

# Challenges ahead for Europe's insurers

Corporate responsibility and transparency are essential new components of every business strategy. Together they mean that managements must be seen to have addressed all the obvious risks. Insurance has a big role to play, but the insurance market itself is facing challenges. Fragile pricing strength looks set to ease, while investment returns remain low. New insurers, new regulations, and serious revelations about some industry practices are changing the environment in which European risk carriers operate. All the while, globalization is driving continued consolidation among commercial insurers.



Profits were excellent for most insurers over the past three years, but some fear pricing for commercial risks will decline steeply. That could halt the positive news before all of the holes in insurers' ulcerated balance sheets have been completely patched. "The sector remains focused on profitability at the expense of volume, but the mantra has now shifted subtly toward profitable growth," says Hans Wright, a credit analyst at the ratings agency Standard & Poor's.

In a recent report, S&P warned that continued optimistic messages coming from many insurers should be heard with caution: investment leverage remains high for some, while risk retention levels have generally increased, as have long-tail risks – those that take many years to develop. "As a result, insurers remain exposed to negative short-term investment fluctuations, losses from large events, and adverse reserve development, which can offset underlying profits," S&P stated.

Although insurance prices have begun to slide for some exposures, particularly for large commercial property policies, Europe's insurers are currently focussed on ensuring price adequacy. "The move towards greater underwriting discipline has been heralded by many competing parts of the industry," says Richard Hextall, Finance Director of Lloyd's reinsurer Amlin plc. "This move, however, has still to be proven, with the real measure of ultimate success being the future avoidance of the depths of the pricing cycle reached in the late 1990s."

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For now, confidence remains. "There are more technical underwriters in the market today who understand the need for discipline," says Henry Keeling, Executive Vice President of Bermuda's XL Capital. "Of course there are some who will completely ignore it, but the cycle will be less extreme."

Although recent results have been good, the late 1990s were characterized by low prices and rising claims, especially for international commercial property and liability risks. Losses from this period continue to develop and plague the industry, with current profits used to cover old losses. Many companies – especially those with exposure to reinsurance, the secondary market for risk – were thrust into financial difficulty. Some failed.

One result has been a continued tendency for European insurers to consolidate and focus on core specialties. The credit insurance market, for example, has shifted from a heavily populated sector with multiple players in each country to a pan-European market of just three major companies. "This is a business where scale matters," says Wilfried Verstraete, Chief Executive of Atradius, one of credit's big three.

Atradius was formed through the merger of Germany's Gerling Credit and Dutch NCM. Both were sold by refocusing insurance groups after the losses of the late 1990s and the big hit from the destruction of the World Trade Center. Atradius also includes numerous smaller credit insurers which the predecessors acquired in the 1990s.



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In the post-globalization business environment, commercial customers need responsive insurers with a geographical presence that matches their own. “It is more than just scale, it is the way you exploit it,” says Verstraete. “We must listen to our customers and put them at the center of everything we do, to provide even better and more professional services.”

Service is becoming increasingly important for Europe’s incumbent insurers as a new breed of companies, primarily headquartered in Bermuda but also from the US and Japan, enters and expands in the European market (see table). Capitalizing on the turmoil and narrowing risk appetite among local companies, some are rapidly becoming accepted players. That’s forcing local companies to improve service standards and sharpen their pencils on pricing.

Meanwhile the industry is under assault for some of its practices. New York Attorney General Eliot Spitzer, longstanding nemesis of the global financial services industry, has brought these to a head. His first investigation focused on broker remuneration, and argued that a conflict of interest arises when intermediaries accept volume-related payments from insurers. Next he probed into the use of so-called ‘finite reinsurance,’ arrangements between insurers and their reinsurers which serve to remove volatility from insurance company balance sheets. Detractors say such deals amount to financial engineering that dupes investors.


Minimum disclosure of payments to brokers is essential to address the first problem, insurance buyers declare. “Transparency of broker remuneration is essential to re-establish a relationship of trust between brokers and commercial insurance buyers, and we need consistency across Europe in the way it is accomplished,” says Thierry van Santen, President of the Federation of European Risk Management Associations. His group is currently working with the Comité Européen des Assurances (CEA) and BIPAR, the European brokers’ association, to create guidelines for brokers, insurers and risk managers throughout Europe.



