



REINSURANCE IN RUSSIA VIEWED BY INSURANCE BROKERS

RNRC's Project | Moscow 2017



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About project

Reinsurance, by definition, is a global business based on diversification of risks by types and territories. In doing this business, Russia traditionally cedes more of its risks to the international market, than accepts them from foreign insurers.

According to the official data of the CBR for 2016, premiums under reinsurance contracts ceded by Russian insurers totaled RUB 132.1 bln, of which RUB 112.5 bln was paid to foreign insurance and reinsurance companies, and only RUB 19.56 bln was earned by Russian companies.

The total insurance premium under reinsurance contracts ceded in Russia was RUB 35.89 bln, including RUB 16 bln ceded from abroad. Payments under such contract amounted to RUB 16.5 bln, of which RUB 8.7 bln was paid under reinsurance contracts accepted by Russian reinsurers from abroad.

Understanding the situation with Russia's missing out on profit from inward reinsurance and identifying the tendencies and trends in the development of the Russian reinsurance market as part of the global marketplace was the key goal of the survey conducted by Russian National Reinsurance Company among the Russian and international insurance brokers, including those operating in Russia.

The brokers were chosen as experts because their business specifics are the most indicative of the dynamics of market processes viewed internally and make them the most insightful about the market situation. Brokers active on the global markets willingly share their analytical data through annual reports. The current project is designed to summarize them and conceptualize the general attitude toward reinsurance in Russia, both for the professional community and for mass media.

The survey was carried out in 2017 by way of interviewing the recognized top managers of the leading insurance brokers. The survey-related questionnaires featured open questions and encouraged free-form rendition of views and opinions within 5 groups of questions:

- I. Tendencies and trends on the Russian and global reinsurance markets
- II. Forecast for the development of the domestic reinsurance market
- III. Forecast for the development of outward reinsurance in Russia
- IV. Forecast for the development of inward reinsurance in Russia.
- V. RNRC

The survey encompassed 11 companies:

- RFIB Group Limited
- Malakut Insurance Broker
- Marsh Insurance Brokers
- Willis CIS Insurance Broker
- Aon Rus Insurance Brokers
- Guy Carpenter & Company ltd
- Greco JLT
- RIFAMS Insurance Brokers
- Skala Insurance Broker
- Sealine Insurance Brokers
- ASB

RNRC profoundly appreciates their constructive attitude and is grateful for their contribution.

I. Tendencies and trends on the Russian and global reinsurance markets

1. Key tendencies on the reinsurance market in Russia and worldwide

The global insurance and reinsurance markets were both affected by the global economic crisis. The insurance markets are stagnating, and the demand for reinsurance services is lowering. At the same time, a continued reduction in the key rates makes it more difficult to ensure profitability of investment life insurance, which attracts investors to the reinsurance business. While the global market is expanding, the demand remains level, and prices are dropping. The so-called «soft market» is a commonplace in the answers of the respondents when they talk about the key trends in the reinsurance industry.

According to the head of Willis CIS Insurance Broker, Alexander Starostin, “the ongoing price drop, which hit the reinsurance segment yet in 2012, will continue into 2017 - 2018.” “At that, the reinsurance market demonstrates unprecedented financial stability,” argues Starostin. “Intelligent Insurer reports that the London market can absorb a loss as great as USD 200 bln, which is four times the loss from the September 11 terrorist attacks, and twice as much as the Hurricane Katrina impact.”

Among the reasons behind the “soft market”, the respondents see the following factors:

- absence of catastrophic losses;
- more M&A deals, with the resulting market consolidation and agglomeration;
- high capitalization of insurance and reinsurance groups, growth of net retention and, as a consequence, lowering demand for reinsurance;
- active involvement of the “new markets” companies – BRICS etc.;
- inflow of alternative capital to the reinsurance market;
- decline in premiums because of the centralization trend among large companies versus regional programs, which improves diversification to comply with Solvency II.

*Alexander Starostin, Willis CIS IB:
“In the last few years, the focus of the international obligatory reinsurance has increasingly been on Solvency II products –*

protection from catastrophic risks, quota reinsurance for Solvency purposes, capital management for insurance companies etc. This has caused the philosophy of reinsurance protection to change.”

