

A year to remember

Losses in 2008 were spread across a variety of risks from oil and sugar refinery fires and the fire at Universal Studios, to natural disasters such as the earthquakes in China and the hurricanes in the Caribbean and Gulf of Mexico.

The per risk losses are estimated at least \$8bn, and while 2008 didn't have a hurricane on the same scale as 2005's Katrina, the combined impact of Gustav and Ike has been more significant than first predicted. Property, offshore energy and reinsurance rates are now expected to harden as a result of the 2008 loss activity.

IKE IN FOCUS

Hurricane Ike in particular has thrown up some interesting quandaries. The initial assessment was fairly low (RMS estimated an industry loss of \$7bn to \$12bn) and PCS currently estimates the loss at \$8.1bn. But as the claims pour in many in the industry are expecting losses to rise. RMS in particular is estimating a final industry loss of anything between \$13bn to \$21bn, so the market awaits the latest PCS number with baited breath.

Will the final PCS number for Ike (which could take at least another 12 months to finally manifest) trigger the industry loss warranties (ILWs) that were purchased between \$10 and \$15bn and even \$20bn?

While we wait for the final Ike number the reinsurance market is feeling the squeeze most acutely. Reinsurers offering ILWs and treaty reinsurance on a collateralised basis are not able to rely on a capital release from cedants.

With little liquidity in the capital markets it is nearly impossible for these companies to replenish their

The combination of two Gulf of Mexico hurricanes and the global financial crisis has radically changed the reinsurance landscape. New Ascot CEO

Andrew Brooks examines how conditions are shaping up for the coming year and assesses the factors likely to influence the market throughout 2009

- THE BRIEF**
- ▶ Combined loss of Gustav and Ike more significant than first predicted
 - ▶ Final PCS number for Ike could take 12 months to manifest
 - ▶ Will the final number trigger ILWs between \$10bn and \$15bn and even \$20bn?
 - ▶ Increase in moral risk set to be an issue over the year ahead
 - ▶ Further insurer financial strength ratings downgrades to come

underwriting capital for 2009. Their restrictions are resulting in less reinsurance capacity being available for 2009, potentially driving up rates and putting the pressure back on direct insurance carriers to increase rates.

THE LONG-TERM UPSIDE OF A DIFFICULT SITUATION

The global financial crisis is another challenge to the market. With insurance rates anticipated to harden from the losses in 2008 there is opportunity for growth. However, the difficulties companies are experiencing in raising debt are preventing new capacity from entering the market.

Insurers around the world have had their surplus impaired by catastrophes and investment write-downs in



2008. It is estimated that companies are experiencing surplus losses of up to 20% to 255%, and this could result in downgrades in the near future.

The long-term effects of the financial crisis could be far worse than recent catastrophe losses such as Hurricane Katrina. Risk appetites will need to change as a result of less reinsurance capacity being available and a decreased ability to raise capital. Insurers will have to reduce their aggregates and increase rating.

At Ascot we expect the market to harden significantly during 2009 as insurers will need to replenish their surpluses. Reinsurance and offshore energy rates in particular are expected to harden and it is likely that the new market conditions will last longer than the post-Katrina market.

ISSUES TO WATCH

Another issue influencing insurers in 2009 is the effect of the global financial crisis on insureds. There are several economic issues at work, such as natural resource supply and demand, commodity prices, and risk management in a period of recession.

For example, as commodity prices decrease and a lack of liquidity prevents the purchase of certain goods, hull owners are being hit hard by a reduction in freight rates. The owners are seeing their daily rates drop significantly, some by as much as 80% to 90% in the dry bulk and container markets.


The concern here for insurers is two-fold: with lower revenues will insureds be tempted to reduce their spending on maintenance, and will they begin submitting more claims for small incidents they may have previously retained themselves during the economic boom?

In a tough financial market there is also the potential for an increase in moral risk. Scaling back on routine maintenance activity can result in a rise in claims and costs for insurers. There may also be a higher than expected level of claims for lost or stolen items and fires. With this in mind Ascot continues to review each risk on its own merit, looking at the technical aspect but with an increased attention to the moral risk.

THE YEAR AHEAD

The January 1 renewals are now upon us and we are seeing the first signs of what is to come in 2009. Rates are already beginning to stabilise and in certain areas harden, and we expect that trend to continue through the year.

Unlike hurricanes Katrina, Wilma, and Rita, which had a significant impact on the US market, the current financial crisis is a global event and its impact is being felt everywhere. We are seeing signs of the influence in many areas of our business, including Singapore where we are seeing rate reductions slowly start to abate.

As the effect of the 2008 losses and the global credit crisis start to affect companies' surpluses, due to lack of liquidity the only way we see surpluses can be replenished sufficiently quickly is through hardening of rates. As a result, in spite of the recessionary pressures on the market, we expect 2009 to be a positive year for the insurance market. 

Andrew Brooks is the CEO of Ascot Underwriting.

MUMBAI ATTACKS – THE MARKET REACTION

Last month the financial district of the Indian city of Mumbai was targeted by a series of coordinated attacks by a group, calling itself the Deccan Mujahedeen.

Following the attacks, underwriters warned that terror pricing kept rock-bottom by fierce competition in the Indian market could harden as a result.

Will Farmer, a senior terrorism underwriter for Catlin said: "The rates for India are lower than those for Scandinavia, which is ridiculous."

The attacks were a reminder to some 'fairly naïve' underwriters that there was still a threat, he said.

Meanwhile, *The Review* can reveal that delicate negotiations to broker a deal between the travel insurance industry and the UK government are underway.

The talks aim to find a way forward in creating a compensation fund for victims of overseas terrorism, to provide British citizens, who are victims of such attacks, with a level of compensation similar to that available if the incident had happened on UK soil.

According to UK government figures, around 190 British citizens have died and another 156 have been injured as a result of terrorist incidents abroad.

Terror victims in the UK may be eligible for a payout from the Criminal Injuries Compensation Authority. However there is no such facility for victims of an attack overseas.

Chris Hill, associate at law firm Lovells which has been working on a pro-bono basis to facilitate discussions between the travel insurance industry said there was at present 'great variation' between travel insurance policies in terms of what they covered.

"Some policies do provide some form of terrorism cover and others don't. The ones that do tend to patch you up overseas and then fly you back to the UK," he said.

He added that this was compounded by the fact there was no government compensation scheme for victims once they returned to the UK.

"In Mumbai the attackers were going into the hotels looking for people with British or American passports. So, it was an attack on the state that the victims came from. However there is a disparity – if the attack takes place on British soil you can claim compensation from the government. But if it takes place abroad the government cannot do anything for you."

Ten of the biggest travel insurers in the British market, thought to include Axa and AIG, are believed to have been approached about the compensation fund.

And if such a fund were to emerge, it may follow the Pool Re Scheme which aims to ensure that commercial property insurance is always available for terrorist attacks.

Under the scheme, set up following the IRA bombings in the 1990s, insurers offer terrorism cover when their policyholders request. However, the government will step in as a backstop when claims rise above a certain level.

Mr Hill said: "We are looking at something similar but not quite. However that is along with a range of other options. We are trying to gauge a deal that will work and that both parties are happy with, that is the way we will go."

Representatives from the UK government's Office of Humanitarian Assistance have met with members of the Association of British Insurers to present their viewpoint in December.

However the ABI appears to be resisting attempts to bring its members on board with any scheme. A spokesman said: "We don't support it because if a person travels overseas, they can take out travel insurance."



Terrorism pricing in the Indian market could harden as a result of the Mumbai attacks