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Developments in Reinsurance

By Alasdair Roe, Vice President, BMS Group

Whether one's challenges happen to be the continuous softening of rates and terms, tracking the impact of claims frequency and severity, keeping a wary eye on core inflation (not just medical inflation), or watching the regulatory trends that speak of national reform while state reform is eroded, risk retention groups are at the forefront of the continually challenging casualty insurance market. The rate of change is frantic these days for all participants. However, assistance in defraying some of this adversity can be obtained from the reinsurance market.

The reinsurance market has continued to attract more capital than it can deploy, primarily because demand has declined as primary rates have softened and cedants have tried to maximize their net written premium (and profits). We should not forget that we are in the midst of a sustained period of consistent profitability for the U.S. property & casualty industry. This has led to record policyholders' surplus, which exceeded $540 billion in 2010.

This activity, or better yet the lack of activity, has lead reinsurers to refine their models and products in the hope of winning back business. This article will feature some of the ways reinsurers are listening to their cedants and engaging them to assist and alleviate the continued pressures of this soft market.

New ideas for new exposures

The explosion of electronic records has led to the need for businesses to protect personal information that is in their possession. The same can be said for electronic media and its applications. A hands-on facilitator is required to keep ahead of the fluid exposures to loss from a breach of privacy, which leads to potential liability and/or fines for breaching the many privacy laws. There have been tremendous advances in products to broaden coverage to include anything from the failure to prevent virus attacks, to costs associated with data recovery, to reimbursement for lost income associated with an attack or recovery, and even for cyber extortion. Reinsurance can be utilized to make such products available to RRGs to private label as a new product written by the RRG. This allows a RRG to efficiently enhance their offering to members while earning a ceding commission to improve the RRG's bottom line. Cyber liability is a great example of a cutting-edge product that requires consistent development in coverages while maintaining quick, effective loss control and risk management. There are quite a few providers of these products, thus ensuring competitive terms and conditions for the RRG.

Class action lawsuits and global settlements or common business practices that lead, for example, to mass infections, or even epidemics, have created an aggregation of retentions for some insurance carriers. Reinsurers have responded to these exposures with the Systemic or Common Loss Coverage. This reinsurance coverage seeks to reimburse claims and loss expense for one or a series of similar or related events. Such coverage has been around for some time, however it continues to build upon its success and application with a much simpler definition of covered events. As Systemic and Common Loss Coverage has increased its popularity, the reinsurance premium has reduced. It is a very effective way of protecting surplus from the unforeseen.

Let's be picky

The above examples are concerned with whole account or obligatory coverages (a.k.a. treaty reinsurance), but what if a RRG could pick and choose what limits to cede to reinsurers to improve their portfolio? What if the RRG chose to cede because the price achieved for the member was cheapest if ceded? And all of this can be done instantaneously at the touch of a button! There are semi-automatic facultative facilities in operation that have given such flexibility. An additional advantage of these facilities is that they do not require a minimum annual premium, so the cedant is free to rate, pick, and choose what risk to cede to their reinsurer—at the click of a button. This product is currently available for auto liability, and general liability is obtainable on the same basis for truckers, but this application can be expanded.

Speaking of facultative, let's not forget about traditional facultative reinsurance as a cost effective way of expanding limits to include a wider group of members into your RRG. Facultative reinsurers provide a quick and efficient way of obtaining capacity without the need for planning and obtaining significant amounts of annual premium income to satisfy the treaty reinsurance underwriters. As an example, there are facultative underwriters interested in providing capacity for hospitals at very competitive premium per limit levels.

Right place, right time!

There is definitely an abundance of interest and a willingness to refine approaches and products from the reinsurance industry. This takes place during a period of time when RRGs can find great solutions to assist them in competing in a softening market against commercial carriers that have, by and large, access to additional capital should they need it—or at least that is what the currently prevailing thought is. Structuring traditional reinsurance to improve and enhance a RRG's long-term financial performance can be accomplished in a number of ways. There is the prospect of applying Loss Portfolio Transfer reinsurance as a mechanism to clear the decks and free up capital for the eminent hardening market. More specifically, there are reinsurers interested in providing Loss Portfolio Transfer reinsurance to medical professional liability carriers who want to alleviate their net loss reserves-to-surplus ratio. While these coverages will not be unlimited, they will provide enough coverage to satisfy owners, regulators, and rating agencies. Additionally, the reinsurers will carry a rating of A.M. Best's A or better ratings.

Alternatively a quota share treaty could allow a RRG to cede true underwriting risk to reduce their exposure to volatility while premiums are suppressed. The task of selecting the best reinsurance for your RRG may seem daunting, however stochastic modelling offers guidance to RRG executives to assist in determining the most effective way of purchasing reinsurance. The stochastic model can be based solely on the RRGs historical experience or blended to include an industry sample.

Swing Plans continue to see improvements in their minimum and maximum rates and the loss load. This is especially true where the business plan is proven to be on target, allowing RRGs to repatriate reinsurance premiums paid. This explains why many RRGs have negative reinsurance premiums in their recent statutory filings—meaning the downward premium adjustments are exceeding the current year's reinsurance premiums on recent statutory filings! Further enhancements to the swing plans are being considered such as swinging premiums on paid claims (as opposed to paid and reserved) or shortening the time to when the premium is adjusted to reflect the treaty's loss experience.

Creative Solutions

Finally, to give you an idea of how far the insurance industry is pushing creative solutions, I think it is worthy of mentioning conversations I have had recently in creating coverage that responds to the insolvency of a RRG and/or a wrongful act on the part of the agent of record. This may be the answer to growing sales with agents who either will not deal with an unrated RRG or need a way to get around not having access to the state guarantee fund(s).

Hopefully this has given you an understanding of the flexibility currently available to assist RRGs in meeting their business needs. Reinsurers have maintained their profitability despite some of them suffering losses through the first two quarters of 2010, and I expect the same to continue should the Christ Church and March 11 Japan earthquake (and tsunami) be the extent of large losses in the first half of 2011. The individual reinsurer appetites for different types of coverage, basis of coverage, and attachment levels will vary among reinsurers in the Domestic, European, and Bermuda/Cayman Island markets. Maintaining an understanding of these dynamics is essential in order to obtain the best solution for any RRG. It is fair to say that all reinsurance applications are on the table for discussion and being negotiated right now.

Alasdair Roe is a Vice President with BMS Group, based in Connecticut. He has over 15 years of experience within the reinsurance industry, eight of which were as a broker in London. He has extensive exposure to medical professional liability and a broader skill-set in auto liability, workers compensation, and accident/health reinsurance. BMS Group is a specialist, independent, broker, headquartered in London and with offices throughout the US, that has served the RRG community since its inception. The Group has built its reputation—over the last 30 years—with great people, who are experts in their fields and who are passionate about the service they provide to their clients.

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