Mutual

# INsurance®

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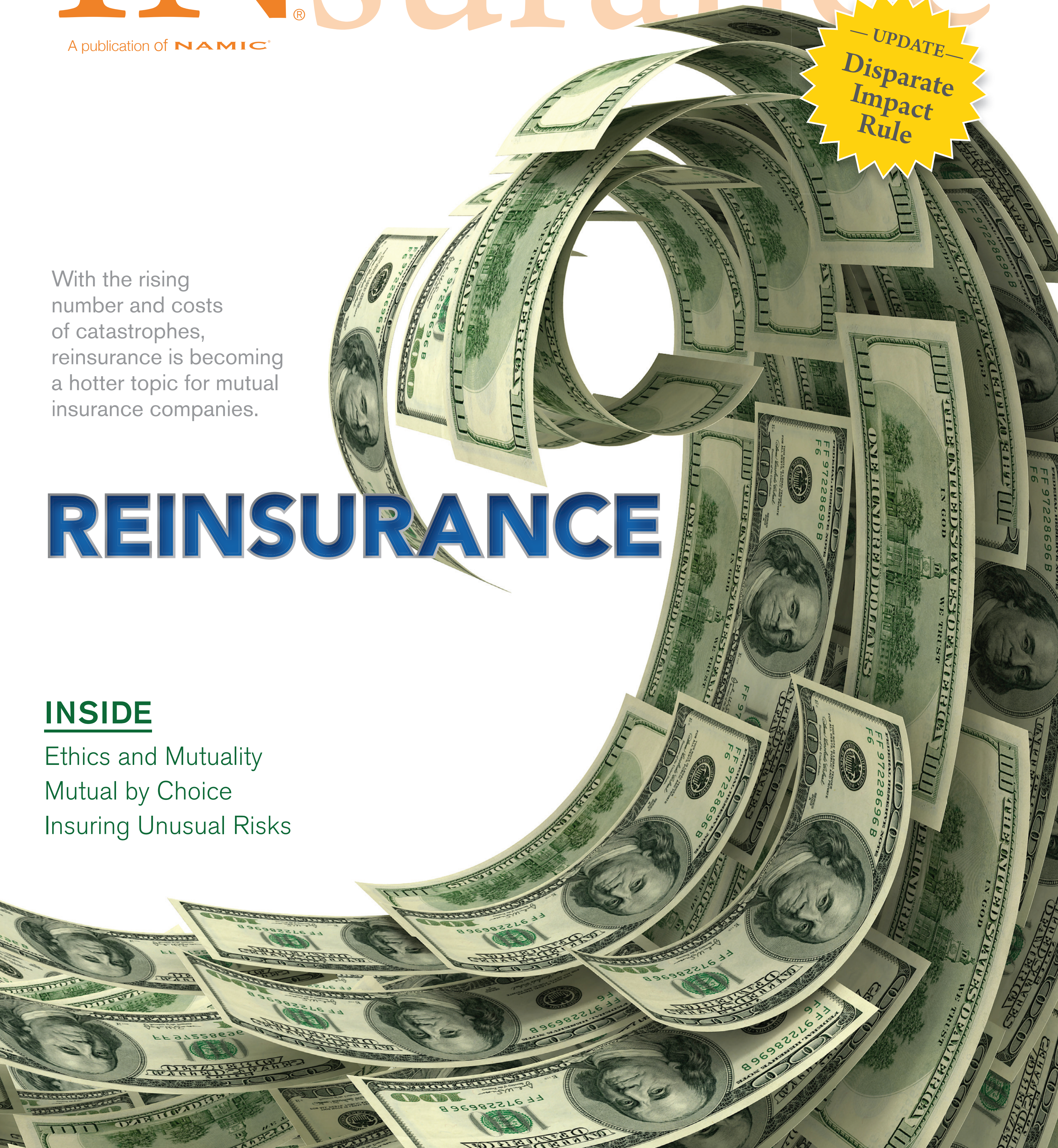
— UPDATE —
Disparate Impact Rule

With the rising number and costs of catastrophes, reinsurance is becoming a hotter topic for mutual insurance companies.

