

Jarzabkowski, P., Bednarek, G., Burke, G. & Cabantous, L. (2012). Beyond Borders: Charting the Changing Global Reinsurance Landscape. Cass Business School, City University London.



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Original citation: Jarzabkowski, P., Bednarek, G., Burke, G. & Cabantous, L. (2012). Beyond Borders: Charting the Changing Global Reinsurance Landscape. Cass Business School, City University London.

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**Beyond borders:
Charting the changing global reinsurance landscape**



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Foreword: The Insurance Intellectual Capital Initiative

The Insurance Intellectual Capital Initiative (IICI) is a consortium of insurance industry organizations. It stimulates and funds research into areas of interest to the broader insurance sector, providing industry with an opportunity to invest in and build closer links with the academic community. The IICI works closely with government research councils to ensure that its projects meet industry needs, attract the right academic partners, and benefit from the research councils' commitment to co-sponsor research with private sector institutions. Supporters of this IICI project are Amlin, Aon Benfield, Asia Capital Re, the Economic and Social Research Council, Hiscox, Liberty Syndicate Mgt, the Lloyd's Tercentenary Foundation, the Society of Lloyd's, Validus and the Worshipful Company of Insurers.

This report presents the full results from a two-phase study commissioned by the IICI, looking at the London, Bermuda, Continental European and Asia Pacific reinsurance markets from the perspective of cedents, reinsurers and brokers. An interim report from Phase 1 was released at Monte Carlo in 2010.

The project, undertaken by Professor Paula Jarzabkowski of Aston Business School and her research team, has been a productive collaboration between industry and academia in first raising a broad research question, and then working together regularly to shape the conduct of the research. The result is a unique study of international distinction for both the level of industry participation and the quality of the data set. The research team particularly thanks these members of the IICI Steering group: Bronek Masojada (Chief Executive, Hiscox Ltd; Chairman of the IICI and Chairman of Lloyd's Tercentenary Foundation); Adrian Clark (Member of the UK Executive, Aon Benfield); James Illingworth (Chief Risk Officer, Amlin plc); Bill Rendall (consultant and trustee, Lloyd's Tercentenary Foundation).

© September 2012

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ISBN Number: 978-1-85449-770-3

Scope and scale of the study

The data for this global study of the non-life reinsurance sector is unique. It is based on ethnographic observation of reinsurance trading, broking, client meetings and conferences, as well as in-depth interviewing of key participants in the reinsurance industry over three annual cycles from 2009-2012. The data set comprises 837 ethnographic observations and 446 interviews, collected in 22 reinsurance and broking firms and 36 insurance firms across 17 countries and 61 offices in all non-life lines of business. We thank the industry for the generosity and transparency that has made the analysis in this report possible.

Executive summary

This report is the result of a three-year study of the global reinsurance industry, covering the main stakeholders of cedents, reinsurers, and brokers. It examines the implications of profound change arising from shifts in regulation, consolidation in the key players, and increasing competition both within the reinsurance industry and from alternative capital providers. These changes are driving convergence in a market that was, until recently, characterised by significant cultural variation in buying and selling reinsurance. The findings in this report will help industry participants to take stock of their current position in the industry, the specific types of differentiation available, and how these differentiators can create advantage. Specifically, the report provides evidence-based frameworks and models that firms can use to diagnose their existing strategies and structures and consider alternatives.

The report has six sections. Section 1 is a call to arms about the current state of the industry. Section 2 differentiates between five main types of cedents according to their need for capital, the products that they purchase and the extent to which they centralise reinsurance buying. It shows that consolidation of cedents into a number of key global players has generated a trend towards centralised and global reinsurance purchasing. This has two key implications. First, centralised retention typically reduces the amount cedents spend on their reinsurance, contributing to a reported stasis in the global premium ceded to the reinsurance industry. Second, global purchasing is shifting towards large, multi-territory programmes that are not closely connected to the primary insurance industry, which lowers the overall transparency of reinsurance products. These two changes are eroding traditional beliefs about long-term relationships and continuity of cover, in favour of more opportunistic and cost-effective business relationships.

Section 3 examines reinsurers. Consolidation has created larger reinsurers that compete for market share, even as new 'start-up' subsidiaries are also heightening competitive pressures. While competition is becoming fiercer, as the pool of reinsurance premium remains relatively static and reinsurers seek new sources of revenue, reinsurers are not yet competing head-to-head. Rather, this section differentiates between five strategic types of reinsurer that compete from different technical bases, with different strategic appetites and perceptions of profitability. We explain the implications of these five

strategic types for a firm's strategy, structure, and underwriting processes. Our findings show that structural tensions abound as reinsurers expand internationally, increasing the cost and complexity of their underwriting processes and altering the focus of underwriting judgement. The section also outlines potential growth trajectories for different strategic types, as some strategic positions become more crowded.

Section 4 examines the fit between different reinsurer and cedent types. It shows that some natural sources of fit within cedent-reinsurer relationships are eroding. Specifically, the shift in premium away from local to regional and global programmes generates misalignment for many reinsurers. These reinsurers need to adapt in order to create better fit in the new global landscape of centralised reinsurance buying.

Section 5 examines intermediation. Brokers have illustrated their ability to add value by increasing penetration within a competitive market. This is partially due to the rapid consolidation of brokers into three main firms that have the critical mass and international reach to offer global services to their global clients. In this section we explain how brokers add value to both cedents and reinsurers. To expand their role, brokers need to generate differentiated value-propositions for cedent types and match these with different reinsurers' appetites. They should continue to focus on the traditional distribution channel and placement services on which they receive brokerage, although these services may no longer yield the highest rents. Therefore, they need to consider how to extract value beyond brokerage for other services that they provide, particularly to key global cedents and their reinsurers. Generating alternative forms of remuneration, such as fee-for-service, is critical for the future of broking.

Section 6 concludes with a cautionary note about some of the trends explained within this report. Specifically, while bundling risk into aggregated multi-territory covers is efficient, it also increases the complexity and global connectivity of reinsurance markets and obscures professional judgement. Such dynamics have a poor history in other financial sectors. The reinsurance industry has avoided the seduction of complex models thus far, retaining underwriter judgement alongside increasingly technical evaluation of risk. We urge industry participants to be cautious in embracing complexity and global connectivity, which predisposes an increasing reliance on financial models, and to retain its focus on judgement.

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1. Globalization, convergence and competition: A call to arms

The global reinsurance industry is in a period of profound change that is challenging many taken-for-granted beliefs about buying and selling reinsurance. Critically, these changes are accompanied by stasis in the amount of reinsurance premium available globally, a series of relatively flat market cycles and growing competition from alternative sources of capital. This report is a call to arms, exhorting cedents, reinsurers and brokers to re-evaluate their trading practices and more clearly define their sources of competitive advantage.

There are three main factors driving convergence and increasing competition in the reinsurance market. First, there are regulatory requirements for global equivalence in capital management, leading to greater standardization in approaches to capital reserving and capital efficiency in both primary insurers and reinsurers.

Second, the growth of vendor property catastrophe models has led to greater standardization in the evaluation of reinsurance risks in information-rich territories such as the USA and much of the UK and Western Europe. This has had spill-over effects in increasing technicality and search for better information in other classes of business and territories. Cedents, reinsurers and brokers thus need to have greater technical capacity and to take a more analytic approach to all classes of business, breaking down some prior sources of variation.

Third, there has been consolidation in cedents, reinsurers and brokers. While small and medium-sized players remain, a few key players who increasingly

transact business on a global scale dominate the market. In particular, consolidation in the primary insurance industry is changing patterns of reinsurance buying. Specifically, global and large regional cedents are centralising their reinsurance purchasing, with shifts in premium from local programmes to bundled global programmes and an increase in central retention. Such changes reduce their proportion of reinsurance spend.

These drivers of convergence have entered a market that was, until recently, characterised by significant cultural variation in the buying and selling of reinsurance. While some variation remains, it is important to take stock of the specific types of differentiation available and how these differentiators can create advantage. At the same time, it is important to question dominant assumptions about opportunism and prevailing myths about long-term business relationships, and traditional concepts of payback. As globalisation, convergence and competition increase, behaviours previously derided as opportunistic are being recast as sensible business efficiency.

It is thus critical for different market participants to re-evaluate their practices in order to remain aligned with this dynamic global landscape. However, there are few evidence-based frameworks available to inform them about the scope of global change or its potential implications for their business. The aim of this report is to outline the key implications of change for insurers, reinsurers and brokers and provide a set of practical tools that will support them in positioning their business in the changing competitive landscape.

2. Who are the buyers and what do they want?

While primary insurance markets vary according to their cultural, historical, economic, and political origins, reinsurance buying can be clustered according to five types, based on the nature of the parent company. Generally, there is a trend across these types towards centralised and global reinsurance purchasing. This has two key implications for the reinsurance industry. First, centralised retention typically reduces the overall proportion of reinsurance spend by cedents, so contributing to the reported stasis in global premium ceded to the reinsurance industry. Second, global purchasing changes the reinsurance products from local covers to multi-territory programmes that are not closely connected to the primary insurance industry being covered, lowering the overall transparency of reinsurance products.

Key points: Reinsurer buyers

- There are five cedent types that differ in their reinsurance buying strategies according to their capitalisation, need for coordination, and product bundling
- There is a general trend for larger cedents to centralise reinsurance buying decisions, centralise retention, and bundle risk into multi-territory products, which reduces their proportion of reinsurance spend
- Traditional beliefs about personal relationships and continuity of cover are eroding in favour of cost-effective business relationships
- These changes are increasing opportunism in buying reinsurance
- In a more opportunistic marketplace, cedents can enhance their attractiveness to reinsurers by managing their information quality and programme transparency, within the context of their market maturity

2.1 Differentiating cedents and their needs

This section introduces different cedent types, explains differences in their reinsurance buying strategies, and outlines the implications of these for both cedents and reinsurers.

2.1.1 Five strategic buyer types

While primary insurance markets vary, reinsurance buying patterns can be clustered into five types according to parent company characteristics: Global, Regional, Local, Emerging Market and Specialty Lines buyers. Each type exemplifies particular strategies of reinsurance buying according to their different needs. As shown in the Cedent Positioning Cube (Figure 2.1) cedents differ on three related dimensions that emphasize different priorities in the purpose, products and organization of reinsurance buying: (1) degree of capitalisation; (2) bundling of the products purchased; and (3) need for coordination of buying. Taken together, these three dimensions also indicate potential trajectories for reinsurance buying as firms grow and mature.

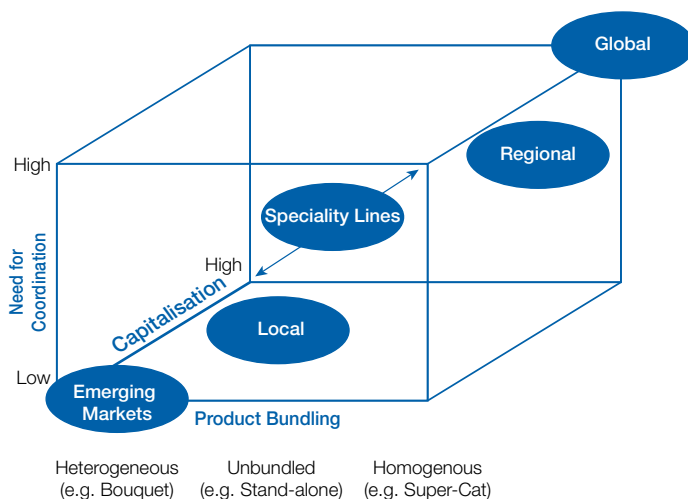


Figure 2.1 Cedent Positioning Cube

2. Who are the buyers and what do they want? (cont.)

Capitalisation: The purpose of reinsurance is to support risk transfer from the cedent to the reinsurer through the provision of capital. Hence, the level of capitalisation in cedents influences their reinsurance needs. Well-capitalised insurers, particularly those with high capital efficiency arising from well-diversified portfolios, do not need reinsurance to grow or to alleviate overall volatility of the risk portfolio. Rather, they require it to cover peak risk. By contrast, less well-capitalised players require reinsurance as a source of affordable capital, enabling them to grow. In particular, transferring risk via reinsurance reduces the amount of capital they need to hold in order to stay afloat or realise their ambitions for growth. Hence, by proxy, buying reinsurance is an affordable way of freeing up or accessing more capital. Reinsurance thus needs to compete as a cost effective source of capital with both other forms of access to capital and also with a firm's own capitalisation.

While larger, more diversified insurers are typically more capitalised than smaller, or emerging market buyers, some features of ownership structure, such as public ownership or mutual ownership, also affect the need for capital. For example, mutuals are more dependent on reinsurance as a source of capital because they do not have the same access to capital as listed companies.

Product bundling: The extent to which reinsurance products are bundled and the form that bundling takes are a feature of a cedent's size, complexity and capitalisation. At one end, small insurance firms bundle different lines into a single product: Such as a bouquet of motor, property, fire and engineering risks. Even where lines are presented separately there may be an expectation that they will be written on a whole account basis, with the reinsurer required to take an equal share across all lines and layers. This is known as heterogeneous bundling because the ceded programme contains multiple different, or heterogeneous, risks. The reason for heterogeneous bundling is that the cedent has some small programmes that would not be viable as stand-alone programmes, or are not attractive on their own, but may be traded in a bundle with other risks. Thus, heterogeneous bundling is an efficient method of risk transfer, which remains popular with small domestic and emerging-market insurance firms. While it is complex for reinsurers to evaluate precisely the different risks being transferred, the amount of premium required is typically relatively small, and the product is often purchased on a quota share basis.

As insurance firms become larger and more mature, they tend to 'un-bundle' their products. That is, as

they develop sufficiently large programmes, they trade these on a stand-alone, line-by-line basis. Such programmes are typically single territory, or combine a few similar territories, for the cover of a single type of risk, such as a third party motor liability product, or a Cat cover. The products are generally simpler and more transparent than bundled products.

At the other extreme, large insurance companies with accumulations of a particular type of risk, favour bundling this into a multiple territory programme. For example, all Cat risk from property, marine, etc., is pulled together across territories into a single bundled programme, such as a Pan-European, or USA nationwide cover, or an even wider cover, such as the regional and global aggregates and so-called Super-Cat products purchased by large multinational insurers. This is known as homogenous bundling because the programme contains a single type of risk. These risks are typically placed on an excess of loss basis and are popular with large cedents because they enable capital and resource efficiency in purchasing cover and support the transfer of peak risk. However, homogeneously bundled risk is complex to evaluate. For example, such programmes may combine mature and less developed markets, each of which has variable information quality about the precise nature of the risk in that territory. Similarly, the capital efficiency assumptions that underlie the bundling of different territories may not be clear.

Need for coordination: The need for coordination is a function of the cedent's size and scope. For example, those diversified multinational insurance companies that are 'household names' around the world need to formally coordinate their reinsurance buying across its local operating companies (LOCs). Coordination of reinsurance buying enables capital efficiency through diversification, avoids duplication as a firm expands by acquisition, and ensures that a group has oversight of, and is adequately hedged for, risk taken in local operating companies (LOCs). High levels of formal coordination are particularly necessary for bundling homogenous risks across multiple LOCs, such as aggregated catastrophe covers. Smaller companies, and companies with fewer product lines and territories to cover, have fewer opportunities for capital efficiency and less need for formal coordination of reinsurance buying. Rather, reinsurance buying may be more easily overseen by a small number of key people who are close to the original business for which reinsurance is sought. Generally, the greater a firm's need for coordination, the higher the tendency to centralise reinsurance buying decisions, centralise retention, and bundle homogenous products.

2. Who are the buyers and what do they want? (cont.)

2.1.2 Variation in cedent types

As displayed in the Cedent Positioning Cube, there are five main types of reinsurance buyers that vary according to their capitalisation, need for coordination, and type of product bundling: Emerging Market, Local, Regional, Global and Specialty Lines Buyers.

Emerging Market Buyers are not necessarily small. However, they typically have lower need for formal coordination because: i) they are less likely to have a highly diversified or complex portfolio of risks, as many products are not in demand in the primary market; ii) they tend to operate in a single territory or small number of similar territories. Most Emerging Market Buyers require reinsurance for access to capital and to alleviate the volatility of their portfolio as a whole, because they operate on relatively small margins and reserves. Commensurate with their need for capital, they tend to favour quota share products and heterogeneous product bundling, such as bouquets and whole account cover.

"We prefer proportional; we think it's safer. It's been a natural progression starting with quota share and a quota share surplus. It feeds confidence in being able to write the business and yet still having the protection of a proportional treaty."

(Emerging Market Buyer)

Local Buyers are cedents that retain strong domestic market affiliation and usually purchase local covers as stand-alone programmes. They have relatively low need for formal, centralised coordination. While they may develop multiple lines of business, their size and scope enables reinsurance buying to remain within a relatively small span of central oversight and control. As they develop sufficient size and/or maturity, they unbundle bouquet products, developing stand-alone products, such as separate motor, property and other programmes. Because of their size, Local Buyers tend not to have high capital efficiency and reinsurance remains a necessary source of capital to support risk transfer and firm viability.

Regional Buyers are cedents that have extended beyond their domestic market to include surrounding regions, leading them to buy regional rather than predominantly local risk covers. While these may be cedents operating across multiple countries within a region, such as Europe, in large countries with diverse exposure to perils, such as the USA, a nationwide company should also be considered a Regional Buyer because it covers multiple territories and perils that diversify exposure. Regional Buyers have more complex divisional structures that necessitate coordination of reinsurance buying. They also have the scale to sustain a central reinsurance buying

department and, with increasing diversification, greater capital efficiency and, potentially, capitalisation to retain a greater share of their risk. However, need for capital may vary according to whether reinsurance is seen as a cost effective form of capital enabling growth into new territories. As Regional Buyers grow, their individual lines of business generate sufficient volume to be bundled across different territories. Therefore, there is a shift from stand-alone lines to homogenous products, such as Pan-European covers or, for regions such as the USA, multi-peril nationwide covers.

Global Buyers are at the peak of all three dimensions of the Cedent Positioning Cube. They have high need for coordination because of the diverse territories and lines of business covered and their complex multi-divisional structure. They thus benefit from centralised reinsurance buying. As they have high capital efficiency arising from diversification, as well as the size and scope to retain a significant amount of their risk, access to capital is not a key driver of reinsurance buying. Rather, reinsurance is seen as a means of securing cover for peak risk. As part of their trend for capital efficiency and central coordination, Global Buyers tend to bundle homogenous risks across territories, developing regional or global catastrophe and per-risk programmes.

"We don't buy proportional; they're fundamentally capital support. We don't need capital support; we have huge access to the capital markets. Any time we want money we just put up a hand."

(Global Buyer)

Specialty Lines Buyers are those cedents that are only in specialty areas, such as credit and surety, agriculture, marine or aviation. While they are often part of a multi-line insurer, they are separated for reinsurance purchasing to accommodate their requirement for specialised underwriting expertise. They have been partially separated in our analysis because they have some different purposes and needs from other cedents. Depending on their size, market maturity and parental structure, they may differ along the three dimensions. Hence, they are not a true 'type' but may reflect characteristics of one of the other types. Nonetheless, they typically have relatively low coordination needs compared to Regional or Global Buyers, buy stand-alone programmes, and tend to purchase products such as quota share (QS) that are typically associated with access to capital.

