

THE ReBrief

THE REVIEW REPORTS FROM THE BADEN-BADEN MEETING 2006



INSIDE

UNDERPRICING OF US OFFSHORE ENERGY IN 2005 HAS DIVIDED THE INDUSTRY OVER ITS VALUE GOING FORWARD

Industry split over energy

Opinions were divided over the value of the US offshore energy market at the Baden-Baden meeting this year.

While Endurance Worldwide announced its departure from the sector following bad experiences with data provision, reinsurance broker Cooper Gay said the pricing problems of the 2005 hurricane season had now been resolved, and saw no fundamental reasons for players to withdraw.

"Under the process of portfolio review post-KRW season, we are taking a look at each line we write and trying to decide on the best opportunities in each type of business," said Dan Izard, Endurance Worldwide CEO.

"We like marine business as a whole

and we think we have got good relationships there, but in offshore energy we are disappointed with the level of data.

"We are a very technical underwriter which relies on actuarial support and science to back up fundamental underwriting judgements, and if that data is not clear it is difficult for us to protect our balance sheet."

Endurance, which will continue to write marine and onshore energy lines, said its decision to vacate the offshore sector was 'not a pricing issue per se'.

But the CEO of Cooper Gay's Lloyd's broking division, James Summers, believes offshore lines could now be profitable for reinsurers.

"RMS gave a lecture down in Houston where it said the models

had got the offshore physical damage component wrong by up to 50%.

"However, they ran KRW on its updated model and the results came out pretty much spot on.

"Generally speaking, people are much, much happier with the data that is now coming through."



James Summers of Cooper Gay

ROMANIAN MARKET HAS STRONG POTENTIAL IN EASTERN EUROPEAN GROWTH

Billion reasons to look East

Eastern Europe contains markets of 'huge potential' according to both Willis and Munich Re which are seeking to extend their operations in the region.

Guy Hudson, executive director of Willis' eastern European team, said Romania alone would soon offer business opportunities worth billions of euros.

Following the devastating floods it suffered last year, the Romanian government realised the need for a comprehensive private insurance

scheme to protect its economy.

According to Mr Hudson, new laws coming into force by July 2007 will open up the country's flood insurance market, enabling reinsurers to bid for business worth at least €1.4bn.

"Romania is exciting due to the privatisation of its catastrophe scheme.

"The floods there frightened the government because there was not a big enough penetration of insurers in the household market," he said.

Meanwhile, the chief executive manager of Munich Re's central and

eastern European unit, Wolfgang von Wasielewski, said there was good value in the Russian reinsurance market.

Half of Munich Re's Russian book is made up of facultative reinsurance, particularly property and engineering lines. It believes other sectors are less profitable.

"Health, third party liability, and household insurance, which are all popular in the West, are not developed there yet," said Mr Wasielewski.



Underwriter's view 2

QBE's Padraig Kelly says discipline is here to stay



Symposium 5

The cost of climate change was top of the agenda



Behaviour science 7

Experts in psychology may be needed to underwrite risks in the future

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CEDANTS AND BROKERS ARE LOOKING FOR JANUARY 1 RATES REDUCTIONS BUT REINSURERS ARE RELUCTANT TO CONCEDE

Rates high... low takes?

Optimism for the future was evident in Baden-Baden this year but while talk remained of discipline, the renewals season will bear out whether it was mere rhetoric. **Padraig Kelly** believes underwriters are sticking to their guns

What a difference a year makes – 12 months ago at Baden-Baden the market was in recovery mode, slowly coming to grips with the impact of the biggest insured loss in history.

One year on, however, and the general feeling among delegates was that of calmness, confidence, and a slowly-returning optimism.

But behind that optimism was a determination to ensure that calmness and confidence did not give way to complacency, the fear being that any short-term loss of memory may lead to a revisiting of the past and its long-term financial implications.

A hitherto cat-free 2006 may have whetted the appetites of brokers and cedants in terms of their price expectations, but underwriters said they would stand firm. Pricing, and how it would develop, remained the dominant topic in Germany.

