Assurances

Current Problems and Trends in the Reinsurance Industry

Christopher J. Robey

Volume 60, Number 1, 1992

Numéro spécial 60e anniversaire

URI: https://id.erudit.org/iderudit/1104883ar
DOI: https://doi.org/10.7202/1104883ar

See table of contents

Publisher(s)

HEC Montréal

ISSN

0004-6027 (print)
2817-3465 (digital)

Explore this journal

Cite this document

Robey, C. (1992). Current Problems and Trends in the Reinsurance Industry. *Assurances*, *60*(1), 89–109. https://doi.org/10.7202/1104883ar

Article abstract

Notre collaborateur de longue date, Mr. Christopher Robey, passe en revue certains problèmes et certaines tendences reliés au domaine de la réassurance. Pour commencer, il examine les marchés; d'abord celui de Lloyd's, ensuite le marché d'exécent de sinistres de Londres (LMX Market) puis le marché canadien. Ces observations se portent ensuite sur les problèmes de baisse de capacité, les nouvelles orientations et la fraude. Dans sa contusion, Mr. Robey démontre qu'il est grand temps pour l'industrie de la réassurance d'innover et d'envisager de nouveaux défis.

Current Problems and Trends in the Reinsurance Industry[1]

by

Christopher J. Robey [2]

Notre collaborateur de longue date, Mr. Christopher Robey, passe en revue certains problèmes et certaines tendences reliés au domaine de la réassurance. Pour commencer, il examine les marchés; d'abord celui de Lloyd's, ensuite le marché d'exécent de sinistres de Londres (LMX Market) puis le marché canadien.

Ces observations se portent ensuite sur les problèmes de baisse de capacité, les nouvelles orientations et la fraude.

Dans sa conlusion, Mr. Robey démontre qu'il est grand temps pour l'industrie de la réassurance d'innover et d'envisager de nouveaux défis.

~

One thing I make sure of doing when I read my *Financial Post* is to see what the *Famous Grouse* has to say. The morning I started writing this presentation, it said:

> Free advice is the kind that costs you nothing unless you act upon it.

This must be comforting for all of you who have paid handsomely for the advice you are getting to-day.

---

[1] This text was prepared for a one-day conference on the legal and business issues and trends in reinsurance and excess insurance. The conference was held on November 27, 1991, in Toronto.

[2] Mr. Christopher J. Robey is an executive vice president of B E P International Inc., member of the Sodarcan Group.

However, the day John Walker asked me to speak here, the Grouse obviously had our industry's problems and trends on its mind too. It quoted George Bernard Shaw as saying:

> We learn from experience that men never learn anything from experience.

That is something to bear in mind as we look at what is going on around us.

Lloyd's

90 The first "problem" John listed as one I should cover was Lloyd's.

Let me quote to you from a text on Lloyd's:

> There were many outside who thought it likely to become a merely quaint survival. 'The Committee walks in shackles and mistakes its awkwardness for dignity', wrote J.T. Danson.

If that sounds about right to you, it only serves to bear out Shaw's opinion of our species, since it comes from a biography of Cuthbert Heath by Antony Brown and refers to the Lloyd's of the 1870's.

Lloyd's is facing problems from three sources.

First, there are American casualty losses, particularly from asbestosis and pollution.

Then there have been the first party losses, particularly Piper Alpha, the European storms, Hurricanes Gilbert and Hugo and the Loma Prieta earthquake.

And finally, there are the lawsuits which these losses have helped generate.

I had hoped to put the legal problems into perspective by telling you how few syndicates were affected, but one of the most recent suits, in true shotgun fashion, appears to name everyone but the cleaning staff. It was filed in New York a month ago and names as defendants the Council of Lloyd's, the chairman, 266 syndicates, 16 members agents and 42 managing agents.

It also seeks triple damages under the *Racketeer Influenced Corrupt Organization Act*, which was designed to fight organized crime. Comparing Lloyd's to organized crime used to be done only by brokers over a pint after the underwriting room closed.

That suit attacks Lloyd's dealings with U.S. names specifically, invoking such things as securities laws.

By the way, one of the litigants is a Mr. Roby, but I hasten to point out that there is no 'e' in his family name.

Lloyd's is also under investigation in the United States by the Securities and Exchange Commission, the Senate and, reportedly, the F.B.I.

