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**A Global Reinsurance
Monte Carlo Roundtable**

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MONTE CARLO REINSURANCE BUYING STRATEGIES ROUNDTABLE

On the sunny morning of 7 September in Monte Carlo, nine senior figures in the reinsurance industry met to discuss current market conditions and strategies for reinsurance buyers. In general, their mood was positive.

There were some clouds on the horizon, however. The widely predicted hard market has materialised only partially. Though rates are higher in some lines, casualty rates are seen as too low, particularly given the looming threat of inflation, which could cause costs of future claims to spike. There was some disagreement between participants on the subject of the insurance-linked securities sector, with some embracing it wholeheartedly and others pointing out disadvantages it has compared with traditional reinsurance.

But you can read the debate yourself in this transcript of the meeting. It is not an essay, but an account of what was actually said on the day. Here, you can relive experts talking among their peers.

I thank the participants for their candour and for their generosity in sharing their deep knowledge and experience. That knowledge, I hope you will agree, radiates from the pages that follow.

David Sandham, Editor, Global Reinsurance


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MARKET CONDITIONS: HARD OR SOFT?

David Sandham Our first question is on the hardening market, if we can call it that. How deep and wide is the hardening that has occurred in the reinsurance market? Nick, would you like to share your thoughts?

Nick Frankland I attended a pre Rendez-Vous briefing last week in London and would reference Dominic Christian, who gave a talk there. He identified the classes that he felt were hardening, which I think we would all broadly agree are aviation, trade credit, Gulf of Mexico and retro/peak zone cat. These are the principal areas where there appears to have been a hardening or toughening of rates over the last 12 months. Their calculation suggested that these represent less than 10% of the globally ceded reinsurance premiums. On that premise, it would be very difficult to argue that it is a hardening market.

David Sandham Peter, you have been through many hard and soft markets. What is your perspective on this one?

Peter Grove There is a hardening due to the payback situations of aviation losses, such as the sizeable Air France loss this year, and the Credit Claims in the market which

have created losses to reinsurers, so there's very much a payback situation. The other hardening is short term in the retro and US cat, because that has very much to do with when the last loss occurred. Reinsurers, at this time of the year should all be tough and hard, saying it is early in the season. Therefore, they should go into this market at this early stage being fairly tough. A lot depends on where we are at the end of November; I think that will determine whether we have a hard retrocession market and a hard US cat wind market. Time will tell on those two classes.

David Sandham Conan, are you being hard and tough as a reinsurer?

Conan Ward One always tries to be reasonable with one's clients about these sorts of things. Largely it is a supply and demand market and, with the credit crisis and with some loss activity from last year, there has, happily, been some uplift in a lot of our businesses. However, the real elephant in the room, in terms of rate rises concerning the largest volumes of premium in the business, is on the US casualty side. I wonder how long that can continue, considering the changes in loss costs and the sorts of yields that people can earn right now, as well as the overall state of people's loss reserve position regarding prior accident years. Most simply it is a supply and demand business but, in each aspect of it, there is a different element that comes to play. US casualty has now reached an inflection point, where it either needs to rise or it will begin to hurt people's balance sheets. There has been some asset recovery but not such that all the businesses are healthy.

David Sandham Benjamin, would I be right in saying that generally the market in Europe has been softer than in the US?

Benjamin Gentsch I would agree with that, but as a general statement I would also say this hardening is certainly wide rather than deep. From our perspective, there has been hardening in a few more lines than what Nick was mentioning, but not as deep as would have been hoped for. Our pricing has changed for this year for the underwriting of 2009, due to the parameters that we had to adopt, for example with the yield curves. This was applicable to all lines of business and, as a result, we were able to push this through in basically all the lines of business.

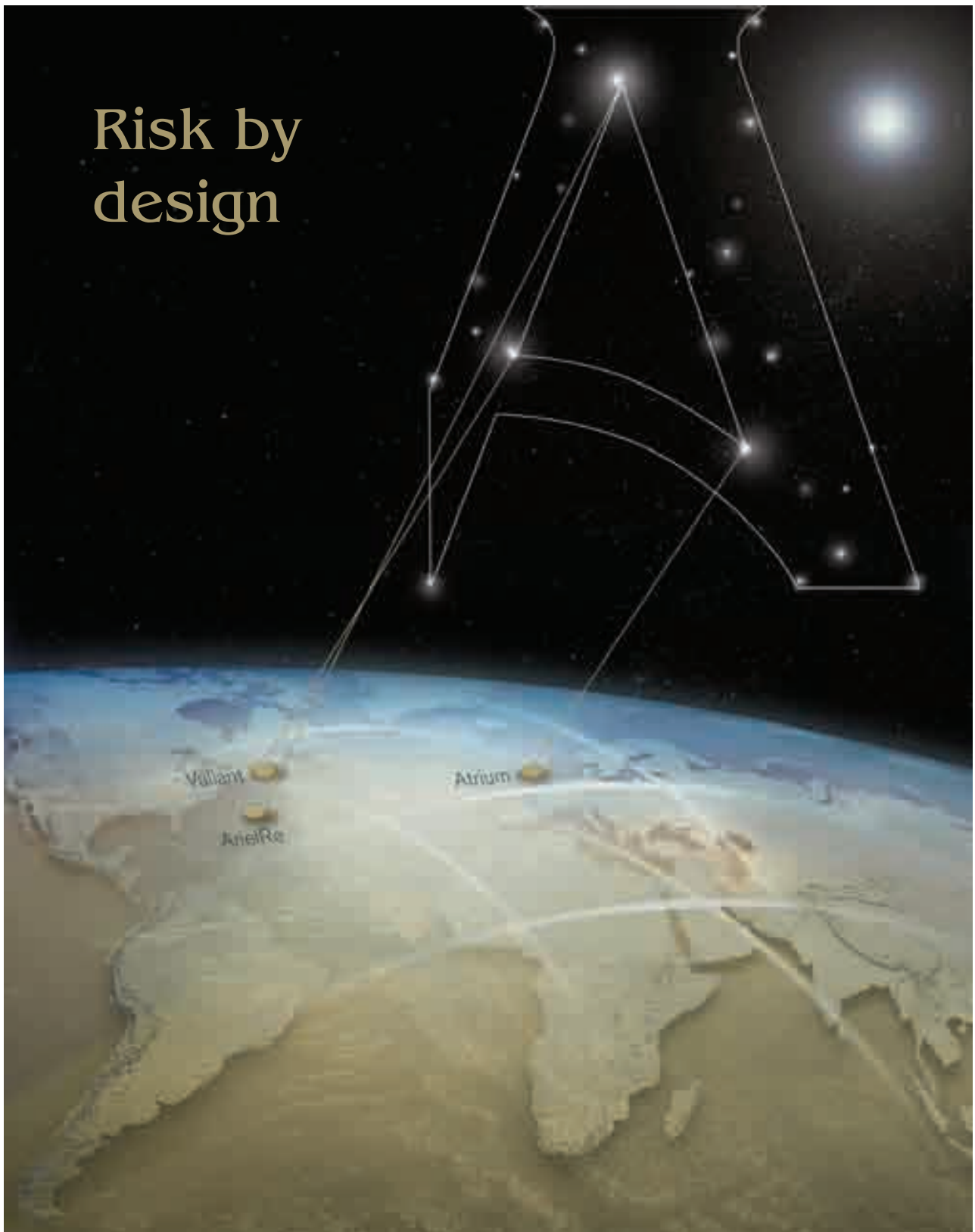
Yet, as we reported, it is a hardening but we must question whether this can be called strong hardening when it is only 3.5% across our portfolio. It is really a soft improvement.

