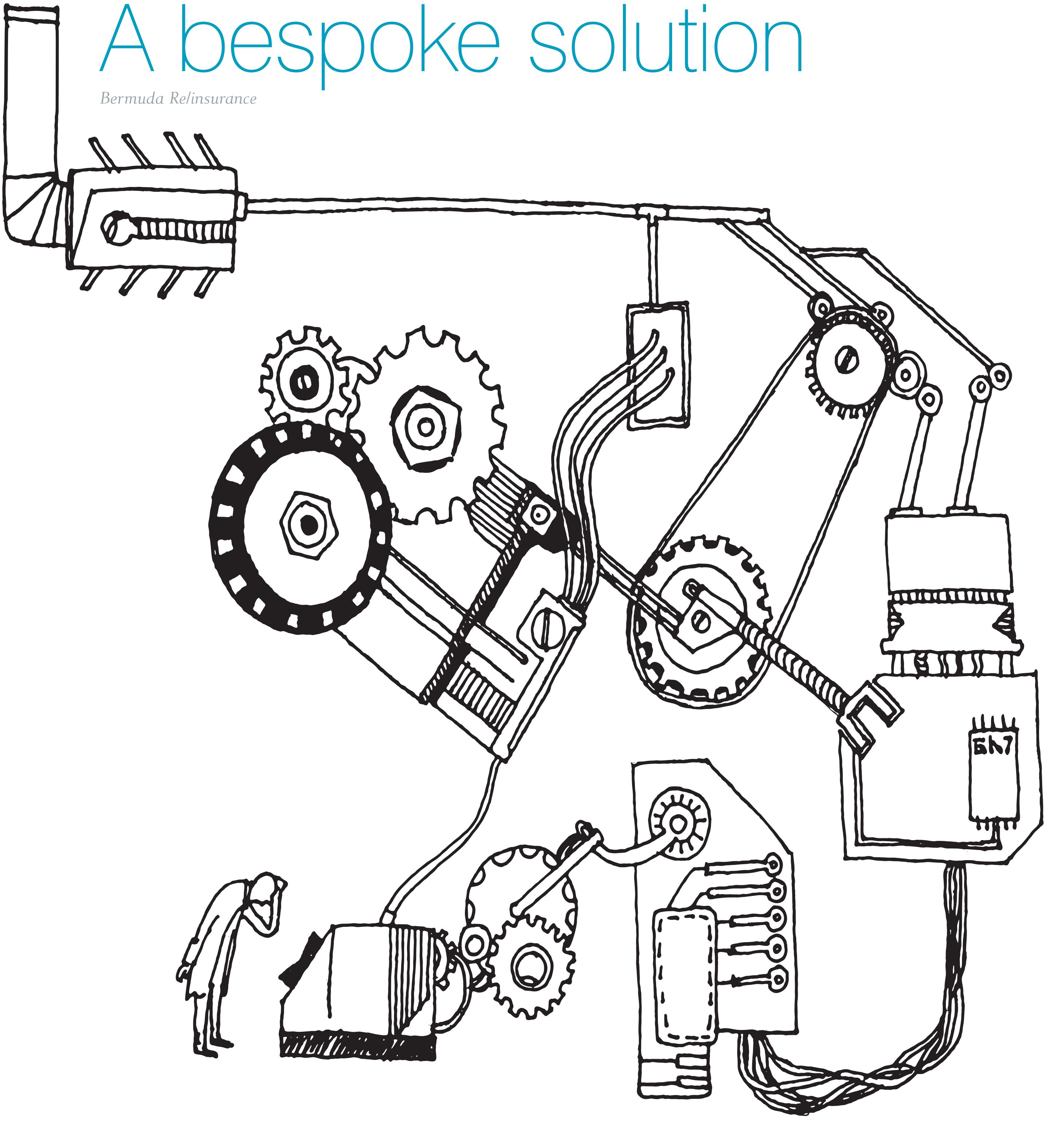
A bespoke solution

Bermuda Re/insurance



The role of facultative reinsurance may have diminished somewhat over the years, but it remains a vital part of the reinsurance industry, particularly in providing coverage to difficult to place and emerging risks. Bermuda Re *spoke with XL Group's Facultative Reinsurance leaders about its continuing value proposition.*

While facultative reinsurance may not enjoy the market share of treaty business, it is clear from talking with the facultative experts at XL—Kip Walker, manager of the North America property facultative reinsurance operations and Alex Galea, manager of the International property facultative reinsurance operations—that facultative reinsurance continues to play a valuable role in providing targeted and bespoke coverage to global insurance clients.