As shown by the arrows in Figure 2.1, these types also represent a trajectory for reinsurance buying as firms grow and mature. For example, as Emerging Market Buyers mature they may become Local Buyers, while growth may turn them into Regional or Global Buyers.

2. Who are the buyers and what do they want? (cont.)

Currently, the most evident trend on this trajectory is the shift towards Regional and Global Buyers, arising from a combination of acquisition and organic growth.

2.1.3 Reinsurance buying purpose and products

While any specific firm will vary a little from the types illustrated in the Cedent Positioning Cube, a cedent that is 'true' to type will cluster around some buying strategies as opposed to others. For example, a cedent seeking reinsurance as a primary source of capital is likely to also purchase proportional products. These clusters are illustrated in the Cedent Purpose and Product Chart (Figure 2.2), which shows that Global and Emerging Market Buyers cluster at opposite ends of the spectrum in terms of their reinsurance buying purposes and products.

Key implications of buyer types

- Consolidation is generating a trend towards large, complex Global Buyers
- The larger and more complex a cedent is, the more centralised its reinsurance buying and the more that it tends towards homogenous bundled products
- Homogeneously bundled products are complex because they are not connected to any specific local market and the assumptions about the different primary markets on which they are based may not be transparent
- As large diversified cedents are better able to retain their risk, reinsurance increasingly needs to compete as a cost-effective source of capital with a Global Buyer's own capitalisation

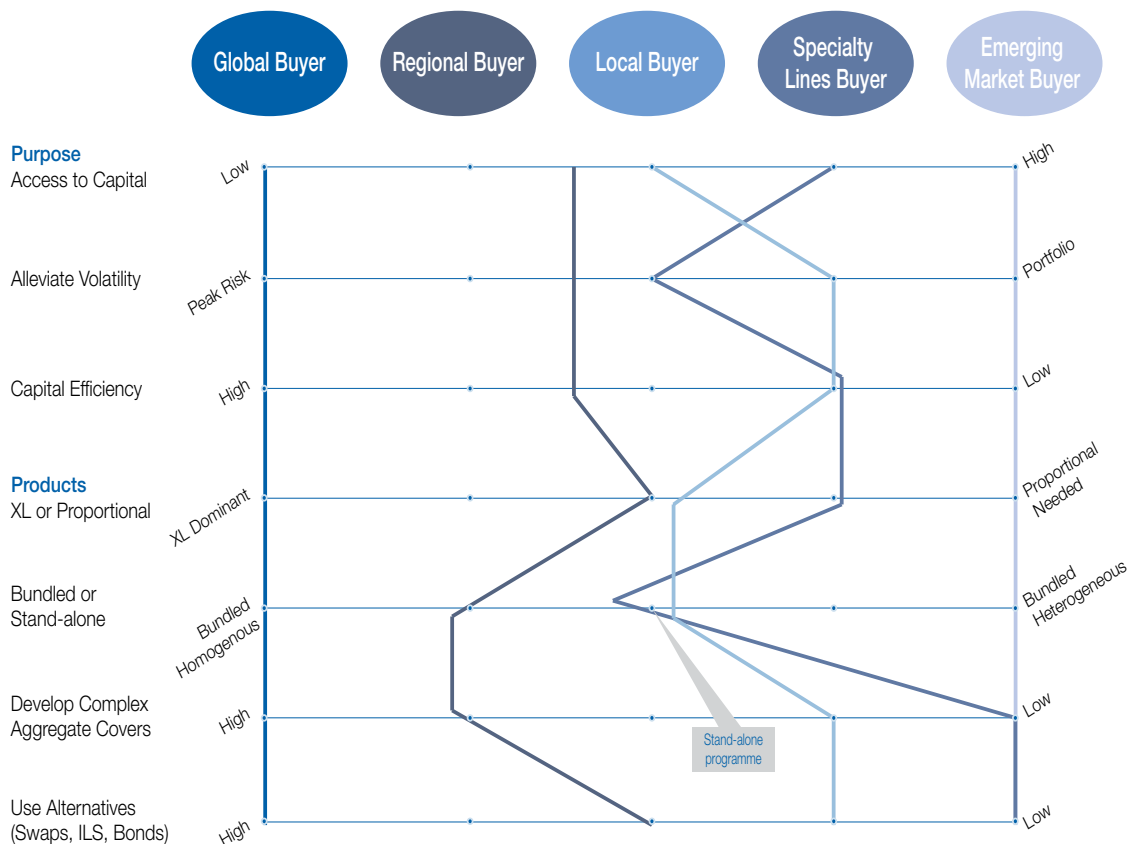


Figure 2.2 Cedent Purpose and Product Chart: Who is Buying What?

2. Who are the buyers and what do they want? (cont.)

Purpose indicates the degree to which reinsurance buying is driven by access to capital and/or the need to alleviate volatility of risk. The distinction between peak risk and portfolio risk also differentiates Global and Regional Buyers who can retain a reasonable level of portfolio volatility from Local and Emerging Market Buyers who lack the capitalization and capital efficiency to do so. While Local and Emerging Market Buyers tend towards the right-hand side of the diagram, the extent to which they are reliant on reinsurance to trade is also a useful indicator of their overall viability.

"They start as risk traders; they don't carry a lot of risk. Their retentions are very low. They are putting less of their own money on the risk. That's why I call them risk traders rather than risk carriers. They take risks with the understanding that those risks are poor, but because they are highly reinsured they don't care".

(Reinsurer)

Products refers to the predominance of non-proportional - typically excess of loss (XL) - and proportional - typically quota share (QS) - products favoured by cedent types, and is associated with access to capital. While Emerging Market Buyers typically buy QS in order to access capital on a partnering basis, their ability to grow their business and transition to XL, at least on some lines, is an indication of internal underwriting discipline and growing maturity. Local Buyers and, to a lesser extent, Regional Buyers, tend towards QS, particularly if they are mutual Regional Buyers, particularly where they are mutual insurance companies that are restricted in their ability to raise capital by other means. Specialty Lines Buyers are a separate case, as they are predominantly a QS market.

'Bundled' refers to three main patterns discussed in Figure 2.1, homogenous (e.g. Super Cat), stand-alone, and heterogeneous (e.g. bouquet) products. In particular, consistent with the trend to Global and Regional Buyers, there is a growing class of products that arises from centralised buyers bundling homogenous products, particularly catastrophe exposure, into large and complex regional or global covers. These products are one of the fundamental changes arising from consolidation in the primary insurance industry.

'Alternatives' refer to a range of primarily collateralised market products, such as swaps, Cat bonds, and Insurance Linked Securities (ILS), which are currently seen as a supplement to, but not a substitute for, reinsurance. While they are not usually particular enough to Specialty Line Buyers' needs and are beyond the requirements of most Emerging Market and Local Buyers, they are attractive to those needing

capacity, such as Global and, to a lesser extent, Regional Buyers. They represent a growing class of products that provide viable cover. In particular, the amount of Cat capacity required to meet the demands of bundled homogenous products increases the comparison with and potential substitution from collateralised market products. They thus represent a threat to the amount of premium placed through reinsurance programmes.

2.1.4 Coordinating reinsurance buying

As the Reinsurance Procurement Chart (Figure 2.3 overleaf) shows, the way that reinsurance buying is coordinated affects the level of retention, the quality of information and the level of decision-making. As Specialty Lines Buyers reflect the buying patterns of various types, they are not considered separately in these results. This section explains some of the choices available to cedents in deciding how to coordinate their reinsurance buying.

Centralisation: Due to their need for coordination, Global and Regional Buyers typically have a very centralised approach to buying reinsurance through a central reinsurance division. These reinsurance divisions vary

"Fragmented buying is just inefficient; they're spending a lot more than if they did it smarter".

(Global Buyer)

in type and may include one or more of the following structures: A captive; a reinsurance profit and loss division; or a service centre. Such divisions are often larger than many of the reinsurers with which they trade. Centralised buying involves assuming risk from the local operating companies (LOCs), retaining some proportion at the centre, and ceding the remainder to the reinsurance market, which can vary in the following ways: (i) transfer some of the risk to the open market in bundled homogenous programmes, so transforming the original local risk covers into a multi-territory group risk cover; and/or (ii) take a share of all the local programmes centrally and cede the remainder of each to the reinsurance market within each local territory; and/or (iii) leave some covers as stand-alone local programmes where there are pricing benefits, or where it is required by local regulators.

Retention: Organizing reinsurance buying is not simply a matter of coordination but also of maximising the capital efficiency gained from group diversification. This is done by centralising decisions about the level of retention. Global and Regional Buyers make central decisions about retention, even where LOCs are able to purchase their own cover. Local and Emerging Market Buyers generally have local retentions, both by virtue of their local scope, and their primary concerns

2. Who are the buyers and what do they want? (cont.)

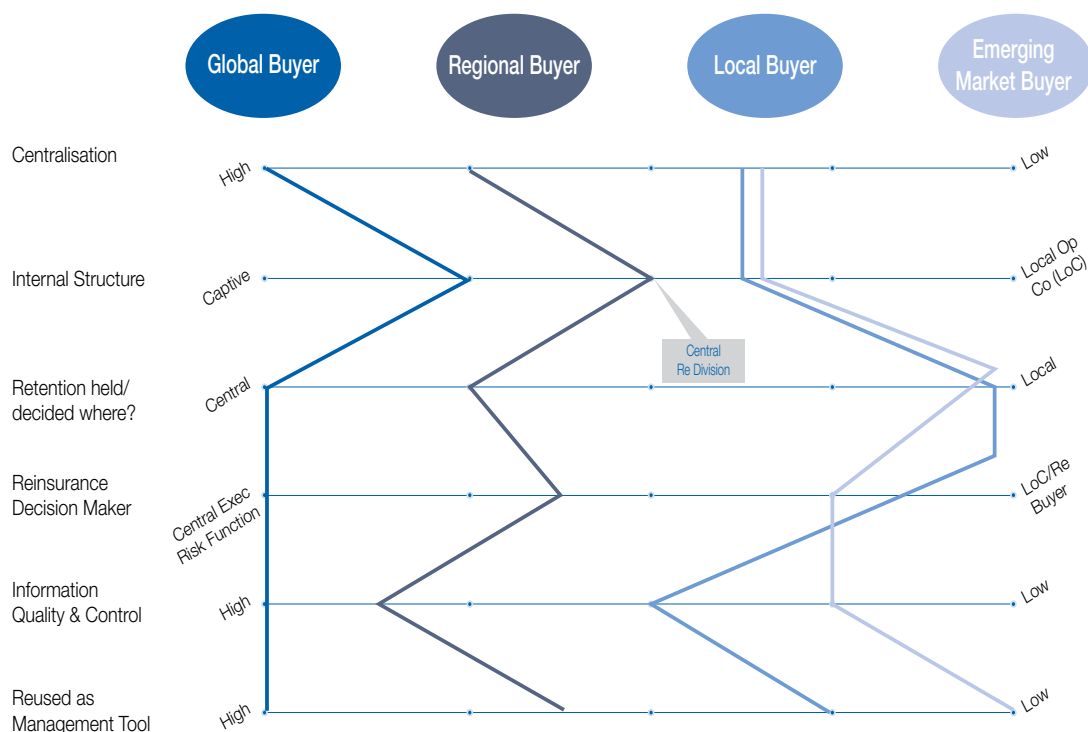


Figure 2.3 Reinsurance Procurement Chart

with risk transfer, rather than capital efficiency. Centralised buying typically raises the amount of risk retained and reduces the premium ceded to the reinsurance industry.

Information: Generally, the more centralised the buying, such as in Global and Regional Buyers, the better the quality of information underpinning the reinsurance programme. This is because the internal reinsurance division has to assume a proportion of the risk from the LOCs and so has both access to data and a vested interest in the quality of information being received. Hence, while the bundled homogenous covers that these cedents purchase are complex, they should also be built on sound information, which may mitigate some of their problems with transparency and lack of connection to the underlying primary risk. Local Buyers often have good information about their own programmes by virtue of their closeness to the underlying business, even where they are not in information-rich territories. Emerging Market Buyers typically lack the data capture systems for collecting primary insurance data and developing it into robust reinsurance information, particularly where the underlying market is subject to

"They went from buying proportional to non-prop and stopped ceding treaties from local operating entities. A lot of meat from the bone was gone for us; we lost 50% of our premium just due to this".

(Reinsurer on cedent's shift to central retention)

rapid change. Quality of information can thus be a key differentiator in selecting these buyers.

Decision-making authority: Generally, reinsurance buying is shifting from individual decision-making to committee decision-making, which is also shifting the nature of reinsurance relationships from personal to business-to-business relationships. All reinsurance buyers are required to justify their purchasing decisions, both in terms of cost effectiveness and extent of risk cover. In Global and Regional Buyers, this decision is usually made as part of a group risk or senior executive committee. Hence, the reinsurance buyer is a key person in the decision chain but is rarely the sole decision maker. By contrast, the reinsurance manager in a Local Buyer will often have significant decision-making authority. For Emerging Market Buyers the cost of reinsurance is a key constraint on the buyer's decision-making authority, as reinsurance rates must reflect the profitability of the underlying primary insurance market, even where this is difficult to balance with the need for risk transfer. Hence, the perception that the lowest price is the best price in emerging markets.

2. Who are the buyers and what do they want? (cont.)

Key implications of centralised reinsurance buying

- There is a trend to centralised buying to increase efficiency of purchasing
- Centralised buying lifts the level of retention, as cedents make more effective use of their diversification for capital efficiency
- Commensurate with this shift, there is also a trend to purchasing more complex multi-territory products
- Centralised buying is usually a group rather than an individual decision, so emphasising the shift from personal to business relationships in the reinsurance industry

2.2 Busting myths: What do cedents really want?

These changes in reinsurance buying dispel some myths about relationships and continuity on which the reinsurance industry has been built. Specifically, consolidation in the primary insurance industry is leading to a more pragmatic approach to reinsurance relationships, which is sometimes termed opportunistic. Hence, while opportunistic behaviour has previously been considered an industry ‘taboo’,

large cedents that cede high-volume premium are increasingly opportunistic in their reinsurance buying in all but their most core partnerships.

2.2.1 Cedent requirements from reinsurers

The Reinsurer Service Segmentation Chart (Figure 2.4) shows what cedents require from their reinsurers. Those items at the bottom right of the figure – such as claims history – are prerequisites, required by all cedents. The other items – such as training and ratings – are differentiators, meaning that cedent types have different requirements that allow reinsurers to develop competencies and tailor their offering to those cedents. These differentiators should, however, be taken with some caution; they are price dependent and must meet the terms of a consensus market. Hence, in the current world of ample capacity and fierce competition to provide capital from within and outside the reinsurance industry, price is also a critical differentiator.

“Price is one of the most important things for me. Because I think it could be cheaper. I have to explain to my clients, my business unit why they have to pay so much money for a reinsurance contract.”

(Cedent)

While all reinsurers need to provide the prerequisite factors, they simply enable them to be in the game. For example, paying reinsurance claims is critical and neither a high security rating nor superior technical

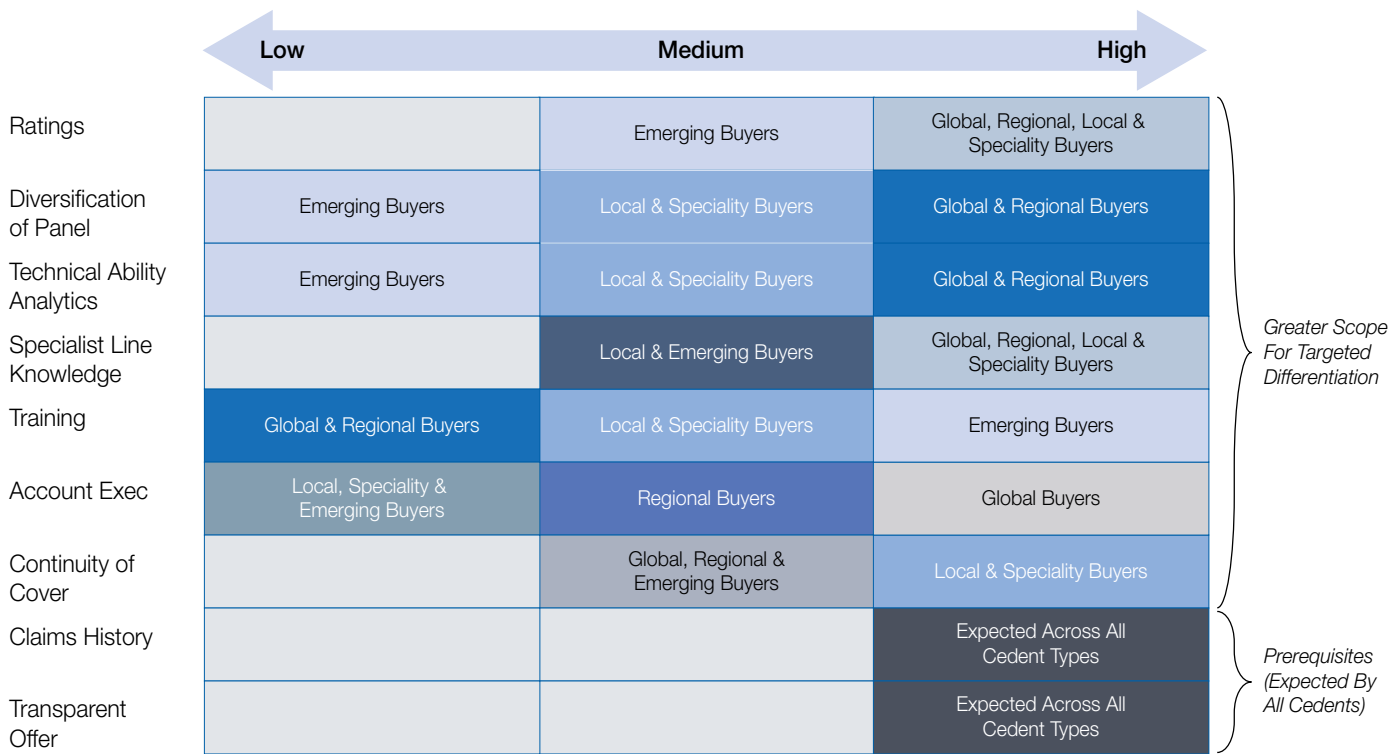


Figure 2.4 Reinsurer Service Segmentation Chart: What do Cedents Need?
(Low to high is the strength of the cedent's need for a particular item from their reinsurers)

2. Who are the buyers and what do they want? (cont.)

ability will compensate for a poor claims history. Yet paying claims will not accelerate a reinsurer to the top of the list beyond other factors because it is expected that reinsurance will provide cover for claims as a base condition. Another critical prerequisite is transparency of offer. While reinsurers often say that continuity of cover is critical 'for the relationship', for many cedents, particularly those placing big programmes with high capacity needs, continuity is less important than transparency from their reinsurers; they want to know early if the reinsurer intends to withdraw or reduce support and why. They are then very pragmatic about the business needs of their reinsurers, such as needing higher prices than the cedent is willing to pay. Indeed, almost all cedents are willing to work with even overtly opportunistic reinsurers for capacity purposes, providing that is a clear part of their offering, and all cedents dislike reinsurers who change their message or withdraw cover unexpectedly.

