

# Reactions

IIS Reporter

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REINSURERS' CAPITAL MANAGEMENT HAS IMPROVED

## Raters are playing catch-up

Since September 11, rating agencies have changed their view on reinsurers' capital adequacy. This has caused a number of once-highly-rated reinsurers to be downgraded. Munich Re, for example – the world's biggest reinsurer – has been stripped of its triple-A rating. It is now rated single-A.

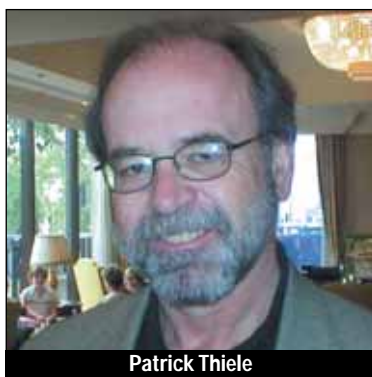
Many reinsurers have complained about the rating agencies' stance. Some observers say this is because reinsurers do not welcome criticism from outside. But some reinsurers feel they are in a better position to opine on capital adequacy than the rating agencies.

"I think companies' capital management has improved at a much more rapid pace than the rating agencies' capital adequacy tools," says Patrick Thiele, chief executive officer of Bermudian reinsurer PartnerRe.

One reason for this, he says, could be that reinsurers base their assumptions on first-hand experience of writing business and coping with losses. "We get tested by the market all the time," he says. "We have real life examples."

Another reason, says Thiele, is that investment banks have developed a number of capital adequacy techniques that can be applied to the reinsurance industry. "The technology today is significantly better," says Thiele. "The capital analysis and tools to analyse risk and return are all much better than they were 10 years ago."

He says reinsurers' frustration with the rating agencies does not stem from them resenting criticism. It is simply that they question the



Patrick Thiele

tools the rating agencies used to arrive at their assumptions. Reinsurers are also disgruntled because they have no way of reversing any decisions they deem to be unfair. "There is no court of appeal," says Thiele.

Whether justified or not, Thiele believes rating agencies' changed opinion of the reinsurance industry could make life tough for reinsurers. "Rating agencies have raised the bar with regards to their view of what constitutes double-A or single-A capacity," says Thiele. "Those new standards are going to have an impact on our ability as an industry to balance the needs of clients, shareholders and rating agencies. It is going to be very difficult."

Rating agencies' needs often contradict those of companies' shareholders. Rating agencies demand certain levels of capital to maintain ratings whereas shareholders want good returns on capital. If they believe reinsurers have excess capital, shareholders often ask for it back in the form of share buy-backs, for example.

In the last soft market, reinsurers were accused of not returning

enough excess capital to shareholders.

But Thiele says there may not have been as much excess capital as shareholders thought. "People have differing views about what excess capital is," he says. "The excess capital that the reinsurance industry was accused of having turned out not to be excess capacity because it was used up on September 11 2001. If, in 2000, reinsurers had given back as much as investors wanted, the industry would have been in pretty bad shape now."

Nevertheless, he believes reinsurers' management of shareholders' expectations is improving. "I believe the industry is getting better at capital management," says Thiele. "The respect for shareholders and shareholders' needs is much more developed than it was in the past."

One of the big topics at this year's International Insurance Society meeting in London will be how to manage the soft market. Prices in some lines of business are starting to soften, particularly property and catastrophe. "We haven't had a significant catastrophe since the third quarter of 2002 – the European floods," says Thiele. "It has been a very benign loss environment." This has prompted prices to fall.

But he adds that the falling rates are not cause for too much alarm at this stage. "[The softening] is relatively well-contained," he says. "There have been low-single-digit rate reductions. Looking at the present rate structure it is not the end of the world. The industry is getting an adequate return."

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PROPOSED REGULATIONS DESCRIBED AS ONE DIMENSIONAL

## Solvency II could hurt life reinsurers

The draft version of Europe's proposed Solvency II regulations could cause problems for life reinsurers writing business in the continent if certain changes are not made, says Rick Hodgdon, executive managing director of Transamerica International Reinsurance Ireland.

"The biggest issue we have right now is the preliminary Solvency II directive," says Hodgdon. He says that life reinsurance is a long-term business which requires participants to commit capital for a long time. "We want to ensure that regulations are well documented so there is no ambiguity. Right now there seems to be a lot of ambiguity in the initial pre-Solvency II directive."

