THE ReBrief

THE REVIEW REPORTS FROM THE BADEN-BADEN MEETING 2008

Security concerns...

SUB-PRIME FEARS MEANS CEDANTS DEVISE QUESTIONNAIRES

Security was a major theme at this year's Baden-Baden meeting with nervous cedants quizzing reinsurers about their sub-prime exposure through questionnaires.

Hans-Joachim Guenther (*pictured right*), Endurance's chief underwriting officer and head of reinsurance for Europe and Asia, said that the credit crisis had particularly rattled smaller insurers.

They no longer felt able to give as much weight to ratings and were more likely to carry out their own checks to scrutinise a reinsurer's financial strength, he said.

"Security is a major concern for cedants as how do you know who is a good party to deal with?" he said.

"There is a lot of uncertainty. No-one knows how the financial crisis will translate into changes for the reinsurance and insurance industries."

Mr Guenther believed that if such questionnaires became wider spread and started to demand more in depth information, legal considerations could come into play.

"I would anticipate that the more detailed the questionnaire becomes the more likely people are to come out with confidentiality agreements," he said.

"It is a major stumbling block and will make things more cumbersome with two lawyers looking at everything."

But Mr Guenther added that this year's Baden-Baden had marked a sea change towards financial security issues.

"I am pretty sure we will see increased dialogue about security in future. We are likely to see more meetings accompanied by chief financial officers to give an insight into public information and set it in a certain context," he said.

Andreas Bergler, the head of Beazley's newly opened Munich office also found an atmosphere of heightened caution at the meeting.

"The main question I have been getting from people is 'what is your sub-prime exposure,'" he said.

"This really is a concern for insurers and there has been a trend for them to look at their reinsurance protection," he added. ®

However reinsurers to benefit

FALLOUT FROM THE FINANCIAL CRISIS WILL SHOW THE VALUE OF REINSURANCE

The reinsurance industry must stay cool and collected if it is to weather the storm engulfing the financial markets, according to Swiss Re.

Thomas Witting, managing director for the German and Nordic markets, appealed for the market to put the recent share price plunges experienced by some reinsurers into context.

"We have to analyse the hard facts and not be confused about short term share prices driven by an erratic market, we need to be objective," he said.

During the Baden-Baden meeting Swiss Re itself was forced to deny rumours it was seeking a bailout from the Swiss Government and Mr Witting added that in such a volatile environment insurers would be extra vigilant in selecting reinsurance partners.

However, he added that despite being hit by the crisis on the asset side, reinsurers may benefit from the credit crisis as prices increased.

"The value of reinsurance will be better recognised now. It offers the kind of security that is long term and is not limited to one or two years," he said. ®

INSIDE

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The view from Baden-Baden

CEDANTS MIGHT BE ON THE MOVE AS WELL AS RATES AS CRUNCH KICKS IN AT RENEWALS

With plunging equity markets, the near collapse of AIG and two hurricanes to boot, it is little wonder that this year's Baden-Baden meeting was described by some as the most significant in a decade. Bill Jewett shares his thoughts with Ruth Lythe on the event's key themes

One of the key messages coming through at this year's meeting is that the pricing cycle is going to turn. In US property and catastrophe peak zone risk we see room for significant hardening in the reinsurance market.

In the European space we have seen some marginal hardening of rates especially in some programmes driven by significant capacity needs.

Other lines of business within reinsurance will perhaps harden more incrementally within 2009. Although in any treaties in which there is an obvious or direct unprofitability we will see corrections taking place.

In non-catastrophe business particularly in the US we have seen signs that a firming maybe taking place but we don't know to what degree that firming will go. In Europe there has been a similar sentiment. We are not planning for significant hardening in European non-severity classes, although we think there will be a stabilisation certainly and a firming.

On the casualty side, at this stage there has been less certainty. But I do sense a momentum developing towards some kind of recognition of a firming marketplace.


Rates and counterparty risk were the talk of Baden-Baden

FOCUS ON COUNTERPARTY RISK

We are seeing across the board an increased awareness and focus on counterparty risk. At Baden-Baden that sense was very powerful and it was a real theme.

If you look at what has happened to AIG and what XL is going through, along with others there is a heightened move towards financial security.

Buyers are relying less on ratings and at Baden-Baden they were really probing at reinsurers to try to find out what they really represent.

The credit crisis is certainly a once in a generation event and is in many ways unprecedented.

