

# A sense of tranquility

A tumultuous market is beginning to show signs of calm: after more than nine months of financial market volatility – and uncertainty as to reinsurance rates – we are looking back on three relatively stable renewals and a full quarter of financial results. Many forecast the worst last September and now we are seeing that (re)insurers have been able to adapt to a capital-constrained environment. Slowly, earnings are recovering and capital is becoming available – both of which are keeping reinsurance rate increases under control. This is the result, however, of a precarious balance between supply and demand, one that could be disrupted by a shock to the marketplace.

Each of the year's major renewals – 1 January, 1 April and 1 June – was accompanied by calls for rate hikes of 20% or more. Anxiety was abundant as cedents headed into these renewals unsure of where the final cost-to-transfer risk would land. Almost uniformly, these fears did not materialise: the global trend for property-catastrophe reinsurance rates ranged from 10% to 15%, with slight differences driven by programme-specific factors such as loss history, region and line of business. Capital has proved to be available, though not to the extent that it had been a year earlier. Nonetheless, the business of risk transfer was able to proceed as one would expect: price increases were reasonable given the broader market conditions.

Reinsurer balance sheets held the explanation for a year of rate increases that have really only returned risk-transfer pricing

roughly to 2007 levels. The widespread loss of capital that occurred in 2008 did not continue into 2009; even the balance-sheet damage that occurred last year was not comparable to the cash payouts following Hurricanes Katrina, Rita, and Wilma. According to the Guy Carpenter Global Reinsurance Composite, shareholder equity increased 4.6% on aggregate – relative to the fourth quarter of 2008 – suggesting that a sense of stability has taken hold. A rush to optimism, however, would be imprudent. Adjusted for reserve releases and the reclassification and revaluation of securities, shareholder equity is up only 1.4% quarter for quarter. Nothing lost, nothing gained: the market seems reluctant to choose a direction. This is the precarious balance that has caused reinsurance rates to increase without skyrocketing.

Carriers are trying to raise capital though progress has been slow. Conditions have con-



Stable renewals and stronger balance sheets suggest that signs of calm might be returning after a difficult 2008, writes **David Priebe**.

tinued to ease through the second quarter of 2009, with some companies successfully raising debt and equity capital, though it has not been cheap. Consequently, carriers can begin to replenish their balance sheets as long as

of a few large reinsurers, net losses were fairly flat and realised and unrealised investment losses are more favourable. Further, the Global Reinsurance Composite posted an aggregate non-life underwriting profit of 60% for the first quarter of 2009 (year on year). The frequent and severe large per-risk losses at the beginning of 2008 did not occur this year, and reinsurers benefited from the release of prior years' loss reserves.

The earnings upturn suggests that financial markets may be loosening, yet the balance remains tenuous. A severe shock could result in a dramatic market turn, bringing back the pessimistic forecasts of late 2008; another round of negative financial disclosures or an unexpectedly brutal hurricane could lead to calamity. On the other hand, positive results for the second quarter would constitute an implicit vote for the start of a market recovery. In any event, rates are likely to continue to increase by between 10% to 15%, while cedents and markets wait for a definite movement in the market to prevail.

In a month, our attention will turn to Monte Carlo, effectively the kick-off of the next renewal season. It is easy to see the market's direction – as long as nothing happens. Unless there is a stiff breeze from financial markets or the gusts of a hurricane, little is likely to change. Positive developments, if they occur, are likely to be slow and cautious; for now, all is quiet and everyone is watching. 

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they are willing to pay a premium to do so. Widespread capital raising of a magnitude to undo the damage of 2008, however, is extremely unlikely. For the foreseeable future, gains will be modest.

Nonetheless, there are reasons to be optimistic. Though the conditions still exist to push prices higher – particularly because of shriveled investment returns, relative capital scarcity (or the perception of it, at least) and the cost of replenishment capital – it has not happened. Income statements and balance sheets indicate the potential for improvement as well.

## Net losses down

Reinsurer net losses from the first quarter of 2008 to the first quarter of 2009 have shrunk by 86%. The Global Reinsurance Composite's unrealised losses have fallen from \$5.3bn to \$3.2bn for the same period – a favourable turn of 39%. Excluding the distorting effects



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