

Insurance Executive Review

Market Commentary on Current Developments within the P&C Insurance Industry

Global Market: Capacity and Market Demand rarely achieves equilibrium that will stabilize product pricing for very long.

insurance markets outside the United States plays a major role in providing capacity to the domestic commercial and personal lines private insurance companies and publicly sponsored programs. The U.S. based carriers cede about \$58 billion of reinsurance risk premium annually to reinsurance markets outside the U.S. Some of these alien reinsurers have affiliated sister companies domiciled within the U.S. but write a broad portfolio of risk business from sources around the world as “spread of risk” is a fundamental principle to be followed in writing global business. With the U.S. being the largest property casualty insurance market among the developed countries, it attracts substantial interest from global reinsurance markets. For a more detailed view of specific U.S. reinsurance market participants see our Newsletter # 28 “Congress and the Tax Loophole...Target Bermuda” at our website.

For the purpose of this paper we will explore the size of the global capacity to support insurable risks in the property casualty segment to determine whether there is excess capacity contributing to the soft pricing in commercial lines. Risk reinsurance capacity that may be abundant to the needs of commercial insurers may be contributing to the continuing lower price spiral for business.

The Business of Reinsurance

Reinsurance was a critical part in the development of international business and markets especially after the industrial revolution. As countries developed their economies the need for insurance grew to help transfer risk associated with such industrial growth, expansion of commerce and innovation. The local insurance economy had constraints on its’ ability to keep pace with the growth of common and localized risks without support. Organizations in more developed markets could help by taking or removing the excessive risk that might jeopardize local profits or even solvency. An early international leader in reinsurance was Lloyds of London who dominated this “capacity market” for decades and literally “operated” in a hundred countries by accepting excess risk business from the small local insurers. The economic expansion after World War II and the development of multinational organizations increased the need for risk capacity so additional reinsurance markets in the U.S. and Continental Europe saw an opportunity for substantial growth. In the U.S. the litigation crises in 1985 saw a huge retreat of international reinsurance support for excess risks that left local insurers unable to write such business literally at any price. As prices escalated the impact on surplus (capital) reduced capacity without relief through international markets. The crises gave rise to new capital some in conventional market form as well as unconventional vehicles such as captive insurers and risk retention groups. The decade of the 1990’s and early 2000 brought the need for more natural catastrophe capacity that saw another burst of new traditional markets being formed via private investor capital as well as more innovative risk vehicles such as catastrophe bonds and side-car Special Purpose Vehicle (SPV) facilities. So the traditional insurance and reinsurance businesses had not only seen more long term conventional growth in worldwide business opportunities but the emergence of these alternative risk financing vehicles that could fill gaps (often competing with) existing capacity. The difficulty here is in trying to measure the “global capacity” for insurance risks at any given time as new vehicles emerge when existing ca-

capacity becomes limited or voluntarily withheld.

Conventional Risk Capacity Deployment

We can look to various sources that monitor risk capacity on a global basis but this tends to only cover traditional markets that have a business model focused on the business of insurance and/or reinsurance. The more difficult problem is trying to measure the nontraditional market that ebbs and flows with the pricing/availability swings commonly faced by traditional carriers. Risk conditions change traditional markets' view on profitability and under very adverse circumstances even the risk of solvency to the enterprise. Such conditions can cause carriers to withhold risk capacity or price it above what the buyer market can bear. It can also inspire new market entrants who see an opportunity in these higher market prices. The "technical" aspect of market capacity is simply a mathematical exercise looking at the regulatory, rating agency valuation and prudent financial constraints on deploying the value of capital to be exposed in order to maximize premium income. But that is as far as it goes. It ignores the profitability component of the premium to be written that might produce underwriting losses. In the latter case it might be more prudent to withhold capacity rather than making it up with volume! This is the "subjective" aspect of capacity utilization.

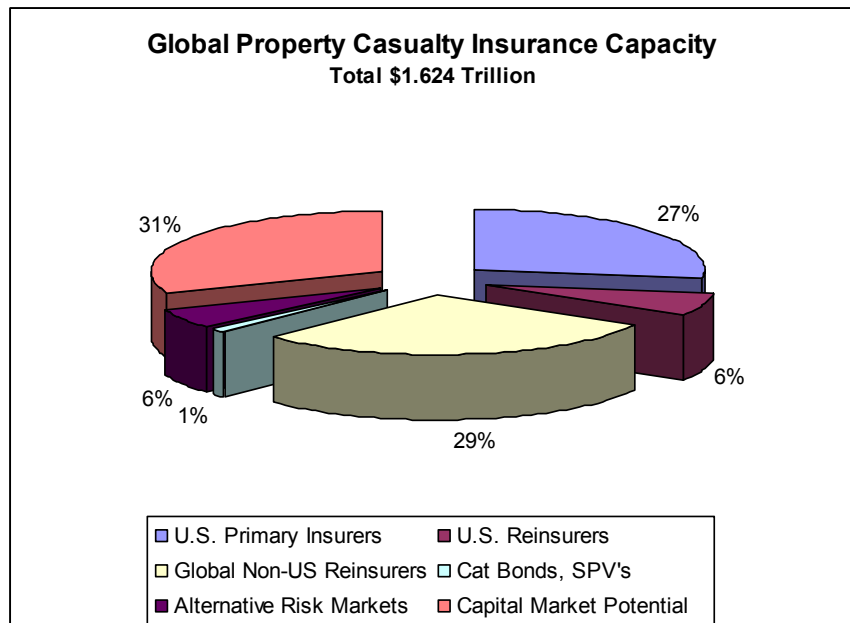
In a fragmented insurance product market underwriters must make choices on where and how to deploy capital based upon the ability to achieve sustained profits and reward investors who have their own alternative investment choices. Underwriters are faced with complicated choices based on such things as risk territories, business availability and special knowledge of exposures to be undertaken. In such cases an underwriter would not want to be "all things to all people" as technical capacity must be modified by subjective deployment decisions.