David Sandham Mark, as a reinsurance buyer, what is your perspective?

Mark Talbot I would describe it as a firm market rather than a hard market. As people have mentioned, there are differences across lines of business and territories. My perception is that there is also capacity available for companies with solid business plans and commitment to underwriting excellence. That shall remain the case unless something dramatic happens on the claims side. We have already witnessed something dramatic on the financial market side of the equation. I expect markets to remain firm, but firm, not hard.

'US casualty has reached an inflection point, where it either needs to rise or it will begin to hurt people's balance sheets' **Conan Ward**

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David Sandham Would you agree with that, Sven?

Sven Schade I would agree with that. Looking at the first half of the year, the asset markets recovered. While they are not at the same level as the middle of 2008, they recovered quite a lot. When we look at last year's renewal, it was not hard and there were rather flat, small increases in prices. As Mark said, it is rather a firm than a hard market. We should not forget that the primary market is still very soft and we must consider the long standing relationship with the reinsurers and how they can help the insurers in the soft market.

Conan Ward If you look at some of the most capital intensive lines of business, they are almost in stasis. A big event in the multiples of billions, on either the supply or demand side, could impact pricing. It is almost the Goldilocks syndrome: it is just right. If, for instance, Florida needed to buy \$5-\$10bn more, it is likely that there would be a run on the shelves. Certainly a Berkshire Hathaway could impact that, and there is talk that they are back, but right now I would say the pricing dynamic is pretty fragile.

John Andre To Sven's point, it depends on what is going on at the primary level. I can speak better of the US than Europe, where the rates in primary business and casualty have decreased considerably due to the recession impact and competition over there. The recession is impacting comp and commercial receipts so the overall basic premium is shrinking. I don't have the same perspective as someone working for a reinsurer but it appears that the behaviour of the primaries in when and what they want to buy is really wavering, as it might have been in years past. It has become less predictable than a few years ago.

David Sandham Marty, do you have any predictions for pricing?

Marty Becker Reinsurers, perhaps uncharacteristically, have been providing a consistent market for some time. Prices for most classes have not fluctuated radically off established means. We talk about slight firming or softening, but these movements appear to be related to unusual losses. It has been a predictable market, which is good for our cedents.

John Andre When we talk to the companies that we rate, they almost universally state that they are exiting commercial business for property business. Looking at six month results on a line by line basis, commercial premiums were down considerably from nearly every reinsurer. People are walking and talking the same line and it is encouraging to see that underwriting integrity is hanging in there for the industry.

AN ABNORMAL PHASE OF THE CYCLE?

David Sandham Leading on to our second point, are we in a "normal" phase of the reinsurance cycle? By that I mean, was the hardening that has occurred caused by external general financial market events, rather than by hurricanes? Peter?

Peter Grove Certainly at capacity point, capacity reduced last year probably because of the financial markets problem. I find this interesting. Perhaps we are about to go into a typical cycle again, which we have not been in since the World Trade Centre disaster. Before 2002, we very much had cycles. After a catastrophe occurred, there was a hard market that sadly usually only lasted two years and then we went back into a soft market again, which lasted from anything between two and 10 years.

After World Trade Centre, that actually stopped and we went through an incredibly hard market in 2002 and 2003. By 2004, typically it would have started to soften but there were some hurricanes that year and it remained as hard. Then, in 2005, there was a series of major hurricanes, so the market stayed hard and that has lasted from 2006 to 2008. However, perhaps we are about to view a more typical situation this year and, if nothing occurs we may return to a different type of market. I hope not.

Marty made a good point: we seem to be at a time now where it is as important for cedents to know where they are, and the volatility does seem to have gone out of the market, because we have had such a long period of change. Perhaps the thinking is completely different now but this is very much a key year. Reinsurers' attitudes this year will follow through for the next few years, barring catastrophes.



'Casualty is something that ought to go up but I do not think it will'

Nick Frankland

David Sandham Mark, are you clear where we are in the cycle as a cedent?

Mark Talbot I agree with Peter; we do not see the radical ups and downs that we might have seen before 2002. I cannot speak for all cedents, but those who have been rationalising their purchases and taking a more global perspective, in terms of capital and risk management, tend to be buying in a different place. They are buying in areas where you would expect the technical price to be realised price more often in the marketplace.

Quite often they are capital intensive placements where reinsurers are less willing to give dramatically on prices. That in itself reduces the volatility. Therefore, I do not think that we will see radical ups and downs and, again, it is a firm and not a radically volatile market.

Another interesting point is that in the most recent past, it has been the business that has caused the volatility. This time, it is not the business itself but the financial markets and we are not out of the woods on the financial market side of the equation. If the business side were to produce a large loss now, it would put a squeeze on a lot of areas, as the situation is fragile.

David Sandham One area where we have seen a radical up move is the D&O and E&O sector. Gavin?

Gavin Coull That is right. We were sitting round this table last year and alarm bells were ringing, but the way the market has handled those losses is much more sophisticated than looking back to Enron, WorldCom or even the World Trade Centre. There has been a much more sensible approach: people have been prepared and there have not been so many unexpected surprises coming through, so that has affected a certain class of business.

Overall, as Peter stated, a lot of the cat events which could impact on 2010 pricing may occur post-Monte Carlo. We should not forget that we cannot predict what will happen after the beginning of September. While there was a hit on the financial markets generally last year, it has been better handled and controlled, which impacts on pricing.

JANUARY RENEWALS EXPECTATIONS

David Sandham That brings us neatly to our third point: what are our expectations for January renewals and is Monte Carlo too early a place to talk about this? Are you in fact talking about this in your private meetings, Nick?

