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## Counterparties, cycles and credit management

*The financial crisis has highlighted the benefits of risk management. But, together with the hardening insurance market, it poses significant challenges, according to a group of buyers, brokers and insurers gathered in Paris by Business Insurance Europe.*

Participants included:

- **Stanislas Chapron**, chief executive officer, Marsh France
- **Hervé Houdard**, CEO Aon France
- **G rard Lancner**, corporate risk officer at Yves Rocher S.A. and president of the Association pour le Management des Risques et des Assurances de l'Entreprise
- **Thierry van Santen\***, executive vice president of business risk management at French food company Groupe DANONE S.A. and *Business Insurance Europe* Risk Manager of the Year™
- **Jean-Paul Rignault**, CEO of AXA Corporate Solutions
- **Tony Rosenthal**, director of the global risks division of MAPFRE Empresas in Paris

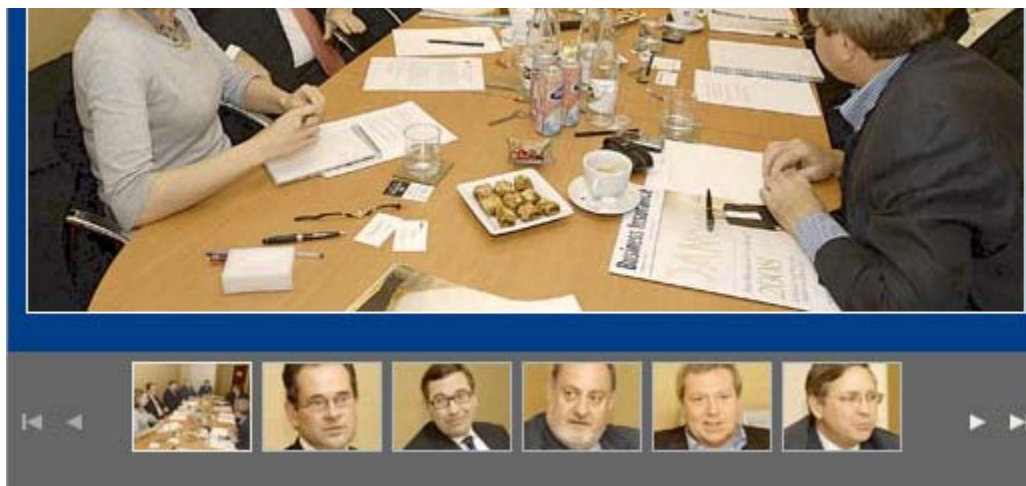
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### Q: What impact has the current global credit crisis had on risk managers and insurance managers in France?

**Stanislas Chapron, chief executive officer, Marsh France:** There are two main effects. One is about making sure companies have good counterparty security. And [awareness of counterparty risk] has underlined again the fact that risk managers or insurance managers are key in the organization of large corporate companies and that they interact more now with their boards and executive committees to look at those exposures.

The other effect is on the receivables of large corporate entities. It is clear that the credit insurance market is more selective and in some cases has retracted a bit, and that there is more awareness of [trade credit] receivables. There are new questions, more proactivity, more management and more analysis by insurers. Risk managers are in the spotlight of what is happening in the crisis as regards what is happening with credit risk.

**Hervé Houdard, CEO Aon France:** The role of the risk manager will be essential and crucial in this crisis. Some risk managers are already under pressure from the boards and management of their firms, which are talking about cost savings, which is difficult when the [insurance] market is turning. The insurance market was stable, but everybody knows that rates will probably increase over the next year. But the role of the risk manager will be crucial in the next couple of months. 2009 will be more

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complicated for all firms across the world, but the credit insurance business is of more immediate concern right now. That is a big topic.

**G rard Lancner, corporate risk officer at Yves Rocher S.A. and president of the Association pour le Management des Risques et des Assurances de l'Entreprise:** For risk managers, the global credit crisis affects the security and the business of our suppliers and distributors. This is what we have to be very careful of. It has nothing to do with a company's assets, it is about the short-term need for credit to fulfill obligations.

So what we have to do in these circumstances is to review, very quickly, the credit situation of our main suppliers and main distributors. This is something we used to do in risk-mapping. But in the past we focused more on the balance sheet strength of suppliers and distributors. Now we have to consider that there could be a lack of economic activity due to a short-term break in credit. That is why we have to create new risk management methods to take into account the situation of both suppliers and distributors. And when I talk about suppliers, of course insurers, brokers and service companies are included in that.

