3. The European reinsurance sector

2017 was dominated by the hurricane trio of Harvey, Irma and Maria, which made it the costliest year ever for the insurance industry. Overall, the final insurance bill for natural disasters is expected to come to USD 135bn.[30] However, the reinsurance sector has proved to be quite resilient as most reinsurance companies were able to close the year with a profit and remain well capitalised. Moreover, the first round of renewals in January 2018 saw only moderate price increases, despite the huge insured losses. Up to now, most analysts expect reinsurance rate increases to be limited to those lines of business and regions affected by the 2017 hurricanes and to one or two renewal seasons, after which the slow and steady softening market may return.

3.1 Key developments

In 2017, the global insurance industry catastrophe losses were considerably higher than the long-term average. According to estimates, natural catastrophes caused worldwide economic losses of USD 330bn (previous year: USD 184bn), the second-highest figure ever recorded. The insured losses amounted to USD 135bn (previous year: USD 51bn), an all-time high. Both the overall economic losses and the insured losses were considerably higher than the 10-year averages of USD 170bn and USD 49bn, respectively. Nevertheless, the number of fatalities increased only slightly from 9,650 in 2016 to about 10,000 in 2017. These figures are significantly lower than the 10-year (60,000) and even 30-year (53,000) averages.

Table 3.1: The five largest natural catastrophes in 2017, ranked by insured losses (in USD bn)

Date	Event	Region	Fatalities	Overall losses USD bn	Insured losses USD bn
6-14.9.2017	Hurricane Irma	USA, Caribbean	128	67.0	32.0
25.8-1.9.2017	Hurricane Harvey	USA	88	85.0	30.0
19-22.9.2017	Hurricane Maria	Caribbean	108	63.0	30.0
8-20.10.2017	Wildfire	USA	25	10.5	8.0
8-11.5.2017	Thunderstorms	USA	---	3.1	2.5

Source: Munich Re, NatCatSERVICE

The hurricane trio accounted for approximately two-thirds of the insured losses in 2017. Regarding the economic losses hurricane Harvey was the costliest natural disaster of 2017 causing overall losses of around USD 85bn.

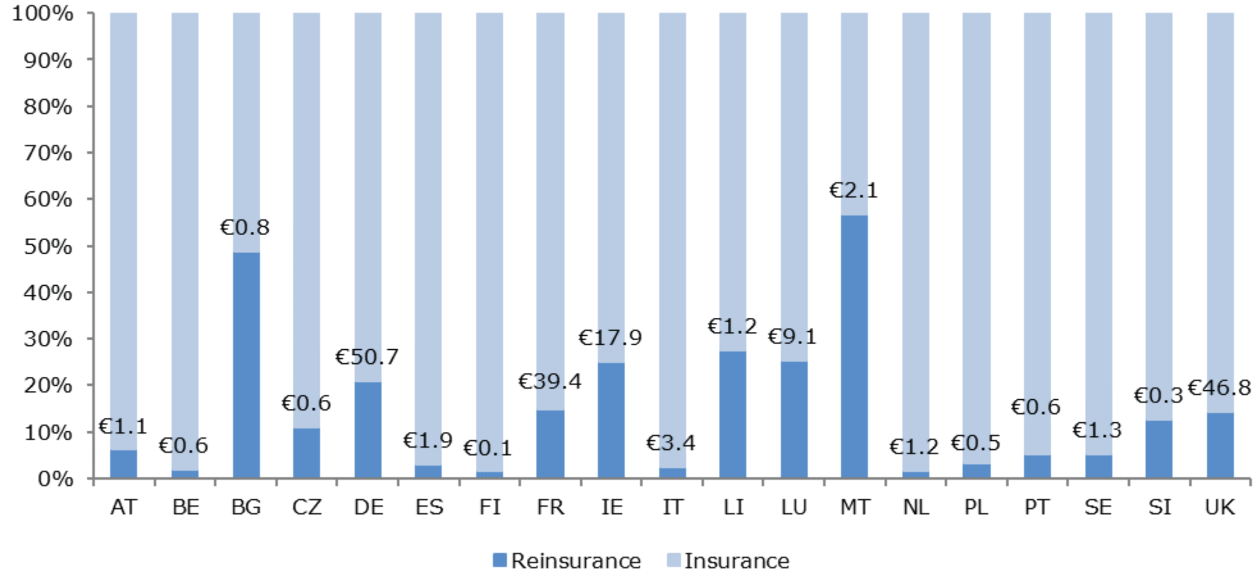
The US share of losses was exceptionally high in 2017: 50% as compared to the long-term average of 32%. This was mostly due to the hurricanes and several other major natural catastrophes, such as the wildfires in California. When considering North America (including the Caribbean) as a whole, the share rises even to 83%. In Europe, unusually low temperatures in early 2017 caused substantial damage to European farmers. Losses caused by the late frost amounted to approximately USD 3.6bn, of which only USD 650m were insured, given the low insurance penetration in the agricultural sector.