Technical Risk Capacity Measurements

We have already taken a hard look at the U.S. private insurance market capacity in Newsletter #52 which includes both primary and reinsurance companies based here. Capacity utilization (premium to surplus ratio) is at an historic low that in turn keeps competitive pressure on insurers to maintain market share. Carriers who are gaining market share at current pricing may experience indigestion in later years if these prices prove insufficient to cover ultimate losses. This U.S. private carrier market that totals \$545 Billion of surplus includes \$104 Billion held by reinsurance companies. There is a substantial amount of global capacity estimated at \$1.6 Trillion that is available as shown in this chart.

Source: Insurance Services Office; Reinsurance Association of America; Captive Ins. Assoc.; Risk Retention Assoc.; Aon-Benfield; Lloyds; Swiss Re Sigma Reports/ Global Cat Bond Index; Insurance Information Institute; Goldman Sachs and CR Market Strategies

One of the major difficulties in combining the reported capital/surplus involving non-U.S. companies is that it may involve the risk of some double counting where subsidiaries' data is consolidated with a foreign parent. While foreign reinsurers also provide support to the life insurance market, we believe this data generally reflects surplus support essentially



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for the property casualty market segment. We noted the Capital Market portion as “potential” as it reflects what investment bankers believe could be raised to support the global insurance market under positive outlook for equity returns. Finally, with the exception of the U.S. Primary Insurers who are focused exclusively on the domestic market, most of the remaining capacity has a global market viewpoint notwithstanding that the U.S. is the largest consumer of insurance.

Insurance Demand Measurements

Since global markets, particularly reinsurers, have a worldwide view of where to seek risk reinsurance opportunities, their extending capacity to selected markets will be based on a number of factors but always focus on efforts to achieve risk diversification and growth management objectives. Each geographical region may have selection criteria that will be based on an evaluation of inherent favorable/unfavorable characteristics that will determine the amount of interest. The local market characteristics such as currency valuation, geo-political conditions, catastrophe exposure, competition environment, inflation trends, economic development and other risk factors contribute to a global capital allocation evaluation. The data below describes some of the fundamental risk/premium opportunities in the global market:

World Insurance Market Demand in 2009

Sigma Report No. 2/2010

	Life	Growth	Non-Life	Growth	Penetration Ratio as % of GDP	
	Premiums	%	Premiums	%	Life Premiums	Non-Life Premiums
North America						
United States	\$501,675	-13.3%	\$648,083	-2.0%	3.52%	4.55%
Canada	\$45,154	-2.9%	\$54,342	-6.0%	3.38%	4.06%
Total	\$546,829	-12.5%	\$702,425	-2.3%	3.51%	5.41%
Latin America	\$42,544	-4.1%	\$67,283	3.4%	1.07%	1.70%
Europe	\$955,373	7.5%	\$662,224	-6.1%	4.52%	3.07%
Asia	\$748,355	-10.3%	\$259,777	8.4%	4.53%	1.55%
Africa	\$32,631	-23.4%	\$16,872	3.7%	2.17%	1.12%
Oceania	\$33,614	2.0%	\$33,731	-2.6%	3.01%	3.02%
Total	\$2,359,346	-3.3%	\$1,742,312	-2.1%	4.03%	2.98%

Source: Sigma # 2 2010 report

The previous surplus chart might align with a possible 1:1 ratio of worldwide property casualty (non-life) premium to surplus ratio that further suggests a rate driven competitive market in the U.S. moving into the rest of this year and at least the early part of 2012. Favorable prior loss (reserve) development that will continue to inflate near term earnings and capital with carriers looking to shed this “excess capital” via stock re-purchasing programs. This will dominate global carrier activity in early 2011 but may subside later this year as evidence of a turn in market conditions in 2012 becomes a real possibility.



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Mr. Ruoff is President of CR Market Strategies Inc. an insurance marketing and risk management consulting organization based in Garden City, New York. Mr. Ruoff has been involved in insurance underwriting, international insurance brokerage and alternative risk management businesses having held executive management positions with Continental, AIG, Johnson and Higgins, Sedgwick James, and Acordia (Wells Fargo). He has been a speaker/panel member at numerous industry events during his over 40 years in the insurance industry including RIMS, CPCU and other conferences. His articles have appeared in many industry publications and is a member of the Advisory Board of St Johns School of Risk Management and Actuarial Science.