

This document charts the questions and answers contained in the February 2010 Hot Topic, which was about pricing and the insurance cycle. View more detail on the Journal Hot Topic at [www.cii.co.uk/journalhottopics](http://www.cii.co.uk/journalhottopics)

## General Insurance Faculties | CII

### Ask the experts

Here is our panel of experts:



**Nick Hankin, Technical Underwriting Director – RSA UK.**

Nick's main areas of focus are delivering underwriting governance and technical development across the commercial and personal lines portfolios of RSA UK. Prior to rejoining RSA in 2007, Nick worked for Zurich and AXA insurance in a range of Underwriting, Strategy and Portfolio Management roles.



**Adrian Ballardie ACII, Tokio Marine Global Ltd**

Adrian Ballardie is an experienced London Market Underwriter who has worked in the company market for over 30 years. His area of expertise is non-marine reinsurance and he has been involved with the Faculty Board since its inception.



**Matt Donnelly ACII, Managing Director - Griffiths & Armour**

Matt is Managing Director of Griffiths & Armour Insurance Brokers Ltd. His principal area of activity focuses upon client servicing and new client acquisition; in 2004 he was President of the Liverpool CII. Whilst headquartered in Liverpool, other Griffiths & Armour Group Offices include Manchester, Dublin, Glasgow and London.

### Your questions

**Q:** *Does international business follow a similar cycle to the UK?*

**Sarah Stuart, Kent**



**A:** Adrian Ballardie: The simple answer is yes. Nat Cat business is written on a global basis by reinsurers, so that they can get a balance on their underwritten portfolios. This means that they will give cover for events all round the world, on the basis of the premium from the many paying for the losses of the few, since Nat Cat losses will not normally occur in the same regions at the same time or within the same annual period in the case of weather related losses. Naturally, the incidence of really large Nat Cat losses will affect the portfolios of reinsurers with the largest of global spreads, by the very nature of the extent of destruction which can be experienced in a severe hurricane or massive earthquake, so global Nat Cat events can also have an effect on the pricing of UK Nat Cat reinsurance.

**Q:** *With so many influences such a capacity, reinsurance, investment returns, profitability etc is it realistic to suggest that as a market we could control / influence / alter the cycle?*

**S Sharma, London**



**A:** Nick Hankin: I think you start from a position of the customer or group of customers that you want your business to serve and then build your proposition around them. Pricing and understanding the market cycle of course being a key element to a sustainable, profitable relationship with them.

One approach is to rigorously analyse and understand where you are in the cycle and then adjust your strategy accordingly - you then need to be able to execute the plan consistently and efficiently through your underwriters and distribution partners. The factors highlighted in the question such as reinsurance, capital levels and investment returns will all have an impact on the length and severity of softening or hardening period of the cycle and need to be adjusted for the type of customers and products. The dynamism and competitiveness of the market means we are all impacting the market cycle constantly.

The opportunity therefore is to pro-actively take your business, customers and distribution partners through the cycle in a way that treats customers fairly and provides a consistent adequate return on capital for underwriters and partners.

**Q:** *The article suggests that one factor influencing the prolonged soft market is the increased focus on risk management. If this is the case, surely over time claims will reduce and the rating will more than adequate for the risk? Therefore, with hindsight in years to come are we likely to no longer see this as a soft market?*

**Ben Jones, Cardiff**



**A:** Matt Donnelly: Quality risk management work implemented by Clients and/or their Brokers should yield dividend's. These can take the form of reduced claims cost, stronger governance/legislative compliance, and ultimately a differentiated premium price.

Those Clients who have an embedded commitment to risk management will undoubtedly be less exposed to market rating cycles as the premium for risk will directly correlate to a managed exposure that is better understood by the market

**Q:** *How quickly does a catastrophe occurrence translate into increased premiums to the end customer?*

**R Bailey, Devon**



**A:** Adrian Ballardie: The increased pricing effect of a large catastrophe loss or series of losses will depend on the size and frequency of the catastrophe event(s), as well as the manner in which insurers have protected themselves against large losses by the purchase of reinsurance.

Most insurers who have portfolios of business which cover natural catastrophe (Nat Cat) events will seek to purchase reinsurance to limit their net losses on such business, usually (but not exclusively) by buying cover on an excess of loss basis.

Whether they seek to raise premiums to their customers will depend on the impact of Nat Cat events to their net underwriting results after the recovery from reinsurance, but also on the revised costs of reinsurance on renewal of their protections. Normally, the treaties bought on a non-proportional basis will have a limited number of reinstatements, so that cover can be afforded for multiple events during the year that the cover is bought. Typically, there may be one full reinstatement of cover for 100% of the premium paid for the cover.

In case the insurer is unlucky enough to sustain more than the number of events allowable by the treaty to be fully reinstated, the insurer will exhaust the available capacity for that treaty programme, and will have to seek renewed capacity. This is rare, but possible, and if it happens, the reinsurance market will react in turn to the size and frequency of losses during a one year period that they grant cover, and will raise the cost of cover for the next renewals, sometimes significantly, and naturally the insurers have to pass these on to their customers.

A current illustration of this is the Chilean earthquake which is the world's seventh largest quake recorded, and occurred on the 27th January 2010. Although it is too early to establish the amount of damage (re)insured, at the time of writing, the industry loss estimates are reported to vary between USD 2 Bn and as much as USD 10Bn. It is also reported at the time of writing that Stefan Lippe, the CEO of Swiss Re, is predicting the Chilean earthquake loss will only impact reinsurance pricing if it costs the industry more than \$7bn.

These considerations will govern the timing and extent of any rises in premium to be charged to the original customer, but the extra expense will usually be passed on within a year of the adverse Nat Cat events.

**Q: Is there a typical market length?**  
**W Irvine, Kendal**



**A: Nick Hankin:** Historically yes - in analysis completed based on the US Insurance sector market cycles lasted seven to eight years. Hardening markets (higher pricing environment) tended to be shorter - peak to trough at three and a quarter years than Softening markets (lower pricing environment) which were four and three quarter years on average. The time in each will vary by insurance class but the overwhelming reason for the difference in timing is to do with capital and supply and demand; effectively capital is quicker to enter the market in hardening market conditions and slower to exit in softening market conditions hence the timing difference. This may help to explain why it is often easy to miss-time the stage of the cycle we are in.

**Q: How can brokers explain pricing fluctuations to clients when not even everyone within our industry understands the drivers for pricing changes?**  
**Tony Smith, High Wycombe**



**A: Matt Donnelly:** Brokers generally enjoy good relationships with their Clients; we are by nature relationship driven animals. As such that brings with it hopefully a trusted partnership, enabling challenging issues such as pricing fluctuations to be more readily and constructively aired.

Clients have experienced different insurance marketplaces. Post 9/11 will still be fresh in the memory of many in terms of the way the market reacted and what it is capable of. Maybe then, fluctuations are less of a surprise to Clients, however one thing is for sure; they expect their risks to be properly understood by the market. They want and are increasingly demanding that the individual merits of their risk(s) are taken account of and reflected as an individualised price rather than commoditised with others in the same sector for example.

It is a lot easier and credible discussing pricing fluctuations with Clients when the “fluctuation” relates directly to their risk(s), accepting that on rare occasions this can spike because of catastrophe. This is an ongoing challenge for both Insurers and Brokers alike.