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Le rendez-vous de septembre de 1982

Chaque année, nous reproduisons un ou plusieurs travaux présentés au Rendez-Vous de Septembre qui réunit, à Monte-Carlo, un très grand nombre d'assureurs et de réassureurs du monde entier. Faute d'espace, cette fois nous devons nous en tenir à la communication de M. Maurice Greenberg et à des extraits en français de l'étude de M. Robert A. Reeves.

A) D'abord le travail de M. Maurice Greenberg, président de l'*American International Group* de New-York. Sous le titre de *Reinsurance in a period of high interest rates*, M. Greenberg y étudie les inconvénients graves de la pratique dite du *cash flow*, si répandue en ce moment.

« So much has been written and said about the state of the insurance and reinsurance businesses that it is hard to believe anything can be added. My own views are well known – that insurers and reinsurers have to make an underwriting profit to be successful in the long run.

Today it is written and said that insurance markets are not behaving soundly and are impairing the long-term health of our industry. A look at the reported numbers also suggests that my views on underwriting profit are not being slavishly adhered to. I like to think there is a connection. One feature of what is going on today is that the price cutting and loose underwriting are always someone else's fault. Consider how often we hear reinsurers blamed for primary price cutting or implored to rescue primary companies from themselves. How often we hear primary companies blamed for living off of reinsurers. Blame is an ineffective way of regulating markets and a weak way of competing. So let's step back from the vicious circle of recrimination. Let's just see what is going on and where reinsurance fits in.

Reinsurance offers one of the easiest ways for new capital to enter the insurance business ; easiest, that is, from the limited point of view of organizational steps and start-up cost. Reinsurance also offers an effective way to connect up different business strategies and objectives.

Since new capital and differing business objectives figure prominently in today's marketplace, reinsurance figures prominently in today's marketplace too. Unfortunately, the motives paramount today are placing a strain on some of the oldest and best traditions of reinsurance. Classic reinsurance is of benefit to both the primary company and the reinsurer. The ceding company gets the ability to spread its risks, from which comes the ability to serve more and larger and more challeng-

ing customers. It gets technical advice and access to capital. It recovers a portion of the transaction cost of servicing a gross book. The reinsurer gets a dependable source of investable funds, accompanied by risks which it can manage better than any one ceding company. At its best, reinsurance involves stable, long-term relationships. Both parties make money from their association. Each can win without the other losing.

Why, then, does reinsurance seem today to be the subject of so much short-term and unstable behavior ? Perhaps because too many people come into the primary and reinsurance business without a coherent strategy, without a long-term view, and with a simple faith that the alchemy of retrocession can turn a bad book into a good one.

The contrast between short and long term views shows up, for example, in the argument over whether primary companies and reinsurers make money off of each other. The proposition can mean that they enjoy a mutually advantageous commercial relationship. In that sense, which reflects the long-term view, it is true to the point of being obvious.

The proposition can also be used to imply that one over-reaches on the other. In that sense it is not true and should not be. Let's look at the record, using the United States market because more complete data are available.

Over the past thirty years, the reinsurance industry has had a combined ratio two points higher than the primary industry, and its underwriting results have been more volatile. Its profitability, measured by total operating income as a percentage of premiums, has been two points lower as well[(1)]. Are ceding

[(1)] Stewart Economics, Inc. (unpublished, 1982) companies, then, profiteering at the expense of unwary reinsurers ? Not at all. The result is just what one would expect from easier entry to the reinsurance market and from reinsurers' dependence on primary companies for service to the ultimate customer and for access to his premiums.

Yet reinsurers have done very well. A leading study showed that, for the six years ending with 1980, twenty-eight representative insurers spent $31 billion for reinsurance, absolute net, and the reinsurers incurred $30 billion in losses. The reinsurers earned one billion dollars of underwriting profit in addition to the investment income on cash balances[2]. Though the world may not be unfair to reinsurers, it is admittedly difficult.

Reinsurers contribute so much to the capacity and responsiveness of insurance markets. Where do they figure in a market with altogether too much capacity and responsiveness ?

As shorthand, we call today's competitive behavior "cash flow underwriting", which is true and vivid but incomplete. We can wish it were only the quest for investable funds, for the flow is drying up. It is that, but it is more. Besides the desire to put money to work at high interest rates, driving the competition are market considerations and cross-cultural factors. Insurers remember how much they lost by pulling out of markets in the mid-1970's and are not about to do so again. Others believe they are investing in setting themselves up in new markets.

Insurers from different countries respond to different accounting conventions and tax laws. Some see insurance as a forward market in foreign exchange. Different insurers look differently at their products and their markets, at growth and profit, at losses and expenses, at underwriting result and total return, at the income statement for today and the balance sheet for tomorrow. All of us want to think of everything, but in reality each of us puts some things ahead of others. Where competitors pursue different objectives, their competition is apt to be a baffling, exasperating mess.