The majority of conversations with clients focused on the upward pressure on rates, not only in regional programmes but also in smaller, single territory programmes, where many expected prices to be falling.

It comes as no surprise to anyone in the market that cedants and brokers are looking for reductions in pricing. However, the message to cedants was clear: there is no change at present and we don't anticipate a reduction in the near future.

DISCIPLINED APPROACH

The polarised attitudes towards pricing are entirely understandable but underwriters were keen to point out that although business had recovered well from the impact of last year's events, the recovery would not be immediately reflected in declining rates – and for good reason.

The consensus of those in Baden-Baden was that the market had so far been diligent with regard to underwriting discipline, and the expectation is that it would continue to do so until renewals.

However, in this market it is difficult to predict what the next season has in store, and the proof of the pudding will be in the eating.

Underwriters are wrestling with issues other than the threat of catastrophes and the claims of the past two years. Increasing exposures and the property pricing of particulars within certain regions still concern underwriters and, as such, a very cautious attitude is being adopted by reinsurers.

Reinsurers felt the need to update their models for all catastrophes which, they cite, is another valid reason for retaining stability in pricing.

Nevertheless, the effort to guard against complacency is not over, particularly amongst primary insurers who see their income levels dropping on some products and subsequently expect to see similar activity from their reinsurers.

Many see it as a major challenge for the reinsurance market to hold pricing at



Baden-Baden's Kurhaus casino: Will the industry be gambling on pricing in 2007?

existing levels, but the clear message at the Baden-Baden meeting was that if a programme requires significant capacity and there is a cost of capital issue, then pricing would continue to increase.

And while there remained talk of new capacity entering the market, there were few who believed that this will have an impact on the pricing of international programmes for the forthcoming January 1 renewals.

Padraig Kelly is senior property treaty underwriter at QBE Ireland.

THE Review

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EDITOR: GREG DOBIE

REBRIEF EDITOR: ANDREW WRAGG

REBRIEF ART EDITOR: BARIS BAYRAM

HEAD OF PRODUCTION: LIZ LEWIS

EVENTS MANAGER: SAMANTHA GRAHAM

ASSOCIATE PUBLISHER: ANDREA WARD

PUBLISHING DIRECTOR: TIM BROOKE-WEBB

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LOYD'S OVERHAUL WILL HELP KEEP LONDON MARKET FREE FROM BERMUDA'S SHADOW

Lloyd's franchise discourages 'punters' mentality

Lloyd's has admitted to feeling the heat of the Bermudan market but says its Franchise Performance division is helping London remain competitive.

Three years after the division's inception, its director Rolf Tolle is pleased with its progress but envisages challenging times ahead.

"The Bermudan market is not only a threat to Lloyd's but a threat to the city of London," he said.

"There are syndicates which have traditionally put holding companies in Bermuda which I have no problem with because it makes a lot of sense in reducing their tax bill considerably.

"One thing we cannot create is an EC3 tax-free zone, so we need to make things more seamless, easy and secure, which will reduce the cost of doing

business here in the London Market."

With the prospect of an electronic London threatening to overhaul Lloyd's operations, Mr Tolle is aware of the need to uphold tradition.

But the furtherance of digital systems could certainly help reduce Lloyd's biggest expense: the cost of acquiring new business.

"Electronic placement will definitely reduce the costs of doing business," he added.

"We have already started with electronic claims handling, which makes the claims process easier and faster, and there will be a number of systems improvements between now and next spring."

Evolution is a key word in the Franchise Performance division's strategy; the challenge being to create a progressive environment while retaining Lloyd's innate strengths.

"The world is not standing still and if we do our part London will stay as a strong, vibrant market.

