Carrier Management

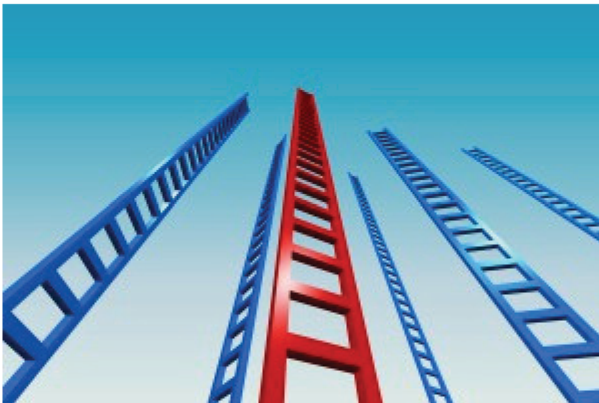
Consolidating Reinsurance Towers to Gain Efficiencies

January 27, 2014 by Mike Schnur

In addition to raising capacity and lowering reinsurance prices, the influx of new capacity from the capital markets is driving more flexible reinsurance terms and efficiencies that primary insurers and their brokers have been seeking for years.

Multiyear programs, once a rarity, are now becoming commonplace, and private placements with bespoke terms and conditions that address specific client needs are gaining traction.

Another trend being ushered in by the flood of new money is the shift of reinsurance buyers to consolidate multiple reinsurance towers into one contract.



Executive Summary

TigerRisk's Mike Schnur explains how a carrier can benefit from a reinsurance buying strategy that consolidates multiple reinsurance towers into one contract, and why reinsurers are willing to sign onto such contracts now even though they've resisted such moves in the past.

Insurers have long complained that the use of multiple towers instead of just one is inefficient and results in a poor return on their investment. For example, an insurer may buy separate programs for individual regions with each program having its own limit. In a portfolio of five programs, the chances of making a reinsurance recovery is lower than when consolidating all of the programs into one.

Besides the additional administrative issues involved with managing multiple programs (including determining appropriate retentions and limits for each), a ceding company is better able to address its risk tolerance levels by managing its placements on a more cohesive basis.

For reinsurance buyers, consolidating multiple programs into one program makes sense in other important ways:

- Buying a single reinsurance program requires less overall limit than the aggregation of multiple programs. Indeed, multiple programs usually result in redundant protection.
- Reinsurers often institute a minimum capacity premium for exposing any limits. By combining programs, these minimum capacity charges for each program can be reduced significantly.
- By combining diverse programs with low potential for correlation under a single cover, further efficiencies can be achieved.

Naturally, reinsurers have resisted the trend of reinsurance buyers rolling several programs into one.

That is until now.

“Nontraditional” is an apt term for the capital markets players who have entered the reinsurance market of late. For them, reinsurance is just another asset class. They are not tied to previous conventions but are looking at reinsurance transactions with a fresh pair of eyes and have shown a willingness to do things differently. You can be sure they will make use of every advantage.

Meanwhile, the additional reinsurance capacity has also made buyers bolder. They realize that it’s a buyer’s market and they expect to see a better return for their reinsurance dollars.

In the face of nontraditional competition and more demanding clients, traditional reinsurers have become more flexible.

One result is a new willingness for consolidating multiple towers. Regional programs are being combined into national programs. U.S. and international covers are being merged. Even business units of insurers are now combining property and casualty under one cover.

Aggregate

In addition to a movement toward single-tower, per-occurrence covers, and because buyers have growing capital positions, they want aggregate-type covers to improve the efficiency of their reinsurance.

Until recently, carriers concentrated on protecting themselves from large single-occurrence losses. Now, thanks to a more flexible marketplace, they are also buying coverage for a higher-than-expected frequency of smaller events.

While aggregate protection was previously available, the scope of coverage has greatly expanded. Carriers can now combine very disparate types of coverage (think highly

Why Carriers with More Capital Want Aggregate Reinsurance Protection

Since 2013 was a light catastrophe year, most insurance companies were able to grow their capital. As their capital bases have grown, they have been able to increase their retentions (and buy reinsurance at a higher attachment point).

divergent lines of business—conventional P/C, marine/energy, assumed reinsurance, etc.) into one program. And it can be done on a multiyear basis.

One potential negative outcome of keeping larger retentions is that an unexpected frequency of smaller losses—those that don't exceed their retentions—could negatively impact their results.

As a result, companies are looking to buy aggregate covers which would respond to a higher frequency of small events.

Other Benefits

In addition to improving efficiency, reducing required capacity and lowering premiums, large single covers are also just plain easier for carriers to manage.

However, there could be some potential downsides to single covers.

Single covers, especially in the case of very large programs, may make cedents more reliant on specific reinsurers that may end up with a much larger share of the program than when participating on individual towers.

Should market conditions change, reinsurers with larger positions could end up in a more favorable negotiating position. Similarly, if a reinsurer with a larger position should change its risk appetite and decide to no longer participate (or to reduce its share) in a specific program, meaningful shares might need to be replaced.

Reinsurer Perspective

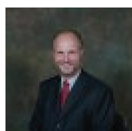
From the reinsurer perspective, there are reasons they prefer not to support single covers. First, it increases their exposure, as losses can suddenly accumulate from multiple sources. In addition, the margin on a big single cover is likely lower than what it would be on five smaller covers.

Reinsurers have their own capacity to manage. When covers are combined (and aggregate covers are purchased), reinsurers often find it much more difficult to internally allocate their capacity. As a consequence, reinsurers are forced to become much more conservative in their underwriting. In the end, that means delivering a lower return on risk.

In a portfolio of five programs, the chances of making a reinsurance recovery is lower than when consolidating all of the programs into one.

For the time being, reinsurers will need to adapt to the trend for single covers. The flow of new capacity is not about to abate. Indeed, in the short term we can expect the capital markets players to be even more aggressive. It's only a matter of time before they become more interested in casualty reinsurance.

Despite the fierce competition, doing business with traditional reinsurers still has many advantages. Reinsurance is their business, not just an asset class, so they are much better equipped to design and administer reinsurance programs. And they are in it for the long haul.



Contributor

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Mike Schnur is a Partner at TigerRisk with more than 30 years of experience in the industry. Before joining TigerRisk he held EVP positions at Benfield and Guy Carpenter. He began his career as a reinsurance underwriter, first with General Re and then with F&G Re.