# REINSURANCE



## INSIDE

Ethics and Mutuality
Mutual by Choice
Insuring Unusual Risks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By Lindsay Robison

# REINSURANCE

Reinsurance may be one of the largest and most varied expenditures on the books. But when abundant risks threaten insurers' foundations, it can be one of the greatest assets in keeping companies from toppling.

Reinsurance might not be the most glamorous aspect of the insurance industry. But ask insurance company leaders, and they will likely tell you that reinsurance is a topic ranked high on their lists of important issues.

It should be, considering that, for many companies, reinsurance premiums can be one of the largest, if not the largest, expense incurred each year. Insurance companies have the potential to spend anywhere from 20 percent to 40 percent of their written premium on reinsurance, according to **Larry Bray**, vice president of client support for **Wisconsin Reinsurance Corporation**.

Because such a large sum of money is dedicated to reinsurance expenditures, an equally significant amount of time should be spent on making reinsurance decisions … at least according to **Steve Chevalier**, CEO of **NLC Insurance Companies**. He says he spends at least 20 percent of his time at the company thinking about and working on some capacity of reinsurance. It also would not surprise him if his counterparts do the same.

Spending time working on reinsurance issues may be common to all insurance companies, but the exact issues that encompass NAMIC members' thoughts on reinsurance differ largely from company to company.

The volatile weather that hammered the United States the last few years has had a significant impact on the reinsurance market, as reinsurers typically bear half of the cost of natural catastrophe losses, according to **Franklin Nutter**, president of the **Reinsurance Association of America**. He says reinsurers have noticed an increasing interest from other businesses, such as hedge funds, in what they see as new market opportunities within the reinsurance sector. This often happens after major events because capital providers anticipate prices to go up and they want to gain what they can from those increases. "[So it is attractive in the sense that the] market conditions may look attractive, and there is an influx of new capital," Nutter said.

Those looking to get into the market the past few years predicted the price increases correctly. At press time, analysts were predicting renewals to be flat or slightly increased. The increasing prices coupled with a "relatively quiet" 2012 weather-wise – until Superstorm Sandy hit, that is – allowed for reinsurers to start replenishing and rebuilding their capital, according to Nutter. But all of these circumstances are reasons why reinsurance is such a concern for primary insurers. It all comes back to them after all.

"The major thing insurers are concerned about is price … and security," said **Timothy Dorr**, president and CEO for **Mutual Reinsurance Bureau**. "They want to make sure their reinsurer has the wherewithal to pay the bill if and when it comes. The reality of it is that for most companies reinsurance is a necessary evil. They would rather not have to have it." But Dorr also says companies realize they have to have reinsurance in order to survive and to smooth out their financial results over a long period of time.

Despite RAA's outlook of robust capital and insurers' need for reinsurance, availability is currently at issue for insurers of all sizes. Because NLC operates in New England and faces a lot of weather-related catastrophe risk, availability is a big issue for Chevalier.

"Reinsurance is the capital that keeps [NLC] in business," Chevalier said. "So when I look to buy [reinsurance], price is obviously a consideration. But availability is the number one item.

"We want to make sure that [the reinsurer] will be there, especially when we talk catastrophe risk," he continued. "We need to know that if the "big one" hits New England they will be around to make good on their obligations."

One thing many mid-sized and larger companies have been doing, though, is looking to make their reinsurers' obligations smaller. They have been accomplishing this by retaining larger portions of their own risk. **Randy Shaw**, president and CEO of **Everett Cash Mutual Insurance Company**, has spent his time at ECM figuring out the company's risk tolerance. While he understands being risky is the nature of the insurance business, Shaw believes that primary insurers should put in the work to rightfully manage that risk and, hopefully, get a return from it.

When Shaw took over the reins at ECM, the company was paying somewhere between $4 million and $5 million in reinsurance premiums. By working with the company's board and its reinsurer to increase ECM's own retention levels, Shaw was able to help his company reduce its premium payment to less than $2 million.

"You've got to make money for the reinsurer, but at the same time you've got to manage your reinsurance effectively so that you're not feeding off business to the reinsurer that is best absorbed by your own company," Shaw said. "When you can look at reinsurance on a catastrophe-only basis, availability can become less of a concern."