[30] See Munich Re: NatCatSERVICE

3.2. Market share and growth

The European reinsurance sector[31] differs substantially between countries due to its global nature (Figure 3.1). In relative terms, Malta and Bulgaria have the largest share of reinsurance in total GWP in Q4 2017, mainly driven by subsidiaries of large EU (re)insurance groups in their jurisdiction. In absolute terms, the European reinsurance market is dominated by large reinsurance companies located in so-called "reinsurance centres" in Germany, the UK and France. Overall, the share of reinsurance in total GWP dropped from 19% in Q4 2016 to 13% in Q4 2017.

Figure 3.1: GWP reinsurance as a share of total GWP (in % and EUR bn) in Q4 2017



Source: EIOPA Quarterly Solo. Template: S.05.01.02. Countries with less than 2% GWP reinsurance share and/or less than EUR1 bn in total GWP are excluded.
Reporting reference date: 30/12/2017

Alternative capital for reinsurance has remained broadly stable, despite the impact of insured losses in the period. In 2017, the market for insurance-linked securities (ILS) reached an all-time high with about USD 12.6bn of ILS being placed, which is considerably higher than the former record of 9.1bn USD in 2014. The total outstanding ILS amounted to USD 31bn by the end of December, also an all-time high. Furthermore, the first-quarter catastrophe bond issuance of 4.2bn USD indicates a new record in 2018.

The ILS market proved itself to be resilient, despite the disasters of Autumn 2017, which many point to as the first real test for the market. The issuance record in the first quarter of 2018 shows that the alternative reinsurance market is still popular. The relatively high yields as well as the diversifying nature of catastrophe-exposed business attract investors who are searching for favourable investments. Consequently, the capital-inflow into the reinsurance market, especially the alternative reinsurance market, is likely to continue, despite the record insured losses in 2017.

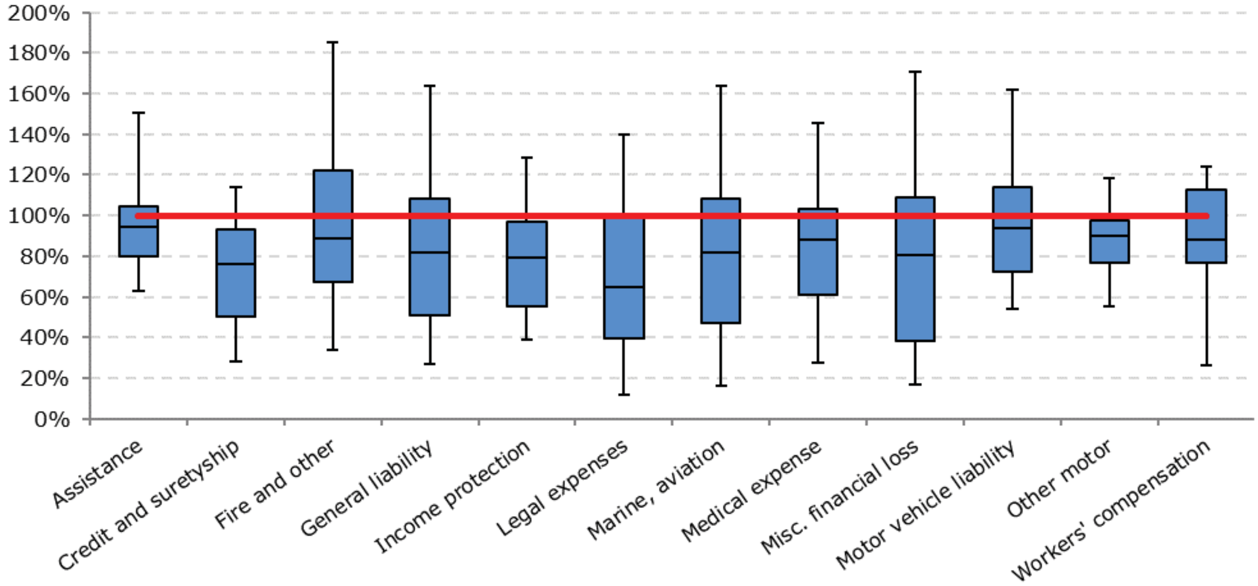
[31] A solo undertaking is listed as a reinsurer if it is listed as a reinsurance undertaking on the EIOPA register, based on Q4 2017 reporting.

