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Résumé de l'article

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Economics of International Reinsurance

by

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1. Introduction

For most people outside the insurance world reinsurance and its task and function is more or less unknown, although reinsurers are involved in nearly every disaster or catastrophe which one reads about in newspapers almost every day and although it is the reinsurers who in most cases pay the greater part of the losses resulting from occurrences like the Torrey Canyon disaster, the fire at Mc Cormick Place in Chicago, a hurricane like "Betsy" or an earthquake like the recent one in Managua. Naturally, this is to some extent surprising if we consider what the scope of reinsurance is. There is probably no insurer who does not require the services of a reinsurer. It goes without saying that the share of business reinsured varies from one class of business and from one company to the next, but it is nevertheless not unusual for an insurer to spend half of its original premium income and in some cases even more, on reinsurance. In fact, the premium that will be paid in 1973 for reinsurance all over the world will presumably be in the region of US $35.000.000.000. This figure alone is adequate proof of the economic significance of the international reinsurance business.

In order to confine my comments to such matters which would be expected under the heading of "Economics of International Reinsurance" I consulted a very reliable book which is both well known and well reputed as soon as I was informed of the topic to be dealt with in this paper. This book was "The Concise Oxford Dictionary". According to the definition provided by the learned authors of this book, "Economics" is "the practical science of the production and distribution of wealth".

Therefore it would actually be necessary, in a paper on "Economics of International Reinsurance", to deal with the question of how a product such as reinsurance is produced which means here calculated — and distributed. In other words, I would have to refer to the function of reinsurance, the contractual forms used by reinsurers for offering coverage to insurers, the consideration payable, and the people and companies whose task it is to provide this product.

However, such elementary comments would be both unnecessary and undesired among experts as outstanding as those for which this paper has been prepared.

I would, therefore, like to avoid disseminating elementary knowledge, by referring to some of those factors applicable to our economic and social world which today and most presumably in the next few years will influence

the risks accepted by reinsurers,
the consideration payable for such acceptance,
the distribution of the product of reinsurance.

Many of the items to be dealt with in this context do not only involve reinsurance, but are perceived by all members of human society, albeit with a different attitude from one observer to the next. A group of young people demonstrating in the streets and wrecking the cars parked there will probably gain a feeling of superiority from their action, whereas the owner of a car repairs workshop living in the same street will be induced to think of the potential profit such action offers him, the elderly reader of a newspaper reporting on the incident will be reminded of the good old days when young people were always full of respect for their seniors, while the insurer — and reinsurer — affected by such demonstration will contemplate whether premiums and conditions still meet today's requirements; they might even feel the need either to introduce new exclusions or new and higher premiums.

Accordingly, I would in the following not like to go into all the details regarding the crime rate, the inflation, or the question of technicological progress, but would rather like to consider the matter of how these phenomena influence the business of reinsurance particularly if the effect thereof on the portfolio of the reinsurer is different from the effect on the portfolio of the insurer who cedes its business to the reinsurer.

2. The hazards covered by the reinsurer

The reinsurer provides coverage and charges a consideration calculated on the basis of claims experience in the past. Should the actual claims experience differ from claims experience as shown in the statistics of the past, such a consideration will inevitably not be adequate. Basically speaking, there may be two reasons for a deviation in claims experience.

The characteristics of the objects insured remain the same and the deviation of current claims experience from that of the past is only of a random and temporary nature. For example, the number of losses which occur within a certain period of time is greater than expected be it that the large number of small and medium losses is higher (unusual number of road accidents in an unusually cold winter with unusual quantity of snow and icy roads) or that more than the normal number of large risks are involved in big losses, be it that a catastrophe produces a multitude of losses at one and the same time and possibly on risks insured in the various underwriting departments (earthquake, flood, epidemic, conflagration). Deviations of normal claims experience brought about by such circumstances are random fluctuations.

Current claims experience deviates from that of the past because the objects insured have undergone a change in risk characteristics, for example — if we go back in history — the ships insured were one day no longer primarily sailing ships.

Although in reinsurance practice both of these causes contribute to the actual deviation from the anticipated claims experience, they shall be dealt with separately in the following for the sake of providing a clearer and more lucid presentation.