Solvency II will impose new capital requirements on Europe's financial services industry, including reinsurers. Hodgdon feels that the proposals do not take into account the life reinsurers' risk



Rick Hodgdon

management practices when deciding on the amount of capital they should hold. "The proposals are very one-dimensional," he says.

Solvency in the insurance business is made up of two parts, says Hodgdon. One is the amount of capital held, and the other is the risk management processes that protect that capital.

"[The directive] pays a lot of attention to the solvency side but is not giving enough

credence to the strong risk management that exists on the life side of the business."

The directive will apply to life and non-life companies. But Hodgdon says it does not take into account the differences between the two. He says the non-life reinsurance side of the business is characterised by severe, unpredictable losses, but that the life side is more predictable. This is because there is more historical data to draw on. "I don't think they [the regulators] give enough credit for this because they don't understand how life reinsurance works."

The fact that the regulations only apply to Europe could make life difficult for reinsurers. "Reinsurance is global, so we have to play on a global playing field," says Hodgdon. "The problem is, if you have regulations that are specific to the EU and we reinsure global risks, that affects our ability to compete

on a global basis."

If these difficulties are not ironed out of the final draft of the Solvency II directive, Hodgdon believes the entire life insurance industry, not just life reinsurers, will suffer.

"What they [the regulators] fail to realise is that a reinsurance market that has the wrong regulations affects the primary market, which then affects the consumer," he says. "This is because certain products will not be available to the insurance buyer unless there is a strong, vibrant reinsurance industry."

As well as leading Transamerica International Reinsurance Ireland, Hodgdon chairs Ireland's life reinsurance society. He says the whole market is concerned about the Solvency II issue. "There has to be regulation," he says. "But punitive regulation such as the preliminary Solvency II draft will affect the reinsurance industry dramatically."

WR BERKLEY BUYS RENEWAL RIGHTS FROM GULF INSURANCE

## WR Berkley grows surplus lines book

US insurance group WR Berkley has expanded its excess and surplus lines book by buying the renewal rights to some of Gulf Insurance's excess and surplus lines business.

The group has also set up an insurance unit called Berkley Specialty Underwriting Managers, which will offer speciality insurance on behalf of WR Berkley's insurance subsidiaries.

The company has not disclosed how much it paid for

the renewal rights. But it says the renewals rights represent \$110m of annual in-force premiums. It has not acquired any past loss reserves or liabilities from Gulf.

The group has also appointed Steven Zeitman, Gulf's former executive vice-president of speciality casualty and environmental risks, as president of the new subsidiary.

John Keefe, analyst at investment bank Ferris, Baker

Watts, likes the structure of the deal. "It is a good book of business. We think the renewed business will have roughly the same combined ratio as WR Berkley's other business – between the mid-80s and low-90s."

According to Keefe, most of the renewal rights are for product liability business, which WR Berkley has expertise in underwriting. He says it was also a good move to appoint Zeitman because of

his long industry experience. According to WR Berkley, Zeitman has more than 33 years' experience in the insurance industry.

Keefe does not expect WR Berkley to renew all of the business that it has bought renewal rights for. He expects the renewal retention rate to be 70%. He expects some buyers will try to place business in the standard market rather than the excess and surplus lines industry.

# The story so far for insurance reporting

Dr. Frank Ellenbürger, Partner, KPMG in Germany and KPMG's European Sector Leader – Insurance

Published on 31 March 2004, IFRS 4 marked the first step in the IASB's project to achieve convergence in insurance industry accounting standards around the world. It provides the first-ever guidance from the IASB on accounting for insurance contracts. While more fundamental changes are to come in the second phase of this project, IFRS 4 is likely to have a significant impact. It includes changes to the definition of insurance contracts, new disclosure requirements and modifications to existing accounting practices.

#### Who is affected?

IFRS 4 is effective for financial years beginning on or after 1 January 2005. Listed insurance companies in EU member states will have to publish their consolidated accounts in accordance with IFRS. Non-listed companies in nearly all member states will have the option to use IFRS for their consolidated and annual accounts. Companies which have issued debt securities on a regulated market must apply IFRS on or after January 2007.

IFRS 4 applies to insurance contracts and ceded reinsurance business, but not to other insurance company assets and liabilities.

