

### **3. The global reinsurance sector**

The ongoing challenging economic environment also increases the profitability pressure in the reinsurance market that continues to suffer from an oversupply of capacity. Reinsurers remain to be well capitalised.

#### **3.1 Market growth**

**The demand for reinsurance is subdued, but the reinsurance capacity remains high.** This reflects a longer-term trend for primary insurers to retain more risk on their balance sheets. Competitive markets as well as low investment returns have forced insurers to be increasingly price sensitive, whilst their risk management capabilities have also developed over time.

Some limited increases in demand for reinsurance may occur following the implementation of Solvency II in Europe. Also proposed changes to the A.M Best rating methodology could impact reinsurance buying as insurers seek to optimise the management of their solvency position and their credit rating.

**Thus, overall, the general environment remains largely unchanged.** Renewal rates continued to soften in 2015. At the January 2016 renewals, rate declines of between 5 per cent and 10 per cent were witnessed. Reinsurers experienced the fourth consecutive year of rate deterioration. In particular, property catastrophe reinsurance rates have declined by 30 per cent during the last two years.<sup>8</sup> In addition to rate reductions, the terms and conditions for reinsurance placements improved for ceding insurers e.g. expanded hours clauses, broadened terrorism coverage, improved reinstatement provisions. On the other hand, the upcoming June/July renewals predict some rate softening for the property catastrophe market.

**Altogether, the competitive pressure in the reinsurance sector will increase further.** The combination of the continuing capital-inflow into the reinsurance market, benign catastrophe activity and increasingly low investment returns due to the ongoing challenging economic environment increases the profitability pressure in the reinsurance business. Moreover, the ability to release reserve from previous years appears to have been diminished, whereas the long-term business is getting less profitable or even unprofitable as the high interest rates calculated in previous rates

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<sup>8</sup> ARTEMIS-Website: <http://www.artemis.bm/blog/2016/02/25/profitability-a-challenge-despite-reinsurance-rate-stabilisation-morgan-stanley/>

are difficult to earn. Against this background getting risk-adequate prices at the upcoming renewals is crucial for the reinsurance companies.<sup>9</sup>

**2015 was once again very benign in terms of natural catastrophe losses, which remained significantly below long-term averages.** Overall losses from natural catastrophes totalled USD 90bn (2014: USD 110bn), of which roughly USD 27bn (2014: USD 31bn) was insured. Both the overall losses and the insured losses were considerably below the inflation-adjusted, long-term average of the last 10 years (USD 180bn, USD 56bn) and even of the last 30 years (USD 130bn, USD 34bn). The number of fatalities increased in 2015 to 23.000 (2014: 7.700), which is still far lower than the ten-year average of 68.000 and the 30-year average of 54.000.

*Table 3.1: The five largest natural catastrophes until October 2015, ranked by insured losses (in USD billion)*

	Event	Region	Overall losses	Insured losses
16.02.-25.02.2015	Winter storm	USA, Canada	2.8	2.1
23.05.-28.05.2015	Severe storms	USA	2.5	1.4
07.04.-10.04.2015	Severe storms	USA	1.6	1.2
30.03.-01.04.2015	Winter Storm Niklas	Europe	1.4	1.0
12.09.-08.10.2015	Wildfires	USA	1.3	0.96

Source: Munich Re, NatCatSERVICE

As in the previous year, 2015 was characterised by weather-related events, which caused some 94 per cent of the loss-related natural catastrophes. Also the hurricane season in the North Atlantic was again quiet, only four tropical cyclones reached hurricane strength (average 7.6). No major hurricane made landfall in the USA, the tenth year running that this has not happened.

The costliest natural disaster event for the insurance industry came from the severe winter weather in the USA and Canada. As in the previous year, the winter in the northeast of the USA was exceptionally cold and snowy. In Boston, almost three

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<sup>9</sup> Under many forms of reinsurance and insurance, the payment of a claim reduces an aggregate limit by the amount of the claim. Provision is sometimes made for reinstating the policy limit to its original amount when the original limit has been exhausted. Depending on policy conditions, it may be done automatically, either with or without premium consideration (i.e. a reinstatement premium), or it may be done only at the request of the insured in return for an additional premium.

metres of snow fell over the winter months – an absolute record. The direct overall losses from the harsh winter in the USA amounted to USD 4.6bn, of which USD 3.4bn was insured (2013/14: USD 4.4bn, insured losses USD 2.5bn). The most costly snowstorm occurred at the end of February 2015 causing insured losses of USD 2.1bn.