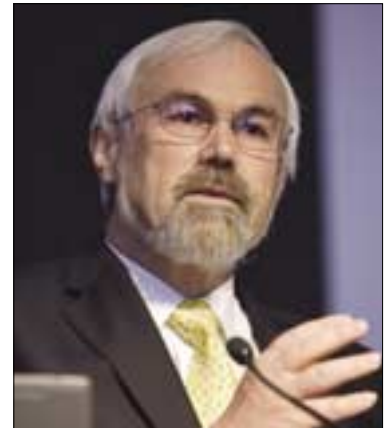
"The biggest challenge is how we can keep one

of the most important virtues of Lloyd's: entrepreneurship.

"How can we embrace it, support it, and bring it to the table.

"Entrepreneurship with discipline is true entrepreneurship. In the past entrepreneurs were just punting. They didn't understand the consequences.

"You have to make sure you don't strangle something which is good and positive – you have to ensure what you achieve keeps the good in place."



Rolf Tolle, director of Lloyd's Franchise Performance

AXA'S TRANSFER OF REINSURANCE BUSINESS TO PARIS RE BRINGS INCREASED CAPITAL AND LIFE BUSINESS POTENTIAL

Paris shines in Axa sunset

Axa Re has announced it would consider making an acquisition to begin writing life reinsurance business in 2007.

"If we build it from the green grass we will spend money years before we start harvesting," said Hans-Peter Gerhardt, Axa Re CEO.

"We need an acquisition. I don't know if that will take place anytime soon because there is not a whole lot out there to be acquired.

"However, if something comes up we will happily react to it – we have the investors and the resources to make it happen."

Mr Gerhardt is overseeing the transfer of Axa's reinsurance book to new start-up, Paris Re, which will retain the Axa label

until the second half of 2007.

Paris Re will be operational 'in full shape and form' by the end of 2006, but will not receive a rating from the rating agencies until 2007. In an agreement with Axa, it could operate under the Axa Re banner until March 2008.

"The Axa brand name is both a blessing and a curse at the same time," added Mr Gerhardt.

"Axa is founded in integrity, strength and stability, but offsetting this is the fact that Axa is quite a big competitor to some of our clients, so we need to overcome their natural resistance to placing reinsurance with a major competitor.

"However, this story has had a lot of

transition time and we have been able to explain the situation to our clients for the past six months."

Mr Gerhardt said Paris Re's greater capital gives it more freedom than Axa Re enjoyed. He added that Paris Re could eventually receive a public listing.

"With Axa we knew that \$1bn was all the group was willing to expose to the reinsurance industry," he explained.

"It forced us to buy a lot of retro but we can now retain more risk and are not a victim of that market."



Hans-Peter Gerhardt, Axa Re CEO

DATA PROVISION AND ACCURACY OF MODELLED RISKS ARE SET TO IMPROVE IN 2007, BUT FEW IN THE INDUSTRY ARE PREDICTING A DECLINE IN PROPERTY CATASTROPHE RATES – EITHER IN THE US OR EUROPE

Pricing matters

While the consensus in Baden-Baden seemed to be that US property catastrophe rates would remain high in 2007, the hiked prices represent more than just reinsurers trying to claw back losses from the 2004/2005 seasons. Technically, prices are probably far more accurate now than before the storms.

During the symposium, which marks the start of Reinsurance week, RMS drilled home the importance of accurate data input when attempting to model risk. To illustrate its point it used Mississippi's floating casinos as a key example of how mis-pricing occurred in the 2005 season.

RMS said the casinos had been entered into the models as 'reinforced concrete land-based structures' which was clearly a complete misnomer: state law had consigned the buildings to the water to appease local religious conservatives who opposed gambling.

But not all the blame was placed on data entry. As has been well reported, recalibration of catastrophe models has raised modelled risks by as much as 40%, which shows that both sides will do their bit to accurately price exposures going forward.

While an influx of capacity could force the rate reductions that so many cedants are paying for, few of those present in Baden-Baden suggested that this would happen in 2007, predicting a trickle rather than a flood of new entrants to the market.

And while climate change warnings abound, only the bravest players would be willing to bet that the next hurricane season will be anything like as benign as the one experienced in 2006 and drop their rates accordingly. The industry opinion is that we are caught up in a cycle of more frequent – and more intense – weather patterns.