And this awareness of counterparty risk, leverage and outlier risk are lessons that will be ground into history. Memories from this will be very long.

One way to ameliorate and manage counterparty risk is through diversifying and buyers' spread of reinsurers is becoming broader.

OPPORTUNITIES AWAIT

In Europe there is a window of opportunity for reinsurers as a result of this move towards diversification, which is also a global phenomenon encompassing many different types of companies and geographies.

In particular this trend benefits reinsurers who do not dominate a programme through their capacity or have a long history with a buyer.

September's financial crisis has also brought the need for Enterprise Risk Management (ERM) to the forefront as companies have suffered the consequences of inappropriate risk management. However ERM is something we have always prided ourselves in at Endurance and is part of our fabric.

WINNERS AND LOSERS

I think that in the marketplace we are entering in future there are some companies that are positioned to be winners and some that won't do as well. And although this market may be a hardening market, everyone will have to rise with the tide.

There will be winners and losers – that is just because of the nature of the market this time around.®


Bill Jewett is president and CEO of Endurance Worldwide Reinsurance.

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Talking up rates at Baden

MUNICH RE PREDICTS DOUBLE DIGIT INCREASES BUT OTHERS ARE MORE CONSERVATIVE

Reinsurers used the Baden-Baden meeting to hammer home their message of increasing rates at January 1 renewals, as a result of the credit crisis and ongoing losses.

German giant Munich Re predicted double-digit increases in reinsurance rates over the year because of a fall in the level of primary insurers' capital.

Management board member Ludger Arnoldussen said that the reinsurer expected 'significantly higher prices, with percentage increases definitely going into the double-digit range'.

"Given the erosion of many insurers' capital, the significance of reinsurance as a direct capital substitute is growing," he said.

Meanwhile, Hannover Re board member Michael Pickel also added his support to the Munich Re line.

"The situation has changed markedly since Monte Carlo," he said.

Managing director for the German and Nordic markets at Swiss Re, Thomas Witting added: "The impact of the credit crisis is that higher demand meets lower capital with ongoing loss activity. In this situation a hardening of the market can be the only consequence."


The industry expects a hard market following Hurricane Ike and the credit crisis

Hans-Joachim Guenther, Endurance's head of reinsurance for Europe and Asia , shared this view that it was a favourable time for reinsurers.

"I think that the more uncertainty because of the credit crisis there is around the market, the more insurers will buy protection. To sum up, I would view the present situation as an opportunity for reinsurers although not an easy one," he told *The Rebrief*.

But Lloyd's franchise director Rolf Tolle took a more measured approach saying that the combination of Hurricane Ike and the credit crisis had not yet turned the market.

"I haven't seen the logical reaction that prices have gone up. I think there is an uneasiness but it is too early to say that we have reached the bottom of the soft cycle," he said.

However, he added that in areas such as offshore energy the trend of softening pricing had been reversed following the impact of Hurricane Ike.

In fact there were questions about whether offshore energy infrastructure in the Gulf of Mexico would be insurable in future, he said. ®

FOR MORE ON HURRICANE IKE, SEE PAGE 6

Questions over capital

BROKERS SPOT OPPORTUNITIES AS RISING COSTS MAY HIT REINSURERS HARD

A question mark hangs over the ability of reinsurers to easily raise fresh capital in the light of the credit crisis, brokers said in Baden-Baden.

Adrian Clark (*pictured right*), managing director at Benfield said the impact of the credit crisis and Hurricane Ike had eroded capital, although not to the extent following Hurricane Katrina.

But he added that because of the credit crisis, reinsurers in need of more capital may struggle to replenish their reserves in future.

"What for me is the real uncertainty is this question of capital. There is definitely a question mark over that this time. That changes the game for some people and we don't know what consequence it will have.

"It might make a small number of the reinsurance market more risk-adverse and more conservative in their approach," he said.

Although Mr Clark added that brokers may see the benefits.

"For a broker a market where there is uncertainty is a more interesting market. There is no doubt that some clients are concerned about whether capacity will be there at January 1 renewals, particularly if they are posting a very large cat programme.

"In general we can expect a more conservative approach to risk from the market but that doesn't mean that some people aren't going to see this as a big opportunity," he added.

Mark Hewett, chairman of reinsurance broker Guy Carpenter UK's operations said that the cost of capital in the light of the credit crisis may hit reinsurers hard.