2.1 Random fluctuations of claims experience

2.1.1 *The increase of peak risks*

For decades, reinsurers have been accepting those shares of the risks insured from their Ceding Companies, which exceed a certain claims possibility or a certain amount for each risk insured. In this way the Ceding Company's retention is geared to its size. Therefore the annual premium income for the business retained by the Ceding Company is many times as high as the probable maximum loss for each individual risk. The effect of this is that major fluctuations in the overall result of the insurer caused by large individual losses become less probable.

In the case of the reinsurer, on the other hand, the individual reinsurance treaty is extremely unbalanced. In fact, ever since the advent of reinsurance, the annual premium income under a treaty was in many cases not higher than the probable maximum loss for a single risk. The only way in which the reinsurer could try to improve the balance of its business, was to accept a multitude of treaties on a worldwide level. However, this method has been subject to the adverse effect of two developments:

The increasing size of the individual risk

In 1960 there were approximately 23,000 merchant ships with over 500 GRT all over the world, the average tonnage being 5,500 GRT. At that time, only 62 ships had more than 30,000 GRT and there was not even one single ship with a tonnage of more than 100,000 GRT. By 1972, however, the number of ships had increased by approximately ⅓ to some 30,000, whereas the average tonnage had increased by almost ⅔ to 8,800 GRT. Over 1,600 ships had more than 30,000 GRT, and not less than 239 had a tonnage in excess of 100,000 GRT.

In Aviation, the number of planes flown by airlines in 1960 was approximately 5,000, the maximum value insured for hull and liability together in respect of any one risk having been in the region of U. S.$30 million. By 1972, the number of risks had increased by about 50% to 7,400, whilst the sum insured for the maximum risk (hull and liability) had risen to almost seven times as much, to U. S.$250 million.

A power station built in the course of the 1960's had a sum insured of approximately U. S. $20 million, while the sums insured of those under construction today already lie in the region of U. S. $175 million and the nuclear power stations projected for the years to come will have a value of up to U. S.$350 million.

These examples show very clearly that on one hand we have a considerable increase in the sums insured whilst on the other hand the number of objects insured is only slowly increasing. This development, which most probably will continue in the future, has had the inevitable effect that the individual reinsurance treaties have become increasingly unbalanced. Indeed, cases are already known where in classes of business in which risks are reinsured by way of surplus treaties only one or two per cent of all the risks written are actually reinsured. I know of a case where, out of a portfolio of more than 4 million risks insured, a mere 20,000 are reinsured. Obviously enough, the effect of such a portfolio structure is that the annual premium received by the reinsurer only constitutes a fraction of the probable maximum loss for an individual risk, in many cases just 10% or even less. The result of such a situation is that when the probable maximum loss becomes an actual one, the reinsurer will still suffer a loss of several 100% of its annual premium income under this treaty even if all other risks reinsured were absolutely free of claims. This development is clearly the result of increasing sums insured without a corresponding increase in the number of insured risks.

The decrease in the number of reinsurance treaties offered

In theoretical terms, it would be possible to compensate this increasing disequilibrium of the individual reinsurance treaty by writing a larger number of treaties. However, this is rendered practically impossible by the fact that the number of reinsurance treaties available to reinsurers has stagnated or is even decreasing. Due to company mergers, the number of potential Ceding Companies has been reduced, and nationalization has also — to a certain extent — brought about a decrease in the number of reinsurance treaties offered.

In view of the unbalanced structure of the reinsurer's portfolio resulting from this situation, it is far more difficult for the reinsurer to obtain a better balance of business by a geographical spread of the risks he accepts, so that the reinsurer is obliged to rely to a greater extent on a spread in terms of time. Nevertheless, such a spread depends on whether the reinsurer can trust that its various treaty relationships will be characterized by continuity. In practice, we are faced with the fact that after two or three years with positive results, the Ceding Companies ask — which from their point of view is understandable — for the conditions of reinsurance to be improved, even in the case of extremely unbalanced treaties. If the reinsurer does then not comply with the Ceding Company's request, he runs the risk of losing the treaty. Should he, on the other hand, make the concessions called for, the funds he needs to create the reserves to meet any possible contingencies, cannot be built up to the necessary extent.

2.1.2 The cumulation of several risks

Quite frequently, Ceding Companies argue that for them catastrophe covers are an almost superfluous precaution. Consequently, they are often only prepared to pay a very low consideration for obtaining such cover.