Nick Frankland To tie back to the last question, we do have to accept the very distinct differences within the business. We have largely been addressing cat in the last question whereas casualty business generally exhibits standard cyclical behaviour much more so than the straight supply and demand of cat.

Regarding Conan's point, casualty is something that ought to go up but I do not think it will. I fear that combined ratios are generally not near enough to 100% yet for the underlying markets to overtly respond.

Considering cat, the capacity issues that affected balance sheets on the asset side were no more than about a 10% capital impairment on average across the reinsurer pool. That is more or less what most companies would write to as an expected PML in the event of a large cat loss. So, there is stronger continuing capitalisation than expected and more players, conceivably with more capacity, suggesting, excepting trade credit and aviation – where we are bound to see continued hardening, it will be a level market.

David Sandham Would anyone like to take up your point about casualty? You said something very interesting there, that pricing ought to go up for casualty but you do not think it will. People are saying we should have higher prices but when we come to do a deal ...

Nick Frankland The problem is that intuitively we all know something has got to be going on because of the credit crunch. There are not yet enough crystallised events: a lot of notifications are out there and potential suit activity, but as yet it is very difficult to see whether it will cost a lot to the underlying businesses.

Peter Grove Another problem for casualty is spread; not just for US casualty but worldwide casualty too. It is not fashionable to be a monoline underwriter anymore. After 2005 and the very large catastrophes, there has been massive pressure on industry to



'I do not think we will see radical ups and downs, it is a firm but not radically volatile market'

Mark Talbot

spread their book. Unfortunately a lot of markets got into long-tail business after that and of course their experience is only two or three years. Thus, they are probably still prepared to compete, simply because they have not quite got the experience of the tail.

There is this pressure to spread and, sadly, it could keep rates down on that side.

Conan Ward That is a fair point. A lot of traditional players say that they have cut their book back, but somebody is taking it. To be fair, some of the clients have taken some lower layer stuff out of the market on the casualty side too, but somebody is writing it.

John Andre Conan might have raised a point earlier about the reserve redundancies that have been released into earnings but as these redundancies wind down, the recent low combined ratios will be pressured as we go into 2010/11. We are currently stable on the non life reinsurance industry but unless pricing improves, results will be significantly challenged.

Benjamin Gentsch I see it a bit differently because we have combined two questions: the phase and expectations for 2010. I agree that it has been a relatively soft cycle. It has not come down as much in this cycle as before, with rate decreases in the late 1990s.

Therefore it is also not jumping up as much as one would have hoped for, especially some investors and analysts who had unrealistic expectations. From our side, we see this slight improvement continuing for 2010 and we would rather put it on some general facts, such as we do not see additional capacity coming into the industry, for example. This is one difference to earlier cycles. We have not seen any major new formation of a reinsurance capacity provider. We actually still see some of our competitors having less capital to date than exactly 12 months ago. This capital has not been fully replenished, so that again means there is not as much capacity as there has been previously.

We would expect the demand to remain at least stable or even slightly increasing and we know some clients would like to buy at different levels, as Mark indicated. Finally, our pricing factors are accounting for the economic hard facts – the yield curve is a fact that has changed even within these past 12 months. Some of the yields have decreased by more than 100 basis points for our pricing model and that will flow into the price that we will quote. We are reasonably confident and will certainly convey to our clients that this will result in a more or less similar hardening or increase of the prices as we have pushed for through 2009. We are rather on the optimistic side.

Marty Becker The challenge when talking about casualty is that there are so many different lines. We are seeing rate increases in many of the professional liability lines, certainly anything related to financial institutions has a big uptake at the moment with good reason – they have had big losses.

The big fear in the casualty space is the impact of inflation. If you are writing frequency casualty, low layer motor liability and primary workers compensation, inflation certainly is a factor that must be considered. If, however, you are writing excess of loss casualty, it is not as big a concern – you are going to get hit or not. You have to be careful generalising about the marketplace. It is dangerous to do, but we all might give some credit to the rating agencies, as perhaps they have brought some consistency to the market.

It is early days but we don't seem to have quite the high highs and low lows that we have had for a long time. Maybe we are becoming better stewards of capital. As Nick pointed out, financial results have been terrific for the industry overall, but this is not seen in the stock prices. They do not reflect the consistency that the reinsurance industry seems to have gained these last few years, so hopefully there is better news on the horizon.

COUNTERPARTY RISK

David Sandham Moving onto our next point, the reinsurance buyer is looking at the risk of the reinsurer. This has particularly come into focus since the financial crisis. Swiss Re are not here today for example but if I was a buyer, Mark, I would be very concerned about such large entities being downgraded by Standard and Poor's (S&P). How do you judge the counterparty risk?

Mark Talbot I will not be commenting on any reinsurer specifically. Of course when we are considering reinsurance partners, counterparty credit



'Counterparty risk is a hygienic factor. If this is not fulfilled, it is not a counterparty with which we would work'

Sven Schade

risk is the first consideration. First, you must establish if the counterparty credit risk is acceptable to you, differentiated by line of business and then it becomes a question of capacity, pricing and the economics. Of course, counterparty credit risk is extremely important. In our case, it has always been important and yes we are spending much more time talking about it now because there is more going on. However, we have not changed our strategy and we have not had to revisit the way we look at counterparty credit risk because we are quite well established in that sense. I am guessing it is getting a lot more attention now throughout the market.

David Sandham When you judge counterparty credit risk, do you look at the rating agency's assessment?

Mark Talbot Similarly to most large players, we also have our own security committee and risk management that looks specifically at counterparty credit risk, including the reinsurer counterparty credit risk. Thus, we do have our own approach. Of course we do consider and respect the work of the rating agencies too.

David Sandham Sven, how is your practice compared to this?

Sven Schade The same. Counterparty risk is a hygienic factor. If this is not fulfilled, even if pricing is very good, it is not a counterparty with which we would work. We have not changed our stance on that during this credit crisis. Before the crisis, we had a security committee, our own measures and our own maximum capacities, with which we were willing to write with reinsurers. This has been a challenge to us in the credit crisis and we are not affected on that side.

I find it interesting that when we discuss counterparty risk in the reinsurance market, we are rarely talking about collaterals. On the asset side, it is normal to have collaterals on everything that you are doing. On reinsurance, we had it in France but, with new European regulations, these collaterals are not given anymore.

David Sandham For clarification, are you talking about collateralised reinsurance?

Sven Schade Yes, on deposits or loss deposits. This would be one efficient way to reduce the counterparty risk but, from the reinsurers point of view, this blocks a lot of capital.