"As far as the reinsurance market is concerned there has been a lot of activity in 2008.

From a reinsurance perspective even with further activity it will continue to be profitable. The flipside is, with everything going on, that the cost of capital is going up significantly. And the cost of capital may impact at a time when reinsurers need it most," he said. ®

Rating agencies must change

LACK OF CAPITAL MARKETS EXPERTISE COST RATING AGENCIES WITH REGARDS TO AIG

Rating agencies' business models must change in light of the near collapse of what was once the world's biggest insurer, AIG.

Stephen Searby (*pictured right*), a former analyst at rating agency Standard and Poor's said in Baden-Baden that AIG's, at the time AAA rating for its insurance operation, allowed it to rapidly expand its financial products division. It was this part of the company where the problems that caused AIG's near collapse stemmed from.

Mr Searby, who is now managing director at Societe Generale corporate and investment banking said: "It (AIG) was doing what the investment banks were doing backed by a AAA rating from its insurance business."

"They had this AAA rating and grew their financial products business very quickly and the rating agencies did not have the expertise to understand this side of the business.

"There should have been someone there with capital markets expertise working in the rating agencies insurance practices, looking at organisations like AIG. They missed the big, nasty animal lurking in the cupboard," he said.

AIG's AA- rating was cut to A- on September 15 by Standard and Poor's. Days later the insurer was saved from collapse with an $85bn US Government bailout loan on onerous terms – later extended to $123bn.

"I suspect that the rating agencies probably acted too late," said Mr Searby.

"It came back to not having the correct resources looking at the correct parts of the group."

He added that AIG's insurance businesses were outstanding. And although the insurer has said that it hopes to hold on to some of its core operations, Mr Searby highlighted the fact that the insurer was, at the time of Baden-Baden paying vast amounts of interest on state aid totalling $123bn.

"I don't think there are any parts of AIG that we won't ultimately see for sale," he said.

William Hawkins, European insurance research director with investment bank Keefe Bruyette and Woods said that a shake-up of rating agencies business plans was needed as result of the Wall Street meltdown.

"It seems to be economically obvious if you are paying someone to do a rating you are generating a potential conflict of interest."

However Mr Searby said that changing the way agencies operated with entities no longer paying fees to be rated would not work, as this would not generate enough revenue.

But Lloyd's franchise director Rolf Tolle argued: "We should change who pays for what. If people are not prepared to pay for it a (rating) then it probably doesn't give you the value you want." ®

Subscription market soars

LLOYD'S EXPECTED TO BENEFIT FROM BUYER DEMAND FOR CO-INSURANCE AND CREDIT QUALITY

The subscription market will see a resurgence due to the ongoing financial crisis, with the issues of co-insurance and credit quality coming to the fore at 1/1 renewals.

Neil Maidment (*pictured right*), chairman, group underwriting committee at specialist Lloyd's re/insurer, Beazley said that there was a tremendous opportunity for large volumes of business from distressed markets to come to Lloyd's in the current climate.

"Lloyd's attractiveness is in its great ratings, great capitalisation and the fact that it is an underwriting-driven business at a time when the focus of the industry needs to be on underwriting," he said.

Beazley is one of several Lloyd's syndicates, including Hiscox, Atrium and Argenta, that recently upped capacity plans for 2009 after initially planning to reduce capacity before the full impact of the crisis became known.

It will now allocate approximately $1.23bn (£770m), up from its original plan for £710m for next year and Mr Maidment noted that that figure may yet be revised upwards again.

"It depends on how much business is remarketed," he said. "But we will increase capital if we need to and it is entirely appropriate for next year.

"The subscription market will feature at 1/1 renewals and significantly beyond that," he continued. "I would see that one of the conclusions of recent events is that it might not be a good idea to have too much cover with one re/insurer.

"The increasing value of the subscription market, that atomising of risk, will add to the upwards ratings pressure," he concluded.®

Renewals season risks

UNDERWRITERS WARNED ABOUT THE PERILS OF DELEGATING AUTHORITY TO AGENTS

Re/insurers seeking to access new markets must be aware of a host of vital issues which to ignore could have dire consequences - warned a leading reinsurance lawyer during Reinsurance Week.

Colin Croly (*pictured right*), head of Barlow Lyde and Gilbert's reinsurance and international risk team told the audience at *The Review's* Baden-Baden breakfast briefing that insurers entering new markets should do so with their eyes wide open.

