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Résumé de l'article

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Voici les principaux thèmes abordés par les auteurs : la position du Canada sur le marché global de la réassurance, l'impact des événements du 11 septembre 2001 sur le marché de la réassurance, les renouvellements de 2002, les conditions actuelles du marché, les défis de certains grands risques sur le plan de la souscription, les catastrophes survenues en 2001, la baisse des investissements et les renouvellements de 2003 pour les assureurs canadiens.

The Canadian Reinsurance Market in 2003

by Christopher Robey and Keith Fillmore

ABSTRACT

Admittedly, the previous decade was not the best for the reinsurance industry. In this article, the authors provide an overview of the current reinsurance market conditions by reviewing the dramatic changes in the market which occurred since the late 1990's and then look at the current reinsurance situation both in Canada and globally.

Here are the main themes discussed by the authors : Canada's Place in the Global Reinsurance Market, Impact of September 11, 2001 on the Reinsurance Market, 2002 Renewals, Current Reinsurance Market Conditions, Underlying Challenges and Major Risk Exposures, 2001 Global Catastrophes, Declining Investment Yields, and 2003 Renewals for Canadian Insurance Business.

Keywords: Reinsurance markets, major risk exposures, global catastrophes, renewals, investments.

RÉSUMÉ

Il faut reconnaître que cette dernière décennie ne fut pas un bon cru pour l'industrie de la réassurance. Dans cet article, les auteurs présentent une vue générale du marché actuel de la réassurance par une revue des changements dans les conditions du marché depuis 1990, puis ils examinent la situation actuelle du marché de la réassurance, tant au Canada que sur le plan international.

Voici les principaux thèmes abordés par les auteurs : la position du Canada sur le marché global de la réassurance, l'impact des événements du 11 septembre 2001 sur le marché de la réassurance, les renouvellements de 2002, les conditions actuelles du marché, les défis de certains grands risques sur le plan de la souscription, les catastrophes survenues en 2001, la baisse des investissements et les renouvellements de 2003 pour les assureurs canadiens.

Mots clés : Marchés de la réassurance, grands risques, catastrophes mondiales, renouvellements, investissements.

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CANADA'S PLACE IN THE GLOBAL REINSURANCE MARKET

Reinsurance by its very nature has always been an international business and the Canadian reinsurance market represents only approximately 2% of the global market. As a result, we cannot look at the Canadian market in isolation.

The dramatic shift in the reinsurance market which began after Hurricane Andrew in 1992 and the Northridge earthquake in 1994 continued to the end of the 1990's with the disappearance of many smaller reinsurers and the resulting increased size of the larger companies. By the year 2000, the ten largest reinsurers wrote 82% of the total global premium.[1]

At the same time, new well-financed reinsurers emerged in Bermuda and Bermuda reinsurers as a whole increased their market share from 1% to 5% with further increases expected. Lloyd's, on the other hand, saw its market share decrease from 6% in 1990 to less than 4% today. The number of active Lloyd's syndicates had dropped from 401 to 170 by 1998 and to 109 in 2002, although premium capacity is at an all time high. Today the top 20 syndicates control over 70% of Lloyd's capacity.

Annex A lists the major changes in the reinsurance market since 1998. The most notable trend has been the exodus of insurers from the market. The most recent are the Zurich spin-off of Converium Re and St. Paul's of Platinum Underwriting, both through initial public offerings, and the decision of Gerling Konzern to put Gerling Global Re into run-off.

IMPACT OF SEPTEMBER 11TH 2001 ON THE REINSURANCE MARKET

The reinsurance market was hardening before September 11th, 2001 due to the poor results of the previous several years. The attack on the World Trade Centre (WTC) accelerated the pace of this change. Perception towards risk has altered significantly due to the major impact of this loss. Many reinsurers had expressed concerns since Hurricane Andrew about unknown accumulations, but virtually no one envisioned a loss where so many lines of business could be affected. The WTC loss is the largest property risk loss, business interruption loss, catastrophe loss, workmen's compensation loss, life insurance loss, and may be the largest liability loss to date.

In addition, two court actions are underway with possible awards in the billions of dollars. A group of the victims' families are suing close to ninety defendants for $1 trillion US alleging they supported al-Qaeda financially. The defendants include many international charities, several banks, Saudi officials and the Sudanese government. Many of these defendants have U.S. assets so any award could be at least partially enforced. The Silverstein case deliberates the issue of whether the WTC loss was one or two "events" with the ultimate settlement being either $3.55 billion US or $7.1 billion US. The outcome in the Silverstein case will have a major impact on some reinsurers, since they have reserved generally on the basis of the lower figure.