WORD FROM THE FLOOR

But it's not just the US cat market that is likely to be subject to further price hikes;

European cat is also expected to see its own set of rate increases.

David Watson, president and CEO XL Re Europe, said: "Everything suggests to me that rates need to increase, particularly cat rates.

"The various cat models have been recalibrated which suggests rates have to go up."

Mr Watson described European cat pricing as 'tricky' and added that casualty results were 'pretty marginal'.

"People are making good money on casualty on prior year results but current accident year is a little tricky," he explained.

Elsewhere, in its non-US international property treaty portfolio, Endurance Worldwide said it had not changed its risk appetite and was actively seeking partners who would complement it in that area.

Endurance had, however, made some readjustments to its US property/cat portfolio and, as outlined elsewhere in *The ReBrief*, pulled out of the offshore energy market.

It believed the hard US property market was forcing clients to provide more accurate exposure data.

"The data in some cases is getting better but that is driven in part by customers who are themselves driven to provide more data because of the hard market," said Dan Izard, Endurance Worldwide CEO.

"The market is asking for a greater level of resolution, and companies are looking a lot more closely at data and accuracy. To this end, we are de-emphasising national account writers in the US where you don't always get the required level of detail.

"The more information we have, the better we understand the risk particularly in terms of the property side.

"The challenge is where we have lines of business in territories where we cannot get the data from.

"When the data is unclear we are forced to make assumptions that are very conservative, if not we could be exposing ourselves to risk."



"The market is asking for a greater level of resolution, and companies are looking a lot more closely at data and accuracy"

Dan Izard, Endurance Worldwide CEO



"Everything suggests to me that rates need to increase, particularly cat rates"

David Watson, president and CEO XL Re Europe

WEATHER EXPERT WARNS RE/INSURERS THEY ARE ABOUT TO FACE A NEW CLIMATE FOR CATASTROPHE PRICING

Industry to shoulder cost of climate change

Perhaps this year's Baden-Baden Reinsurance Symposium was entitled *Models, Reality, Markets: Who is right?* simply to get re/insurers to turn up. It could just have easily been called *Climate Change: You're Paying*, but that might have scared them off.

When climatologist Professor David Stephenson kicked off the discussions, 300 pairs of innocent ears pricked up in the town centre auditorium on an unseasonably sunny Sunday in southern Germany.

"Insurance and reinsurance markets will pick up a lot of the cost of climate change," announced the Reading University weather expert, who is set to join The Willis Research Network with Exeter University in the UK next year.

Perhaps those present should have been better prepared for the announcement: the weather that day had been unusually warm, devoid of the sleet and drizzle that have marked Baden-Baden conferences past.

Dr Stephenson explained that global average temperatures were now more than half a degree warmer than a century ago. The fear among scientists is that they could rise by up to a further six degrees this century, leading to a greater frequency of extreme weather events.

"Warmer temperatures over the oceans will cause them to expand which means sea levels will rise," Dr Stephenson added.

"And warmer sea surface temperatures

in the tropics will cause a moister atmosphere which will have implications for rainfall and consequently more floods.

"We have managed to put carbon dioxide levels to places not seen for half a million years.

"We are in a new zone. If this doesn't scare you about climate change, nothing will."

Modellers across the globe are attempting to map out climate change scenarios – over 50 climate models are currently being used.

Should all the climate change portents be realised; should global emissions continue to accrue apace; should governments fail to take sufficient action before the apocalyptic 'tipping point' is reached (and some believe we're pretty close to that already), then the world will enter an entirely new hydrological cycle where wetter regions get wetter, and dryer regions get dryer. And among the latest raft of concerns is how some countries will cope with the expected mass migration of those most affected by the new environments.

FORWARD THINKING

Clearly, re/insurers are looking to accurately assess and price these numerous new risks, as RMS chief research officer, Dr Robert Muir-Wood, explained.