The Russian reinsurance market is, on the one hand, influenced by the global trends, and on the other hand, has its marked specifics. For instance, the scope of the Russian reinsurance market, according to the survey participants, shows a downward trend, currently seen throughout the world, due to amalgamation of companies and increase in the net retention. However, mergers and acquisitions are not the only reason, as companies also tend to leave the market, either on their initiative, or prompted by the regulator. Also, among the purely Russian tendencies, the brokers operating in Russia mentioned:

- more balanced approach to risk acceptance in form of net retention because of the exit of some insurers and agglomeration of the market;
- dwindling capacity of the Russian market, in particular, through company’s net retention;
- reduction of rates, which is outpacing the average global reduction;
- reduction in facultative risks as a result of the expansion and growth of the obligatory capacities of insurers;
- cedents’ current refocusing from Russian to foreign reinsurers, with a resulting decrease in the number of specialized reinsurance companies due to their shrinking basis of life;
- growing number of obligatory programs and facilities;
- more selective approach in accepting classical risks for reinsurance;
- growing interest to non-classical insurance products and softening of the decision-making systems;
- development of co-insurance for specific risks among Russian companies;
- African and MENA companies’ considering risks from Russia, the CIS and Middle East;
- return by some cedents’ to proportional reinsurance as a sign of immature market and low profitability in direct insurance.

Answering the question about the most relevant and notable events influencing the global development, the respondents named Brexit in the first line, as well as huge losses from natural calamities which occurred in 2016 and the appearance of specialized MGA type general agencies with underwriting powers. In Russia, the most noticeable impact came from the continued sanctions and the establishment of the national reinsurer – RNRC.

2. Cost of reinsurance

On the soft market, the cost of reinsurance tends to decrease, but not as fast as before, the respondents say, and prices are dropping, both for obligatory and facultative reinsurance. The only exception is war risks, including aviation risks, and terrorism risks, especially in conflict zones, such as Yemen, Iraq, Syria, and Turkey, where rates are showing an increase. The global market, amid a general reduction of reinsurance costs for large facultative risks, sees toughening requirements for the minimum premium on a reinsurer's share in small risks.

Most respondents concur that it is reasonable to talk about a more serious overall approach to assessing risks and setting rates in Russia, although Russian companies still often look back at the western market practices.

Nikolai Belyusov, Chief of the Moscow Office of Guy Carpenter & Company Ltd, says: "There were certain significant losses on the Russian insurance market, such as explosion at the Achinsk Refinery and soil subsidence under the engine room foundation at the Zagorsk Power Plant. However, with a shift in the Ruble exchange rate, which reduced the amount of currency losses in Euro, these losses were covered with much lesser amounts than expected. As such, the premium rates on the Russian insurance market were moderately impacted by these events."

3. New solutions in reinsurance

Each year, new products, suggestion and solutions for reinsurance find their way to the market, but according to the respondents, they are not normally intended for Russia. This is true, in the first place for the dramatic growth of the InsureTech segment, actively supported by global reinsurers. This is why the mainstream products are now those based on parametric triggers, reputational and cyber risks insurance. "Unfortunately, it is still too early to talk about the demand for such products in Russia," says Konstantin Rogozin, Director General of Malakut IB.

Among the interesting trends, the respondents listed the following new features:

- customized reinsurance solutions specific for local markets;
- inclusion of terrorism and political unrest risks in the comprehensive risk portfolio;
- insurance of unmanned aircraft and liability to third parties arising in the use thereof (the latter has already become a must in some countries);
- damage to property and business interruption as a result of malicious acts with the use of nuclear, chemical, biological and radiation materials;
- terrorism threat leading to losses because of business interruption, denouncement of events and lost profit;
- coverage for losses arising from an actual or attempted attack by one or more people;
- coverage for events causing profit decrease because of "loss of attraction" for clients in the tourist, hotel and other industries, such as acts of terrorism and natural calamities;
- products designed to protect financial performance – profit, dividends, and to reduce volatility – combined ratio, loss ratio, other KPIs (such products are structured through multi-line/multi-year solutions);
- index-based products (parametric solutions);
- securitization of risks (insurance linked securities);
- reinsurer's assistance in the development of a direct insurance product with an integral reinsurance solution;
- reinsurance solutions for insuring trade credits and entrepreneurial risks;
- reinsurance for construction and installation bonds; appearance of C&I capacity;
- improved diversification through the exchange of portfolios between territories as part of quota reinsurance.