Marty Becker It is certainly efficient for ceding companies; less so for reinsurers.

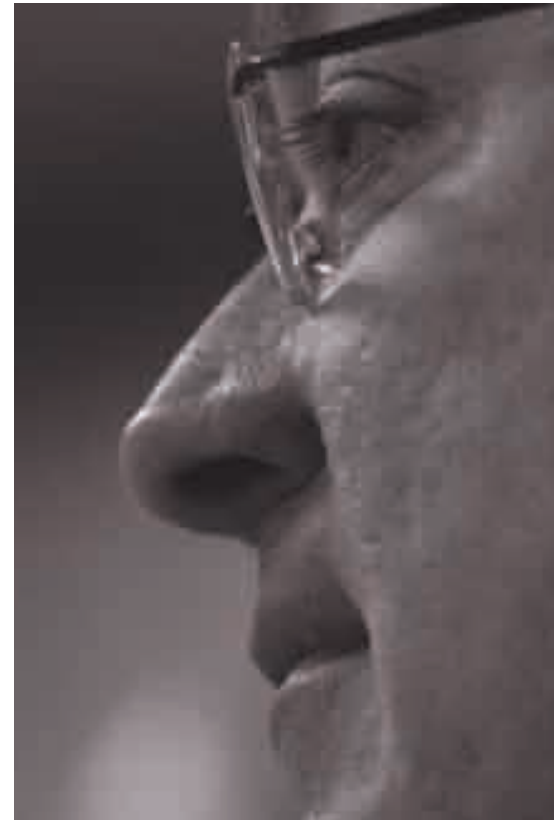
David Sandham Nick, how do you advise clients on counterparty risk?

Nick Frankland Looking at the numbers, by capital the reinsurance block of AA has dropped from 52% to 29%. That squeeze has fallen into the A bands, this is S&P, John, with all due respect to AM Best! *[Laughter]*

The A+ to A band has increased from 41% to 62%, and S&P's capital model does not differentiate between the plus and minus notches. So, 62% of the available reinsurer capital is in the single A band. That is a huge concentration of security. I am not entirely sure of the effects of this, because we can no longer take size as a measure of safety either. But, if you have got a huge band of very similar security, what does that mean? Probably, it enhances the case for further diversification within that A banding. It all supports a greater coinsurance spread out there of much wider coinsurance shares, smaller lines and greater diversity, in order to try to play within that A rated band because you do not have as many other options.

Peter Grove There are other reasons as well. It is not just about security. I agree with Mark's description that it is going to come back more, but it is also because of willingness to pay. Nowadays, you can have a very big and ugly reinsurer who might have several A ratings notched up there, but if they are inclined to say no, then you have got a problem for a different reason. Although our company has not suffered this, the reality is that others have suffered the big and ugly reinsurers saying no and arguing over event definitions or over a class that they thought they were covering, or not. That makes a difference as well and because of that combination we could see the market moving back to a more subscription situation, more so than in the last five years. Again, this will be interesting to see during this renewal season.

Mark Talbot The other thing, again on the cedent side, is that many companies such as Zurich are



'Capital market alternatives serve a limited sector of the marketplace'

Marty Becker

starting to look at gross line underwriting. There is a realisation that over-reliance on reinsurance is not a happy place to be when credit risks come under pressure.



'We were the first one to place after the Lehman collapse with Atlas V'

Benjamin Gentsch

David Sandham Would you care to elaborate on the alternatives to reinsurance?

Mark Talbot First alternative is to hold it yourself – concentrate on your underwriting and live within your means, so control exposures. A substitute to reinsurance is capital market alternatives, which have been somewhat constrained in recent times, but I think they will come back. That is another alternative to concentrating risk among few reinsurance counterparties.

Marty Becker Capital market alternatives serve a limited sector of the marketplace.

Mark Talbot That is the case today but I think it will come back. It is never going to replace the traditional reinsurance market in my view. Yet, as we have seen, in the area of high-level excess of loss cat covers, it has proven a viable alternative continuing to build on already fairly high credit exposures.

Marty Becker There is also the school of thought that reinsurers add some value other than capital, providing cedents with the benefit of additional underwriting expertise. You do not get that from a capital market.

David Sandham SCOR has been a sponsor of a number of cat bonds, has it not?

Benjamin Gentsch These are cat bonds that we place on our behalf, so it is not transactions that we do for clients. I would agree with Mark: I do not see capital markets replacing the traditional reinsurance market but it is a nice and important addition to the capacity of the traditional reinsurance market. I would agree that price is not the main driver,

although it is important. It also depends on the size and origins of the ceding company what service is demanded from reinsurance providers.

Underwriting, intellectual and modelling support for certain clients is very important. It is a much more important driver than pricing but for large companies, for example Zurich, there is a different weight on such aspects. There are certain qualitative differences on the demand side between cedents.

THE CEDENT-REINSURER RELATIONSHIP

John Andre In the US, we rate hundreds of mid size and smaller companies and partnering with a reinsurer is critical. They do not have the depth of the reinsurers staff. They lean on the reinsurer and broker for advice and how to best bring it all together. It is hard to put a price on that but it is huge for these many companies.

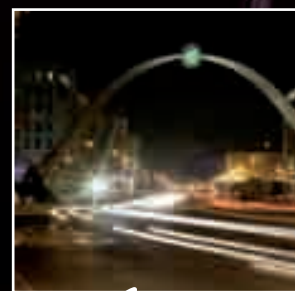
Conan Ward Generally speaking, it is important for us who are reinsurers in the room to offer a level of transparency too, making that process pretty straightforward. We can say: these are the lines of businesses we do, this is how we think about them, this is what we are invested in, and you can make your own determinations. Certainly, John and his colleagues who work at different rating agencies are hugely important, but it is also important for Zurich to make its own determinations about counterparty risk. It is important for us, as customer-facing organisations, to make that easy and to be straightforward about it.

Gavin Coull That is something that does fall down. Following on Peter's comment, in the last 18 months I have certainly seen reinsurers that I will not name getting an awful reputation because they will not pay. It is that lack of transparency from a buyer's point of view: you are buying a product which is to pay claims and there are companies who will not pay and who raise spurious points, although there are of course some that are well made points. However, if you do not have that transparency that Conan talked about in the whole process, there will be surprises. You get a surprise, questions get asked and that is where it falls down. You cannot focus too much just on the quality of security. It is what the product provides that is paying claims.