Smaller companies also think about availability, but on a different level. Smaller insurers need to make sure they are in good enough shape that reinsurers will be able to make policies available to them generally and more specifically at prices that will not put them out of business. To be able to stay afloat, companies have to make sure that they have enough in surplus to be able to afford the risks they've taken on. Unfortunately, WRC's Bray has seen companies that have not been able to succeed.

"I know of one company that had to close its doors," he said. "But there is a very strong reason as to why this is a hot topic. The reinsurance market has changed. Reinsurers are starting to realize that, 'Hey, some companies are small enough that I cannot get enough premium volume from them, so I can't continue to reinsure them.' For small companies it is an extremely difficult [market]."

Because of the market's difficulty, relationship building between primary insurers and reinsurers or reinsurance brokers becomes important. This is especially true for smaller companies. **Farmers Union Mutual Insurance Company** has not had a problem with its reinsurance availability, even though the company has been hit hard with losses in the last few years. **Wayne White**, the company's president, credits availability not being a problem to the relationship Farmers Union has built with its reinsurer over time.

Farmers Union has worked with **Gen Re** for its reinsurance needs for years, and White does not plan to shop around their reinsurance package. "We understand that this is a relationship," White said. "When you go out shopping to find someone cheaper, that reinsurer doesn't have the opportunity to earn money back. So they're not going to look at you as a long-term-relationship-type customer. They're going to price you high because they know they're going to have to make their money back in the short term."

White also says his company heeds the advice Gen Re gives. One thing he took into consideration was increasing the company's rates, advice he believes many smaller insurers are hearing from their reinsurers.

"I think most small companies tend to underinsure and don't charge enough," he said. "They do that because they've been doing it for a hundred years. They will tell you 'it's worked for a hundred years, so I don't need to change it.'

"But I can tell you from personal experience that it does make a difference," White continued. "You better be doing what the reinsurers are suggesting you do."

As the reinsurance market continues to change and the weather patterns continue to upset the American landscape, keeping up a relationship with companies that help pay the bills increasingly looks to not only be a good idea but a necessary one as well.

## Reinsurance and the Role of the Board

**Steve Chevalier,** CEO of **NLC Insurance Companies**, might spend one-fifth of his time as CEO contemplating reinsurance issues, and he might think others are spending the same amount of time on theirs, but there are some companies that only contemplate reinsurance when renewal time comes around – or when an event causes a need for them to fall back on their policies.

For those company leaders, reinsurance can be a confusing aspect of their business. That confusion is compounded when it comes to boards of directors. But boards need to have an understanding of reinsurance – they do make strategic decisions about it.

**Rob Martin,** reinsurance underwriter for **Farmers Mutual Hail Insurance Company of Iowa**, will sit in on the board meetings of the companies for which FMH writes reinsurance directly and take time to explain some of the more important aspects of reinsurance.

"I think reinsurance gets confusing sometimes and I understand it [reinsurance]," he admitted. "So when you're asking someone on a board who doesn't know a lot about reinsurance to make a major decision, it becomes difficult."

Martin would like to see more directors attend workshops to learn about reinsurance. But he also understands there are extenuating circumstances. "It's not their primary job," he said. "Then you're asking them to take more time off [from their other obligations]. It's hard to get that commitment," even if it might lead to a better understanding.

LEADERSHIP FORUM May 21-23, 2013
*Connecting the Small Company Leaders of Today and Tomorrow*

More frequent and severe storms and the ever-increasing prices of property and farming are causing farm mutual insurers to rely more heavily on reinsurance. So when the Leadership Forum's planning committee was brainstorming topics for the upcoming event, reinsurance kept coming up.

In a three-part concurrent session **Larry Bray**, vice president of client support for **Wisconsin Reinsurance Corporation**, will lead a discussion about insurer-reinsurer relationships, types of reinsurance plans, and more.

The event begins May 21, so there is still plenty of time to register. Visit NAMIC.org for more information on the event or to sign up to join fellow NAMIC members in Madison, Wisconsin.