



(re)insurer balance sheets and, possibly, the view that unrealised losses can be accepted in the short-term until investment values recover without sacrificing market share.

After the initial capital losses – driven by investment asset declines and revisions to Hurricane Ike loss estimates – the bleeding stopped. Efforts to raise capital were mixed in a still-cautious market and it will be some time before the industry returns to pre-financial catastrophe levels of comfort. Nonetheless, the precipitous fall came to an end rather quickly.

Through 2009, supply and demand have been finely balanced. Reinsurers have been able to address cedent risk transfer requirements, albeit at higher but mutually acceptable clearing prices. This new equilibrium has kept reinsurance rates from spiking: the worst fears did not materialise but the capital cushion available at the start of 2008 is gone. If the events that transpired a year ago were visited upon the industry today, the outcome would be much different. Carriers have to make reduced and limited capital fully productive. Every dollar put at risk must be accompanied by careful analysis, as the burden on each to generate returns is greater than it was a year ago. Fortunately, financial markets are showing signs of relief, if not recovery, which should allow (re)insurers more maneuverability as the 1 January 2010 renewal approaches. Carriers can secure debt and equity capital but they will have to pay a premium for it.

If the current tenuous stability persists into 2010, (re)insurers may have the flexibility to explore (and invest in) growth strategies, both to push share prices higher and secure market share. The next important indication will come at the 1 January 2010 renewal, with the direction of reinsurance rates signaling the characteristics of the industry for the year to follow.

As experience has proved, an unexpected turn of events could change the market quickly and drastically and risk-bearers must remain vigilant as they analyse risk and deploy their capital. There is no substitute for disciplined risk and capital management, especially because balance sheets will take a while to return to robust 2007 and early -2008 levels. Successful (re)insurers will maximise the productivity of the capital they have and position themselves for the wide range of outcomes we now know to be possible. re

The events of the last year caused drastic change in the outlook for reinsurance. **Peter Zaffino** predicts that the successful (re)insurers in 2010 will be those prepared for all possible outcomes.

This time last year, the reinsurance market was vastly different. A financial catastrophe and major hurricane occurred and changed the way (re)insurers viewed risk. As both events receded, our industry was left with profound uncertainty. More than being concerned about the direction of reinsurance rates at the 1 January 2009 renewal, carriers worried that a widespread capital shortage was imminent, impairing their abilities to assume and transfer risks. Despite the severity of the financial and natural catastrophes, the reinsurance market proceeded in an orderly fashion, with property-catastrophe rates up 10% to 15% on average and other segments not significantly impacted.

While we are still working through the effects of what was witnessed a year ago, it is clear that the industry has persevered through a difficult period. As long as we learn from the lessons of the past year, the discipline of risk management will continue to move forward.

From January to July, reinsurance rate increases relative to 2008 were consistent. As mentioned, pricing was up 10% 15% on average for property-catastrophe lines of business, reflecting an underlying stability in the market. Without exception, capital was not as abundant in 2009 as it was in 2008, as much of the 2009 excess was used to absorb the shocks of last September. The market learned that, despite some alarmist claims leading up to the January renewal,

capacity was sufficient to meet most cedents' needs. There were pockets of capacity shortage that led to substantial price increases but these cases had specific loss history or exposure issues that were more severe compared to the rest of the market.

The reinsurance rate increases of 2009 should be kept in perspective. The net effect of the price change was a return almost to 2007 levels. While the capital lost by the industry was substantial – approximately 18% to 20% – the effect was painful rather than devastating. The potency of Hurricane Ike and the financial catastrophe are beyond dispute but they did not completely disrupt the reinsurance market. Given the capital positions at the beginning of 2008, the cost of the two catastrophes was actually manageable. At the peak of the crisis in October and November 2008, when financial markets effectively closed, reinsurers were still able to supply contingent capital.

### Balance

The consistency of rate increases from January to July this year, however, suggests an evenness that few expected a year ago. In theory, substantially reduced investment income, the reduction of reserve releases and worsening accident year loss results should support price increases and lead to an underwriting-led recovery. The underlying reason for equilibrium appears to be the stabilisation of



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### 40 years of major reinsurance events

**April 1977:** Grundy, a town in the US state of Virginia, experienced a major flood that caused approximately \$15m in damages to 228 residential and commercial structures.