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Market View: Treading carefully in the year of the Dragon
By Peter Philips , Managing Director , Markel International Singapore

The outlook for general insurance in Asia has never been so uncertain. It's often said that the future is conditioned by the past and certainly 2012 will be heavily influenced by the events of 2011 which saw an unprecedented series of natural catastrophes in the Asia Pacific region – truly an "annus horribilis".

It started with the floods which covered most of Queensland, quickly followed by two earthquakes in Christchurch which caused such severe damage that parts of the city have been abandoned. Then there was the quake and tsunami in Japan which not only caused serious damage to buildings but also inundated vast tracts of agricultural land. And to round off the year, the catastrophic flooding in Thailand.

Unlike previous events which are priced into insurance premiums as there is a known risk of catastrophe, the magnitude of the floods in Thailand came as a shock to the market and no specific reserves were being held for such an event. It is difficult to put a precise number on the total losses to the market but estimates range from US$10 billion to US$20 billion.

As if the heavy losses for physical damage were not enough, insurers' agony is compounded by claims for business interruption being filed - mostly in Japan - for loss of revenue due to supply chain failures as a result of the floods in Thailand. A real double whammy if ever there was one! In hindsight too much of the world's manufacturing capacity for auto parts and components were concentrated in industrial estates around Bangkok. A failure of risk management perhaps?

Needless to say, the impact on the insurance and reinsurance markets in Asia is severe. A number of insurers have been in the market buying back ups for their depleted treaty reinsurance programs in order to stay in business. Treaty reinsurance is a form of contingent capital available in the secondary market which enables insurers to offload some of their risk and protect their own capital. Without it insurers are unable to trade. Many reinsurers have now withdrawn flood cover, fearing a repetition and the pricing of Thai risks has increased substantially in order to restore depleted capital.

Another key concern is the amount of Eurobonds held by insurers especially the multinational insurers and reinsurers who provide a sizeable chunk of the capacity supporting Asian markets. It is not inconceivable that we could see the perfect storm – investment write downs in 2012 following hot on the heels of 2011's disastrous trading results.

No wonder the rating agencies are getting twitchy. Downgrades for the more vulnerable insurers and reinsurers are looming and could trigger the loss of key contracts as well as drain customer confidence.

Who knows how things will turn out in the year of the Dragon? Despite the good fortune, confidence and power imputed to the Dragon year, one thing's for sure, companies with weak balance sheets, flawed capital structures or inadequate reinsurance will be exposed. As Warren Buffet once said, "You only find out who is swimming naked when the tide goes out".