**Thierry van Santen\*, executive vice president of business risk management at French food company Groupe DANONE S.A. and *Business Insurance Europe Risk Manager of the Year*<sup>TM</sup>:** At DANONE we see three issues. With regards to credit default, we have refocused on credit management for both suppliers and customers. Supply-chain risk management with regards to credit is probably even more difficult, complex and problematic in terms of suppliers and customers than before.

The second issue is savings. It is certain that this is not the right time to be buying additional insurance covers. Most of the corporations I know have decided to reduce their costs and so we have to take this into account in our budget plans. When the market is as volatile as it is today, some risk managers may have difficulty in making their management understand that it is quite difficult today to make savings on insurance costs.

Thirdly, one of my priorities has been to refocus on the budget plans to be sure that the basic risk management investment is kept in the budget for next year.

**Stanislas Chapron:** Companies that are in a more difficult situation than DANONE—where their profit margins have been reduced—will not want to expose themselves to more risk because volatility has increased on their bottom line. So they will not want to reduce their insurance coverage—but they also will not want to buy more.

**Jean-Paul Rignault, CEO of AXA Corporate Solutions:** More than ever, risk management and risk managers are crucial to large corporate entities. They have to

management and risk managers are crucial to large corporate entities. They have to deal with traditional issues about insurance renewals, conditions, pricing, and so on, but it seems that they now have to face many different issues. And everything is coming to a head at the same time.

The pricing cycle is still soft, but flattening at Jan. 1 renewals and will harden during the course of 2009—insurers, risk managers and their brokers seem now to agree on this.

We live and operate in a world that is more complex every day, so globalization and supply chain risks have become key issues for risk management.

There has been some collateral damage from the economic turmoil, which has resulted in recession and increased pressure on costs—in addition to difficulties in the assessment of credit and security risks associated with certain countries and business partners. That was something risk managers were already aware of. But counterparty risk has become a greater and real cause of concern.

If you transfer a risk by way of an insurance contract with a lower rating than your own company, then you accept an additional credit risk. That is a way of differentiating between one insurance company and another. And the current recession and economic turmoil has put additional pressure on that—not just for the future, but risks already insured—because if anything happens to an insurance company you are not just dealing with the counterparty risk of today or tomorrow but with the one of yesterday as well, and it may be significant.

Reinforced regulation could be implemented following such a deep financial crisis. Consequently, risk managers may face, for example, increased difficulty in the acquisition of more capital from their organizations for their captives—which may be necessary under Solvency II.

If the chief financial officer has to decide whether to revamp a production chain or increase surplus into a captive, that will be a difficult choice because capital is a scarce resource that should be used where it makes most sense.

In such a context, the large corporations which we deal with cannot afford a big loss. It is even more damaging in a recession phase. That is why risk awareness is increasing and loss prevention is still a must.

**Tony Rosenthal, director of the global risks division of MAPFRE Empresas in**

**Paris:** We do not have enough clarity about how long this crisis could last—one year, two years, whatever. One impact this will have is to make the risk management community think more closely about how they deal with risks and credit risks. I believe

...summary think more closely about how they deal with risks and credit. I believe that risk managers will probably spread far more of their risk than they did in the past. Rating agencies will be more careful about what they say and risk managers will probably be more careful about how they listen to rating agencies.

But clearly, for many secure and large European insurance groups, this will be a clear opportunity for them to expand their operations in other countries.

**Thierry van Santen:** Risk managers should not be naïve. At the end of the day, my chairman and CEO are not waiting for me to decide the [company's] strategy during this crisis. We can have some influence on, for example, credit, purchasing, sales, industrial investments or change management, and be sure that people are doing the right things. At the end of the day, we take part in the business of our company, but the top management of all companies is in charge. The good thing is that when you have a crisis, you always have opportunities. I like to sail, and when there is a storm you sail differently to when the weather is calm.

The financial crisis is also an opportunity for risk managers. Many stakeholders see that the risk manager's work is much more important than control and audit. And the opportunity for the risk manager is with enterprise risk management, because you see the true added value of enterprise risk management when you are faced with this type of crisis.

**Q: Are brokers helping their clients determine which insurance carriers are a good risk and which are a bad risk?**

**Hervé Houdard:** In the end, the decision should be taken by the risk managers and by the companies themselves. Brokers can help, and try to give advice, but the final decision is made by the firms themselves.

