3. The global reinsurance sector

3.1. Market growth

The reinsurance premiums have been pressurised because reinsurers face continuing competition from non-traditional resources. The weaknesses of the global economy and soft market conditions have negatively affected reinsurance premium growth rates.[2] Still, global life and non-life reinsurance premiums have been expanding in 2014, albeit to a lower extent for life reinsurance. This positive trend is supposed to continue, also for life reinsurance only.[3]

2014 was very benign in terms of losses and fatalities, not only in comparison with the already mild previous year, but also with the average of the last 10 years. Overall losses from natural catastrophes totalled USD 110bn (2013: USD 140bn), of which roughly USD 31bn (2013: USD 39bn) was insured.[4] Both the overall losses and the insured losses were considerable below the inflation-adjusted long-term average of the last 10 years (USD 190bn, USD 58bn).

Table 1: The five largest natural catastrophes in 2014, ranked by insured losses (in USDbn)

Date	Event	Region	Fatalities	Overall losses	Insured losses
7-16.2.2014	Winter damage	Japan	37	5.9	3.1
18-23.5.2014	Severe storms	USA	0	3.9	2.9
7-10.6.2014	Severe storm, hailstorm	Western Europe	6	4.5	2.5
5-8.1.2014	Winter damage	USA, Canada	0	2.5	1.7
3-5.6.2014	Severe storms	USA	0	1.6	1.3

Source: Munich Re, NatCatSERVICE

The year 2014 was characterised by weather-related events, which caused 92% of the loss-related natural catastrophes. Losses stemmed especially from

[2] IAIS (2014): GIMAR, December, p.16.

[3] According to Swiss Re, global life reinsurance premiums have expanded by 0.8% in 2014, after shrinking 0.3% in 2013. Modest growth of less than 0.5% is expected in 2015 and 2016. Global non-life reinsurance premiums have increased to 3.5% in 2014 from 1.7% in 2013. Real premium growth in the non-life reinsurance sector is expected to be weak in 2015 (minus-1%) and 2016 (1.1%).

[4] Munich Re: NatCatSERVICE

a harsh winter in Asia and North America. In February two snowstorms hit Tokyo and central Japan resulting in high losses. Extremely cold temperatures and heavy snowfalls hit also North America, with a severe negative impact on business, as companies were forced to stop production. The most single severe event in Europe was a storm front in June that passed over France, Belgium and western Germany.

3.2. Profitability

Even if profitability currently remains strong, the pressure related to the risks arising from the low yield environment foreseen in the coming years may lead the reinsurance industry to consolidate. The combined ratio is about 86-88% (compared to 91.9% on a five year average), and ROE remains reasonable at 12% (compared to a 14% five year average) in 2014.[5] These results benefited from benign catastrophe losses. This situation might deteriorate in the coming years if the supply of reinsurance capacity continues to exceed the demand of insurers for upcoming renewals in most global regions resulting in a continuing decreasing reinsurance price level. During the January 2015 renewal season, prices were reported to have fallen by 10%-15% across most business lines and regions.[6]

Furthermore, the recent trade in global M&A highlights the reinsurers' need for scale to compete in the current market. This market consolidation can foster more efficient use of underwriting capacity and reduce undeployed capital. However, a meaningful decline in the number of reinsurers could also reduce cedents' ability to diversify risk exposures.[7] From a financial stability perspective, a further decline in the number of insurers also increases concentration risk in the reinsurance market.

3.3. Solvency

Whereas the reinsurance capacity continues to increase the reinsurance demand is still subdued. The reinsurers´ capital reached a new all-time high of USD 575bn (USD 540bn in 2013), because of below average catastrophe losses, unrealised investment gains and a continued influx of capital.[8] This corresponds to an annual increase of 6% in 2014 following growth of 7% in 2013. The insurers' capital basis rose along with the reinsurers' due to the benign catastrophe activity in 2014 and in

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[5] S&P (2015): RatingsDirect, Reinsurers'shopping spree won't slow down falling rates, 16 February, p.6.

[6] S&P (2015): RatingsDirect, Reinsurers'shopping spree won't slow down falling rates, 16 February, p.3.

[7] Fitch Ratings (2015): Global Reinsurance Guide.

[8] AON Benfield (2015): Reinsurance Market Outlook, January, page 4.

the previous year. Thus, overall, the reinsurance market saw softening prices in 2014. Only lines of business affected by major losses were exempted from that trend. Along with price reductions also the terms and conditions for reinsurance placements improved, e.g. expanded hours clause[9], broadened terrorism coverage and improved reinstatement provisions.[10]

3.4. Alternative capital vehicles

Alternative sources of capital push the sector's capitalization levels higher and pressure pricing. The rise of alternative capital (AC) is a key risk for the traditional reinsurance market, as it has contributed to lower rates and increased competition. Capital market investors, as hedge funds and pension funds, are increasingly involved in the reinsurance sector through non-equity participations. According to AON Benfield, AC inflows into the reinsurance market totalled to USD 61.9bn by the end of 2014 which represents an increase of almost 25% over 2013. AC representing 12% of traditional reinsurer capital is substantially deployed in property catastrophe risks (40 to 50%).[11] Overall, all AC vehicles including sidecars and Insurance-Linked Securities (ILS)[12] now represent 18% of global catastrophe capacity.[13] 2014 marked a new record for annual property catastrophe bond issuance with a total issuance of USD 8.2bn.[14] This increase in the supply of catastrophe protection has pushed prices down. As a consequence, reinsurers are more and more looking at other regions and lines of business to deploy their capital and diversify their exposures.

Against the background of the ongoing finance and debt crisis the diversifying nature of catastrophe-exposed business attracts investors who are searching for uncorrelated investments. Low corporate and sovereign debt

[9] The colloquial term which limits the time period during which claims resulting from a given occurrence may be included as part of the loss subject to the cover. The time period is usually measured in consecutive hours and most often applies to property reinsurance, e.g., a windstorm, conflagration, or earthquake, and less frequently in occupational disease and other aspects of casualty.

[10] AON Benfield (2014): Reinsurance Market Outlook, September, page 9.

[11] AON Benfield (2015): Reinsurance Market Outlook, January, page 3-4.

[12] The total outstanding ILS amounted to unprecedented USD 24.1bn in 2014 (+20% over 2013), with a record of USD 8.3bn in terms of the issuance of new ILS.

[13] S&P (2015): RatingsDirect, Reinsurers' shopping spree won't slow down falling rates, 16 February, p.4.

[14] As of December 31, 2014, total catastrophe bonds on-risk stood at USD 24.3bn, representing an 18% increase over the prior year period.

yields are likely to continue to produce more capacity for catastrophe and other reinsured risks. While the non-traditional capital is mainly going into the non-proportional catastrophe business, this new capital seems to spill over into other reinsurance lines. Furthermore, the investor´s acceptance of indemnity-based triggers has increased and along with that the spreads have tightened between indemnity and other trigger types. This will raise the attractiveness of ILS further for sponsors both new and repeat sponsors, which are expected to issue into the ILS market not only for diversification and complement of overall reinsurance purchases but also due to the alternative market's competitive pricing and broadening indemnity coverage[15].

[15] Guy Carpenter (2014): Capital Markets Report, September.