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A plea for a diversified reinsurance panel

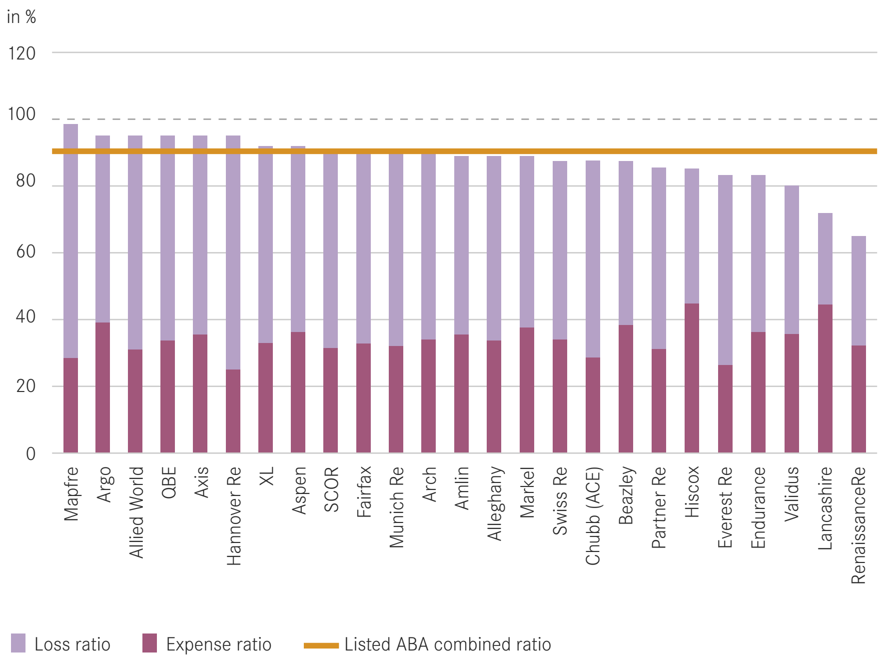
Editorial Bertrand R. Wollner, CEO

In pronouncements from supervisory authorities, rating agencies and large market participants «big is beautiful» seems to be the all-pervasive mantra. Interestingly enough, however, the purchasers of reinsurance coverage are seldom to be found among the leading voices.

The arguments for size in the reinsurance business are sufficiently well known: better diversification and thereby lower capital costs, higher capacities and thus greater relevance for cedents as well as economies of scale with regard to administrative and acquisition costs. In particular, due to the prolonged soft market cycle and the steady influx of alternative capital, the protagonists of this thesis appear to assume that the changing business model in the reinsurance field is favouring the larger companies, while mid to small-small reinsurers will fall victim to an inevitable market consolidation.

The aim of this article is not to refute such arguments. In individual cases, their validity is beyond question. However, what is invalid from our point of view are statements that assert a claim to universal applicability. Empirical evidence has proven that while larger (re) insurers in general indeed show lower expense ratios, with regards to the – more significant – claims ratios element they often lag behind smaller and more focused competitors. Figure 1 shows that the latter can perfectly well achieve an above-average underwriting performance, even when those companies that benefitted strongly from the lower level of damages from natural catastrophes in 2015 are excluded from the calculation.

FIGURE 1: COMBINED RATIOS FOR FISCAL YEAR 2015



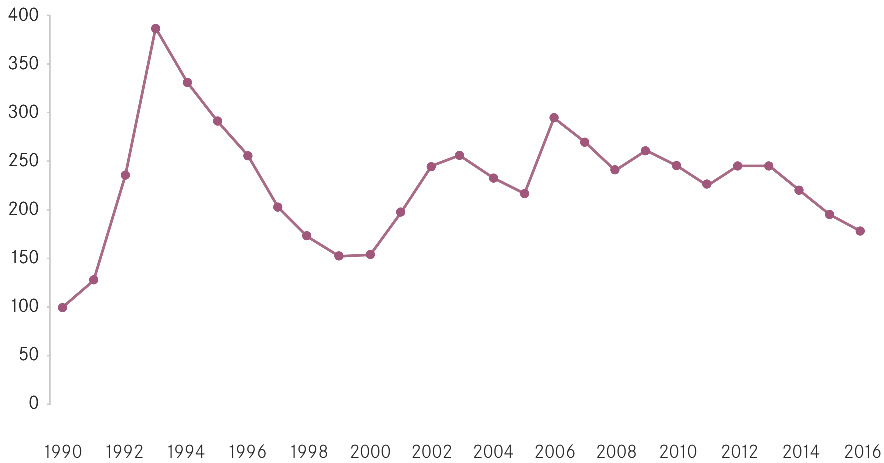
Source: The Aon Benfield Aggregate 2015

So far, so good from the perspective of investors. Yet, what interests us primarily in this respect is the perspective of reinsurance clients. Our key hypothesis is that cedents can have no interest in the emergence of oligopolistic structures in the reinsurance market, i.e. the dominance of a few companies. Our position is underpinned as follows:

Limited risk diversification

Most cedents will continue to prefer working with more than just a handful of reinsurers to minimize counterparty risk as much as possible in the future as well. Recent history has demonstrated that even large market players can run into serious difficulties, and that the conventional financial strength ratings are not entirely beyond doubt.