Those delegating authority to an agent should be aware that the agent would be the underwriter's public face in certain markets in both claims and underwriting, he said.

And although under English Law an agent's duty was not to make a secret profit at the expense of the principal and to exercise reasonable skill and diligence in conducting business on its behalf - this did not always turn out to be the case, he said.

"A principal should not rely on these implied duties and commercial goodwill to maintain control of its agent," said Mr Croly.

"Aim to align such competing interests and put in place sensible controls to govern the agent's actions."

Simon Cooper, partner in the reinsurance and international risk team at BLG, warned it was important to have vital details documented.

Such a document should also cover how a dispute should be resolved and how to terminate the authority or replace the agent.

In addition how the business would be run-off should be considered before underwriting started, said Mr Cooper.

Resolving questions such as whether the underwriting agent would have an ongoing role with claims handling once the business was in run-off was also vital, he said.

Mr Cooper said that licensing restrictions in some emerging markets meant that some business should be written through a 'front'. However this could lead to some legal and practical problems.

In addition, reinsurers should also pay attention to governing law clauses in contracts, he said.®

LEGAL ADVICE

When delegating underwriting authority, document in a written agreement:

- The limits of authority and class of business to be underwritten
- Consider preparing written underwriting guidelines
- The identity of the individuals to whom authority is delegated
- Remuneration: Based on volumes or based on results?

Crisis threatens Solvency II

ADDITIONAL REGULATION FOR INSURANCE INDUSTRY 'INEVITABLE' IN WAKE OF FINANCIAL WOES

Solvency II implementation could be under threat as countries across Europe turn to regulation to address the financial crisis.

Potential regulatory changes were high on the agenda when reinsurers and their clients gathered in Baden-Baden and concerns have been expressed that insurers could feel the backlash of greater regulation in the aftermath of the turmoil.

David Watson (*pictured right*), president and CEO of XL Re Europe, predicted: "There will be a huge change in regulation, particularly for the banks, but it's inevitable the insurance industry will have some additional regulation as a consequence."

With some countries having acted unilaterally to implement measures to address their own financial exposures, some commentators have warned that pan-European rules, including Solvency II, could be at threat.

"There's a danger that it will be delayed," Mr Watson acknowledged. "But I don't think that would be good for the industry. At the end of the day, when you look at regulation, you don't want it for its own sake, you want good regulation."

Rolf Tolle, director of Lloyd's franchise performance board, was also unclear as to the future for Solvency II. He said: "It will be interesting to see what the regulators do."

He suggested the banking crisis was, in part, the result of the Basel I and Basel II frameworks and questioned how legislators would react to that, hoping 'they would concentrate on the banks'.

But Mr Tolle added: "There's the potential that you will get the regulators getting very nationalistic and I hope that can be avoided."®

Gulf profits questioned...

OFFSHORE ENERGY INSURANCE PRODUCTS NEED TO BE RE-EXAMINED AFTER IKE, SAYS LLOYD'S

The devastation caused by Hurricane Ike sparks questions over whether offshore energy infrastructure in the Gulf of Mexico will be insurable in future, according to Lloyd's.

Franchise performance director Rolf Tolle (*pictured below right*), said that while offshore reinsurance prices had been softening, the destruction caused by Hurricane Ike, which crashed into rigs and platforms in the Gulf in September had reversed this trend.

According to Lloyd's estimates Hurricane Ike caused between $17bn and $20bn of insured losses overall, including $2bn to $3bn offshore.

Mr Tolle said that that the 'width' of Ike had been unexpected, causing a vast amount of damage. As a result Lloyd's had changed its realistic disaster scenario (RDS) for offshore losses in the Gulf of Mexico, he said.

While the reinsurance market as a whole had not hardened yet, Mr Tolle believed the offshore market was on the turn because a 'lot of people had lost a lot of money'.


Offshore infrastructure in the Gulf of Mexico was battered by Ike

He added that insurance products now needed to be examined in order to ensure that offshore energy in the Gulf of Mexico remained insurable, especially in the light of climate change which may increase the frequency of storms.

"If this is not addressed the question is can offshore energy in the Gulf of Mexico be insured in the long run?" he said.

But he added: "If from a Lloyd's perspective we think there is no reasonable chance of making underwriting profits, we will work with the market to address the issue.