Lack of availability of retrocession capacity has became more pronounced, since the WTC loss was from an unexpected peril with an unforeseen accumulation across many lines of reinsurance. As reinsurers can no longer rely on cheap retrocession capacity they retain more of the business they write and become more selective in their underwriting.

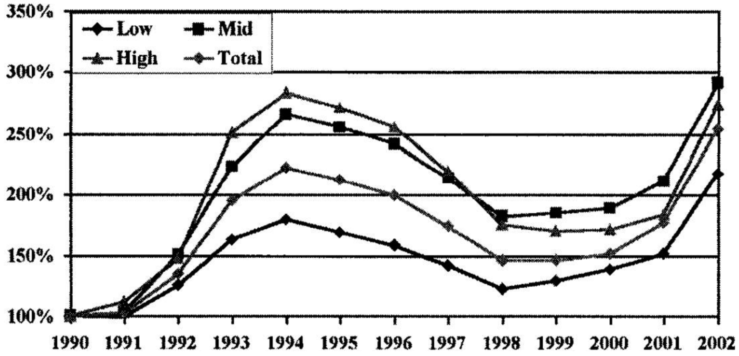
■ 2002 RENEWALS FOR CANADIAN BUSINESS

The World Trade Centre attack in September 2001 became the driving force for 2002 treaty renewals in Canada. Since all open market reinsurance is placed with foreign-owned reinsurers, local reinsurance offices had to wait for their head offices to formulate worldwide strategies to deal with the newly recognized exposure of terrorism in North America. This resulted in a significantly delayed renewal season with little activity until mid-November.

Once negotiations started, terrorism dominated them. With Canadian insurers required by law to give some terrorism cover and international reinsurers seeking to exclude it entirely, discussions were lively. Local reinsurers did an excellent job of persuading their head offices to provide some terrorism cover, but it varied from one reinsurer to another. Although adequate coverage was available for most clients, no consistent format emerged by the time negotiations were closed off.

The terrorism issue overshadowed a sharply tightening market. Catastrophe rates increased by 44%[2], the largest increase since the post-Andrew market of 1993 when the increase was 49%. Catastrophe rates in 2002 were estimated to have reached the level of 1994, the peak of the last hard market.

CHART 1
CANADIAN CATASTROPHE RATES
All Years Expressed on 1990 as Base Year



Sources: Swiss Re Canada

Other renewals also saw sharp price increases. Margins on proportional contracts went from 5% or 7.5% to 10% or more, with quota share automobile contracts being particularly hard to place. Per risk contracts also rose steeply in price following a poor year for individual risk results.

Aside from price increases, the most radical changes as a result of treaty renewals were the imposition of "Total Insured Value" clauses and terrorism exclusions.

Most insurers now require reinsurers' agreement to underwrite property locations with more than $500 million CDN in value. This has meant delays and capacity problems for many industrial schedules.

At least six different terrorism exclusions were introduced. The broadest version provided fire following a terrorist act for physical damage but not for resultant business interruption, in accordance with statutory requirements.

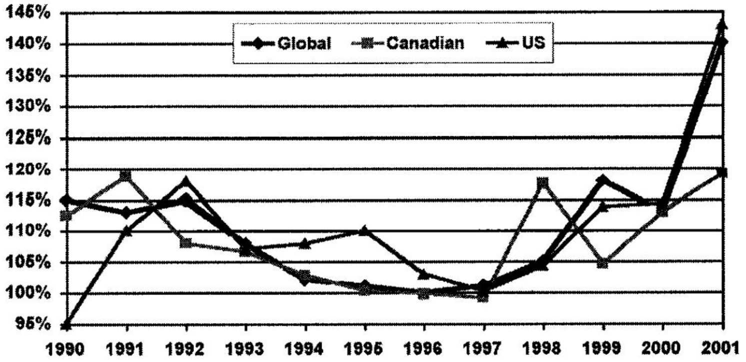
Some insurers however have attempted to exclude both direct and indirect loss as a result of a terrorist act, regardless of legal requirements. Where capacity is required, insurers are seeking and obtaining signed indemnity agreements from insured under which the insured agrees to reimburse the insurer for any fire loss paid by virtue of statutory requirements. The enforceability of this is obviously in question and may have to be resolved by the Canadian courts.