Mark Talbot On Marty's point, and to pick up on the differentiation between large and not so large companies, it is still important for large companies that there is a solid relationship between reinsurer and insured. This is a fundamental part of our

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business. There is a lot of trust involved and transparency is part of that. No matter how large you are, those relationships are still key. I would not want it to be misinterpreted that there is no value in that. In fact, once you have done the numbers, you

then starting to make a judgment call in terms of the firms you want to deal with and that involves quite soft factors. That remains an integral part of our business model, because it is a very long-term business. As a purchaser, that has rationalised purchasing, we are buying what we have decided we need. Therefore we need partnerships for those covers because they are an integral part of our risk management. This works in a different way than for a smaller player, but it remains very important.

John Andre When do you think that behaviour from a reinsurer, fighting over terms and conditions, comes back to bite them? Is it on renewals? Sooner or later that is going to haunt them.

Gavin Coull Whether it is renewals or one or two years down the line, is it a one-off claim or a more generic attitude to the business? Reputationally, it is a big driver.

Conan Ward Caveat emptor is not exactly a new phrase: the buyer has to beware. If someone routinely sells you, year after

year, a product that no one else will sell at that price, you should ask yourself, if ultimately, you are going to get paid. If they sell this to you, they might be selling it to someone else at the same price.

Peter Grove The relationship is key. You have to get into the culture of your reinsurer. Does your reinsurer look for ways to pay claims or avoid them? This is very important. As Mark says, the relationship is what it is all about.

Gavin Coull One of the problems is at what point does the reinsurer decide? Is it a response to market

conditions: our securities have dropped down and capitalisation has been hit, therefore we have to respond by bouncing claims in the short term or the medium term. Yes, there is the caveat emptor, you buy the same product. However, that can change because it is the underlying metrics that can cause your reinsurer to suddenly change their tune. It is that surprise in your own risk modelling which is the danger.

Nick Frankland Claims paying is absolutely critical. That is what all our clients are ultimately buying and all reinsurers are offering as a financial parachute. You cannot get into an aeroplane fearing the parachute is not going to work. You cannot afford for that parachute to fail one time out of 10 in the event of major industry catastrophes. It has got to work 10 times out of 10.

Thus, the broker's job is very heavily related to monitoring aged claim deficits; how quickly money is moved; monitoring markets performance; working alongside rating agencies and others. It is to do our utmost to keep the oil in the system. One question I am intrigued to ask is what do the clients present think with regard to brokers outsourcing their claims activity?

Sven Schade So far, luckily we do not have a lot of claims given to the reinsurers, so personally I have not had any contact with the broker regarding any problems to recover money. Rather, I believe we will start having problems recovering money once the company is put in run off and the run off managers are tackling the issues. Then, it is really a tough job to get the money back. Otherwise, so far, I do not see any issue in there.

I would like to come back to one other point. We mentioned many times that the relationship is key, and there is a lot of trust. On the other hand we say that we need to drive down the counterparty risk, we will have smaller lines; there is somehow a contradiction in there, because we cannot have a close relationship if we have hundreds of reinsurers. Therefore if we spread the risk too far, which is necessary to control the counterparty risk, we cannot have very tight relationships with everyone. We have to somehow balance out the two factors.

David Sandham You mean you cannot be friends with everyone?

Nick Frankland Is that not why one uses a broker?

Gavin Coull Going back to Nick's question about outsourcing claims, one of the biggest bugbears I see both from a buyer and seller's point of view is bad



'Traditionally, we have never thought of the broking model as terribly capital intensive, but I would say now it really is'

Conan Ward

claims service. It is a fundamental part of the service brokers have offered that I think that has fallen under the horizon a little bit, because it has been a service that some brokers felt they did not want to do; you had your brokerage and that was fine, thank you very much. However, I think that is back to relationships. I have seen more surprises and more angry clients with brokers over late notifications, bad notifications, bad reserving and going back to fundamentals that is a key role. Everybody servicing the industry has to be conscious of costs and economics and I think the old days of one size fits all have gone, for lawyers as well as brokers.

BROKERS

David Sandham Nick, do you think the role of the broker is changing? Sven, at AXA you use brokers on a fee basis, for example.

Sven Schade We pay brokers on a global basis.

Nick Frankland The industry is changing a little within it. To Martin and Benjamin's points earlier, I think reinsurers provide more than just straight up capacity; if used well and the relationship is good, the same is true of brokers.

This is particularly so in a subscription market, even though these are much more complex and hybrid markets than they used to be, made up of traditional co insured slips, patchwork quilts involving certain 100% placements, or involving insurance-linked securities (ILS), the principle is still the same: dealing with a lot of carriers to maximise the best price and product for a client is what a broker is best at.

To respond to Sven's point, I think a broker's primary role is to manage multiple relationships. We have to try to be best friends with everyone but, equally, can take the strain where needed in a client reinsurer relationship as well. Relationships have to be maximised to get out of it what you are putting in, being a fair return on what you are paying for, or on the capacity you are applying to it. Naturally you want good relationships between all parties but there has to be a fall guy on occasions.

That is where the broker really does have a role, along with a policing job in addition, monitoring claims, judging what is going on, ensuring we give the best advice as to which reinsurers are being the most co-operative in all the best senses of that word. I think it is an expanding advisory role, as it is across the industry.

Marty Becker I would agree with Nick. I think in the current marketplace, with the greater emphasis on

counterparty risk and more diversification of programmes, the broker's role is likely to be enhanced, because they do have the relationships with markets on multiple transactions, and a better feel as to how they are going to respond in particular situations. You cannot keep track of a hundred markets on your own. You have to rely on the broker to give you that sort of advice. It is probably more of a brokers' market today than it has been for a while.

Peter Grove Do you think it is a large brokers' market today though? The resource that is required by the broker now, all the modelling expertise, all the advisory side, is so enormous; is this leading to a trend towards the big reinsurance broker?

Marty Becker I think it depends on how specialised your placement is. Certainly brokers ultimately boil down to individuals. You can have a great individual at a small broker, who does a wonderful job in a niche class of business, but the facts speak for themselves. The big three brokers control 85%-90% of the business.

Conan Ward Traditionally, we have never thought of the broking model as terribly capital intensive, but I would say now it really is. I would hate to think about what Nick and his colleagues spend on analytical services, but it is tremendous and a big barrier to entry. You need private equity kind of money to start a company that is going to compete with one of the majors now. You can nibble around the edges, as many brokers do. But if you want to get into the deep water, it is hard to deal without a major investor behind you.

BUYING PHILOSOPHIES

David Sandham Let's move on to reinsurance buying philosophies.