According to Nikolai Belyusov from Guy Carpenter, "the primary application for the new reinsurance methods is the world of global retro protections, where about 50% of cash coverage for risks comes from alternative sources of capital (mainly from direct investors, rather than from traditional reinsurers). Examples of this are instruments, such as "catastrophic bonds", special investing instruments used to place third-party capital as part of reinsurance underwriting and limited in time on a "hard" market, insurance-linked securities which allow transferring insurance risks to the capital market."

Irina Gromova, Deputy Director General of RIFAMS Insurance Brokers, says: "In Russia, all new products appear as a replica of foreign analogues, for example, reinsurance of cyber risks or environmental risks, but their presence does not imply development so far as they are not matched with adequate demand."

4. Demand

Soft market suggests a stagnant demand. Most respondents think that the demand for facultative reinsurance follows a downward trend due to redistribution of reinsurance flows as a result of companies' consolidation, and in Russia – because of the market exit trend. There is a sufficient market capacity, both in Russia and globally, for obligatory products. Exceptions are non-standard reinsurance types, such as developers' liability.

Anastasia Farber, Director General of Sealine Insurance Brokers: "The reinsurance capacity decreased in Russia in a specific way due to a decrease in the number of players on the Russian reinsurance market who were actively dealing with inward reinsurance – this, in particular, limited the diversity of approaches and risk appetites. The appearance of RNRC, certainly, mitigates the situation; however, its first steps for the moment are discreet, and there is still a lack of capacity».

Capacity deficit is only seen by the experts in the sanction and nuclear risks segment. They also point to demand growth for reinsurance of large sanction risks and risks with moderate rates (shipbuilding, inventory etc.).

Notably, some of the world's largest risks, such as the earthquake in Tokyo, the insurance and reinsurance services are not available for all risks. This coverage gap is growing and becoming one of the most interesting challenges for insurers.

4. Risk appetite

Generally, risk appetite remains high for both western and Russian reinsurers, especially for target segments and high-quality risks.

Konstantin Rogozin, Malakut IB: "The appetite is growing. Everybody is in search of new markets and new opportunities for business development."

Generally, risk appetite remains high for both western and Russian reinsurers, especially for target segments and high-quality risks.

Some reduction is observed among large Russian universal insurance companies, which see their primary task in protecting their portfolios, rather than improving their earnings through inward reinsurance. This explains their more selective and cautious approach, in particular, to the classical types of insurance.

As to foreign companies, the brokers see a growing interest to the classical insurance lines and appetite for Russian risks. Here, more interest is displayed by Lloyd's in contrast to continental companies.

No appetite is caused by war risks in aviation and terrorism risks, such as the risk of denouncement of a mass even. This is connected to a growth in losses in these areas observed throughout the recent years.

II. Internal reinsurance market in Russia

1. Growth drivers

The brokers participating in the survey agree that the factors driving the development of the internal reinsurance market are as follows:

- increasing market capacity with the establishment of RNRC;
- reduction of the scope of reinsurance ceded abroad because of the sanctions;
- creation of more competitive conditions than abroad, both in terms of price and the scope of coverage;
- reinsurance opportunities where obligatory contracts' capacity is absent or limited;

- impossibility to place specific Russian risks abroad;
- need to arrange loss excess with priority placement in Russia.