Discussions with the government in late 2001 to obtain a backstop to industry for terrorism coverage went nowhere and insurers decided not to revive them following the passage of backstop legislation in the United States. Rather, insurers have chosen to seek changes to provincial legislation to allow them to exclude all losses resulting from terrorism.

CURRENT REINSURANCE MARKET CONDITIONS

The combined ratio of Canadian reinsurers increased from 113% in 2000 to 118% in 2001, which was clearly an unacceptable result for shareholders. On a global basis, reinsurers' combined ratio rose to 140% from 113%, with the WTC loss accounting for over 20 points. US based reinsurers produced similar results of 143%, up from 114% in 2000. The "Reinsurers' Result" chart shows results from 1990.

CHART 2
REINSURERS' RESULTS



Sources: S&P, Swiss Re Sigma, RRA and RRC and various publications

With the substantial price increases for 2002, Canadian reinsurers expected to see a substantial improvement in their results, but that has not materialised. Although there were no significant catastrophes during the year, a number of large risk losses and the deterioration of loss reserves from prior years resulted in only a small improvement.

At the same time, the investment climate has greatly reduced investment income and, for many, eroded capital itself.

Change continues at a rapid pace in the reinsurance market. The spin-offs of Converium Re and Platinum Underwriting and the closure of Gerling Re have already been mentioned. Internationally, there have been senior management changes at American Re, Gerling Re, CNA Re, AXA Re and Swiss Re. Overseas Partners Bermuda was placed in runoff and the US operations are for sale. Trenwick also disposed of LaSalle Re's catastrophe portfolio.

In Canada, the management of Folksamerica has changed and Terra Nova Toronto was placed in runoff. Other local reinsurers are under much more "Head Office" scrutiny and few have full authority in the underwriting of individual contracts.

The management changes at American Re were followed by an increase in reserves of $2 billion US, following a recent reserve increase of $1 billion US. AXA has reorganised AXA Corporate Solutions and closed down its reinsurance operation in the United States. CNA Re and Hartford Re exited most non-North American reinsurance. Employers Re received an injection of capital from General Electric following a loss of $1.5 billion US and will probably be sold, if a buyer emerges.

All these changes share one common thread; shareholders are now expecting a much better return for their risk. Primarily, as a result of the WTC, the risks they accept are viewed as being much greater than previously believed and reinsurers are looking for greater transparency in the risk transfer process.

The changes in the market are not all negative. Over $25 billion US of new capital has been raised since September 11th, 2001, the majority of it targeted for use as reinsurance capital. Eight new Bermuda reinsurers account for over $7 billion US of capital. (see Table 1)

For the most part these reinsurers are different from the post Hurricane Andrew Bermuda start-ups. They are writing a multi-line portfolio, insurance and reinsurance, as opposed to the earlier start-ups which just wrote catastrophe reinsurance.

■ UNDERLYING CHALLENGES

Asbestosis continues to be "*the problem that won't go away*" for insurers and some of this exposure will be borne by reinsurers. Some of the increases in reinsurers' reserves the past year were for asbestosis. A.M. Best recently estimated insurers are under-funded

TABLE 1
NEW BERMUDA REINSURERS 2001/02

Name	Capital and Surplus
ARCH Capital Group	$1,000,000,000
Allied World	$1,500,000,000
AXIS Specialty	$1,700,000,000
DaVinci Re	$500,000,000
Endurance Specialty	$1,200,000,000
Goshawk Re	$145,000,000
Montepelier Re	$1,000,000,000
Olympus Re	$500,000,000
Total	**$7,545,000,000**

Source: Reinsurance Magazine, Swiss Re

for asbestosis by $33 billion US and for environmental exposure $24 billion US. If primary insurers are under-reserved to such an extent, reinsurers are certainly significantly under-reserved as well.

In 2000 and 2001, US insurers paid just over $1 billion US in mould losses. Some industry observers suggest toxic mould will be the next asbestos; while others believe the losses, while significant, will be nowhere near that level.

There have been some instances of mould in Canada especially in portable classrooms. It is too early to know the true extent of the problem in Canada, but it is likely to be excluded from most insurance and reinsurance by the end of 2003.

As noted above, terrorism was the main topic for the 2002 renewals. It will continue to be an issue of concern for reinsurers particularly in the absence of any financial backstop by the Federal government. Nuclear terrorism is a particular concern and the whole issue is complicated by the provision in provincial insurance laws which makes the ability to exclude fire following a terrorist or nuclear event questionable.