3.3. Profitability

Despite the all-time high losses, the bulk of the reinsurance companies generally closed the financial year 2017 with a profit, partly due to the ability to release reserves from previous years. Profit targets were largely missed, however, and the combination of continuing capital-inflow into the reinsurance market, limited investment returns due to the sustained low interest rate environment and the increasing impact of natural disasters continues to put pressure on the profitability of reinsurers. Moreover, the ability to release reserves from previous years appears to fade, whereas the long-term business is getting less profitable or even unprofitable as the high interest rates used in past premium calculations are difficult to attain. Against this backdrop, setting risk-adequate prices at the upcoming renewals is crucial for the reinsurance companies.

The median gross combined ratio for European reinsurers varies from 65% to 94% across business lines for proportional reinsurance, with a total median value of 87% (Figure 3.2). Proportional reinsurance typically shares the fortunes between cedants and reinsurers in a proportional manner.[32] The claims on natural catastrophes, such as the major hurricanes witnessed in 2017, are spread across different business lines, but the impact is typically largest for property reinsurance. Losses on these events might rise even further into 2018 when the full extent of the damage and claims becomes clear. On a global basis, gross combined ratios average around 108 percent to 109 percent in 2017, with over 20 percentage points attributed to catastrophe losses. This surpasses the total combined ratio of 107.1 percent recorded in 2011, the last year with significant insured losses from catastrophes.[33]

Figure 3.2: Gross Combined Ratio across business lines for proportional reinsurance (in %; median, interquartile range and 10th and 90th percentile) as of Q4 2017



Source: EIOPA Quarterly Solo. Template: S.05.01.02. Nominator [R0320+R0550, C0010-C0120]; Denominator [R0220, C0010-C0120]
Reporting Reference date: 31/12/2017

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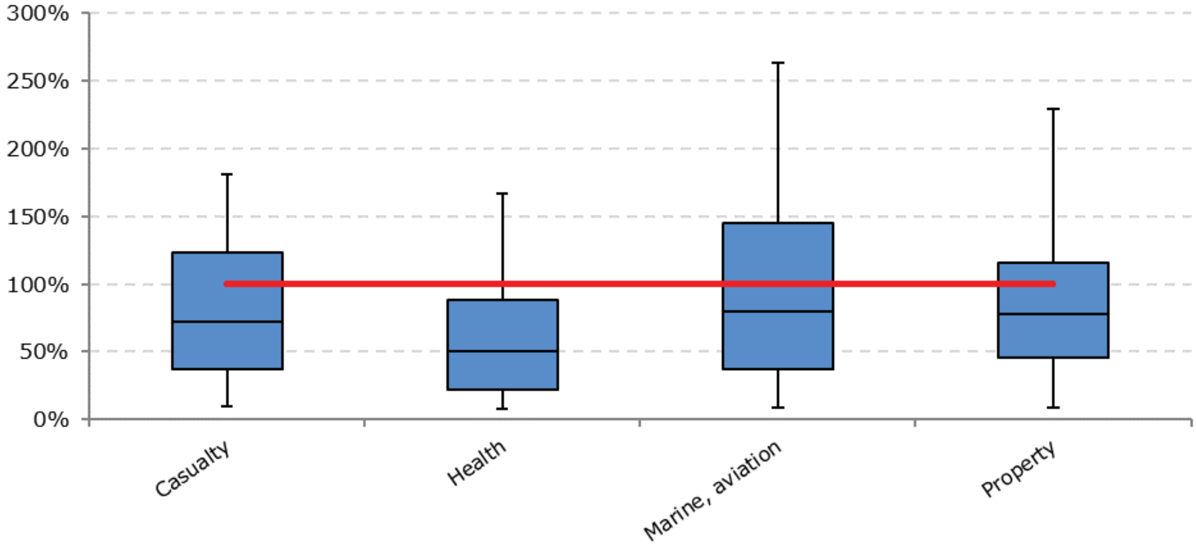
[32] http://www.actuaries.org/LIBRARY/Papers/RiskBookChapters/Ch6_Non-proportional_Reinsurance_2015-08-28.pdf