FIGURE 2: GLOBAL INDEX OF PRICES FOR NON-PROPORTIONAL CATASTROPHE REINSURANCE



Source: The Aon Benfield Aggregate 2015

Besides minimization of the default risks, many cedents are also concerned about ensuring the availability of a healthy diversity of their reinsurance capital sources. It therefore makes sense to choose not only reinsurers who are listed on the New York or London Stock Exchanges, but also others who have private, public or cooperative investors. An appropriate regional mixture of such sources would also seem sensible, especially in order to mitigate financial market risks.

Less diversity of opinions and approaches

In addition to quantifiable risk considerations, there are a number of qualitative reasons for promoting a sufficient diversity in the reinsurance panel. In many cases, the most successful market innovations originate from specialized and entrepreneurial niche providers. Such capabilities provide even small reinsurers with a large degree of attractiveness that extends far beyond the weight of their respective balance sheet or the level of their financial strength rating. Moreover, these reinsurers offer an alternative form of customer service and support, e.g. based on a higher degree of staff continuity.

Increasing risk of blackmail

The vulnerability of cedents related to a high concentration of reinsurers becomes particularly apparent in the wake of major losses. By presenting the example of rate levels for catastrophe reinsurance, Figure 2 illustrates the massive surcharges that occurred after events such as Hurricane Andrew in 1992 or the terrorist attacks of September 11, 2001. At this time, the global market for catastrophe covers was in the hands of a relatively small number of large reinsurers, which dominated the panels of most cedents. Subsequent to the respective loss events, these reinsurers exploited their market power: thus, many cedents were forced to accept a multiplication of rates and could merely react to this by the means of drastic retention increases. This «restructuring through the back door» also took the form of collateral damage, in particular for European cedents, who had not been affected by the actual loss events themselves.

These examples show that the large global reinsurers behave uniformly in stress situations. After the 9/11 attacks in 2001, practically no capacities were

offered for terrorism events. After the outbreak of the financial crisis in 2008, the same thing occurred with respect to credit coverages. These reactions reflect not only an oligopolistic dynamic, but also the considerable similarity of the portfolios of large reinsurers and thus their cycle management accordingly. Cedents can mitigate the repercussions of this co-monotonicity by adequately diversifying the structure of their panels, i.e. by also considering reinsurers with very specific core markets and strategies. At the end of the day, such an approach should benefit reinsurance purchasers in the form of higher price stability and should arm them in stress situations against unpleasant surprises.

Reduced transparency of reinsurance portfolios

A further important point is the limited degree of transparency of the portfolios of larger reinsurers. This fact, which is not without challenging implications for cedents, stems on the one hand from the structural and organizational characteristics of large companies. On the other hand, it also reflects the increasing tendency of such companies to cover either bundled risk portfolios, in particular for leading primary insurers, or to expand into branches that exhibit a high degree of volatility due to their large-scale dependence on macroeconomic developments. From this perspective, an excessive concentration of reinsurance markets and panels can even lead to systemic risks relevant to the economy as a whole.

In summary, we are convinced that a concentration of reinsurance panels solely around a few large providers is neither in the interest of cedents nor conducive to the stability and diversity of the global (re)insurance markets. The protagonists of «big is beautiful» should consider this carefully.

Adrian Suter: The new Head of Finance and Accounting on his first nine months with SI Re

Since March 2016 Adrian Suter heads the Finance and Accounting department at SI Re. The company is particularly benefitting from his many years of experience both as an auditor as well as a Senior Specialist with FINMA, when he was responsible for the supervision of reinsurance and business-to-business insurance companies.

From 2012 until he joined SI Re, Adrian Suter worked for the Swiss Financial Market Supervisory Authority FINMA, first as a Specialist in the supervision of insurance groups and then as Senior Specialist supervising individual insurers (reinsurance and business-to-business insurance companies). Prior to that he was a manager in the Insurance Division of the auditing firm KPMG.

Since Adrian Suter took up his position with SI Re, he has been experiencing an exciting and intense period. He says that for him it was exactly the right moment for this change: «I felt good from the beginning at SI Re. On the one hand, in my new function I am faced with new, quite substantial challenges: For the first time, I have to assess an insurance company from the inside rather than from the outside as a regulator or auditor. On the other hand, as head of Finance and Accounting, I am also challenged with respect to my managerial responsibilities. Nevertheless, the experience gained from my former activities has greatly facilitated my entry into SI Re.»

© Susanne Keller, detail of «Aus den Tiefen der Erde», Fries 2016

In his new position Adrian Suter is responsible for the areas of financial accounting, investments, taxes, ICT and compliance. «My scope of duties now includes a much wider spectrum of responsibilities and is therefore considerably more diverse than that of my earlier activities. Naturally, I'm very happy about that» he says.