2. Growth inhibitors

Without denying that there are factors promoting the development of the internal reinsurance market in Russia, the brokers concede that there are far more reasons preventing same. And the problems are much deeper than the presence or absence of sanctions, namely:

- competition on the level of direct insurance;
- absence of ratings needed by the Russian reinsurers;
- lack of the market's investment attractiveness;
- insufficient capacity for large projects and risks;
- absence of a common IT platform for reinsurance;
- limited reinsurance capacity available to insurance companies (inward reinsurance reservations);
- general condition of the Russian economy, reduction in the scope of direct insurance and, as a consequence, reinsurance;
- subordinated role of reinsurance with regard to direct insurance, where the latter is stagnating;
- negative reputation of insurers among the general public and business, low level of insurance culture and insurance penetration;
- doubtful financial stability and insufficient capitalization of companies;
- security lists of reinsurers;
- situation in the judicial system;
- rising concentration of the insurance business;
- enlargement of obligatory contracts with foreign partners;
- insufficient attractiveness of Russian reinsurers as a capacity for foreign business;
- insufficient qualification of Russian managers and underwriters for the evaluation of foreign business;
- absence of market for certain products (D&O, BBB, Crime, Product Liability, Fine Arts);
- absence of necessary know-how available to western reinsurers;
- further market consolidation (large insurers earmark solid amounts for net retention and cover all their primary reinsurance needs through obligatory programs, mostly placed on the international markets with reinsurers having high international ratings, high capitalization and extensive capacities).

Konstantin Rogozin, Malakut IB:

"Without considering the RNRC factor, the market is in a stagnation phase, and the reasons are the same. Firstly, macroeconomic: zero economic growth and aftershocks of the

crisis events still restrict the demand for insurance services in general, and, consequently, for reinsurance. Secondly, oversaturation of the reinsurance market with "classical risks" (property, C&I etc.) and large obligatory programs. Thirdly, high and hard-to-forecast loss ratio, which curbs appetites of the market participants and hinders the exploration of market niches unoccupied by large obligatory programs (Finprn risks, agricultural insurance, underground risks etc.). Obviously, the setup of RNRC will lead to redistribution of outward reinsurance to the benefit of the Russian market, but this growth factor will be quickly exhausted and further growth of the internal market – without changing the current situation – will be problematic."

3. 2017 forecast for internal market development

According to the respondents, the scope of internal reinsurance correlates, on the one hand, with the share of the companies exiting the market, and on the other hand, with the share of RNRC. Most probably, the market will see some growth of cost indicators combined with actual stagnation and even growth slump.

Irina Gromova from RIFAMS IB: "So far, there are no fundamental premises for a real growth of the reinsurance market. It can be supported by the development of real insurance, which, most probably, will rather be nominal due to a general stagnation trend in economics."

Large-scale insurers look to cutting down their scope of reinsurance on the Russian market, according to the Executive Director of Marsh Insurance Brokers, Andrey Denisov, by shortening their security lists, wary of financial unreliability of Russian companies."

Nikolai Galushin, President and Board Chairman of RNRC:

"In the years to come, the internal market is set to decrease in terms of the premium amount. This will come as a result of such factors as market concentration, growth of net retention among the leading companies, consolidation of obligatory reinsurance programs, avoidance of schemes and shrinking of the direct insurance market in terms of the insurance businesses which are subject to reinsurance. But this will mean market stabilization before its subsequent growth."

III. Development of outward reinsurance in Russia

The brokers are unanimous that the continued international sanctions and the appearance of RNRC will stall outward reinsurance. However, insufficient local capacity is thought by them to inevitably lead to the search of solutions abroad, where a reduction in the local potential can drive the growth of the outward reinsurance market, in particular, for such reasons as:

- appreciation and reduction of obligatory capacity for a number of insurers, which can further increase facultative order on the international market;
- consistently low quality of loss adjustment and the clients' urge to extend placement on the international market;

- appetite for Russian risks among foreign reinsurers.

Andrey Panov, Director General of Greco JLT. Insurance Brokers: "The outward reinsurance market growth is aided by the availability of large and continuously growing capacities against the backdrop of a soft market, as well as high-rating reinsurance and, most important, proven and reliable partners. This growth trend is hindered by the conservativeness in terms of specific products and types of risk, as well as weak interest toward Russian risks demonstrated by such "new" growing markets as China, India, Latin America and Middle East."