#### Key changes and issues

At this interim stage, the IASB is not prescribing specific accounting policy. Within a given framework, insurers can continue their current accounting policy, or they can opt to make changes to achieve more reliable or relevant

financial statements. Significant issues include:

- Equalization and catastrophe provisions are to be excluded from the IFRS balance sheet, and will not be recognized even in Phase I. This takes away a proven instrument to reflect the pooling of risks beyond one accounting period over time in the financial statements.
- IFRS 4 requires insurers to test the adequacy of liabilities as well as the recoverability of assets originating from ceded reinsurance business.
- Discounting of provisions and reduction of the level of prudence are not required, but are permitted.
- IFRS 4 is silent on the issue of recognition of deferred acquisition costs.

#### Continuing controversy over fair value

IAS 39, which covers most of an insurer's investments, mainly requires the application of 'fair values' in the valuation of assets backing insurance liabilities. Insurance firms themselves have serious doubts about whether this methodology can provide an appropriate reflection of the insurance business. They insist that significant problems may arise if they are required to apply fair value: the ultimate fear is that the potentially large mismatches between asset and liability valuations could make insurance companies bankrupt on paper.

But the IASB's point of view - not to exempt insurers

from IAS 39 - is understandable. If insurers are exempt from applying IAS 39, they can continue current practices without any harmonization at all. And insurance firms who are applying IFRS and using US GAAP for the technical items are already faced with this problem. The issue urgently needs to be solved: fair value accounting will probably be the basis for the upcoming discussions on Phase II, even if many questions on its possible implementation remain unanswered.

#### Possible consequences for Solvency II

The question is, if Phase II takes the fair value approach, can IFRS financial statements form the basis for solvency measurement? The EU Commission thinks they can. Solvency II will probably allow an insurer to refer to internal models for the determination of solvency. The basis for these internal models is the determination of economic capital based on market values.

There is no doubt that, for external reporting purposes, the reliability of fair value accounting is an issue of concern. However, a fair value approach shares more characteristics with economic capital than most current accounting policies. If Phase II results in a fair value approach, the systems will have a common basis, both for external and internal reporting purposes.

#### The wider view

The completion of any long-

term solution for insurance contracts may take several years yet.

With work on Phase II due to start soon, we can expect to see an Exposure Draft around the middle of next year and the final standard published at the earliest around the middle of 2006. Assuming a two-year transition period until the first obligatory application, financial statements will not be affected by Phase II until 2009.

Fair value accounting, Solvency II and the resulting increased levels of transparency in the industry will clearly have an impact on the design of insurance products. Guarantees and options provided in insurance contracts have to be backed with adequate funds, and the resulting rise in costs will undoubtedly be passed on to policy holders. So far, no research has been done on the likely macro-economic impact of these changes - for example, how they will affect the stability of financial markets and the role of the insurance industry in old-age provisioning. Any discussions on further changes to insurance reporting must take this into account. ■

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INOKUCHI, STORM AND HANSSON TO BE HONORED

## Three executives to enter Hall of Fame

The achievements of three industry veterans will be recognised this evening when they are admitted into the International Insurance Society's Insurance Hall of Fame. Takeo Inokuchi, chairman and chief executive officer of Mitsui Sumitomo Insurance, Kees Storm, the retired chairman of the executive board of Aegon, and Per Hansson, the deceased chairman of Norwegian insurer Storebrand, will be honoured at a Gala Awards Dinner in the Grand Ballroom tonight.

Inokuchi is only the third person from the Japanese non-life insurance industry to be admitted into the Hall of Fame. He has played an important role in seeing the Japanese non-life insurance industry through a period of deregulation and rapid consolidation. He has helped the market become more efficient and customer focused, promoting the merits of fairness and transparency in the industry. His approach was characterised by his involvement in the merger of Mitsui Marine and Sumitomo

Marine to create Mitsui Sumitomo.

Inokuchi has served as chairman of the General Insurance Association of Japan twice. He also played an important role in facilitating the Japan-US Insurance Talks in 1996, and was involved in applying a safety net when Japan suffered its first non-life insurance failure since World War II. The Society also recognises his achievements in exporting technology to other countries in Asia to help develop their non-life markets.

Storm has worked in the insurance industry since 1978 when he joined Dutch insurer AGO. He was involved in the merger that created Aegon in 1983 and became the company's chairman in 1993. Under his leadership, Aegon has been transformed into a successful company with operations in the US, Europe and Asia. He is known for his charismatic management style and work in generating interest in the industry among young people. He was also closely involved early on in dealing with Holocaust survivors'

claims against the insurance industry.