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[2] Extent of Reinsurance Use & Cost of Reinsurance versus Benefit (Conning & Co. 1981).

Reinsurers are at the center of it all, because they connect up different value systems. They let everyone succeed according to his own definition of success.

The standards of insurance professionalism are also changing. To some the old rules look quaint, and discarding them offers the lure of market advantage. The idea of reinsurance as a stable and long-term relationship grounded in mutual interest and mutual trust shows signs of weakening under just that pressure. I do not always think of myself as a stodgy fellow, but those developments are disturbing to me just as they are to many others who intend to be in the market after this episode is over. Regrettable or not, this is the market we are in. Reinsurers are at once its perpetrators and its victims. Beyond that, what is their role ?

Reinsurance permits primary companies to profit from good market position without overworking their capital. In a cost-conscious world, it enables them to recover a portion of their costs. In a competitive market, reinsurers help primary companies make money by helping them serve their customers better. And the primary company is the reinsurer's customer just as surely as the broker and insured are the primary company's customer. In today's market, refusing or failing to meet the needs of one's customer are merely ways of dropping out. Anyone can refuse to respond to his customer's needs. Anyone can give insurance away. The trick is to meet the customer's needs and to do so at a profit. Many reinsurers are extremely sophisticated financially and are innovative and entrepreneurial besides. Some, whether learned in other fields or not, are new to the insurance business. So it is no surprise that the best and the worst financial games today are played in the reinsurance business.

With reinsurers such a prominent part of the circle of recrimination is about price cutting, a reinsurance perspective is a good one for analyzing the competitive phenomenon we call cash flow underwriting or pricing to a total return.

Insurers, reinsurers, agents, brokers, regulators and corporate treasurers all have a pretty good grip on the financial aspects of insurance. Knowledge is fine, but there can be danger in how it is put to use. Today it is being used to soften the standards of acceptable performance in the insurance business, while making that same business more difficult. The knowledge is employed to inspire and to forgive shortsighted, competitive behavior. It is conceived as a sophistication but enjoyed as an indulgence.

There are five reasons to expect this fever of cash flow underwriting to end badly.

First, it implicitly discards the most widely accepted measure of underwriting performance – the combined ratio.

Obviously, the ratio ignores some components of insurer profit. But it measures better than anything else the market worth of the insurer's services. Maybe that is why not everyone likes it anymore.

More important, the ratio is the key to a whole system of interdependent beliefs which enables us somehow to manage the insurance business at all. The business is hard to manage in the absence of a cartel and has a certain tendency to spin out of control.

Imagine instructing an underwriter in an insurance company branch office to price farm implement product liability insurance the following week to an annuel, post-tax return of 2.1% on attributed equity. It would be interesting to see what happened, but the instruction is certainly not much of a successor to the combined ratio.

The combined ratio is not everything, but it is not nothing either. It governs not just our numbers. It governs our organizations. Only at our peril do we throw away the keystone to a received set of restraining beliefs before we have anything tested to take its place.

Second, cash flow underwriting shifts the locus of decision making in an insurance operation away from underwriting people and toward financial and administrative people. The reason is that when underwriting margins are planned to be negative, they lose meaning to those who live by them. But revenues, investment incomes and operating economies gain in importance.

Financial people will translate their analysis into unmanageable directives. They will surely bring more emphasis on short-term and quantitative measures. at the sacrifice of strategy and strong market position.

Administrators will. just as surely. focus on small reductions in expense. Having squeezed dollar expenses as hard as they know how. they will look to the way expenses are reported. Then they will press for growth in the denominator of the expense ratio.

There is no reason why a struggle for written premium to push the expense ratio down would be any less violent than a struggle for cash premium to push investment income up.

A concern about administrators and financiers pushing underwriters aside in insurance may sound stodgy too. But the same American business schools which preached transferable management and finance for decades now attribute many of the country's industrial problems to a lack of longcorporate vision and to a decline in the status of creative and operating talent.

The third and fourth problems with cash flow underwriting have to do with the risk characteristics of an insurer's book of business. Emphasis on total return pushes an insurer toward liability insurance and toward excess levels. because they offer the longest asset float. Price competition. which began five years ago in commercial property insurance. is now most unruly in commercial excess casualty. Costs there are most difficult to know. mistakes are longest hidden and accepted standards of price adequacy are rare.