**Q: Do you expect insurers to be tougher at renewals because of what is going on in the wider world?**

**Stanislas Chapron:** We have renewed some large programs with decreases and we have entered some long-term agreements. Except for some specialized areas, it has been a declining market, because insurers want liquidity and there was more supply than demand. But there will be a turn in pricing, and that turn will be some time in the first three-quarters of 2009.

**Hervé Houdard:** Insurers do not want to lose market share, they want to retain business.

**Stanislas Chapron:** They want liquidity.

**Stanislas Chapron:** They want liquidity.

**Tony Rosenthal:** It is still very difficult for MAPFRE S.A. to take part on some insurance programs in France, because the leading companies do not want to give up their shares. I'm certain we will not see any real hardening before the second part of 2009, but I think it will come.

**Q: What will force the change?**

**Jean-Paul Rignault:** I would not like to go back to 2001. The Sept. 11 terrorist attacks on the United States were perceived as the reason why insurers raised their premium rates. In fact the hardening had already started, and was accelerated—not created—by the terror attacks. The same may be true with the financial turmoil—that it may accelerate the upturn, rather than create it. No one argues about whether the market will turn up, but when.

I do not expect the market to react again like it did in 2001. But there will be adjustments, step by step, and at AXA Corporate Solutions we will do that through our close relationships with clients and brokers. And we will try to find for each and every account, adequate pricing. Of course, brokers say that the market is still favorable to buyers, but clearly we saw rates flatten at the end of the year for the Jan. 1 renewals and the pricing cycle will rise straight afterwards.

Market-share strategy is a dumb strategy, any underwriter—even with a short memory—knows that it is a dumb strategy. Volume is good, but not at any price. Insurance companies are not like banks and they do not have such a problem with liquidity. I think if anyone today has included investment income in their pricing model, they would certainly have to reduce the amount of investment income in that model, which means that it is back to basics in terms of a technical approach.

Risk transfer through insurance used to be stuck between self-insured retention at the bottom and catastrophe bonds and securitization at the top. Clearly, catastrophe bonds and securitization are a form of risk transfer that will become more difficult, so in terms of insurable volume, from the top there may be opportunity. From the bottom, self-insured retention is a good sign of risk management, so I do not think an insurer can blame any large corporation for retaining a portion of its risk. After that, it is up to the risk managers and insurance buyers to decide how much they want to retain and how much they want to transfer. But under Europe's proposed new capital regime, Solvency II, the captive may need more capital to run the same business and much more to support any increase in self-insured retention. Insurance is still an inexpensive risk transfer.

**Gérard Lancner:** Risk managers will not have a larger insurance budget in 2009 than

in 2008—and may have even less in some circumstances. We will have to take care that companies do not reduce their investments in loss prevention, because if that is the case, it will increase the level of risk.

As risk managers will not be given more in terms of budget, we will have to be very selective in terms of choice—choice of deductible, choice of limit of warranty, choice of insurance. Some of my colleagues have investigated whether they have to continue buying some [lines of] insurance. There are a lot of policies that have been bought that we are asking, along with our brokers, what is the risk if I do not renew? Let us reconsider the risk. We will have to be selective in terms of insurance coverage and in terms of the services we buy. We have to change habits.

**Hervé Houdard:** In a hardening market—and especially combined with the economic crisis—captives make sense and self-retentions increase.

**Q: What impact will the problems at American International Group have on French buyers? And is there concern about choice of carriers for international programs?**

**Gerard Lancner:** Generally speaking, I would say no. People are not worried about having less choice for international programs, apart from in specific sectors such as energy, transportation or, in some cases, directors and officers, though there are competitive offers.

**Stanislas Chapron:** Buyers realize that a company can be well capitalized, but if it has a liquidity problem then it could find itself in difficulty—and that can happen for any player. And so there is more scrutiny from the buyers. And they ask for alternatives, they ask for the pros and cons, and they ask to have choices, and then they make a decision.

On the issue of choice for international programs, there is still competition for companies with large programs, it is a bit more difficult but there are still offers. In a market like insurance when you have players with difficulties then it is not a good thing for the market itself.

\*At the time of the discussion, Thierry van Santen was executive vice president of business risk management at French food company Groupe DANONE S.A. He left DANONE in December and is now chief executive officer of Allianz Global Corporate & Specialty in France.

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