

reinsurance

MORE THAN JUST A LEADING MEDIA BRAND



STILL IN THE LEAD?

Is London doing enough to see off its threats?

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BLOWING UP A STORM

There is still two months until the North Atlantic hurricane season officially begins and it rarely reaches a peak for another five months but the usual parties are already releasing their early forecasts

For the first time in several years the first forecast out of the blocks – Colorado State University’s (CSU) Qualitative Discussion, issued on 21 March – is predicting a below average wind season.

It says: “The combination of a warming tropical Pacific and a cooling tropical Atlantic are leading us to think that the 2012 Atlantic hurricane season will have less activity than the average 1981-2010 season.”

On the face of it good news for the re/insurance industry, but then comes the disclaimer.

CSU says: “However, we stress the need to realize that there is inherent uncertainty in seasonal tropical cyclone prediction. In addition, hurricanes can make landfall in inactive seasons and do major damage (e.g., Alicia in 1983 and Andrew in 1992). Coastal residents need to prepare the same for every hurricane season.”

Well, there are two points in there, first an admission, which will come as a surprise to few that the forecasts, particularly at range are not always accurate and second a warning that it only takes one storm to create a major loss.

James Few, President, Aspen Re, says: “There is some suggestion in scientific circles that we will see

an El Nino later in the year, and you would expect this to suppress wind activity in the North Atlantic. But it is too soon to be sure.

“Short-term forecasts have limited use. By the time you know whether a storm will make landfall the underwriting decisions have long been made. We currently underwrite our portfolio on the assumption that there will be continued heightened activity and do not usually make changes during the year [in response to short-term forecasts].”

Mr Few continues: “We look at both the short and longer-term forecasts. The longer-term are more helpful in setting the scene. We are currently in a period of heightened activity, which began around 1995, and we expect that to continue.

“Short-term forecasts are not overly helpful as they are not sufficiently accurate to have any major effect on underwriting in any given season.”

Karen Clark, President and CEO of Karen Clark & Company, agrees: “They do not particularly have a very good track record, particularly when it is this early. People are thinking it could be a low activity year because of the El Nino and sea surface temperatures and things like that.

“Most of these predictions are for storms forming in the North Atlantic and not for landfalling hurricanes.



Even when they do get it right it does not necessarily correlate to landfalling storms, and to get to insured losses is an even bigger leap.”

She adds: “These things happen randomly. All you need is one storm to hit a populated area for a major loss to occur. Even if this year is a low frequency year we could see a 1-in-100 year event.”

Efforts are being made to close the gap between the forecasts for storms forming out in the Atlantic and the rate of landfall on the US coastline.

The UK’s Met Office recently issued a report that provides an analysis of the HURDAT historical hurricane dataset, split by landfall region and intensity, and compares three methods for detecting hurricane landfall.

Years with warmer Atlantic sea-

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THE UNDERWRITER CAN SEE WHEN A STORM HITS A CERTAIN AREA WHAT THEIR LOSSES WOULD BE *KAREN CLARK*

surface temperatures are also independently analysed to indicate the effect this has on landfall statistics.

Dr Matt Huddleston, Principal Consultant at the UK Met Office, said: “This product is based on the Met Office’s world leading expertise in weather and climate. It takes an open and transparent approach to analysis of historical hurricane landfall rates.

“Underwriters and catastrophe risk managers will be able to understand the data and statistical methods being used, and apply

them in their own risk management approach. We discuss the limitations in the methods, error measures and interpretations, drawing on key peer-reviewed scientific papers, to give as comprehensive a picture as possible.”

Dr Huddleston adds: “The need for a fuller understanding of past and future extreme weather impacts is critical for the stability of the finance and insurance markets.”

Meanwhile, there is also a growing use of characteristic events (CEs) to assess and manage hurricane risk.

The CE methodology uses defined-probability events with characteristics representative of specific return period events for a given region to provide insurance and reinsurance companies with estimates of hurricane losses.

Ms Clark says: “We have a new approach. The CE methodology takes the representative return period event and applies it to every region. It is a scientifically based approach that uses the same data as the models. It takes the 1-in-100 year event and spreads it across the whole coastline.”

She adds: “The underwriter can see when a storm hits a certain area what their losses would be. You do not want your exposures all in one place because that could wipe you out. Most of these ‘Black Swan’ events were events we had imagined could happen, they just happened in places we did not expect them to occur.”

Of course underwriters already use catastrophe models to aid underwriting decisions in hurricane-exposed areas. Last year as notable for the release of RMS Version.11 (V.11), which caused a furore with its assessment of hurricane risk.

Mr Few says: “RMS is one of the most instrumental modelling companies, and therefore people tend to listen to their perceptions of risk. If a company like RMS releases

a significant change in its perception of risk in a single release, it can be complicated for insurers and reinsurers to address all at once.”

He adds: “Management teams have been looking closely to see how RMS reached its conclusions. We are increasingly seeing that the science being put forward by RMS is being accepted as valid, and people are coming to terms with it.”

Mr Few says: “Analysing and applying models such as V.11 takes time and can be complex for buyers and sellers. More and more people are accepting the V.11 view, and therefore we expect rate increases to continue. We saw 10-15% rate increases at 1/1 for US wind and we expect this to continue in the remaining renewal periods this year.”

Stefano Nicolini, SVP at reinsurance broker BMS agrees that V.11 will continue to fuel increased demand for cover this year.

He says: “Going forward applying RMS Version.11 is going to push people to buy more. The rumour in the market is that Citizen will buy significant limits, Texas Windstorm Insurance Association (TWIA) is looking to buy more limits as well.”

Mr Nicolini says: “The price of the business is more important than the forecast for underwriters deploying capacity. We expect an increase in demand for Florida so prices may go up. Prices can’t go up too much though or they will become uneconomical.”

He continues: “Based on supply and demand in the traditional market buyers may start looking at ILW’s as a potential arena for additional capacity. I would say that looking at ILW prices last year you had pre-Japan and then a big spike after Japan. What we have seen is that prices were 15% higher this January than the 2011, which was pre-Japan and down about 5% now compared to the spike price.” □