Hansson, who passed away in 1993, joined Storebrand in 1927 and became its managing director in 1940. He led the company during World War II and its aftermath and developed the company's international operations in places such as the US and Mexico during that time. Storebrand became the largest reinsurer in Latin America. Hansson became known as Mr Storebrand.

The Griffith Foundation for Insurance Education founded the Insurance Hall of Fame awards in 1957. It was later developed by John Bickley, emeritus professor of insurance at the University of Alabama. Today it is run by the IIS in New York. The Hall of Fame has 111 laureates, including the most recent additions. Members are selected by a secret ballot of IIS members. Portraits of the winners, along with details of their achievements, are exhibited at the University of Alabama. A digital gallery is also displayed at the risk management school

of St John's University in New York.

Several other insurance industry executives will receive awards at this year's IIS in London. Martin Sullivan, chief operating officer of American International Group and an IIS board member, will receive the Kenneth Black Jr Distinguished Service Award for his work with the organisation.

The late Frederick Reiss, who passed away in 1993 will receive the John S Bickley Founders' Award Gold Medal for Excellence for his work in popularising the use of captive insurers. He first coined the term "captive insurer" and was instrumental in establishing Bermuda as a centre for captives. He also helped establish the framework for the Bermuda Insurance Act in the 1970s. The award will be accepted by his son Jonathan Reiss, who is an accountant with Ernst & Young on the island.

Further information on the Hall of Fame can now be found on the website [www.insurancehalloffame.org](http://www.insurancehalloffame.org)

PING AN BECOMES HONG KONG'S LARGEST IPO THIS YEAR

## Ping An lists after a year of waiting

The long-awaited initial public offering (IPO) of China's second-largest insurer, Ping An Insurance, has finally arrived. The insurer listed on the Hong Kong Stock Exchange on June 17. The company has been preparing to list for more than a year; Reactions first reported the company's intention to float in

June 2003.

The company's 1.39bn shares were priced at HK\$10.33 (\$1.32) a share before the listing. The opening price on the day it listed was HK\$10.50 a share. The IPO raised HK\$14.3bn, making it the largest in Hong Kong so far this year.

The share price closed at

HK\$10.35 on its first day of trading. Prices during the day were as high as HK\$10.55. However, on the Friday of the week of the IPO, shares closed at HK\$10.30, lower than the offering price on launch the day before. During the Friday alone, some 52.8m Ping An shares changed hands.

When it came to light last

year that Ping An was seeking a listing, there were rumours that it was considering a debut in Hong Kong and in New York. However, some believe the company decided on a Hong Kong float only to speed up the launch.

The company did not respond to requests for comment.

# Marine Insurance – the way forward

By Patrick Foss

The London insurance market still generates more premium income from marine insurance than any other market. In 2002, gross premium for marine, aviation and transportation was approximately US\$7bn. It is estimated that London's market share of worldwide marine premium income is just under 20%, without taking into account the income generated by P&I Clubs, many of which are operated from offices in London.

The English law of marine insurance was codified by Sir Mackenzie Chalmers in the Marine Insurance Act of 1906. Whilst by and large the Act has withstood the test of time, inevitably there are calls for change to some aspects of the law as it stood nearly one hundred years ago. Australia is considering repealing its Marine Insurance Act of 1909, which was based on the 1906 Act, but repeal is not on the political agenda in England despite a Law Commission report recommending changes more than 20 years ago. In the absence of statutory reform, the purpose of this article is to examine three of the main criticisms of English insurance law and to see how the Courts and the London market have sought to resolve these: –

#### "Honest" non-disclosure

Under English law, a failure on placing to disclose material circumstances, or a misrepresentation of material circumstances, can entitle the insurer to avoid the insurance contract even though the failures may be entirely "innocent". These are aspects of the duty of good faith which applies to all insurance contracts by virtue of section 17 of

the 1906 Act. An honest insured who has innocently overlooked to disclose a particular fact may therefore find himself without cover. In many civil law jurisdictions, an innocent breach of the duty of good faith will only entitle the insurer to charge an additional premium, leaving the cover otherwise intact. The English Courts fully recognise the potentially draconian nature of the remedy of avoidance in these circumstances. The Court of Appeal had made it clear that avoidance for honest non-disclosure should be confined to plain cases (*Kausar v Eagle Star Insurance Co Ltd* [2000]). Temperance is often exercised by the Courts where it would be unjust to grant the remedy of avoidance for a technical breach of the duty of good faith.