## Most expensive insured natural catastrophes

Insured losses (\$m, index: 2004)	Victims	Date (start)	Event	Country
21,542	43	23.08.1992	Hurricane Andrew	US, Bahamas
17,843	61	17.01.1994	Northridge earthquake	US
11,000	124	02.09.2004	Hurricane Ivan	US, Caribbean
8,000	24	11.08.2004	Hurricane Charley	US, Caribbean
7,831	51	27.09.1991	Typhoon Mireille	Japan
6,639	95	25.01.1990	Winter storm Daria	France, UK et al
6,578	110	25.12.1999	Winter storm Lothar	France, CH et al
6,393	71	15.09.1989	Hurricane Hugo	Puerto Rico, US et al
5,000	38	26.08.2004	Hurricane Frances	US, Bahamas
5,000	280,000	26.12.2004	Seaquake, tsunamis in Indian Ocean	Indonesia, Thailand et al
4,988	22	15.10.1987	Storm and floods in Europe	France, UK et al
4,613	64	25.02.1990	Winter storm Vivian	Western/Central Europe

Source: Swiss Re, sigma No.4/2005



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Questions about finite reinsurance are on a different level. These products – commonplace and acceptable within the industry for many years – have already ended the career of Maurice ‘Hank’ Greenberg, former Chief Executive of AIG Inc., the world’s largest insurer. However, the introduction of International Financial Reporting Standards (IFRS) for insurance companies had already brought into question the use of contracts which create little or no risk transfer – the usual yardstick for judging a contract to be insurance. Add concerns raised by insurance supervisors in the UK and Australia and new disclosure benchmarks for companies, and this form of insurance financing looks doomed.

As insurers are forced to abandon some of the practices which have helped them to weather the storms of the world’s financial losses, even the weather seems to be changing the rules. While some pundits still debate the reality of climate change, insurers see the evidence almost daily. The quartet of hurricanes in the US last year re-wrote the list of the world’s most costly natural catastrophes in a few short weeks.

In Europe, with memories of the storms Lothar, Martin, and Anatol still fresh, and layers of mud from 2002’s massive inundation of central Europe still waiting to be removed, unprecedented temperatures are causing new problems.

“Heat waves definitely are of concern,” says Professor Dr Peter Höpfe, Head of Geo Risks Research at Munich Re. “The heat wave of summer 2003, with about 35,000 people killed in Europe, was the largest natural catastrophe in Europe for centuries.”

Data from Swiss Re shows that all ten of the ten worst natural catastrophes in history, in terms of adjusted insured losses, have occurred since 1989. Four of those happened last year (see table). Meanwhile the constant earthquake threat, although unaffected by changing climate patterns, has been highlighted by December’s tragic tsunami in southeast Asia. “Much of the coastline of southern Europe is prone, at any time, to be inundated by waves generated by submarine earthquakes in the Mediterranean Sea, the Aegean Sea, or the Atlantic Ocean,” says Dr Gordon Woo, a scientist with Risk Management Solutions.

Even without a serious catastrophe on Europe’s doorstep, the outlook is mixed. Insurance buyers can expect increased transparency, improved risk management, and lower prices. Alas for insurers, it may be that more troubled times lie ahead.

Written by Adrian Leonard, Editor of European Insurance magazine, [www.europeaninsurance.net](http://www.europeaninsurance.net).

## Selected international re/insurers launched since 2001

Company	Date launched	Underwriting focus	Locations in Europe
Allied World Assurance	November 2001	Commercial p/c insurance	London, Dublin
Arch Capital	October 2001 *	Commercial p/c insurance and reinsurance	London, Frankfurt
Aspen Group	May 2002	Commercial p/c insurance and reinsurance	London
Axis	November 2001	Commercial p/c insurance and reinsurance	London, Dublin, Zurich
Channel Re	February 2004	Financial guaranty reinsurance	-
DaVinci Re	October 2001	Property reinsurance	Dublin
Endurance Specialty	December 2001	Commercial p/c insurance and reinsurance	London
Glacier Re	December 2004	P/c reinsurance	Pfäffikon (Switzerland)
Grand Central Re	May 2001	Property reinsurance	-
Montpelier Re	December 2001	P/c reinsurance	London
Olympus Re	December 2001	Property reinsurance	-
Quanta Capital	September 2003	Commercial p/c insurance and reinsurance	London, Dublin
Rosemount Re	November 2001	Property and marine reinsurance	-
Tokio Marine Global	November 2004	Commercial p/c insurance	London