// Who benefits from the «tiering» of reinsurers?

// Significant growth for the SIGNAL IDUNA Group

SI Re

STEPS 2/15

Who benefits from the «tiering» of reinsurers?

Editorial Bertrand R. Wollner, CEO

The reinsurance industry is undergoing radical structural changes. Be it the unrelenting inflow of alternative capital, the increasing standardisation of business lines, collapsing prices and the persistent phase of low interest rates, changes in cedents' buying behaviour or the decline in demand for reinsurance capacity – some of these phenomena may be cyclical in nature, but many others may well turn out to be permanent.

Against this backdrop, there is heated discussion about the issue of «tiering», i.e. the allocation of reinsurers on a reinsurance panel to different hierarchical levels of importance and perceived value.

Drawing lines between «leading» and «following» reinsurers or, in other terms, between core reinsurers and those of less strategic importance is probably as old a practice as the notions of syndication and risk diversification as such. Accordingly, this issue is also affected by cycles or trends that are very similar to the price cycle in the reinsurance market. In the wake of the financial crisis just six or seven years ago, it was all the fashion to advocate larger panels as a way of increasing diversification and minimising counterparty risk. Previously, a trend in the opposite direction had begun in the late 1990s when «reinsurance clubs» exerted substantial influence on pricing and, after 11 September 2001, these clubs brought about a drastic tightening of insurance conditions.

Numerous primary insurers have changed their buying behaviour in recent years. These insurers aimed to reduce their costs, improved their risk management, and have been subjected to stricter governance and regulation. As a result, these companies have increased their retentions and restructured their reinsurance programmes over the last few years. According to KBW, the five largest European primary insurers alone reduced their non-life cessions by approximately EUR 3 billion in the course of the last ten years.

Now, reinsurance panels are set to be downsized yet again. Some primary insurers – and, of course, the leading reinsurers – emphasise that on account of the changed market situation, cedents should only split their risks among a small number of reinsurers from now on. However, the reinsurers concerned should, they claim, be relatively large. Consequently, the argument goes, the distance between reinsurers in tier 1 and tiers 2 and 3 will increase. Reinsurers intending to play a relevant role in the future will have to grow, even merely through acquisitions.

There are actually some good arguments in favour of «tiering» of this sort, i.e. to deliberately select and concentrate on just a few reinsurers who would take on a more prominent role in return. As a

SI Re – Mutually yours
Sustainable, agile, committed

matter of fact, the flow of alternative capital into the market continues unabated, supplied by a variety of sources that include pension or hedge funds, reinsurers and primary insurers, banks and other capital providers. Moreover, this capital enters in the most diverse forms, such as insurance-linked securities (ILS), insurance loss warranties (ILW) and capital from hedge fund reinsurers or sidecars. It would appear that cedents are finding it increasingly difficult to assess the creditworthiness, ownership structures and strategic orientation of parties that offer their capacity. Who can guarantee to the cedent that in ten years' time, the reinsurer will still accept liability for the long-term risk that was taken on so long ago? Entry barriers in the reinsurance sector are certainly too low at present.

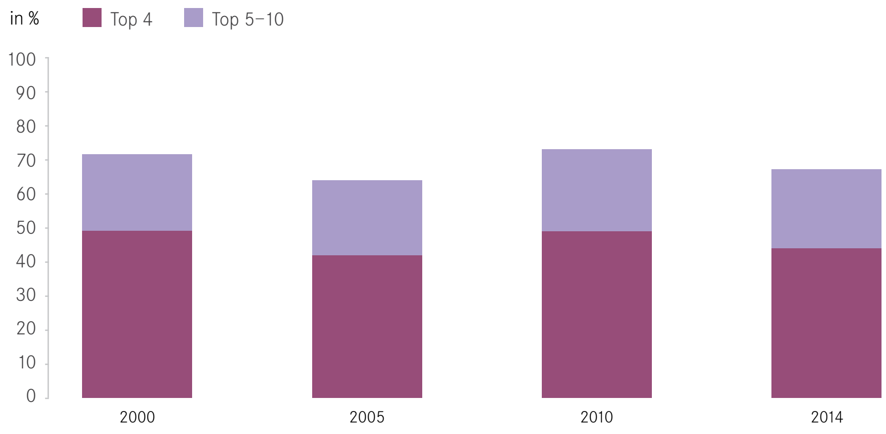
In addition, the recent surge in corporate mergers is producing an increased mix of primary insurers and reinsurers. Few companies nowadays are still «pure plays», i.e. 100 % reinsurers. It can therefore happen that reinsurers who belong to a conglomerate could be in open competition with their cedents.