Insurers and reinsurers will concentrate their efforts during 2003 in getting those provincial laws changed, failing which, the 2004 reinsurance renewals are likely to be dominated by that one issue, with the prospect that reinsurers will withdraw protection for risks insurers cannot exclude.

2001 GLOBAL CATASTROPHE LOSSES[3]

In 2001 global catastrophe losses totalled $34.4 billion US. This includes $19 billion US for the WTC property and business interruption loss alone. In addition, the WTC liability and workers' compensation loss will probably be $10 billion US or more. Only $10 billion US of the total 2001 global catastrophe loss was from natural catastrophes.

TABLE 2

Rank	Event	Region	US $000,000's
1	WTC *	USA	19,000
2	Tropical Storm Allison	USA	3,150
3	Hailstorms, Floods	USA	1,900
4	Explosion in Fertilizer Factory	France	1,357
5	Typhoon Nari	Taiwan, Japan	600
6	Storm Hatmut	Ger,any	500
7	Petrobas	Brazil	500

* Property Loss only

2002 was a much lighter year for catastrophes, with the European floods being the main event to stand out. 2003 has started out with the worst bush fires in Australia in many years and a major earthquake in Mexico, but it is impossible to predict at this stage how the year as a whole will be. Munich Re has been tracking catastrophe losses since the 1950's. The information they have collected, summarised in Chart 3, shows clearly how catastrophe losses have been increasing exponentially both in insured loss and frequency since the late 1980's.

Reinsurers continue to be concerned, despite the increase in losses, that the recent past experience does not represent the maximum loss potential. Various studies have been done since Hurricane Andrew estimating the catastrophe loss potential for some historic events as well as other possible events. These are shown in Chart 4 [4]. Hurricane Andrew and the WTC pale in comparison to some other potential losses.

CHART 3
GREAT NATURAL CATASTROPHES 1950-2001

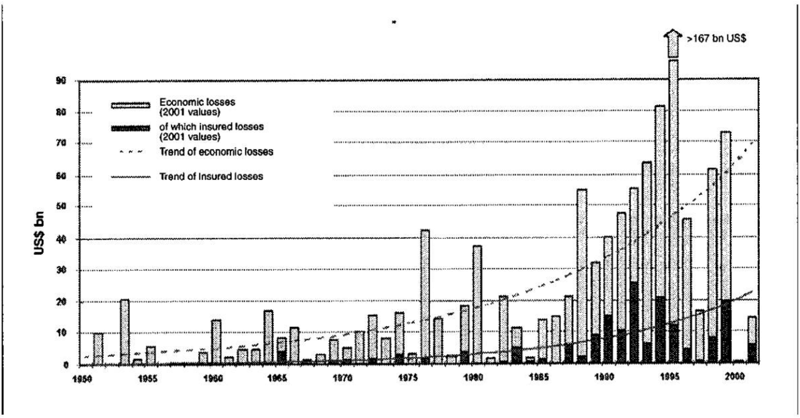
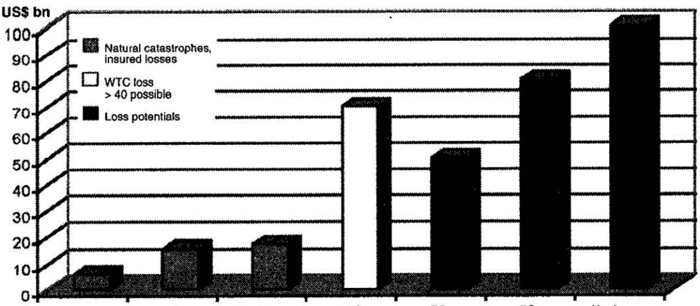


CHART 4
WTC LOSS & NATURAL DISASTER LOSSES
Insured Losses, Loss Potentials



	Winter storm Lothar 1999	EQ Northridge 1994	Hurricane Andrew 1992	WTC 2001	EQ Tokyo	EQ San Francisco	Hurricane USA, East Coast
Insured loss (US$ bn)	5.9	15.3	17	40-70*	50	80	approx. 100
Return period approx. ... years	15	40	20-30		1000	1000	1000