#### Continuing Duty

The duty of good faith does not come to an end with the conclusion of the insurance contract. As a result, the relationship between the duty of good faith and claims has spawned much litigation over recent years. Even though there has been one decision of the House of Lords and a number of decisions of the Court of Appeal, it remains uncertain whether the presentation of a dishonest claim should entitle the insurer to avoid the insurance contract, which would result in the insured being obliged to pay back any earlier perfectly valid claims. This is one of the issues which was addressed by the International Underwriting Association in conjunction with the Joint Hull Committee when the International Hull Clauses 2003 were under development.



Patrick Foss

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Following extensive consultation with brokers, shipowners, adjusters and overseas insurers, these Clauses were drafted to replace the Institute Time Clause Hulls. Clause 45 contains a clear summary of the duties upon the insured in respect of claims and sets out the consequences of non-compliance.

#### Warranties

Under English law, a breach of warranty will automatically discharge the insurer from all further liability under the insurance contract from the date of breach. It will not assist the insured if the breach is immaterial to any claim that subsequently arises. In some other jurisdictions, for a breach of warranty to provide insurers with a defence to a claim, there must be a causal link between the breach and the claim. The International Hull Clauses 2003 contain very limited warranties. The insured's duties concerning matters such as classification, management and compliance with international conventions and the insurers' remedies for breach are clearly set out of the clauses.

#### The Way Forward

For the London market to maintain its position as the centre of marine insurance, it is important for the insurance contracts used by the market and for English law generally to remain acceptable to its customers, the worldwide shipping and insurance industries. Not for the first time, the actions of the London market (assisted by the commercial approach of the English Courts) have shown that they will seek to remedy themselves what Parliament is unable or unwilling to remedy for them. ■



\$125M DEAL COVERS JAPANESE EARTHQUAKE RISK

## Japanese insurer completes cat bond

Swiss Re Capital Markets has closed a new catastrophe bond for a Japanese primary insurer. The insurer's name was not disclosed by Swiss Re although NipponKoa is thought to be the cedant. The \$125m five-year deal, called Gi Capital, transfers Japanese earthquake risk into the capital markets.

The deal was well received by investors because of the relative scarcity of such bonds and the fact that its risk is, to some extent, uncorrelated with other existing Japanese earthquake bonds in the market.

"Even though Japanese earthquake is one of the four peak risks for cat bonds, it is very difficult to buy single-peril Japanese earthquake bonds in the secondary markets," says one investor.

"This is not multi-peril and the cedant is not Swiss Re. It offers us diversity."

The only other single-peril cat bonds that cover Japanese earthquake risk are Fujiyama by Nissay Dowa and Parametric by Tokio Marine & Fire. Both these deals are impossible to buy in the secondary markets, says the investor. Swiss Re's programmes of catastrophe bond issuance, Pioneer and Arbor, both issue Japanese earthquake risk as a single peril. But Swiss Re generally issues these bonds in small tranches and at a very low price, says the investor.

Gi Capital priced at 315 basis points (bp) over Libor. Standard & Poor's rated it BB+. Swiss Re Capital Markets was the bookrunner on the deal. Risk Management

Solutions modelled the deal's risk. Its expected loss is 0.76%. Some 66% of the deal's exposure comes from the Tokyo region of the country.

"A price of 315bp is pretty attractive with that expected loss," says the investor. He says the deal was oversubscribed by two-and-a-half times. He adds that the bond was also attractive to investors because its risk exposure is slightly different

**"Events that would trigger Fujiyama and Parametric might not trigger this bond and vice-versa."**

An anonymous investor

from the existing single-peril Japanese earthquake bonds.

Gi Capital uses a parametric

index as a basis for its modelled losses and its trigger points. This means it is triggered when an earthquake of a certain strength hits certain areas of Japan. But the index the parametric system is based on is weighted to reflect the composition of the cedant's portfolio. This means less basis risk for the cedant and, to a certain extent, more diversity for investors.

"Basically it means that events that would trigger Fujiyama and Parametric might not trigger this bond and vice-versa," says the investor. "That means investors get more of an actual exposure rather than something based on events in a specific area. And if you hold other Japanese earthquake bonds it means you get diversity."