1. Where premiums flow

The top 20 countries by the amount of reinsurance premium earned in Russia, according to the CBR

COUNTRY	TOTAL PREMIUMS	FACULTATIVE	OBLIGATORY
UK	28,352,623	20,043,593	8,307,957
GERMANY	17,413,190	2,997,029	14,415,991
SWITZERLAND	8,410,444	2,798,619	5,611,290
USA	7,064,657	3,437,106	2,713,151
FRANCE	5,840,857	4,169,889	1,670,968
BERMUDA	3,204,600	643,398	2,508,044
BAHRAIN	2,157,622	1,508,644	648,978
CHINA	1,944,606	1,040,382	904,224
KUWAIT	1,846,177	135,080	1,711,097
IRELAND	1,746,201	732,179	1,014,022
INDIA	1,552,329	839,207	713,122
FINLAND	1,218,321	1,163,080	55,241
KOREA	1,196,012	943,168	252,844
JAPAN	1,103,643	1,097,046	6,597
BARBADOS	1,103,026	407,964	695,062
SPAIN	1,079,462	980,119	99,343
LUXEMBURG	982,466	1,196,666	862,800
NETHERLANDS	846,616	362,668	483,948
KAZAKHSTAN	823,594	687,818	135,776
AUSTRIA	817,644	630,250	187,394

2. What risks go abroad

On the international reinsurance market, Russian insurers mainly place obligatory covers and large facultative risks, for which the Russian market lacks the necessary potential or rating capacity. Risks falling outside foreign obligatory contracts also go abroad.

Further, the respondents mention as a significant factor the preferences of their clients - direct insurers, many of which insist on having their risks placed outside Russia. Otherwise, according to the brokers, the following risks are most commonly placed on

the international market:

- multi-country risks,
 - obligatory contracts for classical covers,
 - facultative contracts for large, composite or technologically complex risks,
 - petroleum industry specific risks,
 - large C&I projects, as well as property, casualty, liability insurance and sea risks,
- BBB, Fine Arts, D&O;
 - aviation and aerospace risks;
 - risks requiring specialized loss adjustment / regulation (energy, nuclear, P&I risks),
 - risks subject to lessor's requirements in respect of placements;
 - products requiring know-how.

IV. Development of inward reinsurance in Russia

The amount of reinsurance premiums gained abroad by the Russian insurers is negligible. According to Guy Carpenter, Russia earns about 0.16% of the global total premiums. The reasons for this are the current political situation, low country rating, insufficient capitalization and competence of companies, legislation and law enforcement practice.

As a result, the brokers say, Russia mainly attracts risks from third-world countries and the CIS, sometimes of questionable quality. Normally, these are risks that did not seem interesting to A-rated insurers, in particular, because of low rates.

Cedents operating on the developed markets of Western Europe, US, Japan, Canada and Australia are not really interested in the Russian capacity. An exception is inward reinsurance in Russia coming from subsidiaries or affiliates of some of the Russian insurers which insure Russian (or former Russian) interests abroad (e.g. property of foreign subsidiaries of various Russian companies, or property of trade agencies or businesses incorporated yet in the USSR).

1. Reasons for non-attractiveness

- dwindling numbers of active players, including professional reinsurers;
- concerns about the regular ignoring of obligations by market exiting companies;
- political situation associated with the sanctions and mutual lack of trust, which hinders the "advancement" of the Russian reinsurance market;
- low ratings of Russian companies;
- introduction of insurance supervision in some countries based on the Solvency II principles or similar requirements, which prevents the transfer of risks to Russia;
- market protectionism, in particular, in Russia's partner countries, such as India

etc., which restricts the opportunities of the Russian reinsurers;

- tight limits posed to the inward reinsurance market by low net retention of the Russian (re)insurers;
- economic necessity of reinsurance with diversification by territory and business;

Nikolai Galushin, President and Board Chairman of RNRC: "The reduction of Russia's sovereign rating in 2014 and the resulting rating downgrading for the Russian insurance companies also posed serious problems in ceding foreign risks to Russian companies. Moreover, there are no good prospects for direct interaction between the CIS and EAEU markets due to the regulators' stringent rating requirements in these countries".

2. Prospects for development

For development, the Russian market needs integration and intensification of its activities aimed at its involvement in the global reinsurance space, says Nikolai Galushin, President of RNRC. In his opinion, the Russian insurers are adequately positioned not only to transfer their premiums to the global markets, but also to gain business from abroad, regardless of the rating or marginal net retention volumes. "In this issue, RNRC can play an important part due to its capacity," says he. "And the integration of the Russian market into the international market depends, to a great extent, on insurance brokers."