Peter Grove Where I think there is a difference in the market now is there is not an arbitrage attitude



'All of our surveys almost invariably come out with clients wanting cheap price over anything else'

Nick Frankland

anymore, which is very much what we had. If you go back to the very soft market that we had in the 1980s and early 1990s, a mass of your cedents were actually interested simply in shifting risk onto their reinsurer and it was simply all about arbitrage.

People could buy risk excesses that were too low, they could buy cat cover that was too low and I think if there has been a general trend with all cedents it is to move retentions up. If there has been a general trend with all reinsurers it is to harden and not be so soft at what is referred to as the bottom end and I think that is a very healthy thing that we have today and never used to have in the past.

Marty Becker Is that just another sign that the industry is becoming more consistent and better at pricing its product because there is not the arbitrage opportunity?

Peter Grove I do not think it is just about pricing the product. I think it is about regulation, strong management that exists now, which is forcing retention onto clients. That must be healthy.

Nick Frankland I think companies have got larger generally. You do not have as many of the smaller guys who really only existed to arbitrage.

Companies have got larger, reinsurers have got larger, and models have had an impact. I think the crucial point about captives and internal reinsurance management entities and so on is that there is generally better financial alignment. These guys are retaining their own risks well and it is not always at the bottom. It can be in tranches alongside the existing panel of reinsurers and I think there is a more equalised financial alignment of interest.

The majority of buyers are larger and more committed to buying long-term stability of reinsurance product and, as a result, reinsurers have responded appropriately. I think it is a fundamental sea change in the industry. There will always be elements of arbitrage. There are still

classes where you can buy sub-layers at any given period of time, but they are optional, complementary and non core. In many instances a big company like QBE use Equator in that lower level to manage your retention and now buy at a much higher level. I think it is sharing the risk more appropriately across the industry.

David Sandham Do you have clients come to you and specifically ask for arbitrage opportunities?

Nick Frankland Not specifically.

Conan Ward They all ask for cheap reinsurance.

Nick Frankland Back to that question of what they ask for, all of our surveys almost invariably come out with clients wanting cheap price over anything else. If you really had to push them for just one single differentiator it is price. We can talk about all the other nice things but essentially year on year it is inexorably price. Consequently if ever there is a cheap window of time, whether it be on a particular industry loss warranty (ILW), whether ILS actually becomes cheaper and more competitive to top end, ultimate net loss (UNL) pricing, whether there is something clever that can be done in the Gulf of Mexico, it is complementary. It is not core. You don't really find programmes constructed to provide a pure business arbitrage any longer.

David Sandham Has arbitrage gone on between ILS products and traditional reinsurance?

Nick Frankland To be honest, I think it is difficult to engineer that. One of the reasons the capital market play has diminished is not just the lack of availability, it is currently too expensive. You can buy cheaper UNL cover; the best form of risk transfer has always been traditional UNL reinsurance at the right prices and nothing will ever beat it. That is why the capital market products will always only ever be ancillary and complementary to a core UNL placement if it is achievable at a price the client finds satisfactory.

David Sandham Is that because the capital markets product has to be collateralised, or is it because the advisers such as the banks and lawyers charge so much in fees on the setting up of a cat bond?

Nick Frankland Well you have got significant frictional charges and also invariably some form of insured loss trigger. There is basis risk in here and in most capital market products at the moment which does not exist for UNL.



'You cannot focus too much on the quality of security'

Gavin Coull

Peter Grove So true. Beware of the mismatch. Everybody thinks they know their accounts so well. 'Things are modelled, oh well we know for sure our book will only come in at x factor, therefore it is quite safe to go out there and buy that type of product.' The reality is you run a massive mismatch risk.

Nick Frankland If you are dependent on models, you know it is potentially a huge inherent exposure within that product.

David Sandham Benjamin you are going to defend ILS I hope, on behalf of SCOR?

Benjamin Gentsch As we mentioned briefly earlier, ILS is an interesting addition to the market overall. For us it was an interesting window; we were the first one to place after the Lehman collapse with Atlas V, so we are very happy about that. We see this it as a reasonably efficient tool for parts of the business that need to be placed but that is about it. It is not a total replacement of the reinsurance market, not at all, but it is an interesting and very good tool to widen the basis of the providers of reinsurance capacity.

Mark Talbot At the moment we see ILS as a complement rather than a replacement. I think the basis risk point is paramount. You have to know what you are buying and if you are absorbing a lot of basis risk you need to be extremely careful, because you may be paying for something you really do not know is going to deliver.

I think speed to market is a factor as well; still a lot of lead time. The product is not cheap – not that we are after cheap product per se – but if you combine a lot of frictional cost with a time delay and then basis risk, there is no way that the capital markets are ready to step in where the traditional markets are today at the speed with which they can bring their product to bear. There are very specific areas where we see the capital markets playing a significant role, but, again, as a complement rather than a replacement.

David Sandham Nick, on insured loss warranties will the frictional costs be lower there and if so why is that also quiet at the moment?

Nick Frankland Again because there are original loss franchise triggers you have to sustain a certain figure by whatever definition. As a result, there is always the danger of some form of mismatch with your own book. It is available, it is a good adjunct like ILS, particularly for very regional or peril

specific needs where because of that inbuilt trigger you can occasionally get more attractive prices than UNL capacity.

However, it is all down to available capacity in the UNL market. If you can buy UNL you are happy with on a broad enough, wide enough territorial and peril basis, you will. It is quiet at the moment because there has been relatively reasonable stability and traditional capacity available and the storm activity as yet out in the Atlantic has not worried people enough to go out on a last minute ILW purchasing campaign, which could still happen at any moment. The success or otherwise of the revenues transacted in that area are often dictated by the last half-year's activity.

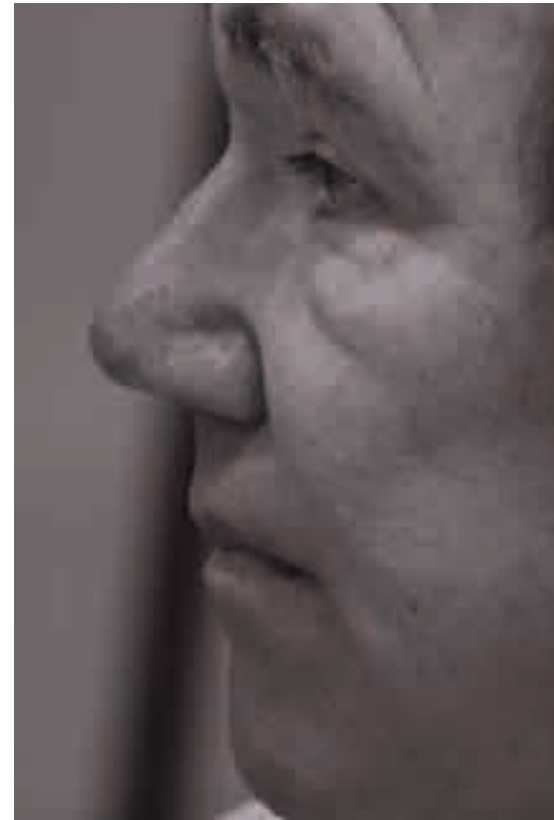
David Sandham Is it right that ILWs will sometimes be traded when the hurricane is in the water in a couple of days from landfall?