Seventy-six Canadian names are also suing and there are other cases in the United Kingdom.

That insurance and reinsurance can lose money is not a surprise to anyone here to-day and should not have been a surprise to the Lloyd's names, although the extent of some of the losses can hardly have been contemplated.

Part of the problem is the combination of the Lloyd's three-year accounting system and the names' unlimited liability.

A joint-stock company closes its books each year and outstanding liabilities are carried forward to the next year at their estimated value. If a shareholder does not like the way things look, he can sell his shares and get out. The new shareholder takes on the outstanding liabilities.

A Lloyd's syndicate waits three years before reinsuring its outstanding liabilities into the next year, but otherwise the process looks the same. However there are major differences.

If the syndicate does not think it can estimate its liabilities reliably, it leaves the year open and this has happened with increasing frequency because of old asbestosis and pollution losses, which defy proper valuation. The names on the open year cannot sell their shares. They are on until the year is closed and that could be a long time and a lot of money later.

There are about 100 syndicate years open. That it is not many when you realize that there have been 4,000 or more syndicate years since 1976, the earliest current open year.

The problem however is that it is often the same syndicates, with many of the same names, which have kept years open — only 37 syndicates have open years.

Syndicates 134, 184 and 387 all have five years open and two others have four years open. Syndicate 762 still has both 1976 and 1977 open.

When a year is closed, any problems have been passed on to the next year, which may contain some new names. If you buy shares in an insurance company which had undervalued its liabilities, you can only lose the value of your shares. But the liability of Lloyd's names is unlimited. He or she can lose everything and that prospect can lead to the law courts.

Syndicate 418 wrote some contracts in 1982 which have proven to be very expensive. But that was not discovered until they had been reinsured out of various closed years. It was not until it came time to close its 1985 year at the end of 1987 that it decided it could not properly fix its reserves.

That year is now open. But over 200 names joined the syndicate between 1982, when the contracts were written, and 1985, the year which will have to pay many of the losses. The 1985 names certainly got some premium for the exposure, but clearly not enough, and it is easy to see why they are upset.

The year Lloyd's has just closed was 1988 and the loss was £510 million on £5.8 billion of premium. This was the first loss Lloyd's, as a whole, has reported since 1967, and that one was for only £1.6 million. Individual syndicates have undoubtedly lost in the intervening years, but most names go on several syndicates to balance their results. A loss, the size of 1988, can destroy that balance.

However, it was a marine market lose. The non-marine, aviation and motor markets, all made profits.

The 1989 loss is something different. It will not be reported until next spring, but it has been estimated as high as £1.5 billion, with another loss of £500 million to follow when 1990 is closed.

Needless to say, some names are saying, enough is enough. About 6,000 of the 26,500 names are expected to leave, an unprecedented 22 1/2%. And the remaining names all want to get on the syndicates which have shown the best performance through difficult times.

The result is a rash of syndicates closing or being taken over by others. Secretan marine syndicate, one of those closing, is one of Lloyd's oldest and began operations in the eighteenth century.

For 1992, there will be fewer than 300 syndicates, compared with 354 in 1991. The total capacity, measured in Lloyd's by the volume of premium which can be written, will drop by 10%. But do not write Lloyd's off just yet. It will still be an impressive £10 billion. That is not far off the size of the entire Canadian market, including accident and health and government insurers.

The big question, however, is how secure is Lloyd's security.

The answer is, it depends.

At the end of 1989, Lloyd's had total funds of £19 billion. That is not all available to all claimants, since liability of the names is several not joint.

There are three levels of Lloyd's security.

First, all premium received is put into premium trust funds for three years, with only claims, reinsurance premiums and expenses being taken out. This is the first line of defence and in most years, it is enough. In the years it is not, the names must make up the difference, each for his or her share of the syndicate, which is where the next levels of security come in.

Each name must place, with Lloyd's funds, up to 30% of their intended annual premium income, with a minimum of £25,000.

In addition, each name must demonstrate a minimum amount of personal wealth, which varies with the category of member.

Then there is the member's wealth over and above this minimum, since liability is unlimited.

Only the assets held by Lloyd's are considered in the member's annual test of solvency, so this additional wealth represents a substantial safety margin.

However, these amounts can be used only to pay the name's own losses.