"The events of 2004/2005 redefined a lot of the elements of catastrophe modeling in the same way that Hurricane Andrew caused changes to the models," he said.



Delivering the news (l to r): Philippe Rochaix, Professor David Stephenson, Dr Robert Muir-Wood, Yorn Tatge, and David Watson

"We have now got five modules instead of four; the new module is 'claiming' which better accounts for criteria such as loss amplification."

Dr Muir-Wood added that RMS had now branded 'occupancy' as the principle driver of loss for property exposures in its catastrophe models.

And both he and Yorn Tatge, managing director of AIR Worldwide, agreed that poor input data had been a key contributor to inaccurate loss assessment in the past.

Modelling companies were now far better placed to assess future risks, they said; models, as do humans, undergo evolution...which may be true. But while evolution is founded on strengthening through adversity, what re/insurers really want is a little foresight. Then maybe the crippling costs of climate change can be paid for – before they are handed the bill.

So, do you think after the 2004/2005 seasons catastrophe modellers might require some kind of error insurance in the future?

Philippe Rochaix, general manager XL Re Europe



People are wising up to the fact that they have to think about climate change and incorporate it into their decision making

Professor David Stephenson, climatologist at Reading University, UK



GOOD PR IS VITAL TO PRIMARY INSURERS IN THE BATTLE FOR CLIENT CONFIDENCE

Insurers in need of image overhaul

Reinsurers are concerned that the primary market has been branded enemy of the state in certain regions across the globe.

Speaking at the Reinsurance Symposium, RMS chief research officer, Dr Robert Muir-Wood, said insurers need to work harder to achieve a positive public image.

“The insurance industry has a problem,” he said.

“What is happening in the US is that insurers are seen as part of the problem rather than the solution if they fail to renew policies or if they put up prices.

“This gives them a poor reputation. Insurers need to make sure they are seen to be doing their part and not simply withdrawing coverage.”

The US mid-term elections saw persuasive insurance mandates high on the agen-

das of Florida gubernatorials Charlie Crist and Jim Davis.

But reports in Florida newspapers suggest the east coast insurance industry is often portrayed as the bad guy by politicians who condemn rate hikes.

Reinsurers can take heart, however, that US catastrophe risk should be better priced going forward, thanks to lessons learned from the previous two hurricane seasons.

“On the loss modelling side we are in a much stronger position than we were three years ago,” explained Dr Robert Muir-Wood.

“All the companies that have provided us with claims data [following the 2004/2005 seasons] have themselves learned a lot from the process.”

Yorn Tatge, general manager AIR Worldwide, added: “Everybody wants to



Yorn Tatge, general manager AIR Worldwide

have black and white so it's difficult to give an answer which is grey.

“But if you can quantify that grey tone it really helps a lot in risk management.”

Uncertainty is something that the industry is beginning to embrace rather than attempting to abolish.

Professor David Stephenson, climatology expert at Reading University, UK, said: “It's about getting a reliable uncertainty estimate of the predictions.

“We know we are never going to have certain predictions, so it's about qualifying that uncertainty.”

SENIOR ANALYST SAYS EXPORTING SERVICES TO INDIA COULD HOLD POTENTIAL PROBLEMS

Moody's issues offshore warning

A senior industry analyst has warned of the potential dangers of concentrated offshoring by companies looking to cut costs on services.

Timour Boudkeev, senior analyst for Moody's, said that players who supported offshoring had mostly chosen India as their new base.

Mr Boudkeev warned that tensions between India and Pakistan could have a devastating effect on service provision should troubles escalate.

“All the offshoring seems to be going to just the one place – India, to the extent that if there is a regional conflict between India and Pakistan, depending on how hot it gets and what the consequences are, this

regional concentration of all the infrastructure for an entire industry would seem to me to be potentially a risk management issue in its own right,” he said.

“It's not the same as having that infrastructure spread between Munich, Zurich, London, Bermuda and the US.

“If it's all in one place it could be quite risky.”