Differentiators fall into a few broad categories to do with security, service and capacity. For example, security is critical as a minimum A-rating level is required within the governance code of most cedents. However security requirements for some Emerging Market Buyers are below an A-rating, meaning that the top-rated reinsurers may not even see them. While additional layers of security, such as the extra 'guarantees' provided by Lloyd's, provide some additional benefit this is not a critical differentiator for Global Buyers. Rather, they conduct their own internal security ratings, including issues such as ratios of risk transfer to capitalisation, calculating the amount of risk they are willing to transfer to a reinsurer as a percentage of that reinsurer's capitalisation. Furthermore, while diversified risk transfer has been considered important, this is primarily for capacity rather than for security reasons. For example, Global Buyers first place much of their cover with 3-5 main reinsurers, and then spread the rest across the market for capacity rather than diversification reasons, while other buyers diversify primarily to ensure that they are not overly dependent on one reinsurer, rather than to ensure capital from diverse sources.

Services, such as training, technical ability, specialist line knowledge and account executives are variable requirements, depending on the cedent's needs. Global Buyers, for example, require reinsurers with the technical ability to understand their complex programmes but are not typically dependent on reinsurers for technical support with structuring reinsurance programmes, other than in a few exceptional cases of new product development with core partners. By contrast, while Emerging Market

Buyers are more dependent on their reinsurers to provide technical support, they typically have less information and are in less analysable regions, so that technical ability in a reinsurer is not a key differentiator; standard technical ability will be sufficient to work with these buyers. Emerging Market Buyers also appreciate services such as training that are not needed by Regional and Global Buyers. Finally, while cedents enjoy having an account executive appointed specifically to their programmes, it is not a differentiator on its own but must occur in conjunction with other factors. It is primarily beneficial to larger buyers, where the complexity of programmes warrants a dedicated point of contact from a supplier. Given that services come at a cost to reinsurers, it is important that they are targeted to areas where they can provide opportunities for differentiation and also a return on investment.

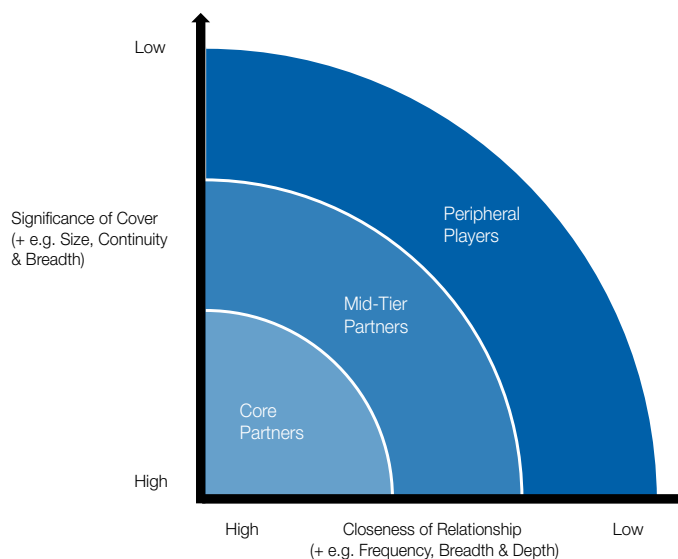


Figure 2.5 Partner Prioritisation Chart: Core vs. Periphery

Two other factors that reinsurers often claim as differentiators are relationships and continuity of cover. While these are important to cedents, as shown in the Partner Prioritisation Chart (Figure 2.5), their expectations are in proportion with the importance that they accord to the partnership, differentiating between core and mid-tier partners and peripheral players. For example, the *depth* (how close the knowledge of each other), *breadth* (multiple points of contact in the respective firms), and *frequency* (number of contacts each year) of the relationship are determined by segmentation; cedents want to see more of their most important reinsurers and are satisfied with maintenance activities from others. Relationship building activities, such as conferences, site visits and road-shows, are thus important for reinsurers in

2. Who are the buyers and what do they want? (cont.)

order to access and understand business (see Report 1⁽¹⁾). However, these necessary activities are rarely differentiators, particularly for big cedents, except with their core partners.

Similarly, issues such as the size (amount of capital), continuity (renewal of programmes) and breadth (across multiple programmes) of cover may be subsumed within significance of cover. Provision of significant capital to a cedent is a differentiator, under which issues such as continuity of cover also become important. Simply, no cedent wants to lose a significant amount of capital from a core partner because this is more difficult to replace. There is, thus, a genuine desire to retain continuity of cover with core partners, although this is price sensitive. As cedents become more centralised in their reinsurance buying they are more prone to 'opportunistic' purchase, as decisions must be justified with a risk or reinsurance committee on the basis of a cost-effective business relationship. While cost-effective does not mean lowest price, only marginal increases in price can be allocated to long-term relationships. Bigger lines or better signings for core partners is a way of providing value to those business relationships, as are private placements. Yet cedents, particularly large buyers, are also pragmatic about losing continuity of cover and accepting 'opportunism' by reinsurers. Indeed, while both buyers and sellers have historically seen opportunism as a negative behaviour, this view is losing validity in the reinsurance industry. Rather, sound and transparent business decisions on both sides are welcome, so that withdrawal by either party on the basis of changing price expectations and risk appetites is signalled in a timely fashion prior to renewals.

"You see very quickly who are really the long-term players and who are the opportunistic ones. You know that with some players if you have the biggest loss in history, they will still look for the cheapest price after because they are very opportunistic. So you have to be very opportunistic with them or not work with them at all, otherwise there is no fit."

(Reinsurer)

Key implications for relationships and opportunism

- Traditional beliefs about reinsurance as a relationship and continuity business are eroding with all but core partners
- Cedent expectations of reinsurers are increasingly based on cost-effective business relationships with core providers
- These changes are leading to a more opportunistic environment for reinsurance buying

2.2.2 Ensuring attractiveness to sellers

As relationships become more focused on cost-effectiveness, it is critical that cedents ensure that their business model is attractive to reinsurers. This will enable them to get the best rates in soft cycles and to access capacity in hard cycles. The Cedent Attractiveness Cube (Figure 2.6) illustrates three interrelated indicators, on which cedents may assess and enhance their attractiveness: Programme transparency, information quality and market maturity. Any cedent can improve attractiveness on the first two indicators and also mitigate the effects of low market maturity. These indicators are now explained and illustrated with some scenarios of how they may be combined by different buyer types.

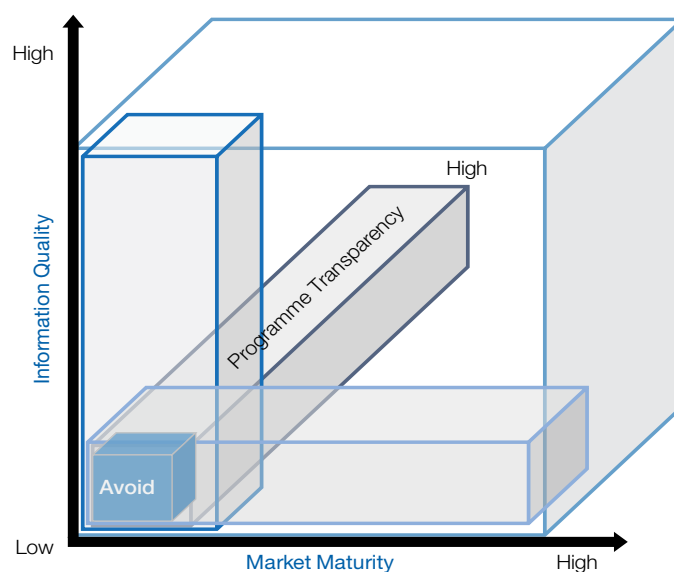


Figure 2.6 Cedent Attractiveness Cube

Programme transparency comprises two elements: Year-on-year consistency and technical transparency. Year-on-year consistency is important because reinsurers dislike 'smokescreen' structural changes that complicate comparisons, particularly after an event, as they generate an impression that there is something to hide. The more comparable programmes remain across years, the more easily reinsurers can evaluate changes in the portfolio and ask sensible questions to understand and provide adequate risk cover. Technical transparency is equally important to facilitate analysis. Programmes that fail to define inclusions and exclusions, conflate multiple perils within layers, or have complex wrap-around structures obscure the risk being reinsured and complicate underwriter analysis. The less transparent a programme is, the more broking and negotiation time it takes to place. This will make it less efficient for the

(1) see Report 1 for findings on reinsurer relationship-building (Jarzabkowski et al. 2010. 'Trading Risks: The value of relationships, models and face-to-face interaction in a global reinsurance market.' Executive Report: Insurance Intellectual Capital Initiative).

2. Who are the buyers and what do they want? (cont.)

broker to place, decrease the chances that reinsurers will understand it, and so reduce the potential panel of quality reinsurers.

Programme transparency is particularly important with bundled products that are, by nature, complex. The technical transparency of heterogeneous programmes can be improved by supplementing this with market data, as they typically reflect the underlying conditions of a specific primary insurance market. By contrast, bundled homogenous programmes are not closely linked to the various primary insurance markets that they cover and so may contain unintended surprises for reinsurers. Their technical transparency can be improved by high quality information that clearly shows the assumptions about capital efficiency and exposure made by the cedent in developing the programme. Lack of transparency comes at a cost because technical reinsurers are likely to load the rate-on-line with an ‘uncertainty factor’ to compensate for a lack of analysability.

"We like to think there's lots of technical pricing going on, but you generally have a lack of data; a lack of transparency in the risk you're actually taking."

(Reinsurer)

Information quality is a key dimension of risk appraisal. It is measured by accuracy, granularity, and verifiability (see Report 1⁽²⁾). High quality information accurately specifies the value of insured assets; for example, a particular cluster of properties in a designated area. Granularity reflects the level of detail with which insured values are covered, for instance, whether property values are aggregated by district or postcode, helping to improve the accuracy of estimates about a potential loss. Verifiability measures the extent to which cedent-provided data can be cross-checked against information from independent sources, such as vendor models, ratings agencies, or subscription databases such as Perils®. High quality information is also presented in a standardized, easily analysable form, which supports programme transparency.

The quality of publically verifiable information and the levels of granularity available may not be fully within a cedent's control, particularly where cedents are in less information-rich territories. For example, the granularity of data within vendor models drops steeply outside the USA and a select number of mature Western markets. However, other measures

"If the level of information is really insufficient and we don't feel comfortable, then we don't write. I would personally rather write a programme where I think it's too cheap but I have good access to information, than the other way around."

(Reinsurer)

can be taken to improve information quality. For example, information about the cedent's governance, portfolio, and underwriting practices can be provided and verified by allowing reinsurers to audit books during on-site visits. Additionally, quantitative data can be gathered to improve systems and data quality each year. Such data can be incorporated into submission documents and supplemented by brokers who may have additional market data to support cedent-specific material. Cedents can also demonstrate strong commitment to information quality by: i) ensuring that consistent information is available during every meeting with reinsurers (e.g. conference meetings should be supported by information on what a cedent writes with that reinsurer and how it has performed for the reinsurer in previous years); ii) clarifying and explaining at submission, if the information provided is different from the information given at a conference or site visit; and iii) being transparent about gaps in information. While these sound like common sense, they are often missing from cedents' programmes.

Market maturity is strongly correlated with the other indicators, because more mature markets have greater levels of public information available, including year-on-year market data, better systems for accessing data and greater stability in the market for conducting comparisons or analysing the probability of loss. All of this increases the accuracy, granularity and verifiability of information in mature markets. Higher quality information can be converted into more transparent programmes. However, this does not automatically mean that more mature markets are more attractive to sellers. Attractiveness depends on how cedents combine the three indicators to be the most attractive or 'best-in-class' of their type. Below, we suggest three scenarios, relating to different levels of market maturity, as examples of how buyers may increase their attractiveness by improving their performance on the other two indicators.

Combining indicators to increase attractiveness

1. Many mature markets, such as those in Western Europe, are saturated with little potential for growth, and thin margins for reinsurers. This is particularly risky for Local Buyers, as their programmes are relatively small, offering negligible premium for many reinsurers and modest RoE, particularly during a hard cycle. Quite simply, these programmes do not look like they provide enough margins to offset potential losses. Hence, buyers in these markets need to ensure that their comparatively

(2) Jarzabkowski et al. 2010, 'Trading Risks The value of relationships, models and face-to-face interaction in a global reinsurance market.' Executive Report: Insurance Intellectual Capital Initiative.

2. Who are the buyers and what do they want? (cont.)

low rates are attractive to reinsurers. They do this by providing high quality information to show the discipline of their underwriting and ability to contain losses that would erode the thin margins available on their programmes. Such information should underpin programme transparency, making it possible for reinsurers to better evaluate the rate of return against the level of risk.

- Global and Regional Buyers are often combining mature markets with less developed markets and multiple perils within a bundled multi-territory product. While it is efficient for cedents to incorporate business from more and less analysable markets within a single product, these products lack transparency to reinsurers; as illustrated by the Thai floods in 2011, reinsurers do not want to find that covers contain surprises of which they were unaware. Additionally, the capital efficiency assumptions that underlie the bundling of different territories may not be clear to the reinsurer. They do not want to take the cedents' diversification model on faith, but rather, on transparency of information. This is particularly important as many reinsurers allocate capacity by territory and so need to know what their risk accumulation is for any particular territory, in order to understand how a global risk cover affects their own capital efficiency and diversification. Hence, it is critical that bundled multi-territory and multi-peril products: i) are transparent in identifying the different markets within them; ii) provide ample information about the types of potential risk contained within each market; iii) show clearly how information has been gathered within those markets; and iv) show how capital efficiency and risk diversification assumptions underpin the combining of different territories and perils. This will add to programme transparency by giving confidence that the quality of information underpinning the programme is consistent across all markets.

"I see a series of the same things from clients; pushing in remote earthquake covers. For some of these treaties we need to get rape and pillage prices. We need to push for significant improvements and be prepared to walk away. Multi-territory covers expose us to multiple perils. We can't know every little exposure the client has."

(Reinsurer)

as well as access to modelled data. By comparison, the information they receive from Emerging Market Buyers seems sparse and may give the impression that the cedent is hiding something. Providing reinsurers with as much comparative data as possible can counteract deficiencies in public information. For example, giving as much year-on-year data as possible, explaining gaps in data and steps taken to address these, providing explanations for projected growth, and explaining any changes that compensate for problems with past performance will heighten confidence in the particular cedent. At the same time, cooperating to provide wider market data will enable reinsurers to perform market comparisons. Quality of information and programme transparency can enable an Emerging Market Buyer to stand out from its peers as a 'market pick' for risk transfer. Additionally, by sharing data, a buyer can benefit from reinsurer knowledge and training and develop a closer partnership for product development, which may enable them to outperform their peers in the primary market.

"We tell them 'this is a very necessary piece of information for us and if we don't get the quality that we need, then we would have to reflect that in the pricing.' Whereas somebody who gives us the full transparency, you just take it."

(Reinsurer)

In conclusion, no cedent is innately attractive to the reinsurer pool, as different reinsurer types have different strategic appetites and different perceptions about acceptable rates of return. Furthermore, reinsurers are hesitant about and/or charge more for products that they do not understand. Improving attractiveness is within the control of all cedents and will ensure their appeal to the widest set of high quality reinsurers.

Implications for improving cedent attractiveness

- Cedent attractiveness to reinsurers arises from a combination of programme transparency, information quality and market maturity
- Improving attractiveness enables a cedent to get the best rates from the best reinsurers, regardless of the market cycle
- Attractiveness of the underlying programme becomes more important as traditional notions of relationship and business continuity erode and are replaced by cost-effective business relationships

2. Who are the buyers and what do they want? (cont.)

2.3 Conclusion: Implications of changing buyer behaviour

Our study has noted a number of trends that are important in charting the changing landscape of the global reinsurance industry. Taken together these trends in buyer behaviour provide both valuable templates, but also the following four caveats that should temper the shift to large-scale homogenised products:

First, centralised buying increases efficiency at the cost of reinsurer diversification. While large programmes may require much of the global capacity available, so having a large panel of reinsurers, they are also complex to write and lack transparency for most reinsurers. Hence, significant lines are placed with only a handful of key reinsurers followed by a high volume of smaller reinsurers. This calls into question the diversification of the reinsurance panel, as some 60% or more of global programmes may be placed with the top 5 reinsurers, leaving relatively small shares among the remaining 40-60 smaller reinsurers. There is thus, a trade-off between core partnerships with those reinsurers who are significant capital providers and capital lock-in, as significant capital providers may be hard to replace.

Second, bundling is complex, increases global connectivity of markets, and may contain unintended 'surprise exposures'. Most reinsurers lack the capability to adequately analyse and understand such risks. While these reinsurers may write lines in softening market cycles, they will be cautious of unexpected losses and will focus more on understandable business, particularly in hard market cycles where they can drive the terms. Hence, it is imperative that cedents work on improving the attractiveness of their programmes for reinsurance providers.

Third, cedents may be unsure of the performance of bundled products when they face multiple unexpected events in different regions. Hence, the tendency to

bundling should be tempered with some caution about the desired level of complexity for both cedents and reinsurers. A series of smaller regional bundles, may, for example, be more attractive than a few larger bundles for many cedents.

Fourth, while homogenous, multi-territory product bundling is largely a consolidated player phenomenon, it provides a possible template for larger Emerging Market Buyers as they develop suitable information to support these covers. For example, multi-territory, multi-peril exposures are also relevant for large buyers in China and India, and these may rapidly develop covers similar to those purchased by USA nationwide insurers. Similarly, Pan-European risk covers may provide a model for other regional aggregation of risk cover. It will be critical to underpin such programmes with high quality information about exposures in, as yet, relatively unknown regions.

Summary of key trends in reinsurance buying

- There is a trend to centralised buying as cedents grow and consolidate
- Centralisation is associated with a trend to bundled homogenous products
- Bundled homogenous products remove reinsurance premium from local programmes into global programmes
- The premium available from local programmes is declining as corporate parents assume a significant percentage of risk from their LOCs and Local Buyers are eroded through consolidation
- Shifting premium into global programmes typically reduces the overall amount of premium ceded to the reinsurance market

3. Strategic types: Bases of competition for reinsurers

Competition is becoming increasingly fierce for reinsurers. The pool of reinsurance premium available globally remains relatively static, while reinsurers seek new sources of revenue. Even as the number of larger reinsurers has increased through consolidation (each with larger market share targets), an increasing number of start-up subsidiaries are also increasing the competitive pressures. However, our findings show that reinsurers are not all competing from the same position, or for the same types of reinsurance products. Rather, reinsurers can be differentiated according to their strategic positions into five distinct strategic types, operating on different strategic appetites and perceptions of profitability. This section shows the implications of these strategic types for a reinsurance firm's strategy, structure and underwriting process. It also outlines potential growth trajectories and areas of increasing competition as certain strategic spaces become increasingly crowded.

