INSURING AGAINST THE FUTURE

EVENTS SURROUNDING 11 SEPTEMBER HAVE AFFECTED SHARE PRICES, WILL PUSH UP PREMIUMS, REDUCE COVERAGE CRITERIA AND BRING ABOUT A DIFFERENT TYPE OF INSURER, SAYS **SAM ALEXANDER** OF SWISS RE.

The insurance bill from the 11 September attacks in the US could be as high as $70bn, according to some industry analysts. Leading insurance and reinsurance companies have been forced to double projected losses as fresh claims are identified or new liabilities are assessed (see *Table 1*). This compares with the costliest catastrophe ever caused by Hurricane Andrew, which cost $20bn.

PRICE AND CAPACITY IMPLICATIONS. The strain of size of the loss is already evident in reduced coverage conditions and rising premiums in the insurance industry. Fundamentally, the losses have significantly reduced the capital and underwriting capacity of the international reinsurance industry. This has the concomitant effect of both reducing the availability and increasing the cost of reinsurance. In addition, many smaller reinsurance operations will be uncertain as to how much capital they have to support their capacity and will consequently either significantly reduce and in some cases have withdrawn from certain lines of business. This has a direct impact on primary insurance companies which will find it harder and more expensive to obtain reinsurance.

Higher reinsurance costs, combined with a heightened awareness and increased uncertainty about risk, will inevitably increase the price of insurance. Significant price increases are already being imposed on renewals of commercial and large property policies. These increases, especially in marine and aviation, are severe.

Equally, there will be significant changes in policy coverages. The availability of certain types of coverages will be subject to both lower policy limits and narrower definitions of what is covered. The terms of these conditions will be dictated very much by available reinsurance terms, which will affect the level of deductibles and retentions corporate clients will be faced with.

The immediate reaction to these losses has been a 'flight to quality' as ceding companies renewing their policies have heightened sensitivity to the financial ability of their reinsurers to pay out claims. This will probably benefit the largest and best capitalised reinsurance companies. The four biggest reinsurance groups – Munich Re, Swiss Re, Berkshire Hathaway and General Electric – accounted for about half of global reinsurance premiums in 2000. This reaction is fairly clear in the European equity market if you look at the relative share price performance of some selected reinsurers just one month after the event.

TABLE 1
IMPACT ON THE REINSURANCE MARKET

Estimates of the major losses are as follows:

Company	US$ (m)
ACE	550
AIG	800
Allianz	912
AXA	550
Berkshire Hathaway	2,200
Chubb	600
CNA	300
GE Employers Re	600
Hannover Re	367
ING	547
Lloyds	1,900
Met Life	300
Munich Re	1,950
Partner Re	375
RSA	290
SCOR	200
St Paul	700
Swiss Re	1,250
XL	700
Zurich Financial	800

Berkshire Hathaway's shares have increased almost 10% (as of 23 October) since the event, while the S&P 500 is flat. Although the group announced one of the highest loss estimates ($2.2bn) of any insurance company stemming from the attack, analysts say it

can easily make the amount up with increased market share at steeply increased premium rates.

Munich Re announced that its profits for 2001 would be 'hit heavily' but that the dividend payout would remain unchanged. In contrast, Hannover Re (the fifth largest reinsurer) announced that its 2001 profits would be 'wiped off' and that it would not pay a dividend to its shareholders in 2001. Nevertheless, Hannover Re remains in a strong position to benefit from the increased future demand for reinsurance.

It should be noted that the insurance groups listed above account for the greatest exposure to 11 September and in total account for more than 70% of the total loss estimates. These entities are all rated at least A and have a combined capital of close to $300bn. The global reinsurance industry has substantial capital resources and even the unprecedented claims arising from the terrorist attacks on the WTC are expected to be handled by the larger reinsurers. Nevertheless, the larger the scale of the ultimate losses will increase the possibility that some smaller reinsurers will fail. Following the attacks Standard and Poor's (S&P) placed more than 20 insurance groups on ratings review for downgrade.

LLOYDS. A particularly problematic area for Lloyds is the discrepancy between its publicly stated net exposure of $1.9bn and the gross exposure before reinsurance recoveries of more than $7bn. US insurance regulators have relaxed the rules governing the amount of funds that are required to be deposited in the US as security for gross claims. Nevertheless, the National Association of Insurance Commissioners (NAIC) intends to conduct a investigation into Lloyd's financial position to guage whether it can maintain its financial position as claims are paid. Lloyds has already made a cash call on its members for £780m in response to the attacks.

TABLE 2
PRICES FOLLOWING 11 SEPTEMBER

Company	Closing price (10 Sept)	Closing price (9 Oct)	% change
Swiss Re	153	162	6%
Munich Re	273	289	6%
AXA	26	22	(16%)
ZFS	414	345	(17%)
Hannover Re	79	59	(26%)
SCOR	47	30	(35%)

ENTRY OF NEW CAPITAL. While the insurance industry reacts to the events of 11 September, a number of companies and private investors are pouring capital into the industry, hoping to take advantage of opportunities they see emerging from shortages in underwriting capacity and rising premium rates. A number of new reinsurance ventures have already been established: for example, Arch Reinsurance, Da Vinci Reinsurance and Axis Speciality.

IMPLICATIONS FOR THE ALTERNATIVE RISK TRANSFER MARKET. The sudden loss of capacity in the traditional reinsurance and insurance markets is widely expected to produce a large opportunity for the alternative risk transfer market. Many insurance buyers believe insurers have acted too swiftly and aggressively and therefore could be in danger of leaving buyers dangerously exposed and uncovered. Many companies will now be seeking help in retaining more risk without unduly exposing their balance sheets. It is highly likely that self-insurance in a tax-efficient form will be favoured among the potential solutions to this problem.

Increased utilisation of captives will be a key response to the hardening global insurance market. Another will be the creation of mutual or pooling arrangements to replace lost underwriting capacity. The benefits of captive insurance are fairly obvious:

- cheaper premiums which may become a source of investment income;
- a formalised method of risk retention;
- direct access to the reinsurance market; and
- the potential to 'customise' the cover to fit the requirements of the client.

The growth in the alternative risk transfer market will inevitably be boosted by the events arising from the terrorist attacks. However, this growth was already clearly one of the many trends that is rapidly changing the landscape of business in the financial services arena. The demand for such solutions was already being influenced by several factors:

- the increasing emphasis on shareholder value;
- increased convergence of banking, insurance and the capital markets;
- an increasingly holistic view of risk management; and
- a heightened awareness of capital optimisation.

Since 11 September, however, the number of companies which will be seeking a cost-effective financing solution to address their increased risk retentions will increase significantly.

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