* Estimations from different sources

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INVESTMENT YIELDS

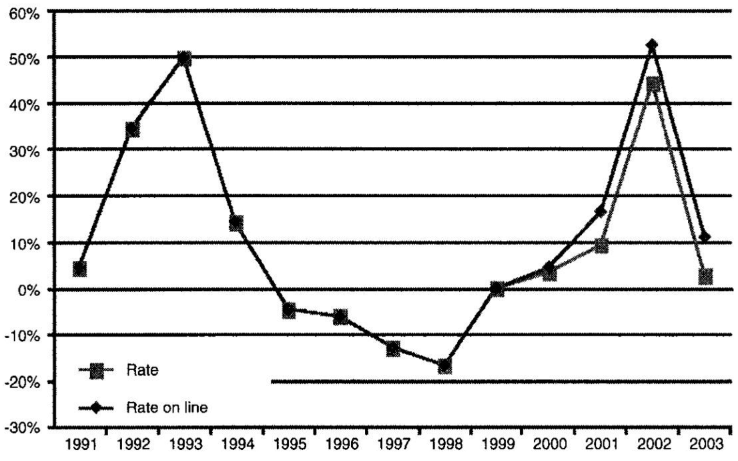
Another major problem for reinsurers is declining investment yields. Low interest rates combined with poor equity markets have reduced investment yields to the point where reinsurers have to make an underwriting profit to make an acceptable return on equity. At the same time, shareholders are pressing for better returns. The Economist magazine estimated that Munich Re's 2001 loss from reductions in equity values was twice its World Trade Centre loss. The reductions were occurring before such problems as Enron, WorldCom and the like. These occurrences only exacerbated the situation. Therefore reinsurers are under intense pressure to get their underwriting right as it is their only hope for acceptable results.

2003 RENEWALS FOR CANADIAN BUSINESS

This is the context in which Canadian insurers came to renew their reinsurance for 2003. The insurance market had improved somewhat, except for automobile, but poor investment performance meant that returns on equity were still depressed. However, reinsurance renewals brought no relief.

Property catastrophe reinsurance is the best measure of changes in reinsurance prices, since the variation in all but prices is small from year to year. Chart 5 shows that catastrophe rates went up about 2.5% overall, but because of the increase in base premium, the bulk coming from increased primary rates rather than increased exposure, rates on line increased by 11%.

CHART 5
CANADIAN CATASTROPHE PRICE CHANGES
Change Over Previous Year



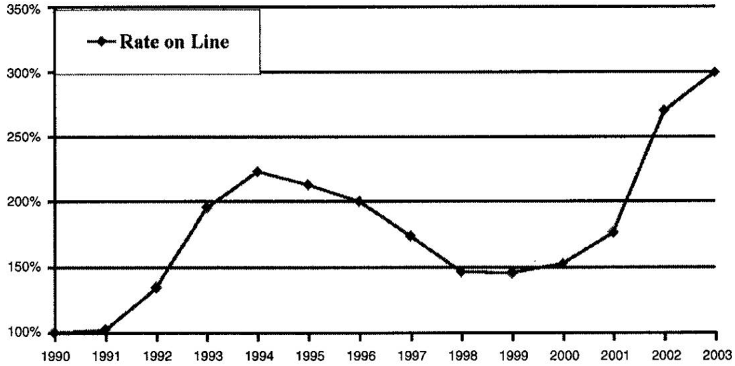
Sources: For Rate -Swiss Re Canada 1990 to 2002 and Aon Re Canada 2003. Note that data from 1990 to 1999 is rate and from 2000 to 2003 Rates on Line was also included with data from Aon Re Canada.

As Chart 6 shows, prices are now well above the peak reached after Hurricane Andrew and the Northridge earthquake and three times their 1990 level.

Prices for other reinsurance contracts also showed increases, and the gradual shift from proportional to non-proportional protection continued.

Mould exclusions became general throughout the market and asbestosis exclusions were introduced to some extent and will probably be standard in 2004.

CHART 6
CANADIAN CATASTROPHE PRICE CHANGES
All Years Expressed on 1990 as Base Year



Sources: For Rate -Swiss Re Canada 1990 to 2002 and Aon Re Canada 2003. Note that data from 1990 to 1999 is rate and from 2000 to 2003 Rates on Line was also included with data from Aon Re Canada.

Terrorism coverage remained limited, although no more so than in 2002.

More serious was the introduction by reinsurers of a nuclear exclusion clause which would have provided no coverage for nuclear incidents at all, not even the ensuing fire coverage which insurers are required by law to give. The exclusion was withdrawn for 2003, but insurers are on notice that it will be required for 2004, which gives greater urgency to the industry's efforts to have provincial law amended so that ensuing fire does not always have to be covered. If the change is not made, it is probable that reinsurers will nonetheless refuse to reinsure it; in such a situation, some international insurers may prefer to withdraw their capacity from Canada rather than leave it exposed to such a risk.