The storms which wrought havoc on the European Continent in the middle of November of last year, were by no means extremely unusual and it is quite probable that storms of the same force will occur any day — not to speak of stronger ones. The damage done by this storm constituted up to 15% of some Ceding Companies' premium income in classes of business like Motor Hull where nobody would have expected the peril of storm to expose reinsurance treaties to such an extent, although the reasons for this are obvious: the increasing population density and the enhanced concentration of values in small areas e.g. camping sites, depots of car factories etc.

In the light of such circumstances, the premiums which, for example, reinsurers have received in recent years for catastrophe covers in the motor hull business are completely inadequate. Reinsurers will therefore be obliged to reconsider these premiums with a view to the experience gained. Incidentally, this applies even more to catastrophe covers in countries exposed to the risk of hurricanes and earthquakes.

Indeed, reinsurers should consider very carefully whether they can accept the responsibility of writing catastrophe covers with a pay-back period longer than a man's life span, simply because the Ceding Company argues that it is just about impossible that a loss will be suffered under the treaty involved and that reinsurance coverage is merely being taken out by the insurer so that he will be able to sleep well at night. After all, reinsurers also have a right to sleep well.

2.2 The change in risk characteristics

Much has been written about this subject in recent times. As far as the present paper is concerned, all the aspects resulting from the influence of increasing claims consciousness, increasing crime rates, deteriorating labour morale with a degree of negligence which sometimes even borders on sabotage, new technologies and the effect which inflation has on claims experience, are only to be discussed as far as these phenomena apply to the reinsurer in a different manner as compared with the insurer. This holds true particularly as regards the influence of technological progress and that of wage and price increases.

2.2.1 Technological changes

Modern research is very expensive. This is the reason why nowadays research is done primarily or even exclusively by large industrial companies and enterprises. The effect of this development, in turn, is that such large companies or the products they manufacture are not only the largest objects insured in the market, but are also, more than any other risks, influenced by the innovations of modern technology. Although this is by no means new, it is quite sufficient to refer to nuclear power stations, supersonic aircraft and super tankers, which have been mentioned in this context so many times. Not only are all these risks large and expensive so that usually they have to be covered to a large extent by reinsurance, they are also new and virtually unknown. No statistics are available as far as their risk characteristics are concerned. True, this may possibly result in a pleasant surprise, as so far in the case of jumbo jets, but usually the surprise is rather unpleasant, as in the case of the super tankers, which proved the old assumption wrong that ships of an increasing size may be regarded as more favourable risks.

2.2.2 Wage and price increases and their effect on liability excess of loss covers

In treaties with a fixed priority, any change in the fundamental data required for carrying out the premium calculation inevitably places a larger burden on one of the parties involved. In the case of wage increases the resulting burden must be borne by the reinsurer alone. For the reinsurer, the difficulty in effecting an accurate calculation is brought about by the long average run-off period (10 years or more), and the annual increase in claims expenditure to be expected during such a period. Both of these factors, i.e. the duration of the run-off period and the extent of the annual increase in claims expenditure, cannot be forecast. Nobody knows whether, in a certain portfolio, claims under excess of loss covers will be settled after 5, 7, 10 or even after 15 years. Similarly, nobody can say whether the increase of claims expenditure during such a run-off period, which is caused by wage and price increases, will be x or y per cent per year. In order to make due allowance for these two factors a reinsurer who writes excess of loss covers is obliged to include a loading in the premium he quotes as a consideration for such future price increases.

If one considers that in recent years a number of well reputed institutions have made forecasts regarding the development of prices for a period as short as the forthcoming 12 months, and if one then bears in mind that the actual price development deviated by up to 100%, one is able to appreciate how very difficult it is to provide merely rough forecasts of the increase in claims expenditure for a period of several years. Indeed, even if the forecast of the annal increase in claims expenditure misses the mark by only 2 — 3% and if that of the average settlement period is inaccurate by a margin of, say, 2 to 3 years — these figures incidentally being quite optimistic — the loading charged for future increases in claims expenditure will deviate from the actual loading required by more than 100%.