Key points: Strategic types

- There are 5 reinsurer strategic types with different strategic propositions based on their varying preferences for relationship longevity, whole accounts, and technical analysability
- While there is increasing competition across the market, a reinsurer's strategic type has implications for its strategic appetite and primary strategic focus on either cycle management or portfolio management

- Structural tensions arise as reinsurers grow and expand globally, which impinges upon underwriter empowerment and judgement
- Different strategic types have different underwriting processes that have varying degrees of trade-off between efficiency, speed and client servicing
- As reinsurers increasingly write global programmes, they need to adjust their approach to underwriting and to exposure management, which may alter their structures and processes

3.1 Strategic types and their different strategic positions

While the reinsurance industry traditionally has been segmented according to cultural stereotypes about Bermudian, Lloyd's and Continental European reinsurance firms, these geographic sources of variation are too crude to adequately reflect the state of global competition. Rather, our research has uncovered five strategic types that compete on the basis of distinct business propositions. Although market proximity may afford locational advantages in accessing business, these strategic types are not restricted to any particular geographical region.

3.1.1 Strategic types

Five main types and an additional strategic play are plotted in the Reinsurer Strategic Positioning Tool

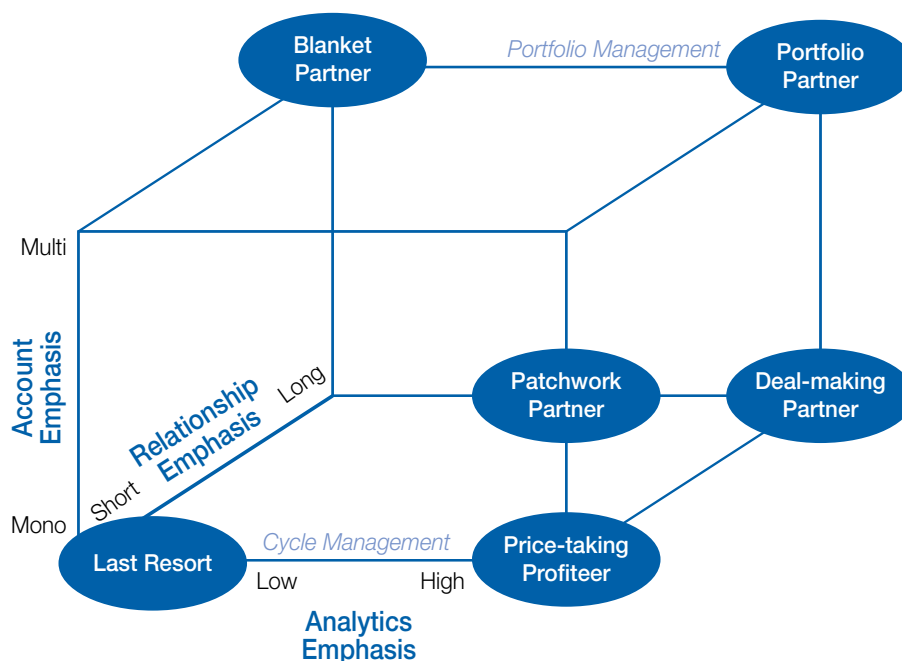


Figure 3.1 Reinsurer Strategic Positioning Tool

3. Strategic types: Bases of competition for reinsurers (cont.)

(Figure 3.1), according to the emphasis each places on three key dimensions of selecting business to underwrite: (1) relationship longevity; (2) mono-line or multi-line approaches to accounts; and (3) analysability of the business. Reinsurance firms' varying prioritization of these dimensions in decision-making indicates their different perspectives on profitability and different strategic propositions.

Price-Taking Profiteers are mono-line reinsurers whose strategic proposition is to provide capacity where it is needed, typically to support US catastrophe programmes. This type privileges the following in selecting business: i) deal profitability; ii) a transactional approach, where they are not willing to leverage low return deals for better ones; for example, writing a QS to get on an XL; and iii) technical and highly analysable business, such as US Cat, which has a high RoE. The Price-Taking Profiteer typically springs up in a hard cycle to capture value at times when the market needs capacity, such as after a major event. It is, thus, very focused on short-term profitability. However, this approach, which requires strict adherence to cycle management, cannot be sustained in softer cycles unless the profiteer is protected by the capital structure of a corporate parent, which enables them to increase and decrease capital with the market cycle. Otherwise, Price-Taking Profiteers are under pressure during soft cycles to either return capital to their investors or morph into an alternative strategic type, which may be done intentionally as part of a strategy for growth and diversification, or may arise out of strategic drift from their hard line on profitability.

Deal-Making Partners are mono-line reinsurers with significant capital whose strategic proposition is to develop deals for cedents looking for tailored capital solutions, typically on catastrophe programmes. This strategic type privileges the following in selecting business: (i) programmes where large capacity is needed; (ii) discrete deals with good returns, where they can put down big lines and write close to the risk; (iii) business relationships where there is potential for lock-in because of the high capital investment required to meet the capacity need

"We don't write business we don't think is profitable. We don't look at it as a loss leader. We just say: 'Look, this is what we do for a living. You can show us your XLs and we'll write them or not. Here's the price, here's the capacity'; and it's more or less 'take it or leave it'."

(Reinsurer)

"We work very hard at trying to craft the deal as opposed to just being a 5% yes or no on some Cat deal. A lot of what we do is bespoke; it's not open market. We try to build extraordinarily strong relationships with the clients."

(Reinsurer)

of a cedent; (iv) very technical and highly analysable business with a high RoE, such as big US catastrophe programmes or those requiring tailored solutions and private deals. While this type provides capital they are more than simply a capacity provider due to the significance of the deals they write, which can include taking an entire programme or layer for cedents with a particular need. They are, thus, relationship focused, within the parameters of their focus on superior returns. While there are few Deal-Making Partners, they take a disproportionate amount of the global premium available due to their business model and the capital they can provide.

Patchwork Partners are one of two 'traditional types' within the reinsurance industry. They are structured as line underwriters, even where they write multiple classes of business. Their strategic proposition is to be flexible in assembling a portfolio of typically smaller lines and deals. This type privileges the following in selecting business: (i) evaluating each line on its own merits, rather than leveraging the multiple lines written across a particular cedent; (ii) continuity of relationships, but with a tendency to scale up or down their commitment according to deal profitability in any given year, for example by moving to remote layers and watching lines; (iii) moderate technicality in conjunction with other factors, such as knowing the market or cedent when deals fall below the technical price; (iv) flexibility in moving along different dimensions in the matrix. The Patchwork Partner has a medium-term profitability horizon, offsetting lower-returning deals with more favourable ones within their overall patchwork approach to assembling a business portfolio. This type has considerable flexibility to pursue opportunities, within a clearly defined strategy of when to privilege different dimensions of our matrix. However, there is also a tendency to become 'stuck-in-the-middle', if Patchwork Partners drift into writing expiring lines over a succession of soft market cycles. This segment is highly competitive, comprising many small and medium-sized reinsurers, as well as encroachment from other types when they attempt small-scale diversification.

"Maximising your exposure to a risk when it's well paid and minimising your exposure in its slightly less well paid periods. But all the time, you're trying to hold that relationship and keep it strong."

(Reinsurer)

Portfolio Partners have a strategic proposition of generating capital efficiency and stable long-term returns through diversification. They thus take portfolio diversification seriously by writing multi-territory (scale), multi-line (scope), and short and long tail business

3. Strategic types: Bases of competition for reinsurers (cont.)

(length). This type privileges the following in selecting business: (i) a 'whole account' approach to the business written with a cedent, either through whole account metrics, or by considering the whole relationship over individual deals; (ii) continuity in business relationships; (iii) strongly technical approaches to evaluating the account as a whole over multiple years, not just the most analysable or technically-priced lines and regions in any given year; (iv) leveraging across the cedent portfolio to gain preferential terms or access to better business. They aim to be more than a capacity provider, even where they may provide significant capital, and so encourage lock-in with cedents through the breadth of cover and services they can offer. Portfolio Partners typically write a wide variety of business at varying rates of return and varying volatility. Their challenge is to make commercial sense of such variety, which cannot easily be compared across a portfolio. Despite their technical strengths, capital efficiency through diversification is, thus, often an article of faith. Much of the globally available premium is placed with these players, because of their involvement in most of the main programmes as well as their spread across most lines of business and their extension into most territories. They thus face competition from all of the other types, and lose market share whenever they waver on their proposition of continuity and reliability, for example scaling back a particular line of business or territory.

"The value proposition is reliability and the relationship. We were able to get preferential terms, due to the value the customer puts into the relationship; and our technical expertise, that we understand what they are doing."

(Reinsurer)

The **Blanket Partner** is the other 'traditional type' in the industry, growing out of writing local business during a less technical era. Blanket Partners also take portfolio diversification seriously by writing multi-territory, multi-line, and short and long tail business. Their strategic proposition is to develop deep, long-term relationships with the best clients in any particular market, write across those clients' portfolios and ride the fortunes of the market with them. This type privileges the following in selecting business: (i) whole account and 'bouquet' programmes, where they write an even share across all layers and lines of business; (ii) continuity in business relationships; (iii) underwriter knowledge of the cedent and market, rather than technical analysis, in order to have the 'market pick' of the best cedents

"The market knowledge and the client knowledge come first and the modelling is second; we do not have to understand each and every detail... It's also multi-year, it's a partnership with the client without any end."

(Reinsurer)

with which to diversify. Blanket Partners are less focused on deal or client RoE in any given year, than on stable long-term profitability through diversification across lines and markets. They are particularly well suited to local partnerships, less technical business, such as bouquets, and less analysable territories. However, much of their traditional local business is eroding due to consolidation.

Last Resort is not a business model in itself. Rather, it is a strategic proposition to capture value on short-term, opportunistic business that has a high price due to shortage of capacity in a given year. Immediately following catastrophic events, much of the industry will pull back in the short-term to evaluate losses, creating a short-term need. Similarly, some cedents after a big loss may need additional, high-priced cover that does not fit the strategic propositions of the other segments of the market. These gaps are opportunities for players with sufficient capital to make rapid short-term moves. The emphasis is not on the analysability of the business (immediately post-catastrophe this might be impossible) but on exploiting rate rises through short-term relationships based on a capacity shortfall. Some Deal-Making Partners are able to exploit this position, because of their significant capital, while other firms may have one underwriter or team with ring-fenced capital that can be deployed purely for such potential opportunities.

"It's short-term. It'll be heavily over-priced, but there's no continuity in it. You know if they hit us, they take the money."

(Reinsurer)

3.1.2 Strategic Emphasis: Myths about Portfolio or Cycle Management

There are two strategic 'pillars' in reinsurance: Portfolio management and cycle management. A reinsurer's strategic-type has implications for its primary strategic focus on either cycle management or portfolio management. While any reinsurer will incorporate elements of both strategies there will be an ultimate prioritization of one over the other.

Those prioritizing long-term relationships across a cedent's account, such as Blanket and Portfolio Partners, will prioritize *portfolio management*. These reinsurers take portfolio diversification seriously, in terms of scope across all lines of business, breadth across multiple territories, and length in writing both short and long tail business. The aim is (i) efficient capital allocation; and (ii) to ride the cyclical fortunes of different markets and stabilize returns. While different deals have different levels of profitability, smaller deals with lower RoE justify the overheads of accessing and

3. Strategic types: Bases of competition for reinsurers (cont.)

writing them because all deals are needed to create the diversified portfolio. However, there always remains a tension between target RoE and actual profitability in different parts of the portfolio. Furthermore, managers in such companies need to be aware that they may be making 65-75% of their income from a smaller book of key players, followed by a high volume of small players for the remaining 25-35%. We describe this as the 'volume vs. value myth', in which a large number of clients (volume) can obscure the reality that the majority of value is coming from a small number of players.

By contrast, reinsurers operating on a more transactional short-term basis, on largely mono-line catastrophe business, will prioritize *cycle management*. As market cycles are globally connected there is an overall cycle management effect of expansion in harder markets and contraction in softer ones. However, each territory may also experience specific, localised hardening or softening, which can be the source of local expansion and contraction. A reinsurer committed to cycle management needs clear metrics and underwriting processes that enable identification of hardening and softening in different markets and the ability to withdraw or escalate rapidly. To be a true cycle manager, reinsurers will need strong parent or investor backing to scale back capacity in a soft cycle and accelerate in a hard cycle, which is difficult in a stand-alone, investor-exposed business. That is, in a soft cycle, cycle managers need to decide what to do with excess capacity that cannot achieve their targeted profitability. We label this the 'withholding capital' myth, as such capital could be returned to investors: But in reality this is hard to do and usually

results in writing business at lower rates of return.

3.1.3 Growth trajectories of strategic types

Reinsurers can use the Strategic Positioning Tool to diagnose their type and evaluate the consistency of their strategic proposition. However, there is no 'best' type, as each is based on different perceptions of profitability, has a different risk appetite, and competes on a different value proposition. Thus, as firms evolve they may re-evaluate their strategic type, which does not need to be static. Rather, reinsurers can also use the Strategic Positioning Tool to evaluate potential growth trajectories. We outline a few typical trajectories below:

Price-Taking Profiteer: A Price-Taking Profiteer set up in a hard market will at some point encounter a soft market. Without a capital structure that allows aggressive cycle management, they often evolve into Patchwork Partners; for example, renewing expiring lines at a lower rate in order to maintain an existing relationship. This decision can either be strategic ('we will accept a lower ROE on business that is less volatile') or merely reactionary. A second viable option is to retain a focus on highly analysable catastrophe business and attempt to shift into being Deal-Making Partners with a few select clients that have larger capacity needs that suit their technical approach to business. This second option may be particularly attractive to those Price-Taking Profiteers who have reached a critical mass in terms of capacity.

Deal-Making Partners:

Deal-Making Partners may come under pressure from ratings agencies to diversify. One option is to evolve into other lines as a Patchwork Partner, maintaining a focus on catastrophe capacity based on its Deal-Making legacy, but offering additional lines of business on a selective basis. Alternatively, they could also evolve into a Portfolio Partner (develop their relationships into other lines and leverage their technical infrastructure to provide a full service. However, this strategic move towards a 'whole account' approach is often a step too far for Deal-Making Partners. Another option is to set-up a subsidiary, operating separately as a 'start-up' in a different reinsurance segment. This is potentially a good way to 'experiment' with excess capacity in soft markets or respond to pressure for diversification.

"This start-up has been established to write the business they don't get at HQ. We are not a Cat writer; our parent has a portfolio like that, mainly Cat."

(Start-up subsidiary)

Contrasting views on strategic priorities

"We need to be mindful of the margin as well, but when you have an across-the-board approach at least you have a more robust portfolio. If you have a loss you have more diversity because you are working with a client who has diverse exposures."

(Portfolio Partner)

"The rating agencies drive us towards diversification. But some of the fields we move into may actually bring our loss ratios up. That's when diversification becomes just 'worsification'."

(Price-Taking Profiteer)

3. Strategic types: Bases of competition for reinsurers (cont.)

Patchwork Partners: The flexibility of this segment means that many Patchwork Partners can maintain their position in the ‘centre’ within minor shifts along different dimensions to adjust for market cycles. However, this approach also has an optimum size. If a Patchwork Partner grows to the extent where it provides significant capacity and also writes multiple lines for a cedent, it will face pressure to become more of a whole account or relationship provider. Similarly, investors are likely to expect some bold strategy to increase returns on their investment, which may curtail the ability to ‘pick-and-choose’ as Patchwork Partners attain critical mass. They may thus choose to grow towards the Portfolio Partner approach with select clients, or to build more significant catastrophe lines with other clients, in a bid to become Deal-Making Partners.

“We have to step a little bit away from this pick and choose strategy. At a certain size you cannot afford to have this attitude anymore; this is a transition phase I think we are facing now.”

(Patchwork partner)

Blanket Partners: As one of the original strategic types, many traditional Blanket Partners have evolved into Portfolio Partners with the growth of technology and modelling. We see this as the main trajectory for Blanket Partners to capitalise on their knowledge of clients and markets.

Portfolio Partners: Portfolio Partners experience the greatest ‘lock-in’ of any strategic type. It is hard to step away from an ingrained approach to whole account relationships, as cedents are sensitive to any ‘wavering’ on the part of their key account providers, while competitors hover, ready to move into any openings made by a breakdown in these relationships. Thus, the sunk costs in technical and market infrastructure, distribution channels, and relationships tend to establish a level of strategic inertia with existing business. Nonetheless, such players may be able to operate differently through different offices (for example, some of their offices in emerging markets may operate as Blanket Partners). Similarly, because of their depth of resources and infrastructure, such players are well positioned to experiment with new product development.

3.1.4 From dance floor to musical chairs: The state of global competition

After several years of soft cycles and static global premium, the reinsurance industry is in a very competitive phase, with ample capacity rapidly absorbing the potential increases from quite major events. In such a market, reinsurers begin to question the viability of their business model. They search for alternatives, primarily by going after market share in mature markets, or exploring the potential for growth in new territories. Consolidation has been an

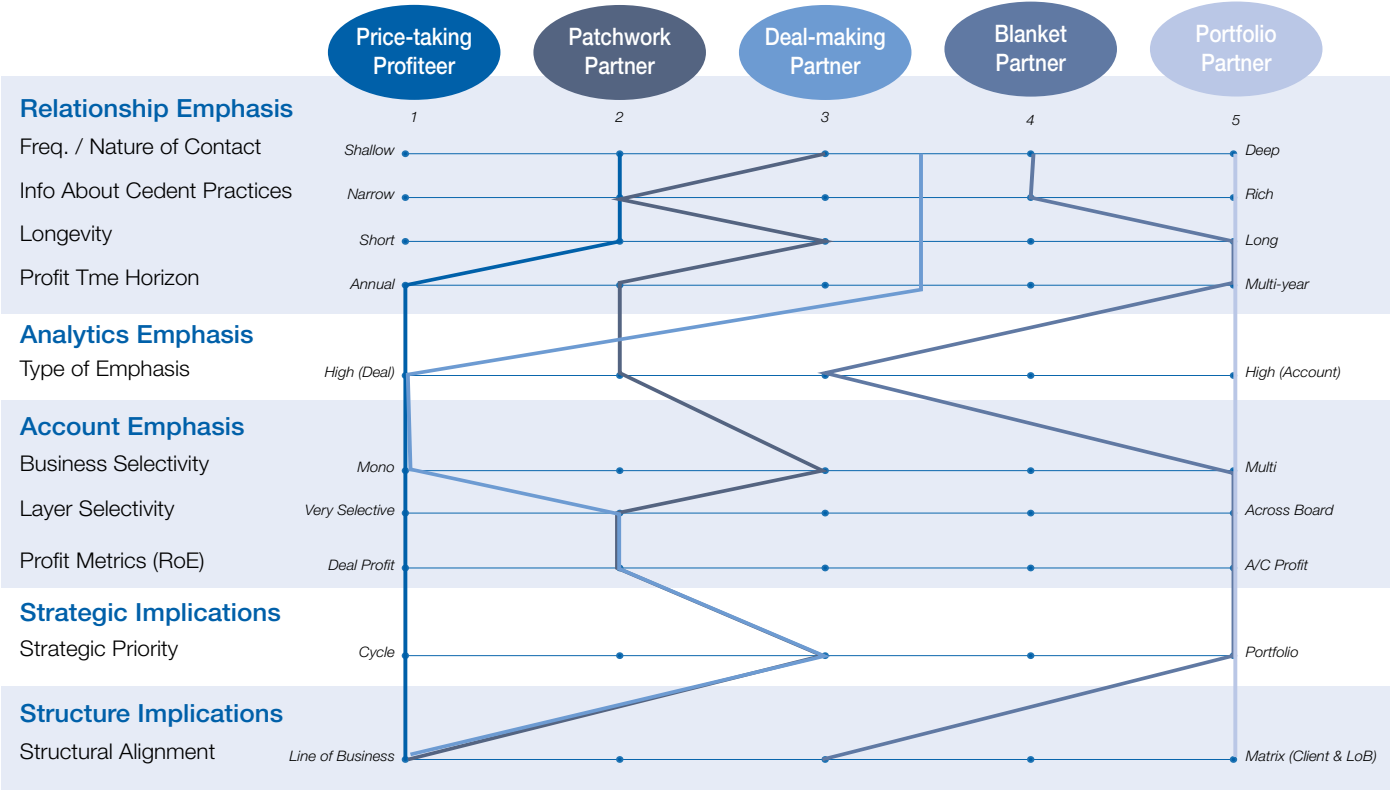


Figure 3.2 Reinsurer Strategic Orientation Chart

3. Strategic types: Bases of competition for reinsurers (cont.)

observable trajectory, where reinsurers use merger and acquisition to access additional revenue. Such acquisitions can either focus on critical mass through mergers between similar types, or accessing different types of business through the acquired firm's distinct business model.

