



Slugging it out

The US is persevering through the renewals gauntlet despite hardening rates and global economic turmoil, writes **Andy Marcell**.



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From the end of April through until July, the (re)insurance industry steps through a rapid succession of renewals, leaving little time to turn lessons from one into an action plan for the next. The first day of April is behind us and the Florida renewal has nearly arrived, which will shape worldwide market conditions for 1 July, 2009. We are halfway through this annual renewals gauntlet yet the continued push forward can obscure the considerable body of knowledge that our industry has accumulated.

For the US market, reinsurance rates increased on 1 April reflecting the continuation of a trend that began three months earlier. Meanwhile, national programmes sustained price increases of 10% to 14% on a risk-adjusted basis and regional programmes varied at 1 April largely because of the perils covered and programme-specific loss histories.

For everyone, however, capacity was a concern, particularly given the depletion of reinsurer capital over the past year.

Costly

Latest estimates put the amount lost at approximately 25%, with cedents hit harder than markets as retentions increased through 2007 and the first half of 2008. Financial

market turbulence also continues, which threatens further erosion.

Reinsurance rate increases were consistent with those at the 1 January renewal, suggesting that the challenges faced at the beginning of the year have persisted, though they appear not to have deteriorated further. Additionally, competition in the US national market has remained steady. Firm order terms (FOTs) settled at 94.8% of average quotes,

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which is roughly the same threshold as was seen three months earlier. For regional programmes in the northeastern US, where reinsurance rates increased by only 6%

to 8%, discounts from average quotes were more pronounced at an average of between 10% to 12%.

As usual, loss history and the specific perils covered influenced the cost of risk-transfer pricing in the US on 1 April. Though there were differences by region and experience, every cedent had to contend with the implications of a global increase in the cost of capital as a result of the ongoing financial catastrophe. The damage to (re)insurer balance sheets has been impossible to ignore as capacity has become increasingly constrained. Furthermore, some reinsurers had already used capital allocated for transactions other than reinsurance and so

had to cut their renewal lines. Nonetheless, the situation remained stable in April: the erosion of surplus did not accelerate during the first quarter of 2009.

Capital is likely to remain constrained for the balance of this year and these conditions are expected to stretch into 2010 as well. The ultimate determinant will be the extent to which financial markets can find firmer footings this year. Volatility remains high, which imperils balance sheets and could result in capital being degraded further. Yet, if markets grow calmer and lenders and investors open their wallets this year – and there are signs that this might be happening – (re)insurers will be able to access capital more easily and reinsurance rate increases may slow. For US carriers, global financial market activity will have a profound local impact. Also, developments in the United States will have worldwide ramifications.

In the near-term, all eyes are on the Florida renewals. For most of the past year, the nearly universal loss of capital in the (re)insurance industry has led to concerns about the availability of capacity for this unique market. Several factors have been in flux, adding to the uncertainty around Florida pricing and capacity.

The primary concern following the 1 April renewal was what the ultimate structure of the Florida Hurricane Catastrophe Fund (FHCF) would be, as well as whether or not it would purchase its own reinsurance. The answers to these two questions were expected to have a profound impact on cedent decision-making and reinsurance rates. Though a decrease in the Temporary Increase in Coverage Limit (TICL) was not expected to be material, it was unfunded at the time of writing.

Pragmatic approach

Even with the results from Florida imminent, the market is looking ahead to the 1 July, 2009 renewal. The capital situation – barring a drastic shift in market conditions – is unlikely to change over the next month, limiting access to capacity in line with the previous 2009 renewals. Cedents and markets alike will have to refocus efforts on managing the capital that they have, rather than hoping to replenish balance sheets with the ease experienced two years ago. Furthermore, the advantages of entering the market early are likely to be considerable because limited capacity might be consumed before cedents bidding their time are able to address their risk transfer needs.

The lesson at this point in the renewals gauntlet is clear: follow the 2009 trend. Capacity is constrained and rates are moving upward. Using the US experience as a proxy for the rest of the world – particularly with Florida as the mid-point in this triad of reinsurance milestones – cedents should be prepared for an increasing cost in cover, though not drastically so. Knowing the landscape will make your risk management plan more accurate, as well as more effective. 