«In my function as the person responsible for the supervision of SI Re at FINMA, I already got to know various aspects of the company and gained insight into its processes and business model. In the past nine months, I have not only come to know SI Re from the „inside", but have also visited SIGNAL IDUNA in Germany on several occasions, since collaboration with the Group, particularly in the area of investments, is very close.»

The new Head of Finance and Accounting sees the current low interest environment as the greatest challenge. To implement a successful, long-term and profitable investment strategy, new ideas and solutions are called for that must be tailored specifically to the business model and to internal expectations alike and need to be continually reevaluated and adapted accordingly. In connection with the changed and tightened regulatory requirements, SI Re must organize its processes efficiently and effectively in order to handle the increased expenses with existing resources. In the reporting, for example, more capacities will be demanded for fulfilling legal requirements. «It is my task in this regard to develop the Finance and Accounting department of SI Re to be well prepared for impending changes in the supervisory regulations.»

He particularly appreciates the manageable size of the company, the lean company structure and the short decision-making channels. Even more important to him is the positive corporate culture, the almost family-like atmosphere and the collegial and personal way people deal with one another. As a native Lucerner, the central Swiss location of Zug is also a plus for him personally.

During his holidays, Adrian Suter likes to travel; ever since embarking on a round-the-world trip ten years ago, Hawaii has become one of his favorite destinations. He has already visited the Pacific archipelago on three occasions. In his free time he is drawn to nature or to the football field – either as an active «over30 player» or as a spectator at high-calibre matches. From time to time a visit to a fine restaurant is also on the program.

The SIGNAL IDUNA Group stays on track

The SIGNAL IDUNA Group, the parent company of SI Re, is satisfied with the results of the 2015 fiscal year. The implementation of the program that was initiated last year to increase customer focus and cost efficiency in the future is proceeding according to plan. In addition, the ongoing premium income of the SIGNAL IDUNA Group rose by 0.4 percent to 5.4 billion euros. In particular, the premiums of the domestic composite insurance companies grew by 4.2 percent, a performance clearly above the market average.

In the year under review, SIGNAL IDUNA successfully implemented the program tailored for the future that had begun at the end of 2014. Taking into account the resulting comprehensive reorientation, Ulrich Leitermann, Chairman of the Board of the SIGNAL IDUNA Group, expressed his satisfaction with the business results for 2015 at the annual report press conference held on June 16, 2016 in Hamburg. The goal of the program is to continue improving customer orientation and competence while simultaneously reducing complexity and costs.

The gross written premiums of the Group decreased by a total of 2.5 percent in 2015. However, at the same time, the ongoing premium income rose to 5.4 billion euros. The invested assets managed by the Group (including its financial subsidiaries) grew by 2.7 billion euros, or 4.3 percent, to 64.9 billion euros as against 62.2 billion euros in the previous year. This includes around 46 billion euros in capital investments from insurance companies with a current average interest yield of 3.8 percent and a net interest return of 4.7 percent. The gross expenses for claims incurred amounted to 4.8 billion euros in fiscal year 2015. This represents an increase of 2.5 percent. In total, the consolidated net income decreased to 93.2 million euros as compared with 175.5 million euros in the previous year. An average of 12,000 employees worked for the SIGNAL IDUNA Group in 2015.

The gross premium income of the two health insurers of the SIGNAL IDUNA Group, SIGNAL Kranken and Deutscher Ring Kranken, remained stable in 2015. In combination, they achieved a gross premium income of approximately 2.7 billion euros. Almost 2.6 million customers are insured by the health insurance companies of the SIGNAL IDUNA Group. Furthermore, both companies are amongst the most premium-stable health insurers in the market.

Following an exceptional year in 2014, the life insurers are looking back at a satisfying 2015. The single premium business was deliberately reduced and decreased by a total of 11.1 percent from 1.7 billion euros to 1.5 billion euros. The gross written premiums of IDUNA Leben decreased by 177.0 million euros compared with the previous year, or 12.2 percent, to 1.3 billion euros. Current premiums, however, fell by only 1.4 percent, or 15.1 million euros, to 1.1 billion euros.

The gross premiums of the composite insurance companies rose significantly more strongly than the market, namely by 4.2 percent, to almost 1.3 billion euros. The entire composite branch recorded a significant increase in claims payments in 2015. Although severe weather events were fewer, average claims amounts increased. For the domestic composite insurance companies of the SIGNAL IDUNA Group this meant 10.1 percent higher expenses for insurance claims totaling 846.8 million euros in 2015. Here several large losses had a particular impact.

The financial subsidiaries of the SIGNAL IDUNA Group, SIGNAL IDUNA Bauspar AG, the banking house DONNER & REUSCHEL and HANSAINVEST (Hanseatische Investment GmbH), are collectively looking back at a successful fiscal year.

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