Another, defining trajectory of the current environment is the 'start-up' subsidiary as a way of exploring alternative types of business. Reinsurers set up offices or separate companies to operate in an alternative way in other markets; for example, to explore whether Asia, particularly China, will yield gold, or to find out whether money can be made from diversifying into alternative lines of business. In doing so, they must adopt the strategic positions and methods of selecting business of other segments. For example, Patchwork Partners, Profiteers and Deal-Making Partners have set up European start-ups to operate as small Portfolio Partners and access new business not available to the parent company. To do this they need the mandate to operate in a whole-account fashion, a business model radically distinct from that of their parent. Others attempt to penetrate Asia, where the lack of analysability in many markets is a source of confusion. Here, subsidiaries need to be confident operating as Blanket Partners, even where this counters the technical, short-term RoE focus of their parent. The result is confusion and shake out, as some reinsurers learn new skills, others refocus on the core business, and yet others get burnt and exit the industry. While the beauty of differentiated strategic types was that reinsurers could all dance their own steps without bumping into each other, the dance floor is now more crowded. Increasingly, reinsurance is a game of musical chairs, in which some parties will have to exit each time the music stops.

"But you can't mix the two business models. It doesn't work! You destroy either model if you try to mix them. It can't be one unit: It has to be two units, but it works extremely well if you look at diversification, capital efficiency, things like that. So it works extremely well in the one company, but not as one unit."

(Reinsurer)

3.1.5 Consistency or strategic chameleon: Conscious strategic positioning

This section outlined five strategic types that have different strategic propositions, different appetites for business, and different perceptions of profitability, as summarised in the Reinsurer Strategic Orientation Chart (Figure 3.2). We end with a word of caution: Reinsurers need to be clear about their strategic position. Despite potential growth trajectories,

consistency remains important. For example, a Portfolio Partner acting in ways contrary to the expectations associated with its type may meet with both internal resistance and external concern from cedents. The Reinsurer Strategic Positioning Tool enables reinsurers to assess their consistency with a particular strategic type. While deviations can be made for strategic reasons, these require the firm to be a strategic chameleon, able to shift types through clear switching rules. For example, a switching rule might be to act as a different type in a particular region or with particular clients. Such strategic clarity makes all the difference in being a strategic chameleon rather than being strategically confused and sending mixed messages internally and to the market.

Key implications of strategic types

- There is no one best way
- It is important for reinsurers to be consistent with their strategic type, in order to avoid sending mixed messages about their strategic appetite
- Moving between strategic types may be part of a growth trajectory as reinsurers seek new business opportunities
- Shifting between types should be accompanied by clear switching rules based on a strategic proposition of accessing different types of business

3.2 Structure and process: Implications for each strategic type

In order to be consistent with their strategic type, reinsurers need to align their strategies to their firm structures and underwriting processes. This section exposes tensions and trade-offs as reinsurers incorporate varying degrees of complexity into their structures and processes as they grow and expand internationally. In particular, it identifies potential line- or market-based multinational structures and their suitability for different strategic types. It also addresses the rise of a new role and function within the reinsurance firm, the account executive, and discusses how this role may best be incorporated into the decision-making structures of the firm. Finally, it examines how structures shape underwriting processes, and which processes are most efficient and effective for each strategic type.

3. Strategic types: Bases of competition for reinsurers (cont.)

Key points: Structure and process

- As reinsurers grow and expand globally they face structural tensions that shift attention from underwriting judgement to other aspects of business development
- Line-based multinational structures align better with Patchwork Partners, Deal-Making Partners and Price-Taking Profiteers, while market-based structures are more suitable for Blanket and Portfolio Partners
- The underwriting process combines four key areas of expertise: Technical; line or market; client; and portfolio. Different strategic types integrate these pools of expertise with varying degrees of complexity, according to their risk appetites and business preferences
- The greater the complexity of structure and process, the higher the costs of pursuing opportunities. Reinsurers need to align their structure and process with the strategic type to minimise unnecessary complexity

3.2.1 Aligning structure and strategy

As reinsurance firms grow and expand globally, they face a number of structural tensions or 'pulls' towards different business requirements. Figure 3.3 is a diagram of the different structural roles that make up a reinsurance firm. At the top of the organization structure is the strategic apex: The senior executive. The operating core that provides the core service of the organization, underwriters in the reinsurance context, is at the bottom. Middle managers are represented in the centre and include managerial staff such as account executives and business unit managers. These main functions are supplemented by technical staff, such as actuaries and modellers, who support the operating core by providing underwriters with technical input, and support staff, such as human resources and claims, on the right hand side. These distinct roles and responsibilities each exert a pressure or 'pull' on the structure towards their function and away from others.

Traditionally the main 'pull' within the reinsurance firm has been that of the underwriter as the empowered 'point-of-sale' decision maker for the company. In many firms this remains a defining structural feature. However, consolidation and globalisation are changing the nature of reinsurance judgement and the empowerment of underwriters. As the technical element of underwriting grows, so there is a stronger technical function and, with it, the tendency to standardize judgement around common pricing and analytic tools and techniques. This shapes underwriter

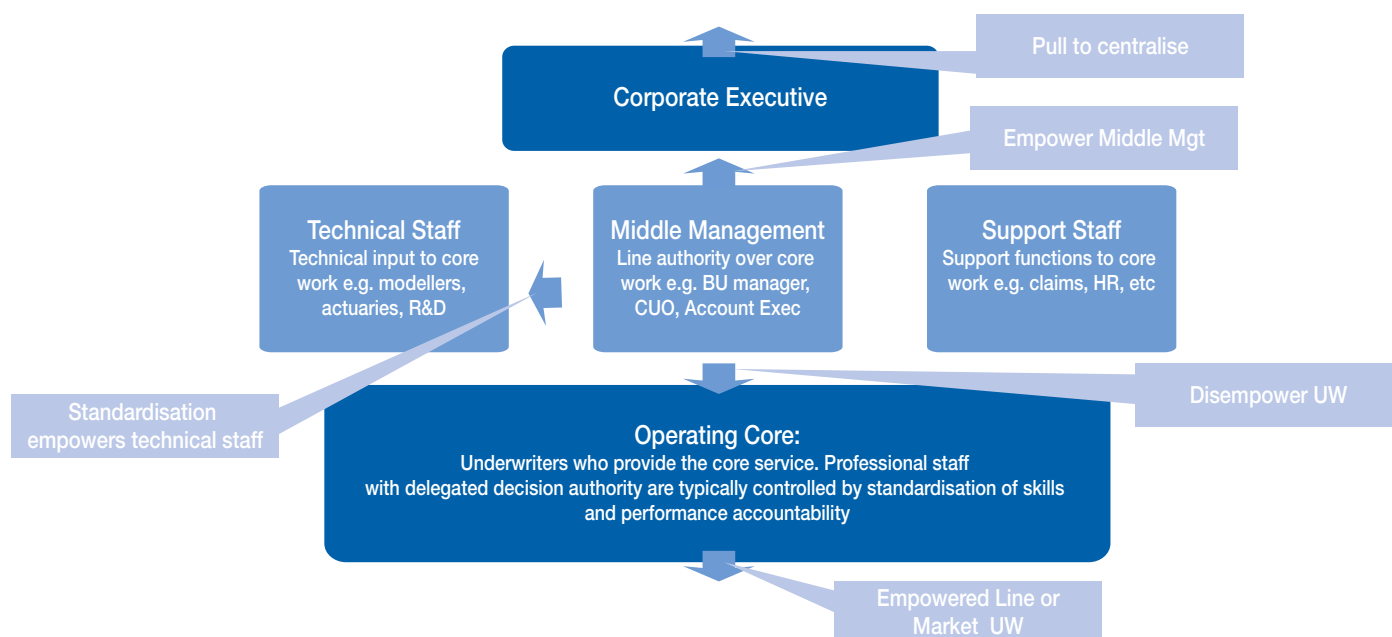


Figure 3.3 Structural Tensions for Reinsurers³

³ Adapted from Mintzberg, H. (1979). 'The structuring of organizations: A synthesis of the research.' Englewood Cliffs, NJ: Prentice-Hall.

3. Strategic types: Bases of competition for reinsurers (cont.)

judgement by providing increasingly tight parameters within which decisions are made.

As reinsurers become larger and more multi-divisional there is also a pull to 'balkanize.' As organizations grow, managers of business units create separate kingdoms, which consolidate decision-making authority within higher middle management levels. At the same time, the account executive role has arisen at the middle management level, often in response to the rise of global cedents that necessitate this coordinating role within reinsurers. As middle management layers grow and corporate executives become more remote from the operating core, there is also a pull up the organization hierarchy towards centralised decision-making. The combined result is increased internal tensions that pulls attention away from the operating core of underwriters and disempowers them by reducing autonomy over point-of-sale decision-making. The incorporation of additional structural complexity, in terms of decision-making and authority, should therefore be assessed

"Our ethos means that we did not want pricing tools to inhibit the underwriting decision. So these models are more here to help the underwriter than they are to tie him down to a particular answer. There is then a lot of freedom and judgment allowed as to how these things are then used."

(Reinsurer)

critically. It brings with it additional tensions as well as reducing underwriter empowerment. The rate of return from growth needs to be considered against the costs and tensions of increased structural complexity.

Line or Market Structure: As firms expand globally, they also need to consider the form of multinational structure. The choice of multinational structure, which is depicted in Figure 3.4, reflects different ways of differentiating expertise within a reinsurance firm, each of which has different coordination problems. Reinsurers need to consider two issues according to their stage of internationalisation: i) in the early stages of international expansion, whether to grow as an international company or simply to establish some international subsidiaries, as per the international subsidiary structure; ii) as they establish a global footprint, should they privilege line or market knowledge which would lead to, respectively, product (line) or area (market) division structures. Reinsurers can also be structured as a global matrix. However, such structures are often hard to manage and overly complex. They are, for this reason, less common. It is the 'line versus market' question that remains the central structural dilemma for reinsurers. As all structures have tensions, we now consider the implicit trade-offs in these two different approaches.

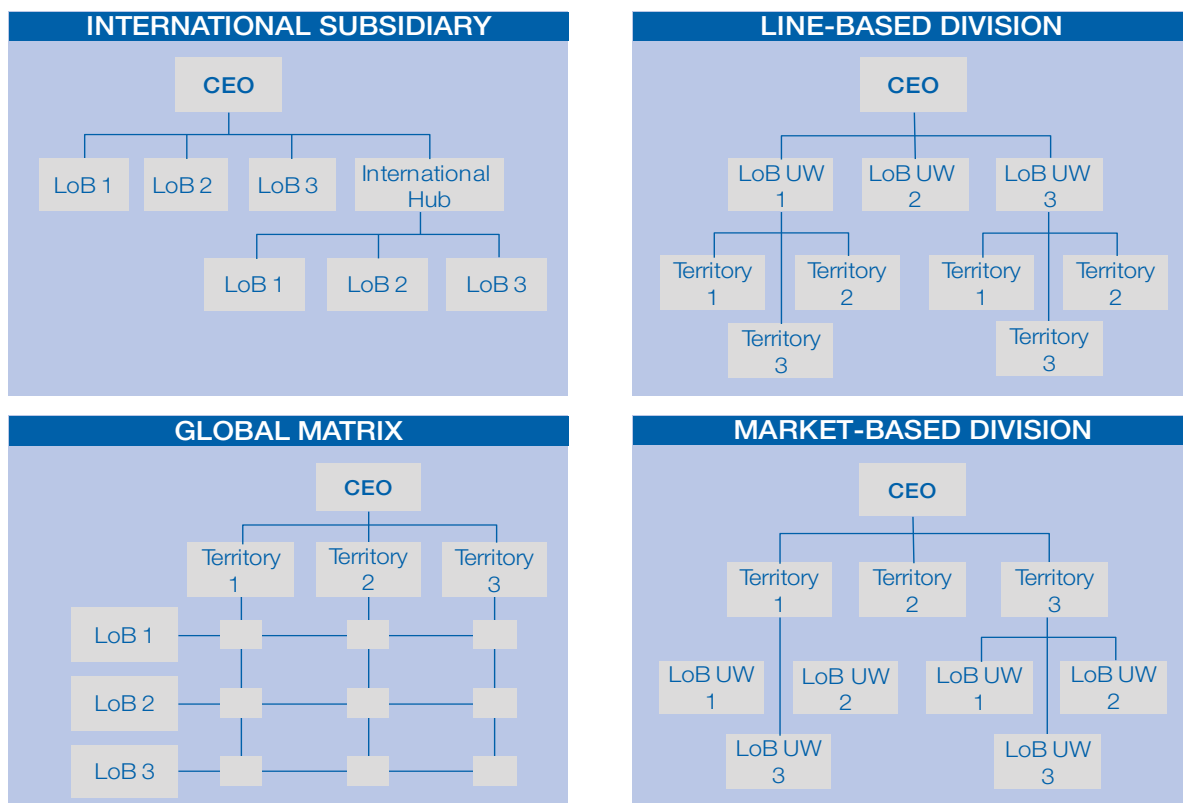


Figure 3.4 Structuring a Reinsurance Multinational⁴

(4) Adapted from Birkinshaw, J. (2001). 'The Structure behind Global Companies'. In Pickford, J. (Ed.) FT: Mastering Management 2.0, London: Financial Times/Prentice Hall: 75-80.

3. Strategic types: Bases of competition for reinsurers (cont.)

A typical line underwriting divisional structure, that may then be further segmented by territory, has

advantages because it:

1. Enables firms to concentrate line expertise around reinsurance products.
2. Is well adapted to cycle management; allowing line underwriters to adapt their deals to the market cycles of their territories.
3. Facilitates performance measurement at the firm level as, data can be collated and compared by line to control risk accumulation and to compare returns on territories.
4. Simple and well adapted to the way that risks are traditionally structured by line and territory.

Given these strengths, Patchwork Partner, Deal-Making Partner and Price-Taking Profiteers are best served by a line structure.

A market-based structure also has advantages:

1. A market-based structure is more aligned with a client centric approach and writing whole account and bouquet programmes.
2. Generally, it enables reinsurers to get closer to their clients and to gain deep knowledge of both their clients and particular regional and cultural specificities.
3. Catastrophe capacity is not separated from other lines, which can be helpful for leveraging the value of this capacity strategically with clients and across the portfolio.
4. A market-based structure is better aligned with a portfolio management strategic emphasis.

These advantages are more important for 'relationship-based' and whole account players, such as Portfolio and Blanket Partners, because lines of business are not written in isolation.

Account Executive Role: A third structural issue in multinational reinsurance firms is the rise of the account executive. An increasing number of reinsurers, particularly those who prioritize whole account and long-term relationships, are incorporating account executives into their structures. This new role within the reinsurance organizational structure is largely a response to the consolidation of cedents; appointing a specific person to support these larger cedents' needs. The structural demands and decision authority of the account executive varies according

to whether it is: i) a sales role, to help with on-selling reinsurance capital across a cedent's whole book of risks; ii) a coordinating role, to interpret and explain the wider implications of the cedent to line and market underwriters looking at particular programmes; or iii) a decision-making role, to bring each individual underwriter's judgement of a particular programme together in a decision on the cedent as a whole. Each of these roles gives more authority to the account executive to influence line and market decisions, such as whether more risk should be taken in one territory or line as part of an appetite for risks in another territory or line. It is, thus, a structurally important role in terms of where it is positioned within the firm hierarchy and how its duties may be carried out across different line and market structures. In market-based structures, an account executive can perhaps coordinate across different markets in response to increasingly regional and global programmes that transcend the traditional territory boundaries. In line-based structures, they can coordinate a view of the client across their different programmes and provide a holistic picture of the client in an otherwise deal-based assessment. A key determinant of structural position in the hierarchy, for example, as a business unit manager with line authority, is whether the account executive has the power to influence underwriting decisions and allocation of capital to key clients. If so, it is a meaningful structural addition that warrants the additional structural complexity that it entails.

3.2.2 Accessing expertise: Line or account-based underwriting processes

Structural considerations are important because they shape the underwriting processes, which are the basis for making decisions about capital allocation in the reinsurance firm. There are four areas of expertise required in the underwriting process: Technical knowledge, contextual knowledge of the line and/or market, client knowledge and knowledge of the firm portfolio and risk appetite. The way that these areas of expertise are combined has different implications for each strategic type. This section discusses the implications of a line- or an account-based approach to combining these areas of expertise within the underwriting process.

Figure 3.5 overleaf displays the line-based underwriting process. The black line indicates the main areas of expertise, technical and contextual, that are used actively in traditional underwriter judgement. This process involves

"We are very transactional. The deal comes to us and we look at it in the [LoB] silo, and it is pure numbers. If the numbers work it is 'yes'; if the numbers do not work, 'no'."