The single most severe event in Europe was winter storm Niklas, which swept across large areas of central Europe and damaged a large number of buildings and vehicles. The overall economic loss was USD 1.4bn, of which around USD 1.0bn was insured.

The costliest natural catastrophe in terms of overall economic losses was the devastating earthquake in Nepal, which took place on 25th April. Some 9,000 people lost their lives and 500,000 were made homeless. The overall losses amounted to USD 4.8bn, of which only USD 210mn was insured, which equals 4.4 per cent of the overall loss. The losses accounted for almost a quarter of Nepal's annual gross domestic product.

Catastrophe losses appear to remain low during first quarter of 2016, based on preliminary data.<sup>10</sup> However, an unusually cold winter again hit the USA, leading to major transportation disruption and business closures in major metropolitan areas.<sup>11</sup> The winter storm from mid-January was rated as the fourth-largest winter storm in the Northeast and Mid-Atlantic. It is expected that the overall economic losses are likely to exceed USD 2.0bn, whereas the insured losses were projected to reach well into the hundreds of millions. The devastating wildfires in Canada could be one of the costliest natural disasters in Canadian history although the total losses can only be estimated at the time of writing, ranging from about USD 5bn to USD 9bn<sup>12</sup>.

### **3.2 Profitability**

The reinsurance market continues to suffer from an oversupply of capacity owing to the absence of large losses and alternative capital inflow. The rate of price declines reduced in 2015, but reinsurance prices have not yet found their floor. Despite this, a benign catastrophe environment has helped reinsurers generate relatively strong profits in the face of these rate declines. However, also low investment yields and

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<sup>10</sup> AON Benfield: April 2016 Market Outlook.

<sup>11</sup> AON Benfield: January 2016 Global Catastrophe Recap.

<sup>12</sup> <http://www.cbc.ca/news/business/fort-mcmurray-wildfire-insurance-rates-1.3573895>

ongoing pressure from alternative capital continues to impact the profitability of reinsurers<sup>13</sup>.

### **3.3 Solvency**

Global reinsurance capital remained abundant at the end of 2015. It totalled USD 565bn at the end of 2015 (unchanged from Q3 2015 but a reduction of 2 per cent since the end of 2014 (USD 575bn)).<sup>14</sup> A number of large traditional reinsurers have also been reducing capacity on offer to certain peak perils, as they seek to remain disciplined on price.<sup>15</sup> The strong position of capital allows insurers to increase net retentions. On average, reinsurers maintained a strong level of capital through the end of 2015 and into 2016, helped by the lack of significant catastrophe activity in recent years and the availability of substantial capital market capacity.

### **3.4 Alternative capital vehicles**

***In contrast alternative capital continued to grow, albeit at a slower pace than in previous years.*** It now represents in total over 12 per cent of the reinsurer capital.<sup>16</sup> At the end of October 2015 total alternative capital amounted to USD 69bn. This was largely comprised of collateralized reinsurance transactions (USD 32.8bn) and outstanding Insurance-Linked Securities (ILS) (USD 23.9bn). The total outstanding ILS amounted to USD 26bn (2014: USD 22.9bn) by the end of December 2015. Third party capital is expected to continue to enter the market as large pension funds and hedge funds search for ways to diversify their portfolios while chasing for higher return. Previously anticipated drops for alternative capital vehicles were therefore not confirmed<sup>17</sup>.

Furthermore, investors' acceptance of indemnity-based triggers has increased and spreads have tightened between indemnity and other trigger types. This will raise the

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<sup>14</sup> AON Benfield: Reinsurance Market Outlook January 2016, page 2.

<sup>15</sup> Artemis-Website: <http://www.artemis.bm/blog/2015/07/02/reinsurance-rates-stabilising-at-renewal-ils-discipline-contributes-willis-re/>

<sup>16</sup> AON Benfield: Reinsurance Market Outlook January 2016, page 2.

<sup>17</sup> Artemis Website.

attractiveness of ILS further for both new and repeat sponsors, which are expected to issue into the ILS market not only to diversify and complement overall reinsurance purchases, but also to benefit from the alternative competitive pricing and broadening indemnity coverage.