2.2.3 The problem of changes involving a regular trend

Theoretically, the risk characteristics which affect the very insurability of a risk, may change on an irregular or a cyclical basis, or according to a regular trend. No doubt, a certain trend is noticeable for some of the changes mentioned before. This applies particularly to the increasing claims consciousness in our affluent society and to the constant rise in wages and prices. Moreover, as far as losses are concerned which are only subject to a random deviation of the actual claims experience as compared with the claims experience anticipated on the basis of statistics, both the insurer and the reinsurer are quite justified in assuming that such deviations will, by and large, be compensated almost automatically by subsequent profits. In contrast, however, as soon as a regular trend must be expected the reinsurer can no longer assume that the seven lean years will invariably be followed by the seven fat years. For example, it would be entirely unrealistic to expect that the average claim in Motor Car Liability insurance, which, in the course of the past 20 years, has increased annually, parallel to the increase in wages and prices will one day decrease. Accordingly, the only way of granting reinsurance cover for losses caused by a negative trend in claims expenditure is that the reinsurer, by providing its services, relieves the direct insurer from a loss until the latter has been able to adapt his premium to the actual claims cost. As soon as that is the case, however, the reinsurer must ask for the expenditure incurred by him to be « paid back » considering that if a development has the nature of a regular trend it will not be possible for the reinsurer to compensate the losses he has suffered in « a natural way » i.e. by claims experience which is better than expected.

In a similar way, it is unrealistic to regard the size of a portfolio as a possibility of compensating bad claims experience caused by a change in the risks insured. A 10% increase in the repair costs charged by car repair workshops will, in proportion, affect a car portfolio involving 100,000 risks in the same way as another car portfolio involving 1,000,000 risks. True, a large and well balanced portfolio is not exposed to random fluctuations as much as a small one, but will be influenced in exactly the same way by any change in the characteristics of the risks insured.

3. The consideration payable to the reinsurer

The traditional assumption that the reinsurer receives his share of the original premium charged by the insurer and therefore also follows the fortune of the insurer, only applies if both parties have exactly the same interest. However, this is very often not the case nowadays. The best example to illustrate the present situation is that of excess of loss covers, for which the reinsurer calculates a consideration, his price, independent of the insurer's original premium income. But even in the case of proportional treaties the ceding company and the reinsurer often do not sit in the same boat. This is shown most clearly by surplus treaties, due to the structure of which — for example in Fire insurance — the larger risks reinsured tend to have more negative a claims experience than the smaller ones retained more or less by the ceding company. In quota share reinsurance it happens quite frequently that the quota share ceded for favourable classes of business is lower than that ceded for less favourable classes of business so that the underwriting results for the direct insurers' net retention are better than those for the business reinsured.

It is for these reasons that reinsurers must receive a consideration for the risks they have accepted which is sufficient to allow them to pay the losses which have occurred, to cover their own expenditure, and to make a reasonable profit for paying interest on the share capital invested and for building up the necessary reserves. Such a consideration can either be calculated directly as in the case of excess of loss covers, stop loss covers and sometimes also facultative acceptances, or indirectly by way of deducting reinsurance commission at a level which leaves the reinsurer an appropriate net premium. Thus, the reinsurance commission is not so much a function of the original expenditure incurred by the ceding company but rather depends on the claims experience involved.

3.1 The consequences of inadequate statistics

If an adequate price for a risk covered by a reinsurer is to be calculated, it is necessary to have realistic statistics. Basically speaking, the statistics we have today are subject to three drawbacks.

In many cases the statistical basis applied is too small so that calculations become unreliable. This problem faces the reinsurer above all in excess of loss reinsurance. The consequent necessity to make calculations not in accordance with the burning cost for an individual portfolio only, but rather by considering the exposure, is a very intricate subject which I merely wanted to mention in this context.

It must be considered that the observation periods, used to make up the statistics on which tariffs are calculated, are still too long in many cases, so that the statistics often include years, the portfolio and claims structure of which have long been outdated. For the reinsurer, this question is of significance particularly as far as proportional treaties are concerned. In a number of countries it has been attempted to avoid this drawback by introducing statistics with a sliding observation period of say 3 or 5 years, an approach which nowadays does not hold as many problems as it did several years ago, thanks to electronic data processing.

Finally, one must consider the basic insufficiency of all statistics today because of rapid progress in a fast-moving world. The fact that the past is only of limited significance for the future which, after all, is the only time of interest to us when making our calculations. Thus, statistics must, as it were, be extended into the future in order to make due allowance for future developments. Therefore, such a loading for future developments is an absolute must in every premium calculation, since otherwise both the insurer and the reinsurer will always lag behind the actual situation.