Then there is the Central Fund, which at the end of 1989 stood

at £404 million, and the Corporation assets, which were valued at £248 million. These funds are available for any losses under a Lloyd's policy not otherwise paid.

There is a commitment to increase the Central Fund to £1 billion within the next five years. This is good and bad news. The £1 billion is impressive; the need to more than double the size of the fund is worrying.

I cannot say this with certainty, but it seems to me that these resources are enough for Lloyd's to maintain its record of paying all legitimate claims under Lloyd's policies.

However, some of these funds could disappear if the lawsuits are lost. If some names are held not liable for their losses — and the names suing are those with the largest losses — the syndicates they are on would not have access to their funds. Only the Central Fund, along with whatever liability insurance the defendants have, would be available and it may not be enough.

The Feltrim syndicate, one of those involved in lawsuits, including the Canadian one, has made cash calls of over £100 million, 25% of the Central Fund could be used for that syndicate alone.

Whether or not the Fund will be enough if many of the cases are lost, I do not know. But Lloyd's has a long record to defend and the members can be expected to come to its defence if needed. And if the cost is not too high.

What does all this mean for the future of Lloyd's?

A commission — of course — is looking into it. It is headed by Mr. Rowland, the chairman of Sedgwick, which itself says something of the difference of Lloyd's. It is hard to imagine the IBC asking the head of Reed Stenhouse to tell them how the Canadian market should be organized.

This commission will report by the end of the year, so I hesitate to speculate on its findings.

However, I will, at least a bit.

There will be fewer and bigger syndicates.

One of every three names at Lloyd's is on one of the Merrett syndicates, about 7,000 names, and there are other monster syndicates, each the size of large insurance companies.

One thing this will bring about is the fracture of the Lloyd's façade and the greater realization that it is not just one entity, but many. Individual syndicates will have to pass brokers' security checks — Standard & Poor's will soon publish its first annual review of the financial strength of individual syndicates.

Unlimited liability has been questioned and the Rowland Commission's recommendations on it are eagerly awaited. Opinion is divided.

Going to limited liability will remove one of the key distinctions of Lloyd's, moving it closer to being a group of insurance companies who happen to underwrite under the same roof. But the continuance of unlimited liability could erode the base of potential names to a point where Lloyd's would become a shadow of its former self.

But Lloyd's will continue to be a factor, I am convinced of that. Not for the first time, it will go through a major shake-up and it will come out of it a little different. And the world around it is changing. Lloyd's greatest asset has been and will continue to be its ability to adapt. That gets it into trouble from time to time, but it also ensures its special place in the industry.

The LMX Market

From Lloyd's to the LMX market is only a small step, since Lloyd's is an integral part of it.

First of all, let me tell you what the LMX market is, at least what I understand it to be.

LMX stands for London Market Excess of Loss. It is the market which provides excess of loss protection to excess of loss reinsurers. It is a highly specialized field, not limited to London, but concentrated there.

The insurance market is three-tiered.

The first tier is the insurance companies and their proportional reinsurers.

The second tier provides excess of loss reinsurance to those insurers and proportional reinsurers.

The third tier is the LMX market, providing excess of loss retrocession to the excess of loss reinsurers.

If everyone limited themselves to their own tier, there would not be what has become known as the LMX spiral. But they do not. Many companies play in the second and third tiers and some play in all three.

The result is that, to some extent, they end up reinsuring themselves, creating phantom capacity.

Let me give you a simplistic example.

Company A reinsures with Company B, who reinsures with Company C, who reinsures with Company D, who reinsures with Company A.

All the reinsurance treaties are for \$50 million excess of \$1 million.

Hurricane Zachariah sweeps through New England and gives Company A \$10 million of losses. A reports these losses, less its retention of \$1 million, to B.

B reports its \$9 million loss, less its retention of \$1 million, to C.

C reports its \$8 million loss, less its retention of \$1 million, to D.

D reports its $7 million loss, less its retention of $1 million, to A.

A sees that this $6 million loss reported by D is from Hurricane Zachariah and adds it to its original loss of $10 million, reporting a reserve increase of $6 million to B.

B reports its $6 million reserve increase to C.

C reports its $6 million reserve increase to D.

D reports its $6 million reserve increase to A.

A reports its $6 million reserve increase to B.

And so on.