Among the growth drivers on the inward reinsurance market the respondents named:

- capacity accumulation;
- improving the underwriting and management quality;
- providing qualified brokers with underwriting authorities;
- strengthening and promoting the existing partner relationships with CIS companies, in particular, through engaging fronting

companies where the counteragent's requirements for reinsurers' rating prevent direct transfer of business;

- active and sustainable efforts aimed at promoting the image of Russian reinsurers;
- improving the loss adjustment procedures;
- building cooperation with China.

Konstantin Rogozin, Malakut IB: "Special attention should probably be paid to the promotion of reinsurance competences as part of some global lines, such as aviation, energy,

aerospace, i.e. those segments which are, firstly, well presented on the Russian market; secondly, have zero or weak connection to local market specifics and mostly follow the international practice; and thirdly, where, due to the availability of appropriate expert services, the value of the Russian market can be associated with the provision of alternative quotations.

V. RNRC

1. How RNRC will change the Russian market

Most brokers see the appearance of a national reinsurer on the Russian reinsurance market as a generally positive factor, offering the following arguments:

- generation of new capacity;
- making the market more regular in terms of computing the technical result for risks;
- redistribution of all obligatory programs on the market and releasing additional capacities for facultative placements;
- increasing the capacity for sanction risks; although RNRC does not fully cover the need for the sanction capacity – due to the cautious first steps and adequate individual risk assessment;
- improving the quality of the insurers' risk portfolios with a more professional and healthier approach to business, provided RNRC creates sufficient capacity and pursues rigorous underwriting policy;
- growing scope of internal reinsurance.

2. RNRC's prospects for cooperation with international partners

Konstantin Rogozin, Malakut IB: "As we know the quality of reinsurance services is finally tested by the reinsurer's loss payment practice. Therefore, as regards RNRC's cooperation with foreign partners, a lot will depend on the image of RNRC, which will be forming in the process of loss adjustment by RNRC."

Foreign partners have long been cooperating with the Russian insurers in a successful way. The brokers are positive that this will be no exception for RNRC. Especially popular will be the practice of cooperation with RNRC with regard to the following risks:

- risks requiring large capacity (nuclear risks, catastrophic risks);
- risks pertaining to Eastern Europe and the CIS;
- low-quality risks, which could not be placed on the international market.

Experts also note that, once RNRC obtains the A- rating, it may qualify for high-profile international risks.

Nikolai Galushin, President and Board Chairman of RNRC: "The setup of RNRC is yet another important factor for redefining the Russian reinsurance landscape. Today, the market is still exposed to great uncertainty associated with RNRC's integration in the reinsurance community, underwriting, loss adjustment, price regulation, client service policies and the development strategy. Our task is to remove this uncertainty and become truly useful to the market."

3. RNRC's prospects for cooperation with international brokers

According to the Managing Director of Aon Rus Insurance Brokers, Boris Korchemkin, "international brokers have always been interested in strong and solvent players on the reinsurance market, and they consider RNRC as a partner in many fields of cooperation."

Boris Korchemkin, Managing Director of Aon Rus Insurance Brokers:

"Russian insurance companies find RNRC to be a strong and reliable partner faced with high expectations concerning its proper and efficient operation, first of all, in terms of loss adjustment."

Other brokers participating in the survey also noted that RNRC could be interesting to their businesses, for example:

- as a capacity for complex placements;
- as a leader in tenders with a share greater than 10%;
- as a player with competitive rates and loss adjustment quality;
- as an additional capacity;
- as a versatile and credible information center on the Russian insurance market;
- as a company ready to accept foreign risks.

Andrey Panov, Director General of Greco JLT. Insurance Brokers:

“The experience gained by the foreign analogues of RNRC (for example, Brazilian IRB) confirms that there is an opportunity for successfully attracting reinsurance from foreign market in significant volumes. In turn, foreign reinsurance companies may well be interested in RNRC’s being involved with retrospective security.”

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