Although the Bermuda market has traditionally focused on property/casualty reinsurance and alternative risk transfer, over the past decade the market has broadened and today life insurance plays a major role in the market. **David Huntley**, chief executive officer of Scottish Re examines this change in direction.

Life changing decision

The Bermuda market came to life in the early 1970s, with the introduction of captive insurance. In the intervening 30 years, Bermuda has never lost the lead in captive insurance, and remains a pioneer in the growing use of risk retention groups, association captives, rent-a-captives and, lately, segregated cell companies. Today, the Bermuda market boasts capital and surplus in excess of US$50 billion and underwrites almost every conceivable line of business, including all the traditional covers, as well as more esoteric products such as political risk and securitisations. Estimates place Bermuda's share of the global captive market at around 30 per cent.

In the mid-1980s, ACE Ltd and the company that is now called XL Capital Ltd, both Cayman Islands-registered association captives, opened offices in Bermuda in response to severe shortages in the excess liability market. Both have since become global insurance and reinsurance giants. ACE and XL remain headquartered in Bermuda, in buildings that stand side by side on the former premises of the Island's flagship hotel property.

In 1992 and 1993, a 'third wave' of Bermuda reinsurance companies was formed in the wake of Hurricane Andrew. Eight companies brought a total of US$4 billion of capital to the global catastrophe reinsurance market, establishing Bermuda as the pre-eminent location for such activity and ending forever the perception that a sunny mid-Atlantic island was no place for serious business.

Following the events of September 11, 2001, existing companies in Bermuda raised about US$8 billion to reinvest, an amount almost twice as large as the net losses they incurred that day. A similar amount was introduced to the Bermuda market by seven new companies that intended to write a mix of insurance and reinsurance.

Despite the predominance of property/casualty reinsurance and later insurance in the Bermuda market, in the late 1990s life reinsurance was first introduced to Bermuda. A number of entities have established varying business models, most of which use subsidiary companies operating from Bermuda offices. One US-based company operates its life reinsurance division as a Bermuda subsidiary. The Bermuda life sector is otherwise almost entirely composed of subsidiary divisions of large international insurance companies; the independence of the Scottish Re Group makes it the exception.

Total Bermuda insurance assets are expected to exceed US$200 billion by the end of 2003. A remarkable talent pool now mans the Bermuda insurance and reinsurance industry, which is centered in the capital, Hamilton. It is hard to think of a major insurance or reinsurance capitalisation in the past three years that has not taken place in Bermuda.

The global life reinsurance market

The amount of risk that life insurers are choosing to cede to reinsurers has increased steadily in the past 10 years. By one estimate, the percentage of business ceded by life insurers in 1993 was 15 per cent, but by 2000 that figure had increased to 64 per cent. That number has almost certainly grown further since 2000.

This has not only meant more business for reinsurers, but an increasingly important role for the reinsurance industry in the way the life insurance industry manages its risk. Partly as a result, an increasing number of life insurers are focusing their efforts on their core strengths of marketing and asset gathering and management, their risk tolerance having declined.

Simultaneously, the number of companies writing life insurance has fallen. The insurance industry in the United States of America alone has contracted by almost 1,000 companies in recent years. Contractions have occurred in all the global markets, including Europe and the Far East. Meanwhile, the basic life company business model has shifted from that of underwriter to that of asset manager. Regulatory, demographic and economic conditions have further altered the shape of the market, as increased demand has been met by reducing supply—the classic recipe for market shortages.

The number of companies writing life reinsurance has similarly contracted, through consolidation and the reallocation of capital. Other companies have demutualised, further concentrating reinsurance capacity.

The reinsurance industry has been contracting at exactly the moment when the need for reinsurance is being vividly underlined by events, which have in turn caused some reinsurance companies to

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concentrate on their core facilities and exit lines in which they have no further interest. Despite the obvious and increasing demand for reinsurance, shortages have been reported in certain lines. The capital markets are not perfect and, from time to time, inconsistencies arise. The necessary reinsurance capacity exists, but the terms and nature of coverage have been at odds with the expectations of those insured.

'Baby boomers', those born during World War II and in the years immediately succeeding it, are now mostly middle aged or approaching retirement age. An increasing number of this generation is taking an interest in products that address retirement planning, estate planning and survivorship issues. The Boomers have come to accept such notions as retirement planning rather later in life than their immediate predecessors.

The zeal with which financial planning is approached increases as the number of years before retirement dwindles. Longer life expectancies and the reduction in government- and employer-sponsored benefit programmes will likely increase demand in the commercial market for life insurance and annuities. This increased demand for insurance will in turn further increase demand for reinsurance products.

Approximately US$2 trillion of new life insurance is written annually in the United States of America; international markets, as a whole, are growing at rates twice as great, with development in several other countries proceeding at even higher rates. The life reinsurance industry is projected to grow at between eight per cent and 12 per cent over the next five years.

Market outlook

Significant growth in the amount of business ceded to life reinsurers in the US market in the past decade has raised the level of life reinsurance to about one-quarter of the total premium mix of the major European reinsurance companies. The basic goals of the ceding companies are risk transfer and financial support. A variety of lines—pure mortality risk products, term reinsurance, financial reinsurance, administrative reinsurance and block assumption deals—have been used. The 10 largest life reinsurers hold more than 90 per cent of the dominant US life reinsurance market, and further consolidation may be expected.

In traditional reinsurance, reinsurers are often able to price mortality risk lower than their ceding clients, sharing the differential. In financial reinsurance, a regulatory arbitrage takes place, as the reinsurer is permitted to keep a lower capital and reserving level than the direct insurer.

Traditional life reinsurance in the United States of America now accounts for two-thirds of the global market. US traditional life reinsurance is no longer expected to grow faster than the direct market. The European and other global traditional life reinsurance markets are less developed, and are expected, therefore, to demonstrate better growth prospects.

Despite a recent pricing upturn in the US life reinsurance market, profitability still favours the European markets. After a decade of decline, the US life reinsurance market is now experiencing price increases, but due to the rising cost of letters of credit, a slowdown in economies of scale following lower market growth, and investment income limited in the low interest rate environment, this may not translate fully into higher profitability for the reinsurance companies ■

Scottish Re Group Limited: Overview

Bermuda-headquartered Scottish Re Group is the only independent, global life reinsurance specialist in the world and a leading issuer of customised life insurance-based wealth management products for high net worth individuals and families.

Scottish Re's clients are global, and to service them efficiently, the Group has built a worldwide platform with operating companies in Bermuda, Charlotte, North Carolina, Dublin, Ireland, Grand Cayman and Windsor, England.

At September 30, 2003, the company's total assets were US$4.2 billion. The core investment portfolio, comprising fixed maturity investments and most of the company's cash and cash equivalents, totalled US$1.8 billion, and had an average quality rating of A+, an effective duration of 4.3 years and a weighted average book yield of 4.8 per cent. At the same date, the company had approximately US$105.2 billion of life reinsurance in force covering 1,972,000 lives, with an average benefit per life of US$53,000, in its North American operations.

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