insurance AGENDA

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EXCLUSIVE INSIGHT AND ANALYSIS FROM INSURANCETIMES, STRATEGICRISK & GLOBALREINSURANCE

Michael Faulkner ■ Editor

One of the insurance industry's greatest concerns is increased regulation of the sector as a result of the banking crisis. Many in the industry are fearful that the general insurance sector will be hit by a wave of excessive regulation emanating from Canary Wharf as the authorities seek to prevent another financial meltdown.

The creation last month of the European Systemic Risk Council, a pan-European supervisory body, has added to the insurance industry's concerns. As David Banks argues (page 2), the Council's composition means that bankers will be making decisions that affect the insurance sector.

In the UK, Aviva is re-examining its relationships with the big brokers. After months of public criticism over the consolidators' commission levels and its pulling out of a number of deals, Aviva is now busy trying to reignite these relationships and stem the tide of business that it is losing. Ellen Bennett looks at what is behind this apparent U-turn (page 3).

Meanwhile, Bermuda has been the stage for an epic drama as reinsurers Max Capital and Validus fight to take over IPC. Validus is in a strong position, but the outcome is far from certain. David Sandham looks at the broader picture in terms of consolidation among the Bermudan (re)insurers (page 4).

Finally, with risk buyers under pressure from their bosses to justify their choice of insurance carrier, Nathan Skinner examines the opportunities for brokers and insurers to capitalise on this situation (page 5).

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David Banks • Deputy Editor • Global Reinsurance

Singing the bankers' tune

In the regulatory backlash, insurers are losing control to bankers

If there's one thing that insurers hate, it is being compared to bankers – especially in the current financial climate. Yet, politicians are making exactly this mistake in their quest to create financial supervision so watertight that markets will never again spring a leak.

Take a look at the new European Systemic Risk Council (ESRC), for instance, composed of three powerful pan-European authorities for banking, insurance and securities. The problem with this mega-supervisor – hastily formed by European leaders in June – will be led predominantly by bankers while the European Central Bank president will automatically be chairman.

Suddenly it is as if the naughty children in the classroom are promoted to prefects. This is ironic since it is precisely insurers' caution in terms of risk taking that has placed them in a better position to weather the current financial storm than the rest of the financial services. And while some have suffered financial shocks, for the most part the insurance industry has been functioning normally.

Insurers are understandably worried about the future; in fact Munich Re boss Nikolaus Von Bomhard says he is nothing less than "frightened" by the potential influence of bankers over insurers in the new European mega-supervisor because banking represenitves on the Council outnumber the insurance represenitves.

"Bankers will hold much greater authority even in matters that impact insurers the most. Already they are making proposals and it really frightens me that there is this prospect of bankers having control over insurers,"says Bomhard.

The ESRC will have powers to investigate cross-border firms and mediate in disputes between national regulators. Among the most contentious areas is that the council could force national governments to take action against insurers or recapitalise banks against their will. Insurers are also fearful that the organisation could act to increase minimum capital requirements in a pro-cyclical manner.

The creation of the ESRC is the latest in a series of events in which decision-makers have attempted to form rules for insurance within a banking context. Three weeks before the ESRC was approved, European commissioner for competition Neelie Kroes asked why insurers should not observe the same competition laws as bankers during discussions about insurers' block exemption rules.

The overwhelming response from delegates at a public hearing in Brussels was that insurance was unique. The insurance industry argues that the unknown future costs of insured risks and the need for companies to share information on risks for the benefit of customers were two unique aspects of insurance that separate it from banking. The International Underwriters' Association says comparing insurance to banking is "like comparing deep-sea fishing to dairy farming".

Insurers await a final decision from the European Commission on whether they will continue to receive a block exemption from competition law on the use of standard policy conditions. Observers believe European decision-makers have gradually come round to insurers' unique competition exemptions – which had been lined up for removal – in light of the financial crisis.

"There is a growing understanding that regulation that reduces risk, and respects the unique aspects of insurance, is a good thing. However, there is still a long way to go," says one insurer.

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Key points

- European Systemic Risk Council (ESRC) was created by European heads of government in June
- The new supervisor for financial services will be dominated by bankers and headed by European Central Bank chairman
- Insurers concerned by the implications of banker dominance on the new supervisor
- ESRC's decisions on capital requirements could affect insurers
- European Commission compared insurance to banking in its review of insurance block exemption rules in competition legislation
- Insurers argued that their industry is sufficiently unique in certain areas that some block exemptions from competition law are required and must remain

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➔ Von Bomhard "frightened" by bankers' influence, 29 June 2009

➔ Kroes has little time for insurers, 2 June 2009

➔ The end of light-touch regulation, 19 June 2009

➔ New EU risk council proposed, 25 May 2009

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Ellen Bennett • Deputy Editor • Insurance Times

Aviva tries to rebuild its bridges

But has the insurer left it too late to become friends again with the consolidators?