Others at the Baden-Baden meeting supported the current trend towards offshoring.

David Watson, president and CEO of XL Re Europe, said: “When you look at offshoring as opposed to outsourcing it's an efficient use of resource.

“What's critical though is to maintain service level agreements to ensure that

Timour Boudkeev, senior analyst for Moody's



you do get a quality return.”

Tad Walker, head of catastrophe at Partner Re, added: “I think there are certain aspects of a company's business process that shouldn't be outsourced.

“But to the extent that non-critical elements of the process can be handled more efficiently, then it's a good thing.”

UNDERSTANDING HUMAN BEHAVIOUR COULD HELP REDUCE EXPOSURES SAYS RMS

Freudian slip for underwriters

Risk modellers are expanding their thinking in an attempt to disprove the adage 'there's no accounting for human behaviour'.

RMS chief research officer, Dr Robert Muir-Wood, said some players would consider using psychology experts to better analyse future risks.

Speaking at the Baden-Baden Reinsurance Symposium, he said: "The whole process of insurance is a human one.

"I came from science and started off assuming that if only we knew more about science or engineering we would know the answer.

"But that is not the whole solution.

"Whatever you do to distinguish classes of risk someone is going to try to find their way around it.

"Experts in human behaviour are going to be incorporated in the way the models are used."

Yorn Tatge, managing director AIR Worldwide, added: "Even if you have the

best models you can't allow for these things. "Human behaviour is very complex."

Dr Muir-Wood and Mr Tatge gave examples of how some insureds look for loopholes in the system; such as those US landlords who choose not to earthquake-proof their property in an attempt to overcome state rent control regulations.

Mr Tatge claims that even model-users could fall victim to the peccadilloes of human behaviour: "It is no longer the common opinion any more that modellers got it all wrong [after the 2004/2005 seasons]," he said.

"The users of the models have to do very delicate and complex tasks.

"Often the lower the result, the better, so the pressure on people using the models is to try to keep the results low and it is very important to understand that it doesn't help you just to sell more reinsurance or offer lower prices."

According to some camps, analysis of human behaviour could actually be bene-



Dr Robert Muir-Wood, RMS chief research officer

ficial to the industry, as XL Re's general manager, Philippe Rochaix, joked at the symposium: "This is good news... because we will get rid of the actuaries and have psychologists in the companies."

THERE ARE HURDLES TO OVERCOME BEFORE RE/INSURERS JUMP ABOARD CHINA'S EXPRESS TRAIN ECONOMY

Data key to China growth

Credible models could help the Chinese reinsurance market grow 'exponentially', according to broker Guy Carpenter.

Chairman of continental Europe and Asia Pacific regions, Geoff Bromley, added that strong partnerships were vital to transacting business in the region, and reinsurers would require quality data if they were to take a punt.

"A lot of work has to be done in areas such as China before there is real confidence in the models," said Mr Bromley.

"I would really welcome the development of credible models there because that will provide a sensible platform for development of a product."

Mr Bromley described reinsurance as a 'mature industry' which was on the lookout for growth markets. He believed China held good business opportunities.

"The rate of growth they have sustained is quite remarkable, and the prognosis is very powerful," he said.

"The most difficult thing looking in is understanding what is driving that growth.

"New players need to understand the dynamics of that business and acquire the data points to make informed decisions.

"The biggest question mark relates to the quality of data – incomplete data affects informed decisions."

Mr Bromley said the Chinese market is currently driven by motor insurance with

Beijing alone expecting a million more cars in 2007, something he described as 'a phenomenon of increasing wealth'.

He added that the country's major infrastructure projects with huge asset values would propel reinsurance business.

"Earthquake and flood are big risks. It's a huge, huge area with some vast conurbations.

"The successful players will go in with appropriate caution, understand the weakness of the database and respond accordingly. Developing great partnerships is important to success there."



Geoff Bromley, chairman of continental Europe and Asia Pacific regions, Guy Carpenter

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TO STAIRWELLS,
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TO INSURE THEM.



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