

Catastrophe risk – lessons learned



Stephen Young, chief underwriting officer and head of reinsurance at Endurance Specialty Insurance Ltd. in Bermuda gives his views.

As the global property catastrophe reinsurance market

tries to recover from the first half of 2011, can it sustain another event or series of events?

Yes, I believe the market can sustain another large event or series of events, but not without adjustments occurring at the next renewal cycle. Right now, the market is at its tipping point relative to increasing rates, although the magnitude of any increase is subject to debate. Given the changes that are now impacting US and European wind models and the financial impact of recent cat events, if additional losses are encountered the market will react quite significantly at renewal time, potentially creating a demand and supply imbalance resulting in rate increases and new clearing prices for cat limits.

Not all reinsurers are created equal, and in this climate insurers need to partner with a reinsurer that will work with them to ensure fair pricing relative to the risks covered – and not just at renewal season. At Endurance, we take the time to understand our clients' business and risk exposures, enabling us to provide solutions and pricing that best address the exposures in our cedants' portfolios.

Has underwriting changed in either insurance or reinsurance in reaction to the catastrophe events of the last year?

How underwriting has been impacted is an intriguing question. I believe underwriters are now more cautious when considering their positions. How can an insurer or reinsurer create a profitable portfolio recognising that major loss has, can and will occur anywhere in the world? The more successful underwriting teams will be those who create portfolios which incorporate multiple strategies that contemplate the downside of taking risk locally, yet still create value on a broad scale and take advantage of opportunities when they arise. This is easier said than

done and requires focused risk assessment and an organised approach to the deployment of capital to create a global portfolio. Any shifts in underwriting philosophy have been a re-affirmation that truly assessing the business must remain a core focus before capital is deployed.

What do you expect the impact of the new US and European Wind Models to be on 1/1/2012 renewals?

The new models, while initially disconcerting to the market, should be viewed as a positive measure that will help companies better anticipate their risk exposures and establish capital needs. No model is absolute, but there is a growing consensus that the logic and science behind the recent model changes have greater merit than first recognised.

At this stage, many reinsurers have had a chance to evaluate the impact of the US wind model changes on their portfolios and are also beginning the work necessary to digest the changes associated with the European wind model. As far as the 1/1/2012 renewals, I anticipate that the changes will have a significant effect with many insurers reassessing their business portfolios and the capital necessary to support them, most likely translating into greater costs for reinsurance. However, it will likely take several renewal cycles before the full effect of the model changes are realised.

Endurance is consistently seeking to provide companies with our perspective on how the models affect their portfolios as we believe these insights can be valuable to insurers as they strive to meet their business needs.

Given the current environment, what criteria would you suggest when selecting a reinsurer?

I have always been an advocate of careful due diligence and believe that insurers should more carefully evaluate potential reinsurance partners. Many use the rating

agencies or their brokers as knowledgeable resources who can provide insights on the relative risks of each company. However, there are certain key questions that I would ask a potential counterparty:

- What are your PMLs and how do you calculate them?
- What non-natural peril catastrophe business do you write and how do you measure and monitor your exposure? What non-natural peril line poses your greatest risk?
- What economic risk do you have within your existing portfolio?
- Have your portfolios been stable over time?
- How transparent is the firm?

There are certainly many more questions, but it does not take much to determine whether a company is managing their business effectively. Especially in this environment, insurers should be probing to understand the underlying risks of a potential reinsurer until they are satisfied that they have the right partner.

What are the short term expectations and long-term prognoses for the market overall?

Short term, we should expect the market to react at the next renewal cycle with a heightened focus on rate movement. My prediction for the long term is that the market, through a better understanding of the loss events that have occurred, will be more knowledgeable and thus will take a healthier approach toward capital deployment.

Is there a single takeaway or lesson learned from the first half of 2011?

Always keep your eye on the underlying risk regardless of the market cycle. It is the key to surviving in the short term and thriving in the long term. Our clients seek partners that endure during all cycles and events. As such, we keep a diligent eye on our business risk to consistently provide the benefits and security that they have come to expect.