Nick Frankland Yes, they can be.

COMPUTER MODELLING

David Sandham Computer modelling: how reliable is the cat risk modelling, and risk modelling in general? Are computers changing everybody's lives?

Peter Grove I think they changed a lot of people's lives before Hurricane Katrina in 2005. There was a lot of reliance on modelling. In truth many people wised up after that particular loss because the models did not necessarily get it right. Sadly, before then a lot of management had lost sight of the sums insured that it had taken onto its books. It thought it understood its business because it understood what the model was telling it, but it lost sight of the actual exposures that it had. I think that applied to a lot of the industry; I do not think that is the case today. Many lessons were learned after 2005, and today the industry is aware of reality as well as what the modelling is telling it.



'Lessons were learned after Katrina, and the industry is aware of reality as well as what the modelling tells it'

Peter Grove

Conan Ward Any good risk management framework should include both model-based probabilistic measures and some absolute measures as a failsafe. It is just that there are too many things that the model as advertised does not

address and one has to be a sophisticated user to try to take all that into account. However, all of that said, there also need to be some absolutes that you manage too, and just say: "From this point I will not go any further. I have got enough limits on my capital base that I am comfortable in a given area and there is nothing left on the shelves to sell."

David Sandham Conan, did you revise your loss estimate after Hurricane Ike?

Conan Ward I would rather not comment on loss reserving except to say that I think our process is pretty healthy, in that we look at the probabilistic measures and the events that might come through a given vendor as maybe a starting point to help us triangulate what accounts might be involved.

However, the loss estimates coming out of the model for Ike, in our mind, were pretty laughable and so we said: "Well that is a nice number to know but it is not what this loss is." You cannot replace experience in these things.

David Sandham Any other comments on the inadequacy or otherwise of cat models or risk models in general?

Benjamin Gentsch If we look at the situation with solvency regimes, with solvency tests like Solvency II you have to give your own model. You have to prove the value of those models with the regulator and the rating agencies, so I simply would respond to the question here in the affirmative. Computer modelling is very important, much more so than it was a couple of years ago. I think it is getting even more important on the non-cat side, with the solvency modelling you have to do,

which is then ultimately driving both a buying and an offering strategy.

John Andre I know it was the flavour of the week a couple of years ago but the enterprise risk management is actually something that we have seen companies embracing and not just paying lip service to. Management teams are looking holistically at the entire organisation. Where are my risks? Over here or over there? And how much do I want to absorb?

I think some of the impact of the credit crisis last year, and Gustav and Ike, would have been a lot worse had companies not followed some of these procedures going into the event. It is pleasing to see it is a tool where they are actually taking it out of the toolbox and it gives us the confidence in the industry.

Conan Ward At the most basic level it allows you to organise your business in a pretty efficient way too, and that is important. If you think about a global organisation, where there may be people in a bunch of different locations who might write risks, say in the US, without computer models how does one organise all that? How does one bring it together to try to look at it in one place? From that standpoint they have added huge efficiencies to what we do.

Nick Frankland Modelling has made the industry a better place. The only danger we have to be wary of is of some sort of systemic business model failure, as has just brought down the banking industry – so one can never sit on one's laurels on these things.

Mark Talbot I think that is right. At Zurich we probably spend more time on analysing the output of the model than we do on the modelling itself; I think that is healthy because whilst the model is a great consolidation tool and a great starting point, it is just the beginning of the process. It gives you an output but then you have to adjust in either direction depending on your portfolio, depending on your understanding of the risk, depending on your view of what comes out of the various models. I think they are a very useful tool but use with caution.

Sven Schade I agree. Models cannot replace other processes in the company and sometimes we see that people today still believe too much in models. There were a couple of years for some reinsurers out there where their business model was just: "I have five cat modellers and then I write the business." There was 100% reliance on the cat model. Even today the data is one thing, but there are so many soft facts that are not in the data which are not taken into account by



'It is almost the height of irony that an industry that writes product liability sometimes does not read the warning label on the products it uses' **Conan Ward**

the models. If you do not have a close relationship with the underwriter you just miss out all these factors you need to take into account when you quote a business.

Conan Ward

It is almost the height of irony that an industry that writes product liability sometimes does not read the warning label on the products it uses. It is true some people say, "Oh the model failed here," but if you read the warning label, they do not really hold themselves out as ever contemplating that in the model in the first place.

BERMUDA'S FUTURE

David Sandham Should reinsurance markets be based offshore and what would be the status of Bermuda going forward? The G20, for example, has come out with some very strange and perverse theories about the causes of the financial crisis being offshore and so on, and threatened crackdowns. Marty, are you involved in the Bermuda First initiative?

Marty Becker The reinsurance marketplace today is global and there are many different places to locate your company. In fact, most companies now have multiple locations in the major trading centres, and I think it's appropriate to consider Bermuda today as really another trading centre.

There is enough concentration of markets and decision makers in Bermuda to ensure that it is going to be a valuable part of the industry for a long time to come. Therefore I think the G20 focus in terms of predominantly taxation and to some extent regulation is good, but it is not the whole story. It is where the concentration of the human talent is that makes a marketplace, because ultimately reinsurance is a relationship and talent-driven business.

David Sandham Also, Bermuda is a little like Lloyd's, is it not? A community.

Conan Ward I think that is right and as a regulatory environment Bermuda has made some nice strides over the last few years and there will probably be more regulatory harmony in the future as regulators will tend to speak to each other more often. As a result of Solvency 2, I think Bermuda has raised its game as well. I think, getting back to the transparency thing, the more our customers understand about the risks we take and how we price things and how we do things generally and manage capital... that cannot be bad.

David Sandham John, you have studied the Bermuda reinsurers very closely. What is the mood at the moment about their domicile?