When Aviva took 80 brokers and their partners on a luxury, all-expenses paid Mediterranean cruise last month, the five-star craft was dubbed “the love boat”. It was a timely symbol of Aviva’s new attitude towards its biggest brokers, the consolidators. After months of public brow-beatings and posturing on commissions, the UK’s biggest insurer has ever so quietly started to change its stance.

The story begins last August when Aviva chief executive Igal Mayer began to talk publicly and loudly about commissions. He made a point of telling the press that he had set a limit of 30% on commission, plus expenses. At the time, the consolidators were demanding commissions of 40% plus; in some case 50% and more. With soaring expense ratios in a soft market, Aviva had little choice but to act. Indeed, all the major insurers were driving down commissions though some, such as RSA, refused to talk about it publicly.

But Aviva shouted about it – either because it felt duty-bound to lead the market or perhaps because it wanted to use publicity as leverage. This, coupled with its tough negotiating stance, led to some difficult conversations over the course of about six months.

Meanwhile, a number of other insurers, led by Allianz, were quick to spot an opportunity to widen their distribution, and became aggressive in snapping up the business coming out of Aviva.

As a result, Aviva now writes considerably less of the business produced by all the major consolidators; its account with Towergate, for example, has fallen from about £400m to £250m. Market sources suggest that, if current trends continue, this could dwindle away to next to nothing in a year.

Moreover, the public and personal nature of the negotiations led to some rather unbusinesslike fallings-out. Certain characters among some of the consolidators were barely on speaking terms with the senior team at Aviva.

Meanwhile, the world’s banking system goes into meltdown, causing investment returns to plummet, and the soft market lingers on. Suddenly, Aviva looks like it’s in a tight spot, and those falling premiums become much more important. It is due to report its half-year result in August and – so market speculation has it – premium will be significantly down.

Mayer needs to have a story to tell the market – not to mention the Aviva bosses – when that happens. And that story needs to be that Aviva is building up its business with the consolidators once again. Hence what one chief executive describes as a “love-in”: a concerted effort to rebuild bridges.

Aviva is not raising commissions so it would be a little unfair to accuse it of a turnaround. Having achieved what it wanted on remuneration – which most brokers agree was fair – it is now looking at other ways of rebuilding its accounts. These centre on underwriting risks at which it had previously turned its nose up.

The market now is left with a number of questions. First up, what of Mayer, the man behind the strategy. There has been no suggestion that he’s about to depart, but he certainly has had to make a number of personal concessions. Second, where does this leave the ongoing power battle between the country’s biggest insurers and their brokers? All of a sudden, the brokers are back in play.

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Key points

- Aviva is attempting to boost its level of business with many of the major consolidators back towards its former levels
- The insurer reports its half-year results on 6 August. They are expected to show a significant drop in premium
- Aviva has not raised commissions; rather, it is being more flexible with the business it underwrites

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➔ Aviva tries to rebuild its bridges with the consolidators, 18 June 2009

➔ Igal Mayer, 14 January 2009

➔ The trend setter, 17 August 2008

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David Sandham • Editor • Global Reinsurance

Bad blood in Bermuda

The gloves came off in the fight for IPC. What are the implications for Bermuda?

1 March 2009 is the date to remember. That's when a merger was announced between two Bermudan companies, Max Capital and IPC. It had been months in the making and only required the approval of the regulators and stockholders of both companies, the former being a certainty. A transition team was formed, and Max looked set to emerge as a $3bn player.

A month later, out of the blue, a third Bermudan reinsurer, Validus, jumped in with an offer for IPC. It was a stunner: there hadn't been an ugly insurance skirmish in Bermuda since ACE queried XL Capital's acquisition of Nac Re almost 10 years ago, forcing XL to pay a great deal more than its originally agreed acquisition price.

Bermudan companies speak of "friendly competition". But the tone of Validus and Max's exchanges became anything but friendly. Privately, executives at both companies denied the existence of bad blood, but it quickly became a fight to the death.

Validus went to court to seek an injunction, arguing that the $50m termination fee in the deal between IPC and Max was excessive, and that agreeing to it and to a "no-talk" provision was a breach of the directors' fiduciary duties.

In May, the Supreme Court of Bermuda denied Validus' application. Nothing daunted, on 18 May Validus sweetened its offer with a cash component of $3 per share. As the days counted down to IPC's shareholder vote on the Max deal, the smart money was on acceptance. Shares in IPC are mainly held by about 200 institutional investors. The rival bidders hit the phones to convince them their deal was the best.

Many were surprised when 72% of IPC's shareholders rejected the Max deal. Although IPC chairman Kenneth Hammond had said that a vote against Max was not automatically a vote for Validus, the disintegration of the Max combination has left IPC highly vulnerable.