(Reinsurer)

3. Strategic types: Bases of competition for reinsurers (cont.)

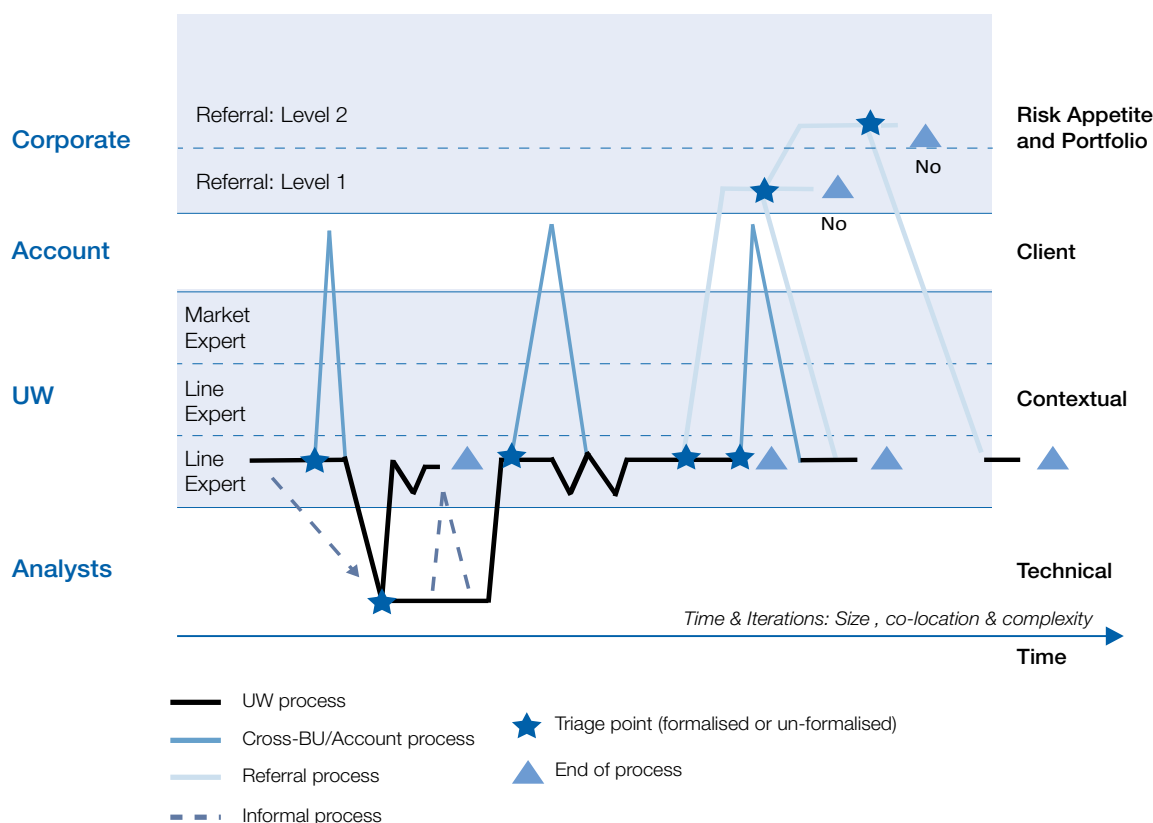


Figure 3.5 Underwriting Process: Line of Business Led

a deal coming directly to the relevant line underwriter, who works with the analyst as needed, then makes a decision that is signed off by a line-underwriter colleague. It is a simple and efficient process. For more complex line-based deals, there may be a longer period of decision-making with more iteration between underwriter and analyst. This process puts line-based underwriting judgement at the core of the firm and favours empowered underwriting. It is well suited to a cycle management strategy where each deal is judged on a stand-alone basis for its profitability. For example, an underwriter can use the technical input to easily compare the RoE and technical ratios of one deal with another. Portfolio concerns about risk appetite and accumulation can then be factored in through analysis of exposure as part of the underwriting process, or perhaps as part of a referral process for large deals.

Many reinsurers can focus solely on this 'core' of the underwriting process. For instance, Price-Taking Profiteers require, for most deals, a simple iteration between contextual and analytical areas of expertise. As their emphasis is analytical, the deal may even be sent straight to the analyst before being assessed by the underwriter. Patchwork Partners similarly tend to have an efficient underwriting process, led by line

"Things are looked at as a whole ball of wax. You can get things done, which in isolation nobody in their right mind would ever do."

(Reinsurer)

underwriter judgement combined with selective use of technical input. Deal-Making Partners are analytically focused in a similar fashion to Profiteers, yet, due to the size of the capacity placed, their process generally entails more iteration between underwriters and analysts. For this reason they might also call on the corporate-level decision makers to a greater degree.

A process oriented around line and analytical expertise is insufficient as firms move towards a whole account approach or want to prioritize the incorporation of market knowledge. For Blanket Partners it is necessary to incorporate market and client expertise, whilst the technical knowledge domain is less of a priority. Portfolio Partners need to formalize the incorporation of all areas of expertise including cross-LoB exchange of knowledge, due to their commitment to whole account approaches, their emphasis on analytics, and their varied portfolio of both small local cedents and large capacity global programmes. Thus, service differentiation provided by Portfolio Partners comes at a greater cost and with greater complexity.

The market-or account-led process depicted in Figure 3.6 provides an alternative, if the traditional line-underwriter driven process does not align with a reinsurer's strategic goals. A market-or account-led process privileges a portfolio management strategy, enabling a more holistic view of a cedent's portfolio

3. Strategic types: Bases of competition for reinsurers (cont.)

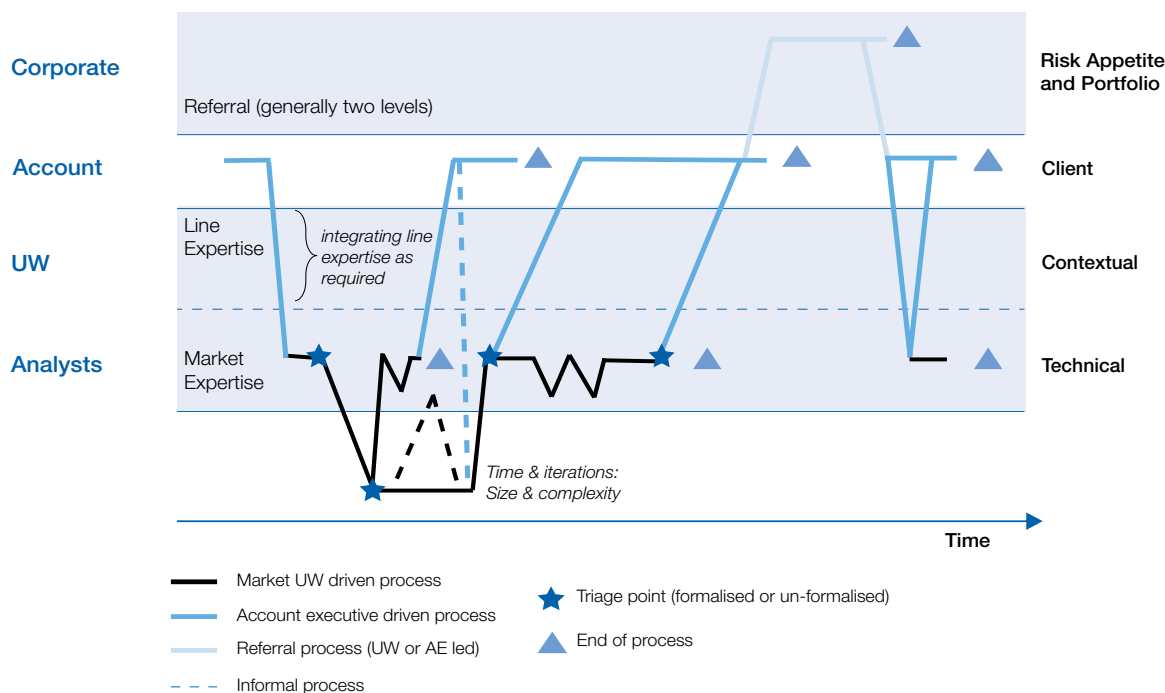


Figure 3.6 Underwriting Process: Market- and account- led

of risks and incorporating this into the reinsurer's portfolio. This happens both at the underwriter level when considering the RoE on any particular piece of business, and also at the account level when considering the profitability of a client. Blanket Partners and Portfolio Partners often adopted such a process, either from their inception or as they realise the need to formalize the incorporation of market and client knowledge within their underwriting decisions. As illustrated by the black line in Figure 3.6, a market underwriter who is a de-facto client manager on local market deals - which is typical for Blanket Partners - can drive this process. Alternatively, as shown by the grey line, the process may be driven by an account executive who draws together the various line and market underwriting judgements, on any particular client, which is the typical approach for a Portfolio Partner. Formalizing the account executive role in the underwriting process may be helpful for all firms when dealing with large clients, as there is an increase in global and regional programmes that transcend the expertise of a single underwriter.

3.2.3 Avoid unnecessary complexity

Reinsurers should be mindful of adding unnecessary complexity to their process. For example, too often reinsurers add blanket referral processes that use scarce senior executive attention when some risk appetite and portfolio knowledge could be incorporated into exposure management tools or delegated to lower management levels. Reinsurers should seek the simplest process possible,

whilst maintaining triage points for appropriate exceptions, such as deals of a particular size or territorial complexity. An underwriting process that is consistent with the structure and strategic type will enable simplicity. For example, a Blanket Partner can simplify its process by ensuring it has a market-based structure and is market-underwriter led rather than having different line-underwriters involved in multiple iterations as they seek to coordinate a client's various programmes. Similarly, a Price-Taking Profiteer gains no value from adding additional complexity around client or market knowledge in the underwriting process.

We end this section with a note of caution. While there is no right way to do things, aligning strategy with structure and process reinforces consistency and reduces unnecessary complexity. It is important to recognise that seeking new opportunities comes at the cost of greater complexity. We question both the rate of return and the implications for underwriter judgement for much of those additional costs and increased complexity. Despite being an industry founded on underwriter judgement and empowered point-of-sale decision-making, many organizations have struggled to hold on to that simplicity as they respond to changes in their environment, such as the growth of 'super-cedents'. Many reinsurers appear to be adding unnecessary complexity through attempting to be things that they are not. Further, even when complex structures and processes are necessary for growth, cost-reducing triage points can maintain a simplified core for much of the business.

3. Strategic types: Bases of competition for reinsurers (cont.)

Key points: Structure and process

- Avoid unnecessary complexity: Assess both the rate of return on any additional complexity and also its potential to shift attention from underwriting judgement
- Ensure consistency with strategic type in order to avoid structures and processes that 'battle' with strategic priorities

3.3 Conclusion: Implications of change for reinsurers

This section has illustrated variation in reinsurers' strategy, structure and processes. We now place these analyses within the context of the changing reinsurance landscape in order to emphasize the implications of change and the need for reinsurers to adapt.

First, the bundled multi-territory products being purchased by Global Buyers are not well suited to the majority of reinsurers, because of the way that

they allocate capital and manage exposures through territorial diversification. For example, most reinsurers manage risk exposures by allocating capacity limits to particular territories, perils and lines. Thus, when they receive a bundled product, individual underwriters are not well positioned to evaluate the risk in relation to their portfolio or the firm's risk appetite. New ways of evaluating such programmes will be necessary which may mean moving from individual to team underwriting

and top-slicing capacity to re-allocate it from local to regional programmes, with commensurate changes in ways of managing risk exposure.

Second, large homogenous covers that require high levels of capacity increase the comparability and potential attractiveness of alternative collateralised products as a supplement for traditional reinsurance products. Reinsurers may, thus, need to become more skilled in understanding these products, which may either be competitive products for reinsurance or may offer reinsurers alternative ways of selling their capital.

Third, as Local Buyers are eroding, the amount of premium available in that space is reducing, which increases competition amongst reinsurers. Reinsurers will, therefore, need to adapt their skills and resources to better service regional and global programmes.

Fourth, emerging markets become key targets to diversify away from the dependence on global players. However, they are still largely unknown and un-analysable for many reinsurers and fail to supply sufficient premium to offset other changes in the global market.

Taken together, these trends indicate that critical mass in reinsurers will be necessary for significant partnering with globally consolidated cedents. Currently, there is still enough variation in reinsurance buying to provide opportunities for a range of different types of reinsurance sellers. However, the market is increasingly competitive and adaptation will be necessary to meet the changes arising from consolidation and global convergence.

4. Fit for purpose? Matching cedents and reinsurers

This section brings the previously identified reinsurer and cedent types together around the topic of fit. It outlines the natural sources of 'fit' within different cedent-reinsurer relationships. It then links this assessment to broader industry dynamics in order to identify where fit is declining, so indicating some eroding sectors of the reinsurance market.

Change to Key points: Strategic fit

- Different reinsurer and cedent types have varying degrees of fit, according to the reinsurer's risk appetite and strategic capabilities and the cedent's needs for capital and other skills and services
- Reinsurers need to target those cedents where they have the best fit
- Some areas of natural fit for most reinsurers, such as Local Buyers, are an eroding sector of the industry in terms of the premium that they cede

4.1 Strategic Partnering: Diagnosing fit between reinsurers and cedents

Knowing who their natural partners are can help reinsurers and cedents to make best use of the resources that go into targeting and developing their business relationships. In this section, we develop a Strategic Partner Matrix for evaluating 'fit' between the strategic positions and business orientations of different reinsurer and cedent types. The general parameters for assessing fit, generated from the preceding analyses of reinsurers and cedents, are outlined below. In Figure 4.1, we illustrate the closeness of fit through a 1-5 star rating with 1-star indicating strong differences in strategic position that are difficult to bridge and 5-stars indicating a close congruence in strategic orientation. We consider 5-star partnerships a 'natural fit', meaning that cedents should look for their reinsurance counterparts in this category as leaders on their slip and long-term partners and, conversely, reinsurers should focus on these types of cedents as their key targets.

Change to Key points: Strategic fit

Basis for reinsurer assessment is:

- Strategic emphasis on portfolio or cycle management
- Strategic appetite, based on preferences for relationship longevity, multi-line business, and technical analysability
- Line or market structure and ability to coordinate across both
- Capabilities in applying the four areas of expertise within the underwriting process

Basis for cedent assessment is:

- Purpose, products and coordination of reinsurance buying
- Expectations of reinsurers, including cedent requirements for reinsurers with technical, line, and market expertise
- Cedents' needs for significant lines of capital and for relationship length, depth and breadth

4. Fit for purpose? Matching cedents and reinsurers (cont.)

	Global	Regional	Local	Emerging	Specialty
Portfolio Partner	★★★★★ Natural fit based on: technical capabilities; account executives; capacity; and relationship focus (if large)	★★★★★ Relationship focus, account executive and team UW result in good fit	★★★★ Reasonable fit: relationship and portfolio focus. Excess resources for buyers' needs	★★ Less fit: technical and account capabilities unexploited; relationship focus not adding value. Write for portfolio	★★★★ Good fit: as part of portfolio mgt. and relationship focus. Relationship focus adds value
Deal-making Partner	★★★ Reasonable fit: Tech expertise to deal with large homogenous programs. Capacity for high RoE or private deals	★★★★★ Natural fit with technical expertise, capacity and relationship focus. Best fit: High information and RoE regions	★★★ Reasonable fit depending on region (analysability and profit). Best fit: high analysis/ RoE Locals	✗ Minimal fit on either side. Not analysable and boutiques the norm	✗ Minimal fit on either side as line and technical expertise is CAT based
Price-taking Profiteer	★★ Less fit: have line-focused technical capabilities but reinsurer appetite misaligned to cedent bundled capacity needs; Follower by RoE	★★★★ Technically driven and line focused UWing is good fit with US regionals (who also match RoE expectations)	★★ Technically driven approach and infrastructure means less fit; opportunism detracts. Best fit high analysis/RoE Locals	✗ Miminal fit (As above)	✗ Miminal fit (As above)
Patchwork Partner	★ Less fit: LoB approach localized; technical capabilities stretched; lack of coordinating account focus	★★★ Reasonable fit: but localized LoB approach & analytical capabilities (for US regionals) stretched	★★★★★ Natural fit: with local LoB, empowered underwriter approach and moderate technical ability and demand	★★ LoB focus (no bouquets and less market knowledge) means Less fit	★★★★ Good fit: LoB and relationship focus. However, not always full range of SL; unlike Portfolio Partner
Blanket Partner	✗ Minimal fit: UW expertise market based and insufficient technical structure	★★ Less fit: as market driven approach only viable for highly-consistent regions; technical ability stretched on aggregates	★★★★★ Market-centric expertise & relationship focus result in good fit. Smaller technical capability sufficient for some Locals	★★★★ Good fit with market centric and less analytical approach. Relationship focus less exploited	✗ Minimal fit Expertise market not LoB based

Figure 4.1 Strategic Partner Matrix
(A relationship with 3 stars is viable with some stretch on either side to create fit, while 1 star is not viable and 5 stars is natural fit. NB. The 'Last Resort' identified in the Reinsurer Strategic Positioning Tool, Figure 3.1, is not included here as it is a strategic ploy, not a true strategic type)

The Strategic Partner Matrix demonstrates that an organization cannot be all things to all people. Even if different reinsurer strategic types can write particular cedent types, this does not necessarily mean that there is good fit or that these relationships are making the best use of their resources. Thus, we advocate a targeted approach: A reinsurer should build the core of its portfolio around those cedent types that are central to its strategic appetite and provide good fit with its structures and processes. To create a balanced portfolio, a reinsurer then engages in a more peripheral way with other cedent types. For example, a smaller reinsurer with less technical infrastructure would find it hard to be a meaningful partner to Global Buyers, and would not be seen as a core partner by them. We thus highlight the following points:

1. The Portfolio Partner has some fit with all categories, albeit less with the Local and Emerging Market Buyer. While the Portfolio Partner has the capital and competence, in terms of technical and client management infrastructure, to write these cedents, their needs do not fully exploit the Portfolio

"If we talk about the 10 biggest insurers; if you look at their programmes it's going to be a worldwide Cat XL: \$2 billion of capacity. What can we do? How can we be with them? We just haven't got the modelling and also capital and capacity to be a meaningful partner to them."

(Reinsurer)

Partner's assets. Hence, these cedents come at a relatively high cost per deal, which is sustainable only because of the sunk costs in a portfolio strategy and the Portfolio Partner's belief in their diversifying benefit.

2. All reinsurers can write Local and Regional Buyers at some level of fit, because these are the traditional buyer types that align with traditional, empowered underwriters with line or market expertise.
3. The Price-Taking Profiteer fit is determined very strongly by the market cycle. As strong cycle managers, they look for analysable, high-RoE deals, which predisposes them to USA business, followed by some other select territories. Consequently, their fit with Regional and Local Buyers is geographically predisposed towards the USA and a few other information-rich territories.

Based on our prior analyses of the way that centralised reinsurance buying is shaping the global landscape, we also provide the following caveats:

1. While one of the traditional reinsurers - the Patchwork Partner - and the traditional Local Buyer have good fit, this space is eroding because of consolidation.

4. Fit for purpose? Matching cedents and reinsurers (cont.)

2. As this space cedes less overall premium to the market, it is becoming more competitive. Those reinsurers who are primarily adapted to the Local Buyer market will struggle to find a sufficient number of profitable or sizable deals to fit their analytic capability and risk appetite.

4.2 Conclusion: Responding to challenges for fit

A central theme of this report is that consolidation is changing buyer and seller behaviour. While Local and Regional Buyers are attractive, with high degrees of fit to most reinsurers, this space is shrinking. As Local Buyers are consolidated into Regional and Global Buyers, reinsurers primarily adapted to have natural fit with these players will struggle to find sufficient profitable or sizable deals to write. The on-going trend in this regard should be a concern for many reinsurers, as much of the industry has developed to have natural fit with exactly these traditional Local Buyers. Consequently, many reinsurers will need to establish their strategic response to consolidation and adapt their strategy, structure, and process accordingly.