If you work this through to its ultimate conclusion, the net loss of each company is as follows:

Company A:	$7 million
Company B:	$1 million
Company C:	$1 million
Company D:	$1 million

The total $10 million is there, but company A, which thought it bought reinsurance excess of $1 million, ends up with a net loss of $7 million, because it got its own loss back through the spiral.

Another effect of the spiral is to exaggerate the size of the original loss. The $10 million loss in the example produced gross losses to the companies as follows:

Company A:	$57 million
Company B:	$50 million
Company C:	$49 million
Company D:	$48 million

That makes for a total gross reported loss of $204 million, more than twenty times the actual loss. A pity mutual funds do not grow that way.

If all this seems rather unreal, it is worth noting that Hurricane Alicia, which blew in 1983, is still generating new loss reports in the LMX market, including to some Canadian reinsurers who were by no means major players. It will be more than ten years after the loss itself before it has worked its way right through the spiral.

Because of the Piper Alpha loss in 1988, costing more than $1 billion dollars, the marine side of the LMX market was the first to unravel. The October 1987 hurricane in Europe had jolted the non-marine side, but not enough to have a major impact. After all, it was the one in 300 years storm.

Apparently, however, 300 years had passed by the beginning of 1990.

The four largest catastrophes in terms of insured damage in 1990 were storms in Europe, and another one came in eighth. Between the 25th January and the 1st March, 35 days, five storms caused nearly $11 billion dollars of insured damage.

This year's Calgary storm, the largest loss ever in Canada, will cost about $400 million, one-tenth the cost of winter storm Daria, the first and largest of the 1990 European storms.

Not surprisingly, those 35 days sent the European insurance and reinsurance markets into shock and virtually destroyed the LMX market.

The 1987 storm and the withdrawal of a number of reinsurers since the heady days of the seventies, when there seemed to be two or three new ones a day, had already cut down the outer limits of the spiral and the 1990 storms, coming as they did after Hurricane Hugo and the Loma Prieta earthquake in 1989 did it in.

The LMX market to-day is severely battered. What there is, is expensive and not enough to come close to meeting the demand. One salutary effect is that companies on the second tier are retaining risk again, something novel to newcomers in the market.

But the marine LMX market survived Piper Alpha and the non-marine market sill survive 1990. The phantom capacity generated by the spiral is no more and prices have skyrocketed, but it fulfils a need which has not gone away and, at the right price in an orderly market, it is good business.

Will the spiral come back? Shaw would say yes and I am inclined to agree with him.

The Capacity Crunch

It is the decimation of the LMX market which has caused the worldwide capacity crunch. The disappearance of the phantom capacity generated by the spiral and the huge losses in the second and third tiers of the market have resulted in some reinsurers giving up altogether and others drastically reducing the business they will write.

How long this will last depends on whether it is a pricing problem which the spate of losses has highlighted or a change in weather patterns which will make these losses regular occurrences around the world.

If the problem is pricing and the losses will be no more frequent than in the past, the much higher prices now being paid for catastrophe cover will attract additional capacity to that tier of the market. Once this is enough to meet the market's requirements, prices will begin to drop and we shall be well on the road to setting ourselves up for the next crisis.

That sounds like a pessimistic scenario, but it is the optimistic one of the two.

If weather patterns are changing and the European storms are just a taste of what will become a regular event, the current structure of the market will not be able to cope. The tendency at the moment is for money to leave reinsurance rather than come into it — look at the number of reinsurers put up for sale and taken off the market for lack of a buyer.

In Canadian terms, imagine that Alberta can expect an Edmonton tornado or a Calgary hailstorm every year. Insureds in the rest of the country will be reluctant to pay higher premiums to subsidize Albertans, which will force insurers to charge enough premium in the province to pay for its losses.

In 1990, a year with only the usual run of weather losses, the combined property and automobile physical damage loss ratio in the province was 84% on premium of $808 million.

If the frequency of major weather catastrophes is only about every four years, prices will still have to go up substantially, the 25% suggested so far being just a start. To pay for a Calgary hailstorm every year and give insurers a reasonable return, the prices would have to just about double.

But there is no capacity crunch in Canada, at least not for most insurers. The limits purchased by most companies are well within the coverage available, even without going to the unlicensed market. What there is, is a price crunch. The capacity is only there if you are willing to pay for it.

New Products

That is why I do not think we shall see in Canada some of the new products which are being used in the United States and particularly Europe to top up the available capacity.