As Walker explained, "the beauty of facultative reinsurance is the ability to tweak the coverage and really dial it in to match your clients' needs". Such coverage does not work in a vacuum he said, rather it provides a welcome addition to traditional treaty coverage, acting "like a puffer fish" that can fill out limits or can fill gaps in an insured's treaty coverage that would otherwise be difficult to fill due to the inherent limitations associated with treaty portfolios. Walker said that facultative coverage enables clients to fill out the programme in small pieces. "Perhaps you've got an account being written by your client and it has a particular coverage, peril or location with which they are uncomfortable. With facultative you can simply pick off that little bit, that one troublesome piece, and get that covered."

It is in providing positive synergies to treaty portfolios that facultative reinsurance can really add value. Galea said that XL's facultative offering sits alongside its treaty business, with excellent communication across the two teams. "This synergy enables us to really understand our clients' exposures and offer solutions that fit their specific needs in a structured way," he said. Coupled with close client interaction, the team at XL are able to best understand the reinsurance needs of their clients and deliver accordingly.

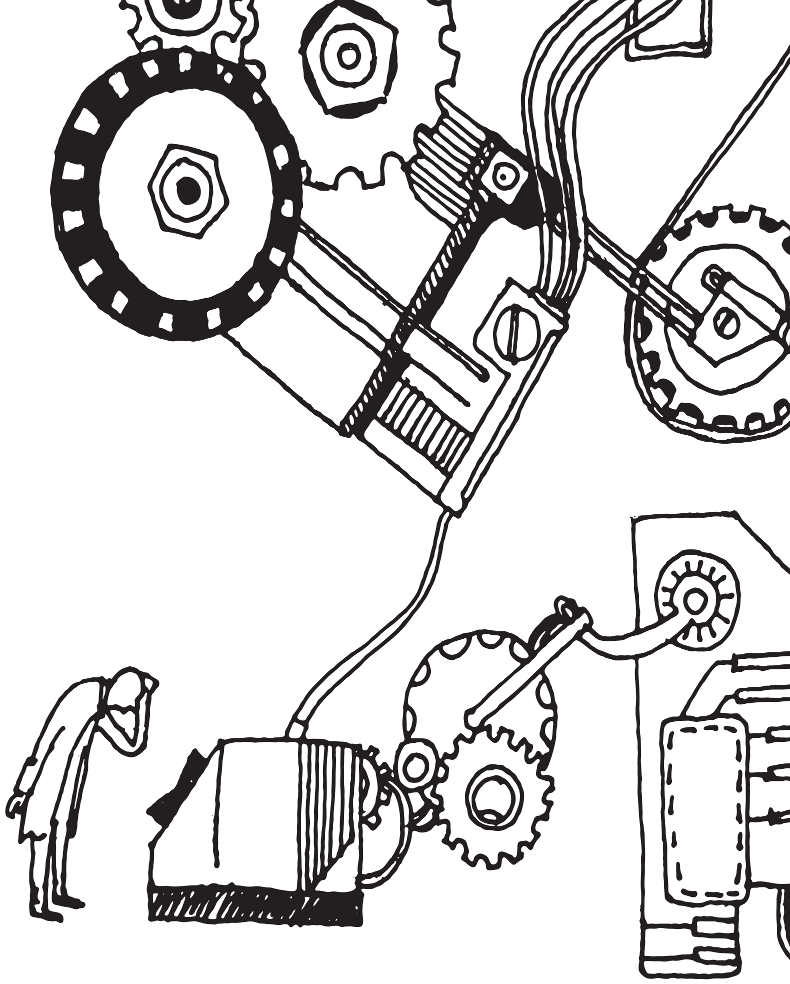
Intellectual capital

Facultative reinsurance offers a welcome addition to insurers' toolkit of options, but also provides an additional pair of eyes to look over portfolios and exposures. As Galea outlined, one of the key benefits of facultative reinsurance is the "additional intellectual capital" it can deliver to the client. He explained that facultative underwriters tend to have a necessarily deeper understanding of the exposures they are writing, knowledge that can be of enormous benefit to the client. This understanding enables them to have a comprehensive two-way conversation, not just around price, but also around their understanding of risk, said Galea. "This two-way traffic of information can be immensely valuable to a client looking to understand and mitigate difficult specific risks," he added.

