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Accident & Health Reinsurance—"Déjà vu all over again"?

By Ted Clark

Ted Clark is president, Prism Information Management Group Inc. and vice president, Marketing, Reinsurance Management Associates Inc. in Toronto, Can. Ted can be reached at tclark@rmacan.com.

As I sat contemplating this article, I could not help but look out of my office window and reminisce about the Accident & Health (A&H) market in the mid- to late-1990s. Toronto, Canada was an international reinsurance hub that arguably rivaled any in the world for A&H reinsurance. Major companies on University Avenue, Bloor Street and Bay Street all wrote A&H reinsurance using dedicated staff which protected risks that were worldwide in scope. In addition to direct writers, there were external managing general underwriters (MGUs) developing business from Toronto on behalf of groups of companies (A&H reinsurance pools) and also on behalf of specific international reinsurers. Brokers and other advisors made regular visits to the city from London, Europe, the United States and even the Far East. Lloyds' and the London market, the United States and Europe were also important players in the A&H reinsurance market, but without doubt Toronto was a key center of excellence and capacity.

I can see some of the corporate offices of these Canadian reinsurers from my window, but today there are only two MGUs operating in Toronto and actively underwriting in the A&H reinsurance market. Only one of these underwrites on behalf of a Canadian company, and this is the Canadian branch of a U.S. entity. So what happened in the last 15 to 20 years and where are we now? To answer this question it is helpful to look at some of the historical factors that affected the market during this period and then compare this to our current situation. In my mind the top five characteristics of the A&H reinsurance market in the mid-1990s were as follows:

1. Too much capacity: The Accident business tends to be cyclical in nature with cycles tied to key events in the world or to supply and demand in the market itself. Profits had been good in the late 1980s and early 1990s, and this attracted more and more reinsurers into the market. A number of reinsurance MGUs also emerged as employees with an entrepreneurial spirit left reinsurers to form their own companies, often with the backing of their former employers. All these entities were competing for the same business;

2. Intense downward pressure on pricing: As competition increased, prices dropped, especially on catastrophe programs where pricing was based upon payback period or rate online which are approaches adopted from Property and Casualty (P&C) pricing and will be familiar to many. The payback approach seeks to calculate how many years of premium it would take to reimburse one full loss. Therefore if the limit of coverage is $1,000,000 and the annual premium is

$50,000, then the payback period is 20 years in that it would take 20 years at $50,000 per year to pay for one full loss of $1,000,000 (Note: this approach does not take account of interest or other factors). The rate online is the inverse of this and would be 5 percent. During the 1990s, on some higher layers the pricing went to 1,000+ year paybacks indicating that reinsurers thought the likelihood of a claim at this level to be one every thousand years. This pricing is fine until that one year …;

3. Relaxation of terms and provisions: Business could be written with fewer exclusions because of the competition in the marketplace. An example of this was the renewal of contracts written on a losses occurring during (LOD) basis the previous year to risks attaching during (RAD) the period basis in the renewal year—for no additional premium. LOD reinsurance treaties protect the reinsured against claims that occur within a pre-specified period—usually Jan. 1 to Dec. 31 regardless of when the original business was written. Therefore a claim that occurred in March of 1995, for example, could flow from a policy that was written in 1994 and also a different policy from 1995. RAD reinsurance treaties, on the other hand, protect the reinsured against claims that occur on policies written in that specified period, regardless of when the claim takes place. Therefore a claim could occur several years after the expiration of the coverage. Because the tail on RAD policies is greater than treaties on a LOD basis, RAD treaties typically cost more than LOD treaties. Capacity was such that in transition years there was often a roll-in of LOD claims on historical policies plus full coverage of RAD for future claims—again for no additional premium;

4. Internal pressure to grow top line: During the same time that competition was driving down premium and relaxing terms, there was internal management pressure on reinsurers to write additional premium and take advantage of favorable historical returns. As a result, a number of creative ways had to be developed to increase A&H premiums. P&C reinsurers had suffered tough losses in the late 1980s and were pulling out of, or reducing their writings in many market segments. As a result, new "lines" of business were explored and this led to the proliferation of "carve-outs" in aviation, marine and workers' compensation reinsurance products. The "carve-outs" were triggered by accidents and in theory excluded the employers' liability portion of traditional form following P&C policies and contained other exclusions and sunsets on claim liability, but often led to disputes on coverage at claim time. In addition, if the P&C reinsurers were having trouble making money for the full policies, many carve-out reinsurers fared little better;

5. Retro Market: The cheap cost of reinsurance and in particular London Market Excess of Loss reinsurance (LMX) led to an active retro market as reinsurers found that it was often cost effective to cede large portions of their risk. Retro business also provided a source of additional premium income, but this was artificial and broad coverage definitions made it difficult for reinsurers to control exactly what was being underwritten. This also led to aggregations of expo-

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"… THE MARKET REMAINED SOFT UNTIL THE MORNING OF SEPT. 11, 2001 WHEN THE WORLD, AND THE A&H REINSURANCE MARKET, WAS CHANGED FOREVER."

sure and to contrived spirals whereby reinsurers protected each other in tight formations and passed claims to higher level retros. In some cases retention was only $5,000 per loss with the excess amounts up to tens or hundreds of millions reinsured.

As you can imagine, these developments were not generally positive for reinsurers and by 1997/8 it was clear that the issues above were manifest and that profits were becoming hard to come by. Some companies began to pare back their writings, exclude more exposures and even exit certain lines. However, in spite of the tightening of terms and the slight correction in the late 1990s, the market remained soft until the morning of Sept. 11, 2001 when the world, and the A&H reinsurance market, was changed forever. As a result of tremendous losses stemming from 9/11, more reinsurers pulled out of the business entirely and the overcapacity of the previous 10 years evaporated overnight. For those few that remained in the market, and for the small number of new entrants in 2002, prices shot up and were often many times higher than had been in place earlier in 2001. Furthermore, restrictions on terms were put in place and new exclusions for claims caused by terrorism, and a few years later NCB (Nuclear, Chemical & Biological) became commonplace or were only covered with high load factors. Profits returned and for the next five to eight years this was again an exciting and profitable business. Since then there have been corrections as the market responded to events as they occurred, such as the March 2011 earthquake in Japan that led to a new round of exclusions and/or loads on Nuclear Radioactivity, but capacity again increased.

So where are we today and is this "Déjà vu all over again”? The answer is decidedly mixed. There has recently been an influx of reinsurers into the A&H reinsurance market, attracted by strong and steady profits and tighter terms. Some reinsurers are entering the market for the first time, whereas others are re-entering with a new approach. Simultaneously there has been continued merger and acquisition activity which has increased company retention, and consequently reduced demand for A&H reinsurance and many other lines. This has led to overcapacity in the marketplace and put downward pressure on pricing, with some programs currently being written below the historical burn rate for claims. In other situations there is oversubscribing of capacity and renewal shares have been reduced. Companies seeking reinsurance have also been able to obtain more favorable terms and exclusions on occasions, but there is not a general relaxation taking place and in some cases there have been additional terms and exclusions being inserted into contracts recently such as for pandemic exposure. Growth in premium and profits remains a priority, and new products and features are being explored, but in a more cautious and calculated way. The retro market of the 1990s has not yet re-surfaced in the same manner and many reinsurers have been reluctant to enter into retro arrangements. Some specifically exclude this business. As in earlier periods, it is a difficult time to be in A&H reinsurance and it requires careful risk selection, a lack of natural or man-made disasters, and a bit of luck, to make this a profitable line of business. ■