The sharp price increases of the last two years have not resulted in the increase in retentions, which would normally have occurred however, because of the level of risk in the balance of the insurers' world. Automobile insurance, by far the largest segment in Canada, remains problematic, with changes in Ontario coming, but their impact still to be measured and problems elsewhere only beginning to be addressed. The investment climate shows no sign of dramatic improvement. At the same time, companies must move from the minimum asset test to which they have become accustomed to the new minimum capital test, the impact of which is still unclear.

Finally, foreign owners are suffering themselves from a strain on their capital and are no longer willing to support underperforming subsidiaries, so Canadian companies must make it on their own or risk being shut down so that their parent can put their capital to use elsewhere.

Both the Canadian insurance and reinsurance markets are faced with more serious problems than have been the case for many years. With the relatively new willingness of foreign owners to withdraw from markets which do not offer adequate returns, the challenges facing local managers are severe and without easy answers.

ANNEX A
REINSURANCE MERGERS, ACQUISITIONS AND CHANGES

Year	Buyer	Country	Acquisition	Country
1998	EXEL	Bermuda	Mid Ocean Re	Bermuda
	Berkshire Hathaway	US	General Re	US
	Gerling Global	Germany	Constitution Re	US
	Swiss Re	Switzerland	Life Re	US
	GE Capital	US	Kemper Re	US
	Munich Re	Germany	Reale Re	Italy
	Kohlberg, Kravis, Roberts & Co.	US	Rhine Re	Switzerland
	Odyssey Re US	US	Skandia Re	Sweden
	Swiss Re	Switzerland	Reas. Alinza S.A.	Mexico
	Partner Re	Bermuda	Winterthur Re	Switzerland
	Odyssey Re US	US	Sphere Drake	UK
1999	X.L. Capital	US	NAC Re	US
	ACE Limited	Bermuda	Capital Re	US
	Trenwick Re	US	Chartwell Re	US
	Markel Corp.	US	Terra Nova	UK
	NewCap Re	Australia	In run off	
	Rhine Re	Switzerland	EQUUS Re	US
	Swiss Re	Switzerland	Reacol	Columbia
	Trenwick Re	US	LaSalle Re	Bermuda
	Swiss Re	Switzerland	Underwriters Re	US
	GIO Re	Australia	In run off	
	Danish Re	Denmark	Begins Underwriting	
2000	REAC	Australia	In run off	
	Scor Re	France	Partner Re Life	Bermuda
	Rhine Re	Switzerland	Imperial Fire & Marine Re	UK
	CNA Re	US	Closes Toronto Office	
	CCR	France	Open Toronto Office	
2001	Scor Re	France	Sorema	France
	Zurich Re	Switzerland	IPO to Converium Re	
	CNA Re	US	Exits International Reinsurance	
	HART Re	US	Exits International Reinsurance	
	Allied World Assurance	Bermuda	Begins Underwriting	
	Arch Capital Group Ltd.	Bermuda	Begins Underwriting	

ANNEX A
REINSURANCE MERGERS, ACQUISITIONS AND CHANGES (continued)

Year	Buyer	Country	Acquisition	Country
	Axis Specialty	Bermuda	Begins Underwriting	
	DaVinci Re	Bermuda	Begins Underwriting	
	Endurance Specialty	Bermuda	Begins Underwriting	
	Montpelier Re	Bermuda	Begins Underwriting	
	Goshawk Re	Bermuda	Begins Underwriting	
	Copenhagen Re	Denmark	Placed in run off	
	Endurance Specialty	Bermuda	LaSalle Re	Bermuda
	Scandinavian Re	Bermuda	In run off	
2002	Overseas Partners	Bermuda	Placed in runoff	
	Overseas Partners	USA	For Sale	
	Olympus Re	Bermuda	Begins Underwriting	
	Queen Island Re	Bermuda	Begins Underwriting	
	Gerling Re	Germany	For Sale, then placed in run-off	
	Wellington Re	UK	Begins Underwriting	
	St. Paul Re	USA	Spun of reinsurance operations into Platinum Re	
	American Re	USA	Exits International Reinsurance	
	Gerling Re	USA	Placed in runoff	
	Terra Nova - Toronto	Canada	Placed in runoff	

Sources: Swiss Re Sigma, Swiss Re Canada and various news reports

Notes

1. Standard and Poors
2. Catastrophe price increase information is taken from the Swiss Re Canada Review, June 2002
3. Swiss Re Sigma - Issue 03 2000
4. Source: Munich Re