Also if a twice-sweetened offer from Validus does finally snag IPC, Validus could still end up paying less than book value. IPC asked Validus for something nearer to book value, but was in no position to barter.

Will anyone else now come forward to bid for IPC? At the time of writing, Validus looks likely to swallow IPC before autumn sets in. That would in turn make Validus a $3bn player, assuming IPC's shareholders go along this time. It seems unlikely that they will not.

So are more mergers on the cards? Consolidation is supposedly overdue for the "Class of 2001" – the reinsurers which set up in that year. Its predecessors, the companies formed in Bermuda in 1993, have been reduced to a rump (including IPC) within five years, although a continuing soft market was a big factor. In the mixed markets that have prevailed since 2001, the comparison is a little odious.

Some say that to be taken seriously these days, a reinsurance company needs $1.5 or $2bn in capital. On that basis, a few merger candidates present themselves —Hiscox, Montpelier Re Holdings, Max itself, Lancashire Holdings and Flagstone Reinsurance Holdings have capital of less than $1.5 bn. Platinum Underwriters Holdings has less than $2bn.

Given the continuing rarity of credit, acquisitions would have to be funded by shares as, in the main is Validus's offer for IPC, and as would have been the case with the Max deal.

While the shape of future deals is unclear, another lesson is clear: to avoid unpleasant surprises, directors must at all times closely consult with their shareholders and fight hard to create value for them.

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Key points

- A hostile bid by Validus led to IPC shareholders rejecting the agreed offer from Max
- More mergers could be on the cards, as size is considered important in reinsurance
- Mainly share offers, rather than cash, are more likely

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➔ IPC shareholders turn down Max offer
12 June 2009

➔ Bermuda Triangle
11 June 2009

➔ Validus ups offer for IPC
18 May 2009

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Nathan Skinner • Associate Editor • Strategic Risk

Home-grown credit checks

There are opportunities for the insurance industry to give more financial information to buyers

Since the financial crisis severely tarnished the reputation and reliability of credit rating agencies, most companies now do their own checks into the financial health of their business partners – including their insurers.

Risk managers are pressured to prove that they are making sensible decisions when it comes to insurance partners. Before the collapse of the financial world, they could select insurers based on their credit rating and avoid any difficult or probing questions from their bosses. But chief financial officers are now much more inquiring and uneasy. It is no longer good enough to stay with an insurer purely to maintain a precious long-term relationship.

Companies are also under a lot of external pressure with institutional investors increasingly showing an interest in a company's main insurance carriers. That is only set to increase as shareholders become more sophisticated. Monitoring the security of insurers therefore has become more important than ever.

But conducting a detailed and meaningful financial assessment is hard and time-consuming. That's why, in the past, companies relied on a third party to do it. However, given this trend, there are opportunities for the insurance market to respond.

Companies measure the volatility of their business partners by using third party analysis, their own investigations and the stock market. But one of the most important sources of information is their peer group. That means good communication from insurers is essential.

Brokers can help by providing financial information and services to their clients; global brokers already have begun offering a much more detailed financial analysis. Risk managers have even called on some to validate who they elect to deal with. But brokers will always fall short of making specific recommendations about which insurer a company should go with, for fear of opening themselves up to professional indemnity claims. Ultimately that decision will always rest with the insurance buyer. Brokers should set up teams to undertake analysis on behalf of their clients. This should go beyond reporting public information and brokers should be able to leverage their knowledge and understanding of specific insurers to provide deeper analysis.

There is an opportunity here too for insurers. Established relationships are no longer enough to stop new players from breaking into the scene. To start with companies want to enhance their programmes by syndicating the risk among more than one insurer, so that if one has solvency difficulties there are others ready to take up the slack.

Diversification is the best form of risk management. There also is now much more scrutiny on the decision to go with one carrier over another. That means if an insurer can show that it will do a better job – by delivering the coverage buyers are looking for with better service and speedier settlement – it may be able to acquire new business. Buyers are also increasingly interested in meeting their underwriters face-to-face to understand their risks better and gain reassurance around any exposures. If insurers are willing and able to do this it can help cement trust in the relationship.

The brokers and insurers that step up their game and help risk managers meet the challenges they face are the ones who will be rewarded with new business.

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Key points

- Given the failure of the rating agencies, companies are monitoring insurer security like never before
- Partly this is driven by internal and external pressures to validate insurance carrier choices
- Word of mouth is one of the biggest information sources; good communication on the insurer's side is vital
- There is also an opportunity for brokers to provide clients with deep financial analysis
- New insurers may also be able to acquire new business if they can show that they can do a better job

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→ Risk managers dig deeper into insurer security
18 June 2009

→ Out of the frying pan
6 May 2009

→ S&P places XL Capital on CreditWatch Neg
3 July 2008

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