"We would discuss what could be done and if there is no chance under normal circumstances to make an underwriting profit we would not make capacity available - that is the logical conclusion," he said.®

But Ike will turn marine market

LOSS ESTIMATES UP FOR IKE. PRICING, RETENTIONS AND AGGREGATE RESTRICTIONS TIPPED TO GO THE SAME WAY

Hurricane Ike will be a 'market-turning event' for marine re/insurers, the head of QBE Re Europe told T*he Rebrief* in Baden-Baden.

The prediction from managing director Jonathan Parry (*pictured right*) came as modelling agency RMS also significantly upped its revision of estimated total losses from Hurricane Ike in Baden-Baden to between $13bn and $21bn, following weeks of speculation that initial predictions had underestimated damage from the storm.

Mr Parry said that while it could well take the combined effect of the credit crisis along with hurricanes Ike and Gustav to cause the reinsurance market as a whole to harden, Ike alone was enough to change the dynamic of the marine market.

"Ike will have an effect in terms of increased pricings and retentions and reinsurance aggregate restrictions. Things are very much going to tighten up," he said.

Hurricane Ike smashed into oil platforms in the Gulf of Mexico in September. RMS' new loss estimate indicated that damage to offshore platforms is expected to cost between $1bn and $3bn, although industry ballpark figures put the damage closer to $3bn.

It also includes a projected $10bn to $15bn of onshore wind and storm surge losses in coastal states.

RMS had previously estimated losses to be in the range of $6bn to $16bn in the immediate aftermath of Ike's landfall, before refining this to $7bn to $12bn four days later.®

Cooper Gay's aviation wins

BROKER TAKES ABC ACCOUNT AND AVIATION SPECIALISTS FROM BENFIELD

Reinsurance broker Cooper Gay announced in Baden-Baden that it had won the bidding battle to administer the Aircraft Builders Council (ABC) programme, designed to provide aviation products liability insurance for manufacturers of aircraft component parts.

The programme, which has been administrated by Benfield for the past 10 years, became available following Aon's announcement earlier this year that it was to buy the reinsurance broker.

It provides limits of up to $1bn for manufacturers, mainly in the US, but also around the world. Since the majority of the business placed under the programme emanates from Aon, Marsh and Willis none of these brokers can administrate the programme without there being major objections from other brokers .

The ABC's board of trustees made the decision at a meeting in San Francisco to appoint Cooper Gay, which does place business under the programme, and the broker has now assumed administrative responsibility.


The ABC programme provides aviation products liability insurance for manufacturers

"Cooper Gay is undoubtedly delighted to have won this prestigious account," CEO Toby Esser told *The Rebrief*. Over the years, aviation products liability insurance has been very difficult to place so the ABC programme has been regarded as a jewel in the market for all brokers in trying times.

Perhaps more significantly the transfer of the ABC programme represents the first major knock-on effect from the Aon/Benfield deal for the broking market.

Meanwhile Cooper Gay also announced in Baden-Baden that it had acquired 10 members of Benfield's London based wholesale and direct aviation team for an undisclosed sum.

The move has meant the transfer of a number of Benfield's aviation specialists, along with their client portfolio.

Cooper Gay said it was looking to buy other businesses and attract specialist teams. It said it was involved with a number of further acquisition opportunities at varying stages of development.®

Underwriters update daily

INTENSE DISCUSSIONS AT BADEN AS CEDANTS SEEK MORE INFORMATION AND FEEDBACK

Reinsurance company managers are demanding more frequent and in-depth updates from their representatives at the coalface as uncertainty in the markets continues.

According to Victor Peignet (*pictured right*), chief executive of Scor Global Property and Casualty, discussions this year between cedants and their reinsurance suppliers are much more intense.

He predicted decisions would be made later. "People will be looking to avoid bad surprises. It's better to wait and talk," he said.

"At the moment it's difficult to predict what's going to happen in the next three or four months. Everyone thinks some people will come out stronger in relative terms, but it's difficult to bet who's going to be the winner and who's the loser," Mr Peignet said.

As a result everyone is looking for more information and more feedback, he suggested.

"We're insisting we want information to come up to management level very quickly after Baden-Baden and through the renewals," he said.

Mr Peignet added that he expected updates from underwriters on a daily basis so that the management board was aware of any developments among buyers and competitors as soon as they happened.

"What's important is to make sure that the difference [between the insurance and banking sectors] is understood," he said.®