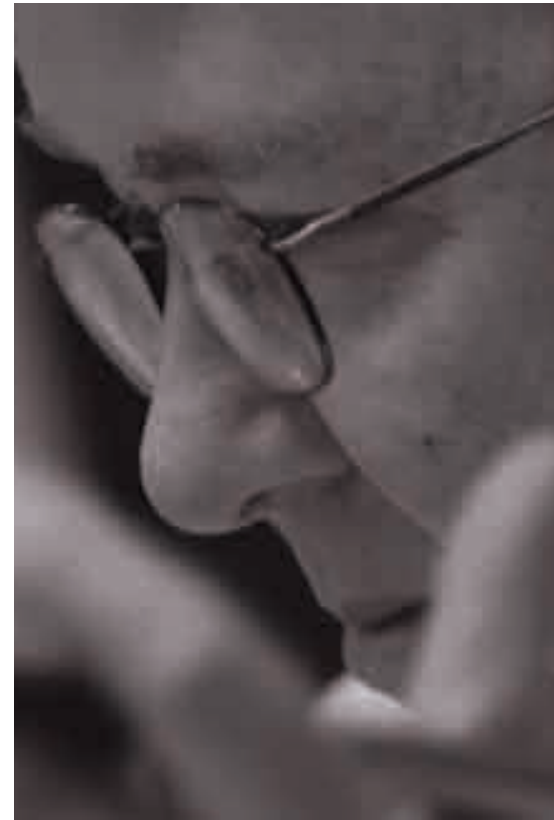
John Andre I guess much of it is just the unknown about what the Obama administration might or might not do, and they have been pretty evasive about it. To Marty's point, I think regardless of where a company is domiciled, there are still going to be hundreds of insurance professionals on the ground in Bermuda. This has proven true with those companies who have re-domesticated to Switzerland.

Nick Frankland Most businesses are now multi-territory platforms. I think the one unfortunate thing occasionally that works against Bermuda, which is happening at the moment, is being grouped as "Bermuda". The current average price to book value ratio is only 0.86 and is being spoken about as "The Bermuda Markets", which I think does not necessarily do justice to the individual character of each entity out there. Sometimes it is that that actually inhibits more than anything else.

Marty Becker Right. And it is a real mystery why Bermuda has always been priced below London or the US, because ROE is ROE (return on equity). If you take the average ROE of the Bermuda companies, it is equal to or superior to that of other marketplaces. However, we have always traded at a discount, relative to other markets. I think to Conan's point, Bermuda has really made strides in the last few years in conforming to global regulation and there is a lot more on the horizon – the Bermuda Monetary Authority is a really legitimate body.

Conan Ward Absolutely.

David Sandham Long may Bermuda continue. Unless there are any further points, I will bring the discussion to a close. Thank you all very much indeed.



'Regardless of where a company is domiciled, there are still going to be hundreds of insurance professionals on the ground in Bermuda' **John Andre**

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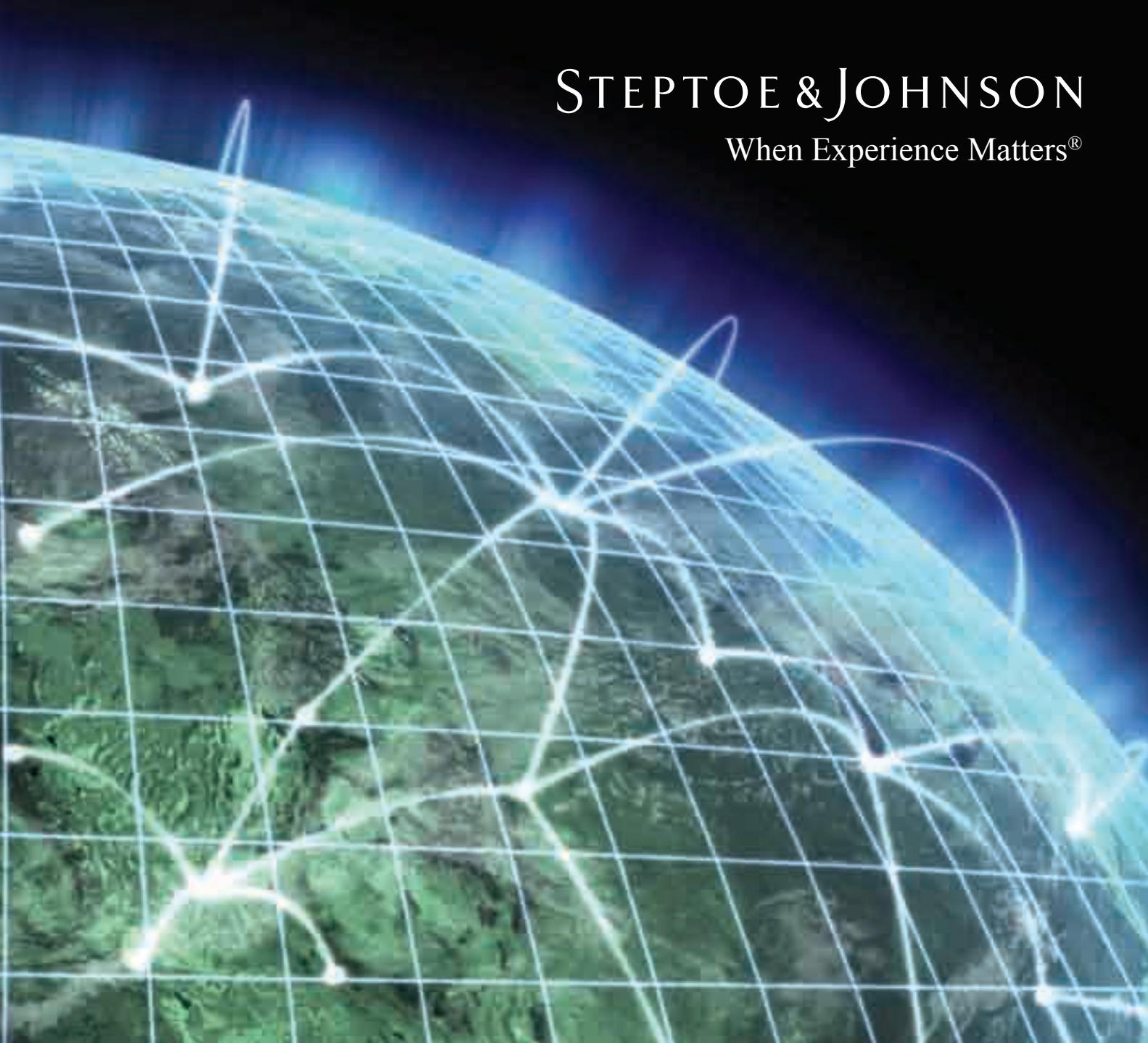
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