What we shall see increased interest in are funded covers. Insurers forced by the price increases to raise their retention to a level they are not comfortable with, will want some other way of paying for that bottom layer and funded covers seem to offer the possibility.

However, all insurance companies already have a funded cover; it is called surplus, which is where the money put into a fund would otherwise go.

But money goes into surplus only after tax and tax has to pay on the income it earns. What insurers really want is a tax-free fund earning tax-free income. The tax department does not like this and are rumored to have a task force checking reinsurers books to ferret out such behavior.

There are some funded covers in place, but not nearly as many as the talk about them would have you believe. Our experience is that they do not seem like such a good idea to the insurer once he finds out what the reinsurer wants to charge. There is always a significant difference in perception of the risk involved, once it has been structured to pass scrutiny by the regulator and the tax department.

The Canadian Market for Renewals

To get back to the conventional market, let us look at the 1992 renewals.

Automobile will not be a major subject of discussion, since it is dominated for most companies by Ontario and the product will change during 1992. The changes expected, particularly indexed accident benefits and unlimited medical and rehabilitation, have a disproportionate impact on excess of loss reinsurers and they are not likely to give cover beyond introduction of the changes until the details of the changes are known.

This probably means some form of "change in conditions" clause, and renegotiation next spring, whatever is agreed now.

Liability is generally reinsured jointly with automobile, with automobile driving the terms, so there is not much to talk about there. For liability only covers, renewal will depend on the results of the covers themselves.

Surety reinsurance is a disaster and will result in tough negotiations. Commissions may have to come down, and maybe some capacities as well, but as the economy slowly recovers, so should results, so the slump should be a short one.

Property will be the main battleground.

Per risk excess of loss treaties will be looked at on their own merits and renewal terms will reflect the results.

This is also true of quota share and surplus treaties, but the difference is they are almost all bad. They were last year too, but there was a lot of forgiveness on the part of reinsurers because we looked like losing Ontario automobile and nobody was going to throw out property, almost no matter what the results.

There will not be the same forgiveness this year.

Commissions will come down and so will some capacities. Some unbalanced second and third surplus treaties will disappear altogether.

There is a danger that reinsurers will force commission terms to a level where the ceding company will find switching to a per risk protection more attractive for most if not all of the exposure. If this happens, ceding companies will have a more volatile net account and increased catastrophe requirements, neither too attractive at the moment.

But for reinsurers, the long term affect could be worse. They will replace a large block of proportional premium giving more or less predictable results, albeit bad at the moment, by a much smaller volume of more volatile excess premium. Their better years will be better, but their bad years could be a lot worse.

The price for catastrophe programs will certainly increase, probably from 15% to 25% for most companies. For companies with a large loss from the Calgary hailstorm, it may well be more.

Canadian companies cannot escape entirely from the international catastrophe losses. Increases in price last year were quite small, but this year the full impact of the tight retrocession market will be felt and reinsurers will be looking for a greater contribution to their increased costs.

Some other changes can be expected.

Co-reinsurance, where the ceding company must retain 5% or 10% of a layer for its own account, will come back — it is a familiar component of a tight market.

In addition, there will probably be more bargaining over the cost of reinstatements. A catastrophe loss exhausts part of the cover and an additional premium must be paid to get the cover back for the next loss.

Two catastrophe losses in the same year are not unknown in Canada. In 1987, in addition to the tornado in Edmonton, Montreal suffered losses of $25 million from a hailstorm at the end of May and $71 million from flooding in the middle of July. In 1988, there were three losses in Alberta, $50 million from hail in Medicine Hat, $21 million from flooding in Slave Lake and $22 million from hail in Calgary.

The 1985 loss in Southern Ontario, which started as hail in Leamington and ended as a tornado in Barrie, was one loss or two, depending on to whom you listened.

And the five storms in thirty-five days in Europe in 1990 show what can happen without warning. So reinstating the catastrophe coverage after loss is important.

The amount of premium to be paid for the reinstatement is negotiable.

This premium is based on the original premium for the cover. This year, the most common way to calculate it is to apply to the original premium the pro-rata of the time remaining in the life of the contract.

Most treaties follow the calendar year. So, if a total loss occurs on the 1st April, 75% of the original premium is paid to reinstate; if the loss occurs on the 1st July, half way through the year, a 50% additional premium is paid, and so on.