One response is that reinsurers can become 'strategic chameleons' in their client management and develop triage points in their underwriting processes that enable them to treat different types of clients differently. This can be achieved through clear switching rules. We argue that this should be done as a way to grow a portfolio of business not in a way that undermines a reinsurer's strategic identity, or indeed relationships

with its core group of cedents where natural fit exists. For example, a Portfolio Partner reverting to a Blanket Partner with emerging market clients does not change the fact that its primary focus remains Global Buyers that benefit from and appreciate the full service and infrastructure a Portfolio Partner provides. By contrast, a Patchwork Partner might develop a separate 'Global Account' unit to run alongside (rather than supplement) its traditional line and deal focused structure and processes, in order to increase its fit with Global and large Regional Buyers.

Finally, many things can moderate the degree of fit between reinsurer and cedent, including stage of market cycle, size of capacity offered, and broker supplementation of skills and expertise. This last point is the focus of the next section as we turn to the role of brokers.

Summary: Strategic fit

- Reinsurers should target those cedents where they have natural fit
- Reinsurers whose natural fit is misaligned with the shift in global premium away from Local Buyers towards Regional and Global Buyers need to address this as a strategic priority

5. Intelligent matchmaking: Adding value through brokers

While brokers have always been an integral part of reinsurance trading in the Lloyd's of London market, in Continental Europe, direct relationships between cedents and reinsurers have often been the norm. Yet, at a time when most sectors move towards increasing dis-intermediation, there has been an increase in brokered reinsurance placements, even in mature markets. The ability of brokers to penetrate a market in which the reinsurance premium ceded is relatively static, indicates that they are able to add value within the changing global landscape. This is partially due to the rapid consolidation of the broking market into three main firms that have the critical mass and global reach to offer services globally to their global clients, as well as to exploit opportunities for growth in emerging markets. In this section, we explain how brokers add value to both cedents and reinsurers. The role of brokers is then introduced to show where they may add value by increasing fit between cedents and reinsurers, as well as where broking opportunities are eroding. Finally, we consider how brokers may also extract value for the services they provide.

Key points in this section

- While brokers are advocates for cedents, they are also an intermediary in the cedent-reinsurer value chain and must, thus, consider the value that they provide to reinsurers
- To expand their role in the market, brokers need to generate clearer value propositions that differentiate between the services needed by different cedent types and match these with different reinsurer types
- Brokers must focus their traditional distribution channel and placement services on those cedent-reinsurer relationships that could not be conducted without intermediation. This is heartland business in which brokers can clearly both add and also extract value
- For other relationships, brokers' ability to add and extract value depends on the specific competences they are able to bring to a changing landscape for broking opportunities
- Some services are not easily remunerated through traditional means such as brokerage. Broadening the horizon on alternative forms of remuneration, such as fee-for-service, is critical for the future of broking

5.1 Brokers' added value

In this section we disentangle where and how brokers add value to both cedents and reinsurers and then unpack the different service expectations that cedents have of brokers. We conclude by suggesting that alternative forms of remuneration are critical in order for brokers to better create value for, and extract value from, their role in the reinsurance industry.

5.1.1 Brokering value triangle

As the main relationship for exchange of products and services is between cedents and reinsurers, inclusion of an additional intermediary in the reinsurance value chain suggests that brokers are perceived to add value beyond the costs they create. As illustrated in the Brokering Value Triangle (Figure 5.1), cedents and reinsurers jointly create value in the form of reinsurance cover for the cedent and premium income for the reinsurer. The extent of value in this direct relationship (Vd) revolves around particular challenges that both cedents and reinsurers want to minimize. Brokers have entered the market with services that can mitigate these challenges on both sides. To succeed, they have to create greater net value within the value chain (Vi), than could be achieved through a direct relationship ($V_i > V_d$). In return, they are remunerated through brokerage upon the successful placement of a reinsurance programme. As brokerage is paid by the cedent, but reclaimed from the reinsurer, it is important that – even though the cedent is the broker's client – the reinsurer gets good value from the broker as well. Serving a client to the detriment of their counterpart, the reinsurer, is a poor business practice that eventually will come to harm the cedent as well. The value brokers can provide centres around challenges reinsurer and cedents face in the area of distribution, information quality, and pricing, as well as additional services generated through their infrastructure and technical knowledge.

"If the broker is adding value to the companies, and very often they do offer additional value, it has a price. The broker has to be paid, so it will come out of the price that the client has to pay us. If that doesn't add anything to the client, we'll say 'Well you can do it direct'."

(Reinsurer)

Distribution is a challenge that traditionally has necessitated the role of brokers in the reinsurance market. Cedents may struggle to access sufficient quality capacity for their programmes because: i) they are large and capacity is limited; ii) they do not have a good understanding of reinsurers' specific risk appetites in order to target them directly; or iii) placing

5. Intelligent matchmaking: Adding value through brokers (cont.)

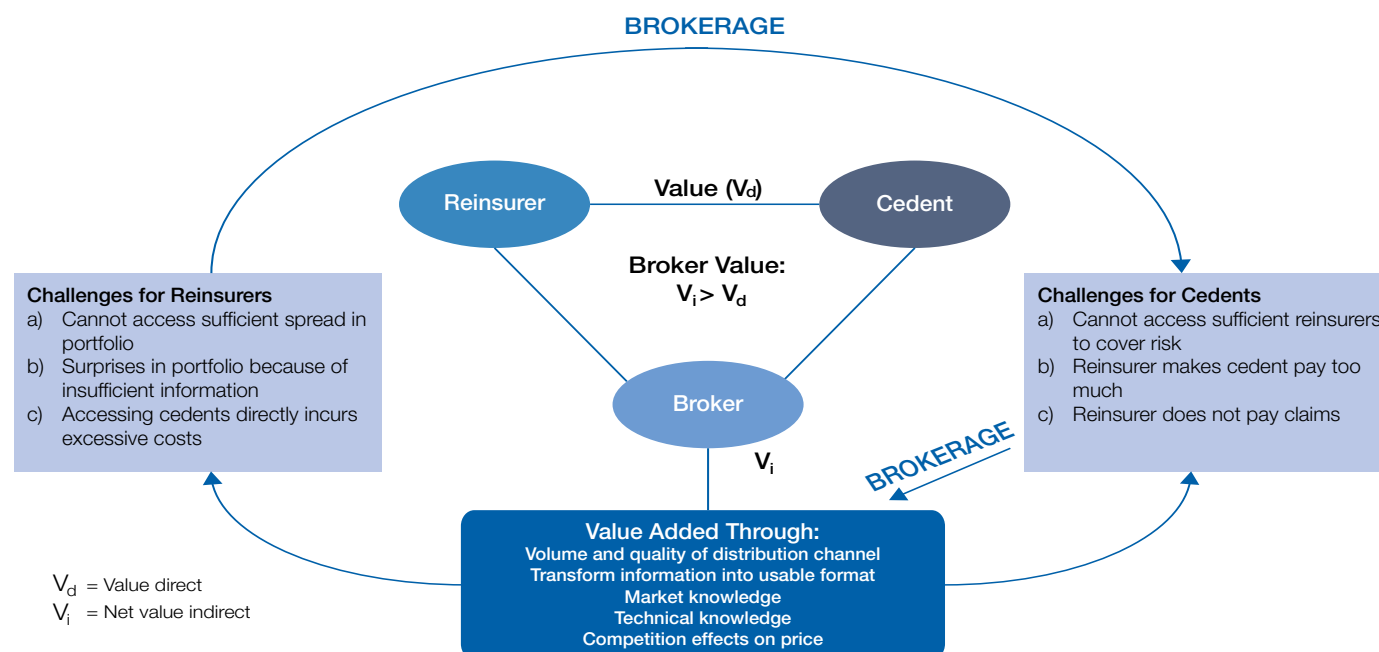


Figure 5.1 Brokering Value Triangle

a programme across a large number of reinsurers requires an infeasible or expensive amount of leg work to be done by the cedent.

Reinsurers also confront distribution challenges in terms of accessing sufficient good quality business to fulfil their portfolio goals. They can struggle to access sufficient *breadth* of business to diversify the risk in their portfolio. Diversification into sub-par programmes can quickly lead to 'worsification' in terms of portfolio profitability. Reinsurers may also struggle to access sufficient *depth* of business, failing to allocate their full capacity in a market or line of business. Particularly when they are newcomers in a territory or line of business, reinsurers can struggle to generate interest in their capacity, as many 'start-up' subsidiaries experience. In such situations, reinsurers can use brokers as a distribution channel to market their capacity.

"Many people had never heard about us, so as new capacity we need somebody who's doing advertisement for us: The brokers. The brokers are going around saying: 'There's new capacity, by the way very good security'. This helped because when I went to companies, they already knew because the brokers had told them. It was very important."

(Reinsurer)

As distribution challenges are flip sides of the same problem, brokers can use their market intelligence to connect cedents requiring extra capacity with reinsurers looking to make their capital work harder. This is at the heart of the brokers' role in the global reinsurance marketplace; using their networks to do the legwork of identifying promising matches

between cedents and reinsurers. Internationalisation and diversification of reinsurer portfolios present distinct opportunities for brokers, helping reinsurers to establish their global presence by identifying cedents where they may be able to gain an initial share of the business. Where reinsurers struggle to access business due to the absence of an office in a targeted region, brokers can be their 'eyes and ears on the ground.' To do so, however, requires a globally coordinated and joined up approach from producing brokers accessing cedents in various regions to placing brokers that understand the reinsurer's appetite. Importantly, this move allows brokers to create a win-win situation from which both cedent and reinsurer benefit.

Information quality is another substantial challenge for both cedents and reinsurers; and an area where brokers sometimes have misinterpreted their matchmaking role in the past. For reinsurers, poor information means assuming risks that they do not fully understand. The Thai floods were a striking example, taking reinsurers by surprise with losses that they had not realised were in their portfolio. Brokers have a critical role to play making sure that reinsurers are spared from such surprises.

Improving the information their clients provide and the ways in which they present it, can reduce perceived

"We appreciate the fact the brokers pre-crunch the information and present it in a more usable way. What we get is normally a much better presentation if they come from a large reputed broker than what we would have from a small client with very little internal resources for that."

(Reinsurer)

5. Intelligent matchmaking: Adding value through brokers (cont.)

uncertainty and so lower rates from reinsurers. Where cedents are unable to deliver accurate, detailed, up-to-date information on the risks they are seeking to place, reinsurers respond with scepticism. At worst they refuse to write the programme. At best, they demand additional information and 'load' their models to reflect their uncertainty. While the risk to the cedent of overpaying for reinsurance cover is a very real one, aggressive pricing from reinsurers, based on poor information is not helpful either, as it exposes cedents to the risk of a shortfall. As brokers play a critical role in helping cedents to structure reinsurance programmes, it is critical that they understand their matchmaking role in this regard. Re-structuring programmes to obscure performance issues or complicate year-on-year comparison is not doing clients a service. By contrast, responding to reinsurers' information concerns in a constructive fashion strengthens reinsurers' confidence in a programme, broadens the pool of interested reinsurers, increases capacity, and creates room for manoeuvre to lower rates. And *that* is in the cedent's best interest, both short-term and long-term.

Brokers' responses to these concerns about distribution and information quality impact on the **pricing** of programmes. Cedents try to keep pricing under control through sophisticated programme structures that minimise the price to pay for the desired cover. Brokers can assist by helping cedents devise structures and choose products that sit comfortably with reinsurers. As they deal with many reinsurers, brokers understand what does and does not work and can help their clients avoid those structures and products that naturally reduce the pool of possible reinsurers, artificially reducing capacity, and driving up the rates on placements. Where brokers generate additional interest in a programme, both through the way it is structured and the extent to which they improve distribution to interested reinsurers, they shift the balance of supply and demand. This ensures that incumbents on the programme must remain competitive in order to maintain their share.

Finally, brokers can provide important services that are independent of the reinsurance placements that were their entrance ticket into the industry. This kind of value-added can flow from their global **infrastructure**, such as their ability to provide in-house claims handling services for multiple smaller cedents, and their **technical knowledge**. In particular, there is a growing role for brokers to act as continuous service providers to both cedents and reinsurers, rather than merely as renewal assistants. This is particularly important, as ceded premium

has remained constant, meaning that brokers need to consider alternative sources of income beyond premium. Brokers should consider supplementing their offering with ancillary services to win the right to distribute cedents' programmes. Furthermore, brokers should consider branching out into alternative services to generate revenue independent of any placements. Brokers' infrastructure and technical knowledge are the key ingredients to this strategy. Solvency II compliance, modelling, or claims handling are just some examples of how brokers can use their technical knowledge to sell consulting services independent of renewals and placements. The bigger challenge beyond accessing the expertise for these services, however, is the way that they are remunerated. As long as the industry stays committed to brokerage on placements as the dominant means of remuneration, it will be relatively easy to deliver these services, but relatively difficult to get paid for them. In this sense, the problem for brokers is not so much about *generating* value for the industry, but *capturing* that value and turning it into a profit for themselves.

"Brokers need to sell themselves as providing services to their clients, because their main added value is not placing the reinsurance programme. It's much more about how they manage Solvency 2 issues, do they have to buy a traditional reinsurance cover or do they need other financial solutions. So they are much more financial solutions provider now than just the reinsurance placing broker."

(Reinsurer)

5.1.2 Cedent expectations of brokers

The starting point of value creation for brokers is cedents' expectations. As shown in Section 2, cedents come in different types, and so have varying needs from and expectations of brokers. Understanding these different expectations allows brokers to channel their efforts, differentiate how different resources are deployed in different client segments, and identify the critical ingredients that distinguish a 'global' broker from the rapidly eroding smaller brokers.

As shown in the Broker Service Segmentation Chart overleaf (Figure 5.2), there is a cluster of prerequisite services that all cedents demand, including market-specific knowledge, technical knowledge, a distribution channel, and market intelligence. As discussed above, the key purpose of the broker-cedent relationship remains placing the cedent's business: Any broker who does not have a sufficient distribution channel to access good capacity for a variety of lines of business and territories will naturally struggle. Successful placement depends on two factors: Market-specific knowledge of the primary market and market intelligence on current capacity

5. Intelligent matchmaking: Adding value through brokers (cont.)

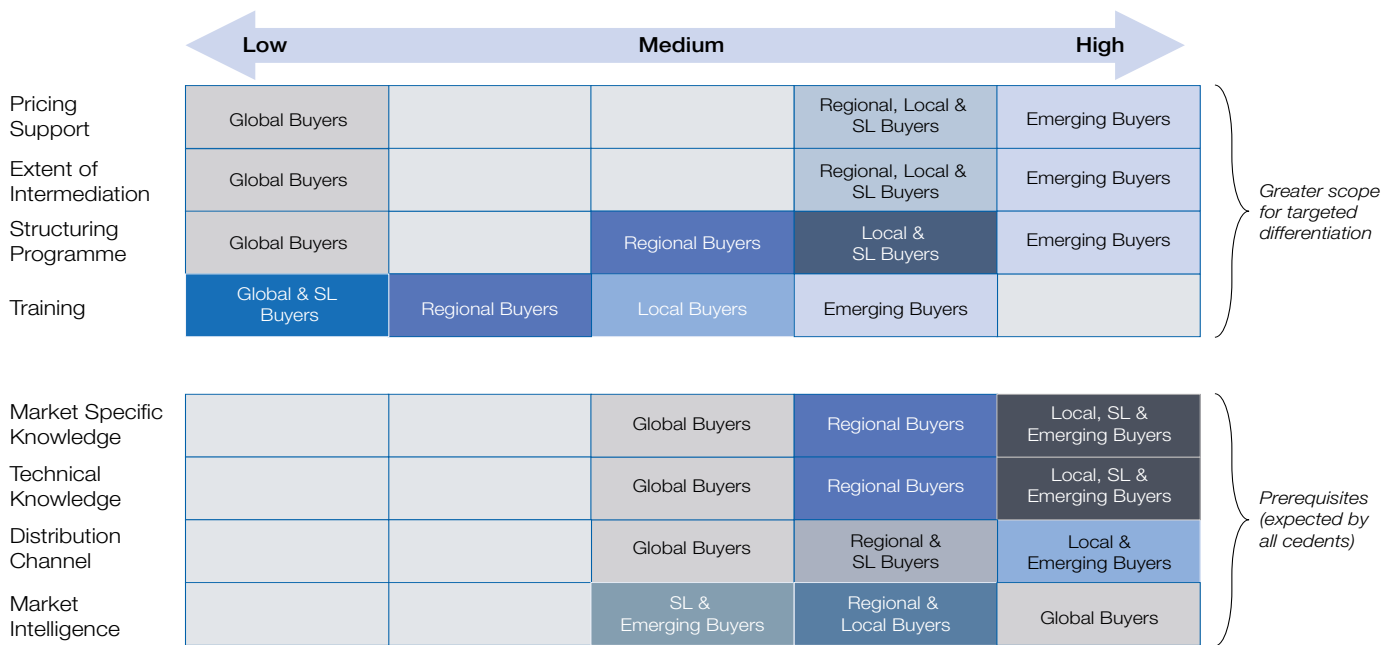


Figure 5.2 Broker Service Segmentation Chart: What do Cedents Expect?
(Low to high is the strength of the cedent's need for a particular item from their broker)

and risk appetites in the reinsurance market. Especially where programmes are hard to analyse given their underlying risks, contextual knowledge of the primary market is paramount for preparing information, structuring the programme, and broking the deal to a variety of reinsurers. Knowing who to approach, where to find extra capacity in the market, and how to leverage current market cycles to the benefit of the cedent are equally critical. Brokers who underperform in this respect put their clients at risk, either by overpaying for their cover or ending up with a shortfall. Technical knowledge, unsurprisingly, underpins brokers' bread-and-butter business of customising, applying, and evaluating vendor models for structuring programmes⁽⁵⁾. In a world where statistical risk modelling is increasingly pervasive, any type of cedent expects this service from their broker.

At the other end of the spectrum sits a range of services that have varying relevance for different types of cedents. Brokers can maximise their value in these areas by making sure that they are targeting the right services at the right clients; and ceasing those services that cost a lot of resources, but generate little client value or revenue.

- **Pricing support** is a low priority for most Global Buyers. They have sophisticated tools for pricing and structuring programmes and do not need brokers to perform these activities. However, they

do want brokers to provide consultancy, market intelligence, and ideas against which to test their own tools and analyses. Brokers are also important to give internal transparency on these firms' audit and regulatory processes, and to satisfy internal policies about pricing of LOC cessions. Understanding these specific preferences helps brokers to tailor their offering and complement existing competences on the part of their clients. By contrast, Emerging, local, small Regional and Specialty Lines Buyers are likely to be more dependent on brokers for analytic capacity and structuring programmes.