Insurers and reinsurers, who attempt to apply such a loading in order to make allowance for future claims developments, will be confronted with a task which is relatively new to them. The observation of present and future developments. If this is to be done properly, the staff must have new qualifications. We need an increasing number of engineers, mathematicians, chemists, statisticians and other specialists, in order to enable us to observe more exactly than hitherto the risks insured and the factors which influence the calculation of premiums, so that in turn we will be able to adapt the premium to actual claims experience more rapidly than before. Today, for example, a company I know best of all has quite a number of mathematicians who work in various fields and departments and an even larger number of engineers specialized in various subjects. True, such a staff is expensive and will obviously increase the cost of administration so that it becomes even more necessary to achieve an adequate profit. Nevertheless, we do believe that this technical know how and finesse are necessary, considering it is the only possibility of gaining control over the constant change of risk characteristics — unless of course either one tends to tackle unknown risks with an attitude of wishful thinking, hoping that somehow things will turn out all right or unless one restricts the scope of coverage offered. It goes without saying that no insurer or reinsurer will be interested in these alternatives.

There is another item which should be dealt with in connection with the information required for the purpose of risk assessment, viz. the bordereaux service. In the past years, reinsurers have, to an increasing extent, been forced to do without bordereaux, since it proved too time-consuming for insurers to make out the bordereaux manually. The effect of this is that today many reinsurers are not informed even of the most elementary facts regarding the reinsured portfolio. The spread of risks and their size, the data required for judging the PML estimate etc. Obviously, if the reinsurer does not have this information, he is compelled to apply a safety margin which will unavoidably restrict the capacity available otherwise.

In the meantime, however, the possibilities of using electronic data processing equipment to make out and evaluate bordereaux have been improved, so that it would now be good for insurers and reinsurers to get together and develop common programmes to ensure that the data required by the reinsurer are, from the very beginning, included in the insurer's electronic data processing programme, and that they may thus be supplied to the reinsurer without really a considerable amount of additional work.

3.2 Problems involving major customers

The principle of insurance, according to which the Community of the Many bears the Losses of the Few, is rendered rather disputable by the attitude unavoidably taken by the individual policyholder on many occasions, in calculating whether his insurance has been « worthwhile » to him, i.e. whether the claims amounts received have been higher than the premiums paid by him. However, whereas the small customer in the mass insurance business does not have the power to make his insurance policy « profitable » for his own purposes by exercising pressure on the insurer, it happens time and again that major customers — who obviously calculate with a tighter margin because the insurance premiums they pay are part of their own production costs — are able to obtain « rebates » and other benefits which sometimes reduce the premium to an uneconomic level simply because they are powerful enough to do so in view of the volume of the premium they pay. Here, it must be considered that while the insurer normally has a very large number of small customers and relatively few large customers, a reinsurer has normally only large customers and none of them is particularly keen to finance its competitor by way of its own good results. This is the reason why reinsurers tend to make concessions on repeated occasions, which technically are not justified. The most significant example is profit commissions stipulated for treaties, even where it is only possible to see after very many years whether a profit has been made at all. This applies particularly to covers for regions subject to the risk of earthquake or hurricane.

After years, however, in which heavy losses have been suffered, also major customers like to believe that one or the other large loss should actually not be considered, maintaining that such an unusual occurrence should be borne by the community of all insured. Similar arguments are used by insurers in negotiations with their reinsurers, after years of heavy losses. Here, it must be considered that in view of the relatively small number of customers which a reinsurer has it is only possible to a limited extent to compensate the results of all the customers — as the direct insurer usually does in his portfolio. For example, if a large claim occurs involving one private third party liability policy out of several hundred thousand, it will usually not affect the premium to be paid by this policyholder. In contrast, heavy losses suffered under a reinsurance treaty will, in general, force the reinsurer to compensate a certain portion of these losses, by adjusting the terms of this treaty.

3.3 The small margin for price competition in reinsurance calculations

The margin available in the reinsurance business for genuine competition in terms of prices is certainly small in comparison with the direct insurance market or the manufacturing industry.

Obviously, competition is not possible — at least not reasonably — in terms of the actual claims expenditure as this expenditure is the same for each reinsurer, provided the scope of cover is the same. Thus, there can only be genuine price competition as far as costs are concerned. In the field of direct insurance this is possible. In Germany, for example, the cost of acquisition and administration incurred by non-life companies is approximately 30% on an average with large deviations herefrom between the individual companies. In practice, this means that insurers who have particularly low-cost channels for selling their policies or who have low internal administration costs thanks to particularly effective rationalization, are able to offer premiums up to 10% lower than those quoted by their competitors. In the case of the reinsurer, on the other hand, the average of its own administration cost — the only item subject to his control — is roughly 2% to 4% of its total premium income (even less for large proportional treaties, whilst it is more for facultative business and non-proportional treaties). This shows quite clearly that the « masse de manœuvre » for price competition in the reinsurance filed is very small.