However, it is not uncommon for the percentage to be fixed in advance and to apply regardless of the date of the loss. For example, if the additional premium is agreed in advance at 50%, it will be calculated at 50% whenever the loss occurs, even if it is on the 1st January or the 31st December. And reinstatement is compulsory, so the premium would have to be paid even if the loss occurred on the last day of cover.

There will be more negotiation than usual this year on the amount of the reinstatement premium. In a soft market, it is usually at pro-rata and sometimes free. In a hard market, it will go up to 100% and even higher.

100% will not be uncommon in 1992.

But again, reinsurers must play their hands carefully.

It is of course the bottom layers which generate the most premium, often a third or more of the limit, compared to a top layer at 1% of the limit.

If the prices at the bottom end go up too much, ceding companies will not buy them, preferring to run the risk themselves. They may then use some of the reinsurance cost saved to buy more coverage at the top end. Reinsurers will be exchanging small limit high premium business for high limit small premium business. It may make sense for one year, but that bottom layer will not come back and a permanent change in the reinsurers' risk to premium ratio will make it more difficult for them to buy their retrocessions and pay the major earthquake loss which will come one day.

Ceding companies, however are also reluctant to see that bottom layer go. It is not uncommon for a company to have a deductible lower than it can safely support, while not carrying enough protection against a Vancouver or Montreal earthquake. For about the same cost, it could drop its bottom layer and buy more coverage at the top and ensure its survival.

However, managers are under pressure to produce bottom line results each year and it is easier to do that with a low layer which gets hit every few years than a top layer which would have never paid a penny in losses.

This was brought home particularly hard in 1991 by the Calgary hailstorm. Our clients who ignored our advice to increase their deductible and limit are glad they did.

There is also a feeling that, following an earthquake of the magnitude needed to hit those top layers, the government will step in anyway. I am sure it will, but, given the state of government finances these days, it will make sure that every penny is wrung from the insurance system first.

Fraud

Fraud was another subject which John Walker asked me to talk about, but I shall only say a few word about it, since it is not a problem in the reinsurance market in Canada.

Where it is potentially a problem, apart from the national pastime of ripping off insurance companies by the general public, is in the harder to place lines of insurance, what in the United States would be classified as surplus lines.

There are always some insureds who will go for a cheaper price and take the risk of an unlicensed and unknown insurer. It is standard in society to-day to protect such people from themselves, rather than make them pay for their mistakes, which makes it easier for the fraudulent company to get away without being thoroughly checked.

However, the Canadian licensed reinsurers can meet almost all the markets needs and they are almost all members of large and well known international groups.

When the unlicensed market must be used, there are again many well known and highly reputable firms willing to provide coverage in Canada, so there should be no need to go to the Turks and Caicos, except for a holiday.

And our regulators are much better at policing the marketplace than they were fifteen or twenty years ago.

Developing Challenges

Now that we have looked at the problems we are facing to-day, let us look at the challenges which lie ahead.

For insurers, the immediate emphasis is on turning around the property and surety markets and negotiating an Ontario automobile insurance product which will not bankrupt us ten years from now.

For reinsurers, the challenges are less evident but just as pressing.

There is a consolidation going on in the reinsurance market worldwide and the insurance market in Canada. Ultimately, this will mean fewer reinsurers reinsuring fewer insurers.

For the reinsurers, there will be less premium available but more capacity needed. Larger groups can afford higher retentions and less proportional reinsurance but need just as much catastrophe protection as they did before the merger, and probably more, because at least one of them almost certainly did not have enough.

This will produce more volatile results for reinsurers and, in time, will mean that they must rely more on their international writings to support their Canadian business.

Canadian insurers will then be less insulated from worldwide results, since they must pay for catastrophes in other parts of the world if they expect others to pay theirs.

At the same time, reinsurers may find it difficult to increase their capital base to meet the needs of the market.

Most reinsurers are part of an insurance group, and often low on the ladder when it comes to handing out more capital. More and more reinsurers are being put up for sale as no longer part of the "core" operations of their parents.

There are also many overlapping interests in reinsurers, particularly following the spate of mergers in Europe in preparation for the single market there.

This has its impact on Canada, where, for example, the Groupe Victoire owns the Abeille Re, the Kölnische Rück and half the

Laurentian Group, all competing in the Canadian reinsurance market.