Furthermore, the growing complexity of risks and the increase in regulatory requirements favour the development and maintenance of substantial long-term reinsurance relationships. Cedents rarely seek a pure capacity provider, but they expect, in addition to reliable capital strength, market and product expertise, as well as the ability to offer custom solutions or provide support with innovations.

Several factors militate against a self-imposed limitation of the reinsurance panel. These include experiences from the recent past, which are often still present, and not infrequently painful, specifically in connection with the financial crisis, when there was a sudden sharp increase in counterparty risk. Besides, focusing on a few reinsurers with a larger share would also mean greater dependency. What happens if a major reinsurer on the programme suddenly bails out, or if two reinsurers merge and their share of the programme doubles? Is that in the cedent's interest? Would alternatives be available at short notice?

A concentration of the panel may very well entail a weakening of one's own position. Cedents would sacrifice the flexibility they could use to enforce their own reinsurance conditions, thereby strengthening their own risk management. There is an emerging trend for cedents to allocate an exposed share of up to 15 % to one single reinsurer, but to supplement this allocation with additional smaller participants in the panel whose shares range between 5 % and

MARKET SHARE OF LEADING REINSURERS, 2000–2014



Source: Guy Carpenter, Swiss Re (Sigma), S&P

© Susanne Keller, detail of «Playfield»

10 %. With this approach, the cedent retains flexibility. In addition, the cedent benefits from the tier 2 and tier 3 reinsurers that often call the tunes with regards to pricing, as it is increasingly the case in the developed markets.

SI Re is convinced that stable diversification, experienced support as well as access to a well-founded and independent assessment of its own risks are ultimately the key criteria for the composition of a reinsurance panel. Equal importance should be granted to knowledge about the quality and transparency of the ownership structure, thereby enabling the buyer to know that the cover purchased is solid.

Cedents expect their reinsurers to do more than merely implement strategies that are geared purely to competitiveness and scale. Our customers prefer to entrust their risks to a reinsurer that actively manages and diversifies its portfolio to make it resilient. In return, the reinsurer asks for a margin that not only covers its capital costs but also helps to operate successfully in the market.

Significant growth for the SIGNAL IDUNA Group

The SIGNAL IDUNA Group, SI Re's parent company, posted a significant increase in its overall result and looks back on a successful 2014 financial year. Premium income rose by 2.2 % to EUR 5.67 billion. In both life and property/casualty insurance, the Group's companies outperformed the market.

As in previous years, the Group's health insurers kept their premiums almost stable. They are still among the health insurers with the most stable premiums in the market. SIGNAL IDUNA anticipates only moderate adjustments to premiums even in 2016.

The SIGNAL IDUNA Group's premium income rose by 2.2 %, whereas its gross expenditure on insurance claims amounted to EUR 4.72 billion equivalent to an increase of 1.7 %. Investment assets managed by the Group (including its financial subsidiaries) grew by 5.8 % in 2014 to reach EUR 62.2 billion. The SIGNAL IDUNA Group posted a consolidated net profit for the year of EUR 175.5 million. This represents a year-on-year increase of 32.9 %.

Speaking at this year's financial results press conference in June, Ulrich Leitermann, chairman of the SIGNAL IDUNA Group, said that he was more than pleased with the overall performance. Nevertheless, he stressed that the increased income was required for necessary investments in the future as well as provisions associated with the persistently low interest-rate environment.

The Group's life insurers reported total growth of 6.3 %, from EUR 1.55 billion to EUR 1.65 billion. Regular premiums in direct business rose by 1.2 % to EUR 1.29 billion.

The SIGNAL IDUNA Group's two health insurers achieved a total gross premium income of over EUR 2.7 billion, slightly less than in the prior year. In all, nearly

2.6 million people are insured with the health insurers of the SIGNAL IDUNA Group.

Once again, IDUNA Leben can look back on a positive financial year. Gross premiums written by IDUNA Leben outperformed the market average with a 5.6% year-on-year increase from EUR 1.38 billion to the current EUR 1.45 billion.

In contrast to the prior year, the property/casualty insurers in the SIGNAL IDUNA Group were virtually unaffected by natural catastrophe claims. Claims expenditure in 2014 therefore fell by 10.4% to EUR 879.9 million.

The foreign companies in Eastern Europe increased their premiums by a total of about 25% in 2014. In particular, the subsidiaries in Hungary and Romania posted growth well above the average market rates in their respective countries. For the first time, our Hungarian subsidiary was included in the Top Ten companies in that country's insurance market.

On average, 12,500 employees were working for the SIGNAL IDUNA Group.

SIGNAL IDUNA
Reinsurance Ltd

A subsidiary of
SIGNAL IDUNA Group

Bundesplatz 1
Postfach 7737
CH-6302 Zug
Switzerland
Telephone +41 41 709 05 05
Fax +41 41 709 05 00
www.sire.ch