Nevertheless, price competition in reinsurance has become a reality which we are all familiar with. There are two main reasons for this.

A reinsurer is able to offer a lower consideration, i.e. a better price, for a certain reinsurance treaty than its competitor, if he can apply a so called « calculation mix ». Let us assume, for example, that the reinsurer holds a very profitable Life treaty so that he is able in turn to offer an excess of loss cover to the Ceding Company in Motor Car Third Party Liability business which — as the reinsurer is quite aware of — has actually been calculated on the low side. It is here that we encounter the trend towards « bouquet thinking » which, although it is often criticized, is applied again and again. In fact, such an approach is quite feasible for a reinsurer who has such a share in the bouquet ceded by one insurer so that its results therefrom are quite acceptable to him, while it is certainly not appreciated so much by a reinsurer who is only offered a share in treaties with too low a rating.

In practice, however, more frequently there is another reason why the prices quoted by two reinsurers for the same treaty tend to deviate considerably. This reason lies in the fact that although claims expenditure constitutes a fixed value — which of course is the same for all competitors concerned — it is nevertheless an unknown value at the beginning when the calculations are effected. Here again, methods depend to a great extent on how complete the statistics available for the past are, whilst it is just as important how future developments are judged. Here we need and have to use the advice of experts and specialists. Nevertheless there remains a certain question mark, the answer to which depends on the sense of economic responsibility and the optimism of the individual reinsurer.

3.4 The discrepancy of results between insurers and reinsurers

In the years from 1960-1971, the combined claims and expense ratios of German professional reinsurers in Non-Life business were some 6%-8% higher than the corresponding figures of direct insurers. The situation was fairly similar in other countries, as far as relevant figures are available. To a certain extent, the less favourable underwriting results of reinsurers are compensated by the fact that in reinsurance, due to the nature of the business reinsured, claims reserves play more important a part than in direct insurance, so that the interest on the investment of these reserves is of greater significance.

At this point it is perhaps quite appropriate to make a few remarks on the way in which many Ceding Companies attempt to interpret underwriting losses as an overall profit by including reinsurers' investment income.

Within an individual treaty relationship, the insurer can only consider such investment income of the reinsurer which is derived from its own payments. For example, if the claims reserve of a certain treaty is 1,000, of which however only 800 stem from the balances remitted by the insurer, the reinsurer is obliged to provide for the difference of 200. Accordingly, in such a case the ceding company cannot consider investment income from the entire 1,000, but only from the 800 which it has made available. It should be noted here that negative underwriting results involving high claims payments often have such an adverse effect that the investment income influences the results of the respective treaty by a mere 1% or 2%.

Particularly when foreign reinsurance business is involved, the reinsurer must be very careful in considering for which period the money which provided him with an interest was really at its disposal. In this context one should not forget the reinsurer's obligation to pay cash losses, nor should the fact be left unconsidered that for some reinsurance treaties not only the accounting periods are tending to become longer and longer, so that the reinsurer receives balances due to him at a later date, but that also delays of several months very often occur until balances already due are remitted.

Sometimes, the reinsurer is obliged to deposit premium reserves and claims reserves with the ceding company. In such cases the interest the reinsurer receives is generally considerably lower than market conditions which are normally obtained by the ceding company.

In this context one should not forget to refer to the influence resulting from the revaluation or devaluation of currencies, which obviously also have an effect on the investment income. No matter how hard a reinsurer tries to cover its obligations in the individual currencies by making investments on an international basis, it is impossible for reinsurers working world-wide to escape the consequences resulting from alterations in the rates of exchange, which have become all too frequent in recent years — a development which is even more detrimental to international commerce and industry in general.

To summarize, it may be said that the investment income of reinsurers certainly plays a significant part within the scope of overall profit and loss calculations, but that in the individual case interest has much smaller an effect than the ceding company normally expects.

The frequent and large gap between the result obtained by the ceding company from the business it retains and that by the reinsurer on the business reinsured, which is so often seen, should become narrower. This applies so much more when on the one hand reinsurance treaties become more and more exposed and on the other hand expenses incurred for dealing with peak risks and for increasing services which are demanded from and rendered by reinsurers are constantly rising.