Fourth. the concern for float works not just on the sellers of insurance but on the buyers as well. The insurance culture is a single one and ideas move freely within it. When the buyer responds to the same financial analysis we have been attributing to sellers. he naturally wants to hold onto as much cash as possible for as long as possible. That means retaining. in one way or another. the most predictable exposures and only buying fixed-cost insurance for what is left. Much insurance pricing is on the tacit assumption that whole exposures are insured. Good risks tend to subsidize bad ones. If insurance is bought only for the exposures which are more dangerous and difficult to price. it is all too clear what happens to the insurers' book.

Fifth, in the long-tailed liability lines, whoever holds the premiums gets to earn compound interest for a long time. Insurers are under pressure to give up those earnings or part of them.

But those investable funds are not free. The losses will eventually have to be paid. Once the premium is set, the insurer has the risk of having to forecast the ultimate loss payment. Setting a price for insurance for legal liability involves, in addition to underwriting judgments about occurrence, estimates about future price levels, future liability rules, future standards of care and of proof, and future measures for damage awards. Many a banker finds it challenging enough to forecast interest rates six months ahead. Here we are forecasting many and more complex and interacting factors not months but years ahead. In some lines it can hardly be done at all.

Compound interest from holding premiums is the only significant cushion for error the insurer and reinsurer can have when making those heroic estimates. Even compound interest is unlikely to be a fully adequate cushion, for interest rates are not intended to compensate for such extreme uncertainties. Without the interest cushion, the insurer and reinsurer are just gambling. For them to price to an underwriting loss is for them to plan to give up some or all of the cushion. That kind of blind confidence does not have a good record in the casino at Monte Carlo. Even when the present competitive episode is over, we may find that it has set us on a false course for a long time.

Over the history of the insurance business, the underwriting return has gone for current expenses and rewards to managers, and the investment return has been a reward for capital and a source of recommitted financial strength for the future. We have it today because our predecessors had faith in the future and invested in the future. Why should we be the ones to give up? Indeed, nothing we have said here implies any of us should give up. We simply live in interesting times, and nobody promised us it would be easy.

We should even forego the comfort of blaming each other. For blame distracts us from what we can do for ourselves. None of us is helpless. Certainly not reinsurers.

Last year, reinsurers in the United States, including reinsurance departments of primary companies, had a combined ratio of 110 %. Yet 124 companies which were willing to be named in a leading survey, had a combined ratio of 106 %, and 27 of them had an underwriting profit[3]. The difference between the most and the least successful reinsurers is sharp and, under the strain of this competitive market, is bound to get sharper.

Today, all of us primary companies and reinsurers alike, have a great deal at stake in our individual organizations to select markets, to attract customers and then to underwrite and price their exposures consistently with our chosen business objectives. So all wrongfully accused insurers and reinsurers can take heart. We are all in this together, just as we are together in easier times. And some day it will all change. Some day once again a primary underwriter will take you to lunch. Unless, off course, he has a prior invitation from a broker. »

B) *Les télécommunications et l'assurance* est le titre de l'étude présentée par M. Robert Reeves, président de Health Services Group, Division of Hospital Corporation of America, Nashville. Celui-ci insiste, en particulier, sur les implications des télécommunications dans la gestion des risques, tant pour leur analyse que pour leur *transfert* :

« Analyse de risque

Les années 1990 seront celles de l'analyse de risque. La capacité de manipuler de grandes quantités d'informations grâce aux télécommunications comble le désir de chaque gestionnaire de risque d'étudier les données de sa compagnie de façon rapide et plus perfectionnée que jusqu'à présent. Non seulement l'analyse en sera plus aisée et moins coûteuse à l'avenir, mais l'information elle-même en sera beaucoup plus exacte. Étant donné que les assurés eux-mêmes partagent des statistiques sur les sinistres, les prévisions de probabilité de sinistres en gagneront en exactitude. Les programmes informatiques d'analyse d'incidents et de sinistres se généraliseront parmi les entreprises.

(3) Reinsurance Underwriting Review (Reinsurance Association of America, 1982).

Au début, ils seront proposés par des entreprises extérieures mais, comme la technologie avance à grands pas, des systèmes intérieurs à l'entreprise seront mis en place dans un grand nombre de départements de gestion de risque des grandes compagnies.

Quant aux *consommateurs* d'assurance de petite et moyenne importance, les associations professionnelles feront bien d'encourager leurs membres à partager des informations sur les sinistres afférentes à leur branche ou secteur d'activité.

Grâce à l'usage croissant de l'analyse de risque, les assurés deviendront beaucoup plus avertis qu'auparavant. Étant donné que leurs programmes d'assurance sont consolidés et analysés, ils continueront à augmenter leurs propres conservations.