And the Groupe Victoire is itself owned 34% by the UAP group, which owns the SCOR Re of Canada. SCOR is in turn in the process of absorbing the Canadian business of the General Security of New York, another UAP subsidiary.

There are several other examples of licensed reinsurers in Canada under the same ownership and some rationalization seems inevitable, possibly reducing the number of reinsurers by as much as a third.

With reinsurance not making large returns, there is not much incentive for their owners to put in more capital. And they cannot generate all they need from their own operations. So we could find it increasingly difficult for the international reinsurance market to meet the needs of its insurer clients as exposures grow.

What is to-day a capacity crunch brought on by the collapse of the spiral could become more fundamental challenge.

However, capacity also responds to the marketplace. If it becomes scarce enough, prices will go up and stay up, generating enough profit to attract new money. In the process, though, there will be periods of very hard markets.

There are a couple of more immediate concerns which I think reinsurers must address.

Since the introduction of free trade with the United States, there is a steadily increasing number of Canadian firms expanding south of the border. In southern Ontario in particular, with the cost differential with northern New York State and the business distrust of the current government, this is likely to accelerate.

Most Canadian reinsurance contracts limit United States exposures to incidental, which is a vague term meaning not enough to have a loss. Liability exposures are specifically limited to sales offices and warehouses, whether the other operations are incidental or not.

Genuine multi-nationals are served by a specific market segment organized to meet their special needs. But the Canadian manufacturer who expands in Buffalo will find it difficult to stay with the same insurer, unless it is the subsidiary of an American insurer, which arranges its reinsurances in the United States.

There is no reason why Canadian insurers should not write this business, so long as they organize themselves appropriately and recognize that Buffalo may be close in kilometers, but is a long way away in liability exposures. But the risk can be written — American insurers do it all the time.

And they reinsure it with members of the same reinsurance groups which will not give the coverage to their Canadian clients.

Reinsurers of course have the same sort of problem themselves, in that their retrocessions contain the same restriction. In addition, they often have strict territorial limits mandated by their parents, which prevent them from doing anything more than incidental business in the United States.

But the need is there and may soon spread to Mexico. Reinsurers should organize themselves to meet it. If they do not, those insurers who give the cover will buy their reinsurance elsewhere.

But the biggest challenge facing us is undoubtedly environmental impairment — pollution.

This is a challenge for the market as a whole and I know we shall be hearing more about it this afternoon. But reinsurers have their role to play in finding a way to meet the needs of society.

To-day, coverage is given away in general liability policies, using IBC endorsement 2313. There is no regular reinsurance available beyond that.

First party clean-up coverage is only available, as far as I know, from AIG, although with last year's new Ontario pollution law, there is a definite need.

Environmental impairment insurance is similar in many ways to boiler and machinery.

108 There is a strong need for engineering the risk before underwriting it, and continuing afterwards. In addition, it combines first party and third party exposures in the same accident. And it will never be dealt with adequately, either by insurers or reinsurers, until it becomes a specialty line for even the routine exposures.

The new Ontario law has given a strong impetus to the need for first party cover, particularly from lenders who want to be sure that their collateral will not end up costing them more than the loan itself.

If environmental impairment insurance were a separate class, requiring a specific license, the industry, insurers and reinsurers, could organize to provide the coverage, with enough potential insureds to produce a level of premium where the law of large numbers would begin to work.

It is an opportunity for the industry, but one which will only work if all segments work together to meet it. We have a well-deserved reputation for only reacting to crises, usually too late.

It is not yet too late to act on pollution, but we must be proactive if we are to get something we can handle. If we wait to have something imposed on us, and it will be, we risk taking on a serious problem which we shall make worse because of our lack of preparedness.

It is much a reinsurance problem as an insurance one and reinsurers must involve themselves in dealing with it.

There is clearly much to occupy us over the next while. And we shall have to learn how to deal with more than one problem at a time. Ontario automobile has occupied our minds almost exclusively for three or more years and will not go away just because we have a new product. Property is crying out for attention and liability is just waiting its turn to go wrong.

But if Shaw's view of experience gives us little cause for optimism, we can always turn to an even more radical socialist, Karl Marx, who told us that:

> Mankind always sets itself only such problems as
> it can solve.

Given the challenges ahead, this could be one time when we should adopt the Marxist creed as our own.