Walker concurred that the facultative product acts as a form of "peer review" of a portfolio, which can play an integral role in the structuring of risk. "Clients may come to us with one expectation," he said, "but if they're open to solutions or options we may ask, 'have you considered looking at it this way?'." This is where the facultative option can come in, offering bespoke solutions that provide clients with a better understanding of their portfolio and the reinsurance options available to them.

When it comes to what exactly facultative underwriters bring to the table, it is evident that a more hands-on approach to underwriting can offer considerable benefits to insurance clients. Galea said that facultative underwriters typically spend far more time working with brokers and ceding companies in order to provide insights into their exposures, "providing feedback on risk management procedures, business continuity plans, and our thoughts regarding probable maximum losses". Insurers are often looking for another set of eyes to look over the assumptions when it comes to the type, scale and shape of coverage, he said, and facultative underwriters can offer them exactly that. "Treaty underwriters on the other hand tend to be focused on statistical indices, something that suits the examination of a wider portfolio," he noted, but hardly offers the in-depth insights that form an integral part of the facultative offering.

As Walker explained, "a treaty underwriter might only have two touch points with the customer throughout the year—at the



annual renewals and as part of an annual review of files. Facultative reinsurance involves multiple touch points throughout the year, with regular weekly and monthly meetings directly with the underwriters who produce the business, and the management teams and brokers that represent the company". It is very much a direct and ongoing dialogue, said Walker, whose US operations expanded this year with the opening of offices in Dallas, Texas and Philadelphia, Pennsylvania so he can be in closer proximity to his clients.

Facultative reinsurance also offers clients more options when it comes to their ability to select ceded business, something that is becoming increasingly significant as insurers strengthen their financial positions and retain more business. Galea said that facultative reinsurance enables primary players to consider what exactly is the right formula for their balance sheet and what business they should consider ceding and retaining. "Facultative coverage enables them to take out big spikes associated with a single peril or geography, providing insurers with a valuable addition to their risk management toolkit," he said.

Emerging opportunities

Addressing the continuing development of the facultative offering, Walker said that he expected it to be both more client-focused and risk-specific going forward. "In the end it is about getting closer to the client and talking with them about risk solutions that enable them to write their business more efficiently. That's a key part of what we do here at XL." He said that the facultative offering works particularly well for those companies that don't want to enter into significant treaty obligations, with considerable opportunities evident in emerging markets.

Galea concurred, adding that facultative reinsurance has an invaluable role to play in such markets, "delivering capacity and expertise on a bespoke basis". He explained that with large US and international corporates looking to develop a presence in emerging economies, facultative reinsurance enables them to get a true handle on their exposures and tailor their reinsurance buying accordingly—"something only facultative reinsurance can truly do".

As Galea explained, "the knowledge an experienced facultative underwriter can bring to bear in such relationships enables clients to better manage their individual risks—whether it is in growth areas or emerging markets". This is an attractive proposition for those considering developing a presence in new lines and geographies, particularly as developed economies look to countries such as the BRICS (Brazil, Russia, India, China and South Africa) for growth. Walker said that the facultative model is a perfect fit for such markets, with companies like XL able to deliver much-needed capacity and expertise quickly and—thanks to increasingly sophisticated IT and communications—often without the need for an extensive presence on the ground.

Walker said that while technology would not replace the need for face-to-face interaction, XL is paying close attention to how IT can strengthen the facultative offering. "We are 100 percent committed to understanding how this is going to change our business and make operations more efficient. Our business is so transactional in nature that it is tailor made for improvements through technology." Advances such as social media, real time reporting and cloud computing all have the potential to change the way that re/insurers transact business and should enable reinsurance underwriters to achieve greater proximity to the client, said Walker. Such changes will undoubtedly be watched with interest by a section of the industry that has further developed its close and bespoke interaction with clients.

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Sandy: an opportunity

Facultative reinsurance was given an opportunity to prove its worth following October 2012's Hurricane Sandy, with facultative underwriters able to extend considerable, and much needed, capacity to the market post-event. As Walker explained, a host of insurance policies had seen their annual aggregate limits breached by the storm. This left a number of insurers exposed following the event and many turned to the facultative market to fill gaps in their exposures. "Those who were caught off guard by the event, turned to the facultative market," said Walker. "And here at XL we were able to step in and extend needed flood capacity to our clients." ■