RSA SELLS DENMARK UNIT

## Codan Life sale should benefit RSA

UK insurance group Royal & SunAlliance (RSA) has sold its 71.7% share in Codan Life, its life and pensions operation in Denmark. The company has also confirmed that it is in talks to sell its UK life operations, which are in run-off. Observers say the sale of Codan Life is in keeping with RSA's goal to concentrate on property/casualty business, and the sale of its UK life operations could benefit the company's turnaround further.

The group has sold its stake in Codan Life to Swedish life insurer SEB Trygg Liv. RSA expects the proceeds from the

sale to broadly reflect net asset value. Codan's full net asset value at the end of 2003 on a UK GAAP basis was Dkr2.6bn (\$423m). RSA's portion of that would be about Dkr1.9bn. The UK insurer estimates that the transaction will release about £150m (\$272.6m) in capital.

Rating agency Standard & Poor's (S&P) says RSA's strategy to free up more capital is in line with expectations. The rating agency will not change RSA's rating – A- with a negative outlook – because of the transaction, says Rowena Potter, credit analyst at S&P.

"This sale is already factored into our rating of RSA," she says.

However, Potter admits that the rating does not take into account the sale of RSA's UK life operations. "The price of such a sale would obviously be quite important," she says. "RSA has already released some capital from its UK life operations. It would be a positive if it could receive a good price for this business to release more capital."

She adds that the sale of Codan Life, which was RSA's only remaining source of new life premiums, is a concern

because there will no longer be any new life premiums coming in to support the UK life book, which is in run-off. She argues that the sale of the UK business would correct this imbalance.

RSA would not disclose details about its talks to sell the UK life operations. The company has reportedly had an offer of £750m in cash and £150m in deferred payments for the business, but it denies receiving such an offer.

"These discussions are at an early stage and the amounts referred to in the press are purely speculative," says a company statement.

KILN CLOSE TO EXHAUSTING PROPERTY CAPACITY

## Kiln to decline new property business

Kiln's flagship Lloyd's syndicate, Syndicate 510, will write no more new property business in 2004. This is because, thanks to higher-than-expected rates, it expects to exhaust all its property capacity by the end of the year.

"We're not going to look at any more new business at the moment," says Robert Chase, Kiln's underwriting director. "But we will have a careful look at what renewals are coming up between now and the end of the year."

He stresses that the company still has some capacity left, but it is giving the market plenty of warning to avoid surprising clients and brokers when the capacity finally does run out. "It's not that we have exhausted the

capacity. It's just planning ahead and trying to let brokers know," says Chase.

Despite Kiln's decision to close its doors to new property business for the rest of the year, Chase says the company is unlikely to miss opportunities or lose clients to competitors. "I would not expect [the amount of lost business] to be significant in any way at all," he says. "I guess it would be if we gave brokers a complete surprise about this. But that's why we're informing them of our intentions now."

Chase adds that the amount of property business that is available to write could slump in the second half of the year anyway. "We expect much of the facultative business that we

write on the property side to decline in amount over the next few months," he says. "It has simply been a question of timing. We expected that to happen during the first two quarters of the year. Instead, it is probably more likely to happen in the next two quarters."

And although Kiln is not looking at any new business, it is unlikely to turn good business away. "On business that we really want to write, that's quite unlikely," says Chase.

Kiln's lack of capacity has been caused by persistently high property rates. Kiln decided how much capacity to allocate to property business in October last year. Despite talk in the market of property rates falling, they have not declined by as much as the company

expected. This means it has written more business than it was planning to.

Property capacity at Syndicate 510 for the 2004 underwriting year is between £260m (\$481m) and £270m. This is slightly lower than last year's property capacity of between £270m and £280m.

The company writes property business both on a facultative business and through coverholders. Rates in the coverholder business have been particularly resilient, says Chase. And rates on the facultative side were expected to drop off but did not. "What we expected to happen was that more of the facultative business would disappear during the first half of the year. It hasn't – that flow has kept up," he says.

U.S. MODEL CANNOT BE EXPORTED

## Programme business tough in Europe

Growing programme business in Europe is tough, said Hannover Re's chief executive, Wilhelm Zeller, at a press roundtable in London in June. The company writes European programme business from its London unit, Inter Hannover. But 90% of the total gross written premium of this line of business, which was €2.6bn (\$3.2bn) in 2003, still comes from the US.