3.5 Foreign exchange control

In view of recent government interventions in the free transaction of foreign exchange, it appears necessary to pass a few comments regarding this subject as well.

Ever since the first experience gained with currency devaluations, reinsurers have known that the only real protection against losses resulting from revaluation and devaluation of currencies is to invest the respective reserves in the currency of that country, in which the corresponding business is being transacted.

Whereas prior to the Second World War and in the years thereafter, the shortage of foreign exchange in a number of countries was the main problem, the situation is now exactly the opposite, so that many countries want to protect themselves against an undesired inflow of foreign currency. This is the reason why some countries impose measures such as those taken in the last few weeks by various governments, for example to prohibit the purchase of securities by foreigners.

As we all know, such measures are introduced in order to restrict monetary speculation. In the case of reinsurance, however, this poses certain problems as, although reinsurance involves financial transactions which to a certain extent are similar to pure capital transactions, the reinsurance industry is nevertheless a specific service industry. This is a fact which was accepted generally for decades. But it is after nearly 20 years with more or less complete freedom of transaction being forgotten. Therefore, the competent authorities must be reminded time and again that, due to its very nature, reinsurance can only be effective on an international level and that such international activity is at least restricted to a significant extent by all government measures imposed on the free transaction of foreign exchange and investments in foreign countries.

4. **The reinsurance markets**

Basically speaking, the internationl reinsurance market can be split up into three different sections : the professional reinsurers, i.e. reinsurers who transact reinsurance business only; Lloyd's, who receive more than 40% of their overall premium income from transacting reinsurance; and finally the numerous insurance companies all over the world which write mainly direct insurance but reinsurance business as well. It appears that in recent years this third group has gained importance. Some of the companies involved here operate in the reinsurance market only in order to obtain reciprocity for their own outgoing reinsurance, whereas others acquire reinsurance business intentionally for its own sake.

I may point out from the very beginning that the following observation does not apply to the London Market, since both the London companies and Lloyd's have been working on a world-wide basis for centuries and therefore have profound knowledge of the overseas markets.

However, one wonders whether insurers who are specialized in the direct business of their national markets, and who then make reinsurance capacity available for other markets, the conditions of which they are not so well acquainted with are not on a dangerous path. It must be considered that in recent years reinsurance has become more and more popular which in turn has led to a certain surplus in reinsurance capacity and has accordingly resulted in a certain deterioration of prices. It therefore comes of no surprise that such reinsurance business written abroad by these companies shows particularly unfavourable results. Furthermore, this situation is hardly remedied by the fact that many such companies state in their annual reports that after some years they have decided to discontinue their activities in reinsurance, since for every company which withdraws from the reinsurance business others decide to start writing such business. Because of this situation it will — regrettably — often be easier to place a reinsurance treaty which has shown high losses at the same or even at better conditions spread across foreign markets, than it is to have a direct insurance policy with unfavourable claims experience renewed on the same terms in a national market. Obviously enough, such circumstances make life very hard for companies which only and permanently operate in the reinsurance market. But I feel that, in view of increasing international contacts there is a good chance in the not too distant future to improve the situation to the benefit of those offering reinsurance coverage as well as of those trying to obtain first class security.

5. **Summary**

Every company working in the reinsurance industry would obviously like to increase the volume of its business. This, however, will always be at the expense of others trying to acquire the same business. Nevertheless, if, due to a technically sound offer from one of its competitors a reinsurer does not receive a share he had hoped for, this should not induce him to take a pessimistic view of things but should rather stimulate him to improve its efficiency.

Obviously, however, the aim of all reinsurers is not just to acquire new business but also to make a profit. This aim is obstructed by a number of influences, some of which I have mentioned in this paper. Moreover, it must be considered that these influences do not affect just one reinsurer or merely a few, but the entire reinsurance market. If the steps necessary to counteract the adverse effects of such influences are not taken, this will prove negative not only to the reinsurer who has neglected them but also — either directly or indirectly — to all other parties concerned. It is therefore advisable that all those offering reinsurance coverage work on a basic understanding of those factors and developments which affect all reinsurers in the same way. Such common ground, to which much can be contributed by a discussion at the kind of forum ROA offers to its members, appears far more important than the triumph felt by a reinsurer at having increased its share in a treaty at the expense of a competitor.