L'impact sur les coûts des sinistres devrait également se faire sentir et ceux-ci devraient être réduits grâce à un service plus rapide, tant au niveau des déclarations qu'à celui des enquêtes. Grâce à une meilleure analyse des sinistres, la prévention en sera axée sur des besoins nouvellement détectés. La gestion des sinistres ordinaires des grandes firmes s'y fera directement. Les companies d'assurances installeront des canaux de communication directe avec les départements sinistres des grandes entreprises et le gros des tâches de gestion en sera assumé par l'assuré lui-même. Cette évolution débutera avec le traitement des sinistres de l'assurance médicale de base pour toucher ensuite les accidents de travail et devenir enfin un système d'information destiné à recevoir le plus gros des informations apparentées à l'assurance.

Transfert de risque

Comme nous avons vu plus haut, les consommateurs de l'assurance, en particulier les entreprises, deviendront beaucoup plus avertis. Grâce à sa capacité accrue de manipuler les informations, l'industrie de l'assurance sera en mesure de fournir, en quelque minutes, les cotations les plus compliquées. Ceci rendra l'assurance beaucoup plus compétitive que jusqu'à présent. D'un côté, les compagnies d'assurance pourront déterminer plus facilement leurs coûts sur un portefeuille spécifique et, de l'autre, les assurés sauteront les techniques de *tarification à la moyenne* qui tourmentent notre industrie aujourd'hui. Les assurés avertis exigeront davantage de cotation *sur mesure.* Ils redoubleront leur attaque contre les niveaux de sinistre contrôlables, et l'auto-assurance sera le principal concurrent de l'industrie de l'assurance pour les grosses polices incendie, risques industriels. On sautera encore plus minutieusement les frais fictifs des transactions d'assurance et on augmentera la pression sur les compagnies afin qu'elles réduisent tous les frais autres que ceux se rapportant à la gestion des sinistres.

Conclusion

Afin d'assurer la survie de votre entreprise pendant *l'explosion* de la technologie des télécommunications, nous nous permettons de vous proposer les recommandations ci-après :

1. *Prévoir :* Les entreprises qui réussiront sont celles qui préparent le changement plutôt que celles qui restent passives sous la contrainte de la concurrence.

2. *Tirer profit de cettte nouvelle technologie plutôt que de regarder les autres le faire* :

L'entreprise qui gagnera à la fin sera celle qui distribuera les primes de la grande masse des assurés à un petit nombre de malchanceux dont la gestion de sinistres est la plus efficace, financièrement s'entend. Utilisez les nouvelles techniques de traitement et de transmission d'informations pour réduire vos frais de gestion.

3. *Étudier et installer* un système d'information pour la gestion afin de communiquer des renseignements financiers et non financiers à vos responsables et ainsi leur permettre de mieux gérer vos affaires. Grâce à un bon système de traitement de données, en cas de catastrophe, vous connaîtrez vos engagements, les expressions telles que chevauchement et construction pyramidale des risques étant complètement dépassées.

4. *Plutôt que de rester à la traîne, inventer de nouveaux contrats d'assurance* dont les gestionnaires de risque ont besoin en cette ère des télécommunications.

5. *Apprendre à connaître* les désirs des gestionnaires de risques, vos vrais clients :

a) Aider à la conception et à l'installation des systèmes informatiques de gestion de risques.

b) Proposer l'utilisation des technologies modernes pour gérer les sinistres plus rapidement et à moindre coût.

c) Aider à l'étude et à la consolidation des programmes d'assurance des directions et filiales en un programme mondial intégré commun à toute l'entreprise.

L'industrie de l'assurance est plus vulnérable au changement causé par les technologies de pointe et les télécommunications que n'importe quelle autre branche.

Les télécommunications instantanées permettent l'élimination du papier ainsi que le traitement avec aisance de grandes quantités de données.

Notre industrie changera.

Votre compagnie va-t-elle aussi changer ? »

~

Le conférencier va-t-il bien vite en besogne ? Peut-être pas, quand l'assureur ou le réassureur possèdent les ressources nécessaires.

Lloyd's Act 1982. Lloyd's London

Nous venons de recevoir un exemplaire de la nouvelle loi qui régit Lloyd's London. Éditée par The Corporation of Lloyd's, Lime Street, London EC3, la nouvelle loi incorpore celles de 1871, de 1911, de 1951 et de 1982. Il y a là un instrument de travail intéressant que nous signalons aux lecteurs. Dans chaque cas, le Lloyd's Committee est intervenu d'abord, puis le parlement, afin de préciser certains actes, certains contrôles ou certaines autorisations données à Lloyd's.

Le document est important puisque, en regard des dispositions anciennes, il précise les règles nouvelles imposées à Lloyd's London pour donner aux affaires de ses syndicats la plus grande sécurité possible. On y trouve l'esprit, sinon la lettre de certaines mesures adoptées à la suite de ce qu'on a appelé le Rapport Fisher.