

Reinsurance Roundtable Panelists Discuss Sustainable Pricing In An Uncertain World

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As Hurricane Dorian lashed the U.S. eastern seaboard over the weekend, panelists at the S&P Global Ratings reinsurance conference in Monte Carlo discussed the industry impact of increasingly large catastrophic events. One notable issue is cross-subsidization between catastrophic and "non-cat" business lines. Most agreed the sector needs to make more headway in tailored-pricing strategies. That said, well-developed enterprise risk management and disciplined underwriting practices are among the factors supporting stability in the sector.

Panelists at the conference's "S&P Global Reinsurance Roundtable" were:

- Johannes Bender, director of insurance ratings at S&P Global Ratings, and moderator of the round table
- Ivan Bokhmat, European insurance analyst, equity research, Barclays
- Christian Dunleavy, chief underwriting officer, Aspen Re
- Dr. Markus A. Eugster, CEO, Korean Re Switzerland
- Waleed Jabsheh, President, IGI

The session covered a range of topics ranging from pricing adequacy, earnings potential, reserve adequacy, third-party capital, and technology.

Mr. Bender kicked off the roundtable by saying that he expects the recent positive pricing momentum to continue over the next 12 months. S&P Global Ratings' stable outlook on the reinsurance industry is based on robust capitalization, sophisticated risk management, and still-rational underwriting practices. "But we also believe the sector is facing a lot of pressure from alternative capital and it remains a very competitive environment," Mr. Bender said.

Price Increases Are Only Keeping Pace With Loss Experience

Discussing the prospects of rate increases over the next 12 months, Mr. Bokhmat of Barclays highlighted that most reinsurers anticipate the positive price momentum seen in 2019 will continue. This consensus is also reflected in the share prices of reinsurers, he said.

Mr. Dunleavy of Aspen Re agreed that rates are increasing but said that more hikes are needed. "There is a lot of talk on price increases, but they are really only just keeping pace with loss experience as opposed to materializing into better margins. Further improvements are needed. Prices have been on a downward trajectory in too many segments for a long time and they remain below where they need to be." But he added that he believes the industry was at the start of a

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structural change that should, eventually, make increases more sustainable.

Mr. Dunleavy also made the case that the pricing dynamic in the industry has changed in the past decade whereby rate changes are more localized to individual markets. He said this might be down to changes in the capital structure of the industry, which has muted the cycle. "But rather than talk about the market as a whole, we should talk about price adequacy for each class of business--that is more meaningful than the blunt tool of looking at pricing globally," he said.

He added that, for some time, the market had been relying on a lack of big catastrophe claims to bail out under-priced non-cat lines. "But every product should stand on its own in terms of pricing," he said.

He added that the industry must also move away from the notion of payback, whereby rates increase substantially in the aftermath of a large loss--cedants thus paying retrospectively for part of their claims. "Rather, we need to get paid for the cost of capital and the volatility we assume," he said.

Mr. Eugster said that Korean Re takes a long-term perspective on pricing but it is also important that reinsurers have a clear understanding of when to walk away from business they feel is under-priced. Moreover, reinsurers must also keep a close eye on the asset side of the business as a number of macro issues have the potential to hit both sides of the balance sheet.

He added that it is for individual reinsurers to decide which lines of business offer suitable returns and to develop relationships with cedants. "There are still buckets of reinsurance that remain attractive--each company will have its own strategy on that. We launched in Europe because we see opportunities here. The patterns and dynamics in Europe are different to the U.S.--there is cat exposure and also secondary perils but we look at it risk by risk, country by country."

Mr. Jabsheh at IGI agreed with the other panelists that for many years rates on many lines of business had been unsustainable. He said he expected the momentum toward rate increases to continue in 2020, though much would also depend on the level of cat losses in the rest of 2019.

He also agreed that pricing has become more regionalized. "Many domestic markets are stronger and more independent than in the past," he said. "Yes, we are operating in a global market, but companies will have different strategies within different territories. We are a global company, but we rely heavily on local talent and devise a strategy for each country."

Dorian Is A Good Reminder Of The Big Loss Potential To The Sector

Mr. Bender said that it is still early to estimate the sector's potential losses, and asked the panelists to on their expectations.

Mr. Bokhmat said that Dorian should be well within reinsurers "cat" budgets for the year but also warned that there were several months of the hurricane season to go.

Mr. Dunleavy also had a warning: "If Dorian's track had shifted and it had gone up the east coast of the U.S., you would not be looking at an earnings event but a potentially large capital event. That should serve as a reminder to everyone about the size of the potential losses from these events. It could have been very different; we should see it as a narrow escape."

Sector Is Well Reserved Albeit Moving Into A Pain Phase

Mr. Bokhmat noted that certain cases had emerged where reserves had not been sufficient and that some warning signs could be observed on both casualty businesses and in terms of so-called

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"creep" of loss estimates post some cat events. "But on the whole the industry still seems to be reserved well and prudently," he said.

Mr. Dunleavy agreed that the industry is still pretty well-reserved but it has also "clearly moved into more of a pain phase." He noted that it has become apparent in recent years that some cat events can have a longer tail than people thought possible. "Some cats are complex and so are some capital structures involving third-party capital. The industry needs to be cautious on these things, but on the whole it is well reserved."

Mr. Jabsheh added that he felt balance sheets were not as strong as they were 10 years ago and the levels of reserve releases have been slowing as a result. He said that rate increases will help with this but they must also exceed loss trends. "The momentum in pricing needs to continue to move the market to sustainable levels," he said.

Growing Interplay With Convergence Capital

The panel discussed the growing importance of alternative capital to the market and the industry's reaction to several years of losses, and other issues including trapped capital and loss creep on cat business.

One consequence of alternative capital, said Mr. Bokhmat, has been that investors need to get more comfortable with risk models. However, he said, cat bonds still offer a very attractive risk-adjusted return for investors as well as diversification, while the barriers to entry in terms of the deployment of capital are low. This means that this form of capital is here to stay.

Mr. Dunleavy said that he no longer refers to investment from the capital markets as alternative capital, rather he just sees it as another source of capital. "We do not see it as a threat, we use it ourselves and we use it to solve problems for our clients." He added that he had observed flight to alignment among investors from this space where investors are being more discerning about their strategies and want a better understanding of the risks and exposures--and how the risk models work.

M&A Dance Will Continue

Mr. Bender said mergers and acquisitions remain a hot topic for the reinsurance sector thanks to relatively cheap capital, as some players are posting subpar returns due to cost inefficiency, and margin pressure.

Mr. Jabsheh said that the hunger for, and lack of, organic growth will continue to fuel consolidation.

Panelists agreed on the importance of technology to decrease their cost base. In fact, expense inefficiency could further drive M&A activity.

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