"We found out that you cannot export the US programme model straight into Europe," says Zeller. "There are cultural and infrastructural differences." He explains that Hannover Re's strategy with programme business is to be very choosy



Wilhelm Zeller

about the risks it writes. At the moment, very little European programme business is written so selectively.

He explains: "You often find that a broker has gained underwriting authority with its

client over years because the broker produced a certain amount of business. Such a broker might say to its client: 'For ease of administration, why not authorise me to underwrite on your behalf?' We don't do programme business like that."

Hannover Re entered the programme-business market when it bought Clarendon Insurance Group in the US in 1999. At the same time, it started writing programme business in Europe through Inter Hannover. The reinsurer also writes a small amount of programme business in South Africa.

In his presentation, Zeller referred to programme

business as a "plantlet" – meaning that it is a young and growing operation. He is hopeful that it will develop further in the US and Europe for Hannover Re to be a market leader.

The reinsurer has given Inter Hannover a mandate to develop the business in Europe, Zeller says. "We are aware that this is an experiment. So for this part of the business we don't expect the 15% or 16% ROE [return on equity] we expect from our other business units. It's not losing us money. And we will continue to look at it for another couple of years. By 2006 or 2007 we'll know whether it will fly."

BRAZILIAN REINSURANCE MARKET ON THE BRINK OF CHANGE

## IRB Re's monopoly must end

The challenges facing the insurance industry in the US and Europe today will hit South America tomorrow, says Luiz de Campos Salles, the chief executive of Brazilian insurer Itaú Seguros. He is attending the International Insurance Society (IIS) conference in London this year to establish what these challenges will be.

"The issues faced by the US and Europe usually only crop up two to five years later in Brazil," he says. "For example, the accounting regulations are an interesting issue – one where opinions differ strongly. Brazil is too far away to influence changes, but somewhere in the future, it will become an important matter to the Brazilian insurance industry."

He says the Brazilian market is already taking a strong interest in accounting regulations. He recently presented a paper on proposed changes to the profit and loss accounts of Brazilian insurance companies. He says his report was received with much interest.

"I didn't know that this very issue was so important in the US and Europe at the moment. But after a meeting this morning [Sunday] with the IIS board, I realised it is quite a talking point. I can see what is happening here eventually being mirrored in Brazil."

He explains that the Brazilian insurance industry is changing rapidly. However, future regulatory changes remain low on the list of most Brazilian companies' priorities. Other day-to-day matters, such as product distribution, are still the main challenge for most



Luiz de Campos Salles

companies in Brazil and in most of South America.

The Brazilian reinsurance industry is also due for a change, says Salles. At the moment, the state-owned IRB Re has a monopoly of the reinsurance market in Brazil. Primary insurers can only reinsure through IRB. The cedants can request that IRB retrocede any excess to specific companies in the global marketplace, but the choice of the retrocessionaire remains IRB's prerogative.

Itaú is the second-largest general insurer in Brazil by gross written premium. Salles says the company uses reinsurance brokers to negotiate with IRB. "There are quite a few reinsurance brokers operating in Brazil, which we use extensively. We go to IRB hand-in-hand with our broker to propose who we would like IRB to retrocede our risks to. And generally IRB deals with us fairly."

Many large international reinsurers would like to operate directly in Brazil.

Salles says IRB's monopoly will end. "It's just a matter of when. For a truly free market to exist, competition is imperative. The Brazilian reinsurance industry is still lacking the competition element. And reinsurance is by its very nature an international business. It is capital intensive and the spreading of risks is most important. The single reinsurer in Brazil cannot continue to exist."

He says that over the years some reinsurers have set up operations in Brazil in the hope that the rules would change and they would eventually be able to write reinsurance in the country directly. But some have given up hope and closed their offices. "It is taking too long for the monopoly to dissolve," he says. Other reinsurers are still hanging on in the hope that the monopoly will end, he adds.

One of the reasons the monopoly still exists is because regulators are trying to address two issues at the same time, says Salles. And this has complicated matters. "People are trying to solve two different issues. One, that IRB is state-owned, and the other, the fact that IRB has a monopoly. As far as I am concerned, I have no problem with the state being involved in reinsurance. But I have a huge problem with the monopoly part of it. It hasn't been addressed properly because people are trying to solve these two issues at once," he says.

Separately, Salles says he will step down as chief executive at the end of 2005. He is required by contract to step down when he reaches the age of 62 next year.

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