex over the past few years. In the wake of Hurricanes *Katrina*, *Rita* and *Wilma*, risk-bearers sought the best pricing for sufficient risk transfer and tried to negotiate the best terms possible. Profitability came from underwriting along with investment gains. The scope of options was limited by the realities of the market; even difficult decisions were limited by the market itself. Instead of deciding whether to transfer risk, (re)insurers considered how much to transfer and at what price. The questions that (re)insurance executives faced tended to deal with the mechanics of having only a limited set of options.

When the market became much more competitive, everything changed. (Re)insurers had the option of increasing retentions and using their own balance sheets instead of paying others to assume risk. They could transfer risk, as softer conditions tend to lead to favourable pricing. This approach can be advantageous when a firm wants to make additional capital available for strategic purposes, such as share buybacks or investment in internal initiatives.

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With a daunting array of choices, some (re)insurers have a tendency to rely on practices that worked in previous market downturns. Some return capital to investors instead of using it to support diversification or growth. Others reduce reinsurance purchasing by increasing their net retentions. Quite simply, some experienced risk bearers tend to repeat familiar or comfortable strategies, while potentially missing other available opportunities.

A new strategy may be more appropriate for current market conditions, possibly yielding even greater returns than had been experienced in the past. The options that align closest to a company's objectives should receive the most consideration. This can entail a leap into the unknown, particularly for firms that may be focusing on a subset of familiar choices when the market softens. A better answer, for instance, may be diversification, particularly by entering into new business segments. It can be frightening but it can lead to substantial returns.

The combinations are endless and the array of options can be even more confusing. The competitive market dilemma results as much from the countless available alternatives as it does from basic market dynamics. Competitive market conditions underscore the need to stay abreast of the latest trends, the latest technologies, the latest entrants in the global (re)insurance arena. In a soft market, competition can be fierce. All are looking for an advantage, and who you collaborate with could make a significant difference.

Of course, brokers provide a breadth of knowledge and services unique to our industry and can be an independent, trusted advisor to help companies navigate competitive and difficult market choices. But even brokers are subject to market conditions, and selecting the right broker becomes simply another dilemma, though one with profound implications. The brokers that have made investments over the last market cycle are providing new value-added services to protect and broaden client relationships while developing new business opportunities. Specialty expertise, modeling and actuarial services, portfolio management and risk management technologies available from intermediaries all can be applied to decisions about retention, risk transfer, portfolio optimisation and even acquisition targeting.

The far future

Navigating choice is not easy. Trading the strategic opportunity for the familiar tactic can have an impact that lingers for decades. The effect of a planned merger, for example, will be felt far into the future. An unexpected catastrophic event could make market capacity constrict, leading to the possibility of capital shortfalls and high costs of capital.

All choices, of course, could have positive or negative outcomes. It is best to beware of those who over-promise and under-deliver. Consider carefully before engaging partners. Reach out to trusted advisors to thoroughly research each decision. And before simply pursuing the usual, fully evaluate your alternatives and find the opportunities that exist in a more competitive market. Choices may complicate decision-making, but they do offer more possibilities for growth. With effective advice and a clear understanding of the alternatives, a market downturn can present opportunities for growth. re