- While a distribution channel is a prerequisite for all brokers, the **extent of intermediation** required by different cedents changes with their size and nature of business. Global Buyers often have historical direct relationships that account for a significant amount of their placements with reinsurers. While they broker a proportion of their programmes, a large amount is placed directly, because of the volume of trade they do with a small group of the

"Because of the complexity of putting it all together - we were pulling together a large number of underlying programmes - we had the brokers involved effectively structuring the deal, presenting the information. But in a sense they weren't traditionally broking, they got a fee for doing all the work but they weren't really broking per se because the distribution channel was effectively done direct."
(Cedent)

(5) Jarzabkowski et al. 2010.Trading Risks The value of relationships, models and face-to-face interaction in a global reinsurance market. Executive Report: Insurance Intellectual Capital Initiative.

5. Intelligent matchmaking: Adding value through brokers (cont.)

biggest reinsurers. While these buyers require placement services because their capacity programmes are spread across the market, the total placement may only comprise a relatively small amount of the overall premium ceded. Smaller and specialist insurers by, contrast, do not have these direct relationships to the same extent and are more reliant on brokers to place their business across a sufficiently diverse panel of reinsurers.

- **Programme structuring** is similar. Global Buyers have the technical capacity to structure their own programmes and often do so together with the key reinsurers with whom they maintain direct relationships. Here, brokers may provide useful comparisons with global peers and support internal transparency, thus providing advice for structuring, rather than doing the structuring per se. By contrast, support with programme structuring is of more importance for Regional Players and, in particular, for Local and Emerging Market Buyers, who may lack the experience and market intelligence to structure their programmes so as to appeal to a large spread of fragmented reinsurers taking their risks. It is these classes of cedents that assign the highest importance to these services, indicating an area where brokers can add substantial value through support with programme structure.
- **Training** is of low importance to Global, Specialty Lines, and Regional Buyers. They either have in-house capacity to address any needs or their training needs are too specific to be serviced by broker generalists. By contrast, Local Buyers give medium and Emerging Buyers high importance to training services, welcoming broker support in developing their human capital.

These varying service expectations show that cedents are not a homogeneous mass and that targeted service offerings can unlock substantial value for brokers. Being a 'global' broker, able to deliver for Global Buyers, takes a distinct set of services and skills, indicating how consolidation in the broking sector matches consolidation in the primary market: Only a large, technically capable broker with a globally integrated distribution channel can support the needs of Global Buyers. Value-generation is easier for other classes of cedents, where brokers can more easily identify and plug capability gaps. Importantly, the sophisticated analytic capacity, business solutions, and training that big broking houses can provide, means that brokers are increasingly competing with many large reinsurers who have historically relied on these capabilities as a source of differentiation and

competitive advantage.

5.1.3 Summarising broker value to cedents

Two insights are important in summarising broker value to cedents: First, prerequisite services are safe, and indeed necessary, to invest in, as they can be deployed across the entire client portfolio. However, as any broker needs to provide these services as the entry criteria to the industry, it is difficult to differentiate through them; they allow firms to enter the competition, but not necessarily to win. By contrast, more differentiated services that only specific segments of the client population require need to be considered more carefully. Brokers need to assess whether their service portfolio actually matches the expectations of their client portfolio, and whether these services are being deployed in a tailored way to both add value to cedents and also capture value for brokers.

"We offer our opinion and advice, we do a lot of simulation work for them and technically analyse their programme. It is heavily administration-related work; hence they use brokers. Very clever ... but we only get remunerated through other programmes."

(Broker)

Second, the prerequisite services of brokered reinsurance are also the ones that are most easily remunerated through brokerage. Those services that are cedent segment-specific and allow brokers to position themselves as 'specialist' or 'global', brokers are, typically independent of placements and therefore not covered by brokerage. In particular, as Global Buyers both place some of their programmes directly and also assume significant proportions of the risk internally, such services may not lead to brokers placing those programmes on the open market. This affects their potential for

Implications of cedent expectations of brokers

- Prerequisite services are safe and necessary to invest in, as they can be deployed across the entire client portfolio. However, they are not the key differentiators within the industry
- Prerequisite services are associated with placing business and are easily remunerated through traditional brokerage
- Differentiated services that are required only by specific client segments need to be considered more carefully. The tailored deployment of such distinctive services can enable brokers to distinguish themselves

5. Intelligent matchmaking: Adding value through brokers (cont.)

- Those services that allow brokers to differentiate themselves as 'global' brokers are typically independent of placements and need to be remunerated in alternative ways to traditional brokerage
- There is still little clarity in the industry about how to charge for such tailored services

remuneration via brokerage. Thus, we query whether brokerage remains the only or the most suitable form of remuneration for all services. However, neither cedents nor brokers seem to have established a clear position on the best alternative routes for remuneration, with the exception of some fee-for-service in particular markets and on some new global or large regional programmes.

5.2 Intermediating reinsurer-cedent fit

Building on the Strategic Partner Matrix in Section 4, this section addresses how brokers can add value by increasing the fit between reinsurers and cedent types. We then develop a Broking Partnering Matrix, to consider those relationships where brokers may best extract value for the services they provide.

5.2.1 Extracting broker value

To maximise their value, brokers should be strategic in selecting the relationships that they intermediate. Otherwise they may invest effort in facilitating relationships that would have come to pass anyway and where their value-added is perceived as small or,

even worse, invest their effort in forging relationships that are unlikely to yield value to any party.

In Section 4, we identified how the strategic positions and business orientations of different reinsurer and cedent types align, based on a 1-5 star rating. To summarise some key points that are relevant to brokers' ability to add value, all reinsurer types can write Local and Regional Buyers at some level of fit. With a large pool of reinsurers genuinely interested in this business, brokers' focus can shift from accessing capacity to pressuring price in this segment. However, while the segment is profitable, at least for the moment, an exclusive reliance on distribution and pricing services means that broker margins are likely to be squeezed in future. Additionally, consolidation may reduce significantly these relationships that have traditionally relied on brokers. We, therefore, use a red, amber and green system in the Broker Matchmaking Map (Figure 5.3) to show which relationships are most likely to yield value to brokers, and so indicate where they should focus their efforts.

- Those relationships where there is minimal fit between the expectations and demands of different types of cedents and reinsurers are highlighted in red. Brokers should steer clear of these relationships. No matter what effort they exert, the strategic orientations and reinsurance requirements of these pairs are so far apart that they will yield little value, even with the broker's help. Trying to facilitate these relationships will waste brokers' time and resources.

	Global	Regional	Local	Emerging	Specialty
Portfolio Partner	Value added through 'impartial' services and fee-for-service	Value still added through distribution. Build services and protect from going direct as they grow	Value added by providing services that are not economic for reinsurer to provide	Value added by offering market knowledge and increasing technicality of deals	Value added by providing specialist knowledge
Deal-making Partner	Value added by distribution; Matching solution providers with seekers. May be fee-for-service	Value added through distribution and improving technical transparency	Value added by distribution of those locals that are technical and good RoE	Rarely adds value. May turn into a deal but not usually attractive	Rarely adds value. May turn into a deal but not usually attractive
Price-taking Profiteer	Value added by increasing transparency of bundled deals	Value added through distribution and improving technical transparency	Value added by distribution of those locals that are technical and good RoE	Rarely adds value. May turn it into a deal but not usually attractive	Rarely adds value. May turn into a deal but not usually attractive
Patchwork Partner	Value added by showing reinsurer how to evaluate bundled deals within their exposure management	Value added by interpreting multi-territory and regional deals to reinsurer	Value added through distribution	Value added through distribution, market knowledge and technical support to increase attractiveness	Value added through distribution and specialist knowledge
Blanket Partner	Rarely adds value. May turn into a deal but not usually attractive	Value added by Interpret the technicality of deals to increase appeal to reinsurer	Value added where broker offers superior distribution channel to those of existing relationships	Value added through distribution of 'market picks' to reinsurer	Rarely adds value. May turn into a deal but not usually attractive

Figure 5.3 Broker Matchmaking Map

5. Intelligent matchmaking: Adding value through brokers (cont.)

- Those relationships where brokers enjoy good value-generation potential are indicated in green. These are those pairs of cedents and reinsurers that gain increased fit through traditional forms of intermediation, such as distribution channels and the application of technical knowledge. Here brokers enjoy the greatest value-adding potential by accessing capacity that the cedent is unable to access on their own. Enabling additional capacity shifts the balance of supply and demand and allows brokers to put pressure on prices on their clients' behalf. These areas of matchmaking should form part of a brokers' core business.
- Those relationships that are coded amber represent different conundrums for brokers about how to add value. In some relationships, such as the Portfolio Partner and Global Buyer, there is such natural fit between the two parties that the perceived value of the broker as matchmaker may be minimal. Hence, brokers always run the risk that these natural partners decide to engage in a direct relationship and cut out the broker. Focusing on this type of business, therefore, requires an alternative approach to value-adding, based on differentiated services that may not result in large placements or be remunerated through brokerage. Other areas that are coded amber represent an alternative challenge for value-adding, largely based on developing reinsurers' abilities to write particular types of cedents for which they may lack the requisite technical skills, or for which they have a lower risk appetite due to their underwriting processes. For example, Patchwork Partners do not have ideal fit with Global Buyers, because they lack the scale and, usually, the appropriate exposure management tools, to write multi-territory programmes. Brokers will thus need to support the reinsurer side of the relationship in order to increase fit.

A close look reveals that the majority of the matrix is actually not green, but amber. The key insight is that brokers need to work on transforming these amber relationships into more promising alternatives. The strategic implications for brokers are unpacked below.

5.2.2 Extracting value from matchmaking

Just as reinsurers work hard to diversify their portfolios, so brokers should take a careful look at who they count among their clients. Focusing on those clients where brokers can add substantial value through matchmaking with reinsurers, and where they also

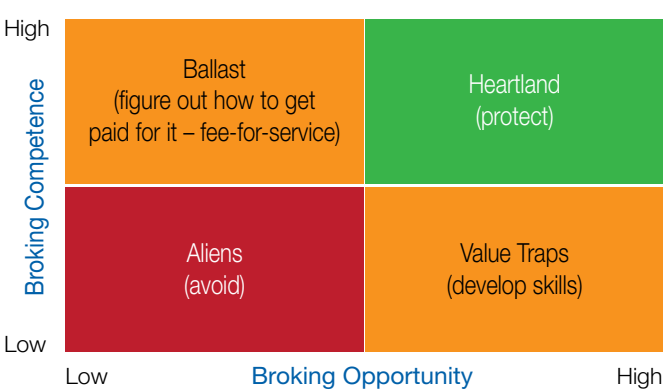


Figure 5.4 BrokerTarget Business Chart⁶

have the competence to do so, is critical.

We develop a Broker Target Business Chart (Figure 5.4) that brokers can use to identify core clients, based on two dimensions: Broking opportunity and broking competence. The **broking opportunity** dimension denotes a client that has value-generating potential for the broker. Typically, broking opportunities arise where a broker is able to improve a cedent's fit with a particular type of reinsurer: The brokers' matchmaking function. Where broking opportunities are high, brokers are in a good position to facilitate a renewal placement and reap rewards in the form of brokerage. In situations where cedent and reinsurer would have struggled to come together on their own accord, both will appreciate the broker's value added and perceive good value for money. **Broking competence** refers to the specific skills and services that a broker can bring to any cedent, which will enable that cedent to improve their access to capacity. As previously noted, different cedents have different requirements of brokers, so that a blanket approach to skills and services will not necessarily mean that all broking competences can also yield value in broking opportunities. The Broker Target Business Chart, thus, allows us to systematize the red, amber, green relationships identified in the Broker Matchmaking Map.

Those cedent-reinsurer combinations where brokers can add maximum value by unlocking capacity that cedents could not access on their own should constitute brokers' 'Heartland' business. Here, they enjoy a strong opportunity to add value and they have the competence to do so, as their services, such as structuring, pricing and information processing, help to match cedents with suitable reinsurers. The strategic implication is that brokers have to protect their Heartland business from competitors.

(6) Adapted from Goold, M., Campbell, A. and Alexander, M. (1994) 'Corporate Level Strategy: Creating Value in the Multi-business Company', NY: John Wiley & Sons.

5. Intelligent matchmaking: Adding value through brokers (cont.)

By contrast, constellations in which there is no broking opportunity because the respective parties' strategic orientations are too different to be brought together, and where brokers lack the requisite competence for matchmaking between them, are 'Aliens'. The strategic implication is that brokers should avoid these situations.

Situations where the broker feels they have good competence in an area, but there is such natural fit between reinsurer and cedent that they can easily do the deal without a broker, constitute 'Ballast' for the broker. The two parties are so well aligned that brokers cannot add much value through their traditional broking competences, such as distribution and technical support. As such relationships are unlikely to facilitate a placement and earn brokerage, the strategic implication is that brokers need to find a way to deploy their competence in new services that are remunerated independently. While there is no broking opportunity in facilitating these relationships, there may be ample opportunity in ancillary services, as noted in previous suggestions about fee-for-service with Global Buyers. Additionally, helping a reinsurer to strategically re-position may be an area through which brokers can generate revenues through service fees. There are still good opportunities to be found in "amber" areas of the map, as long as brokers recognize the necessity to act and do not become complacent in these areas.

Finally, those situations that present a good broking opportunity, but brokers simply lack the competence to facilitate them, constitute 'Value traps'. For example, in some areas a broking firm may lack access to market, due to barriers to entry from their competitors, or a lack of market specific knowledge about local regulations or conditions. As brokers are, thus, unable to either produce business in such markets or place it convincingly with reinsurers, cedents will work with a different broker that has the required competences. The strategic implication is that brokers either exit these markets, so not wasting time and resources trying to penetrate a closed market, or they address these situations quickly, ideally by developing or acquiring those skills that are required to take advantage of the broking opportunity.

"The clients actually value the role of the broker increasingly because they use the broker as their R&D a lot of the time. With some very large customers, we give them everything for a fee, rather than traditional brokerage. But have we got to the stage where we're measuring the intellectual capital appropriately? Probably not, we're probably giving it away for free."

(Broker)

5.3 Conclusion: Implications of change for brokers

These analyses indicate a number of critical points for brokers to consider for their current and future position in the reinsurance industry.

First, brokers who are over-exposed to Local Buyers as key clients are vulnerable to increasing competition over those players remaining after consolidation.

Second, technical, specialist, and market knowledge can underpin services that generate value to both cedents *and* reinsurers. A one-sided orientation as a cedent service provider is screening out substantial value-generation and revenue potential from services to reinsurers. Services to reinsurers can prove to be doubly beneficial, as they may generate revenue and facilitate future services to cedents.

Third, brokers' distribution networks need to keep pace with the evolution of global and regional cedents. While the leading brokers increasingly have critical mass and global reach, more globally integrated operations can greatly improve brokers' position in the market, helping reinsurers to access regional business, and broadening the capital pool for those regional cedents. To this end, however, brokers need to overcome their localised structures and set themselves up as globally integrated entities.

Fourth, brokers should protect those Heartland cedent-reinsurer relationships where they have the opportunity to improve fit, as illustrated by the Broker Matchmaking Map and Broker Target Business Chart.

Fifth, with broker value-added increasingly occurring independently of placements, brokerage is a problematic form of remuneration that needs to be addressed in order to ensure that brokers are rewarded for their services.

Key implications: Broker value

- The traditional Heartland space for brokers, of matching Local and Regional Buyers to all but the largest Portfolio Partner reinsurers is still profitable, but some sections are eroding.
- Brokers need to both protect their Heartland business but also develop new competences to access other business opportunities, which are likely to fall outside traditional placement services.
- The revenue streams and business models for these additional opportunities will need to be developed alongside the traditional brokerage business.

6. Conclusion: A word of caution

This report has highlighted a number of changes in the global reinsurance landscape and their implications for cedents, reinsurers, and brokers. In particular, we have noted how consolidation is driving change as a few key players who transact business on a global scale increasingly dominate the market. These changes are accompanied by a shift in reinsurance purchasing, and, consequently, reinsurance premium, from local programmes to bundled global programmes. It is important that reinsurers, cedents, and brokers recognize some of the more sombre implications of some of these trends. We, thus, end on a cautionary note.

Bundling risk is efficient and adds value to cedents. However, it should be treated with caution and observed carefully for the following reasons. First, such risks are remote from the specific primary insurance markets being covered, and so may not easily reflect the current cycles and state of development within those different markets. This means that the deep knowledge of specific markets that typically underpins underwriting judgement is less applicable. Secondly, transparency is reduced, as it is difficult for reinsurers to tease out the assumptions about capital efficiency and diversification that underpin bundled risks. While complex forms of efficient frontier modelling may underpin the bundling, the reinsurance underwriters who assume the risk do not easily understand the assumptions on which such modelling is based. Third, bundling increases the global connectivity of reinsurance markets and, with it, the potential for surprise exposures that have global ramifications, as indicated by the supply chain interruptions incurred in the 2011 Thai floods. These three factors, which

increase complexity and connectivity in financial risk transfer and obscure professional judgement, have a poor history in other financial sectors.

The reinsurance industry has avoided the seduction of models thus far, retaining underwriter judgement alongside increasingly technical evaluation of risk. It is important not to lose sight of this rare quality in a capital market. In particular, reinsurance is based on the transfer of risk between two parties, both of whom are risk carriers. That is, reinsurance risks are not traded-off ad infinitum, but are specifically exchanged between a buyer and a seller for the financial protection of both parties. It is undoubtedly important to support judgement with technical analysis, and to generate greater capital efficiency for all players. However, we urge the reinsurance industry to be cautious in embracing complexity and global connectivity, and to retain its focus on judgement.

Key points of caution

- Reinsurance bundling increases the complexity of financial models and global connectivity of markets
- Increased complexity and connectivity in financial risk transfer have a poor history in the banking sector
- We urge the reinsurance industry to be cautious in embracing complexity and global connectivity, which predisposes an increasing reliance on financial models, and to retain its focus on judgement

Appendix: Participating organizations

We would like to thank the 58 firms that participated in this global study.

Of the 17 participating firms in Phase 1 of this study (2009-2010), the following eleven agreed to be named:

- Amlin
- Aon Benfield
- Ariel Re
- Axis Reinsurance
- Brit Insurance
- Hiscox
- Kiln Group
- Liberty Syndicate Management
- Talbot Underwriting
- Tokio Millennium Re
- Validus Re

Of the 11 reinsurers who participated in Phase 2 (2011-2012), the following seven agreed to be named:

- Amlin Re Europe
- Asia Capital Re
- Catlin Re Switzerland
- Mapfre Re
- Munich Re
- Partner Re
- SCOR

Of the 37 brokers and cedents who participated in Phase 2, the following 29 agreed to be named:

- Achmea Reinsurance Company N.V.
- Aon Benfield
- Aioi Nissay Dowa Insurance
- Allianz Re
- Amlin plc
- AXA
- Coface
- Euler Hermes
- Farmers Mutual Hails Ins. Co. of Iowa
- FM Global
- Hiscox
- IAG
- Iffco Tokio General Insurance
- ING
- Jubilee General
- Liberty Mutual
- Mapfre
- Menora Mivtachim Insurance Ltd.
- Overseas Assurance Corporation
- Oriental Insurance
- Pioneer Insurance
- QBE
- Suncorp
- Tokio Marine Nichido Fire
- Tugu Pratama
- Vereinigte Hagelversicherung VVaG
- Vienna Insurance Group
- VVAA
- Zurich