[33] https://www.insurancebusinessmag.com/asia/news/breaking-news/fitch-catastrophe-losses-impact-reinsurers-combined-ratios-90379.aspx

Non-proportional reinsurance is concentrated in fewer business lines with a median gross combined ratio ranging from 50% to 80% (Figure 3.3). Non-proportional reinsurance, where losses are transferred beyond a certain threshold and which allows for tailor-made solutions, is used as a predominant risk mitigating technique for non-life business. The use of non-proportional reinsurance for tail risks, which require a substantial amount of capital under Solvency II, can reduce the SCR for non-life catastrophe risk as well.

Figure 3.3: Gross Combined Ratio across business lines for non-proportional reinsurance (in %; median, interquartile range and 10^{th} and 90^{th} percentile) as of Q4 2017



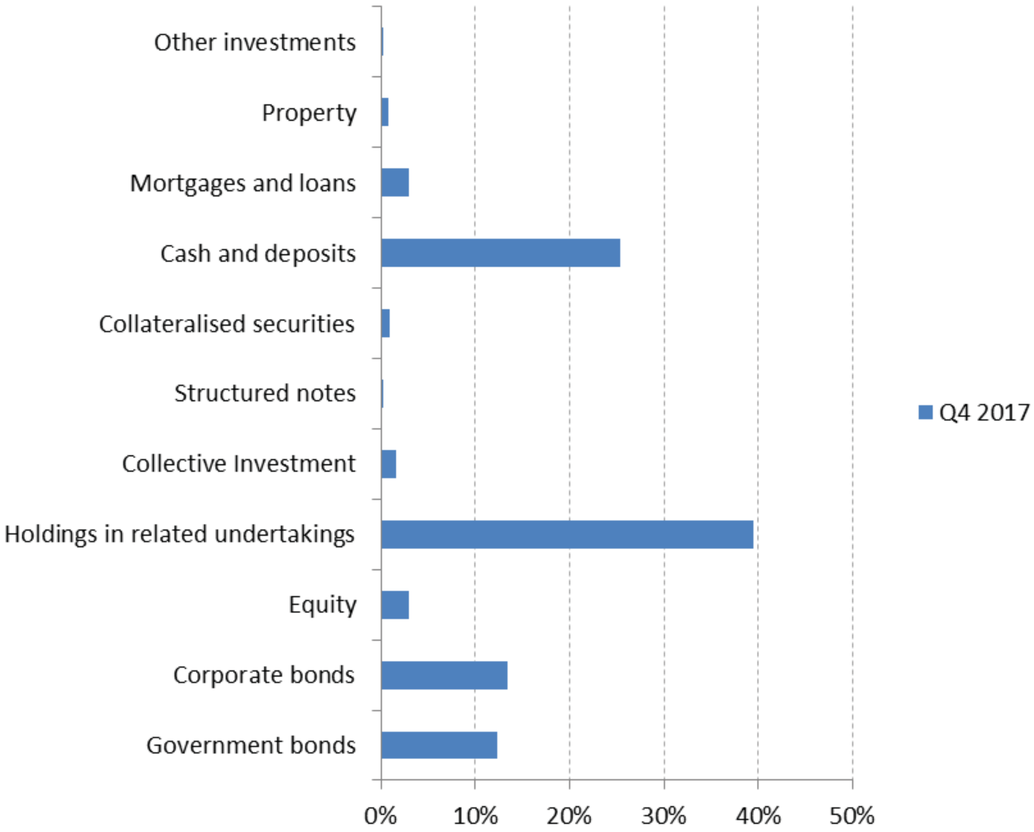
Source: EIOPA Quarterly Solo. Template: S.05.01.02. Nominator [R0330+R0550, C0130-C0160]; Denominator [R0230, C0130-C0160]
Reporting Reference date: 31/12/2017

The impact of the large insured losses on future prices in the reinsurance sector is uncertain. While price increases are typically expected following significant reinsurance losses, so far the first round of renewals in 2018 saw only moderate price increases and mostly only for the regions affected by the 2017 hurricanes. This is partly due to the excess capacity and the continued inflow of capital into the reinsurance sector, which dampens price increases. However, demand for reinsurance is expected to increase further as a result of the higher frequency and the larger scale of natural disasters, all in a context of a risk-based regulation that better reflects the risk mitigating effects of reinsurance (Solvency II and IFRS 17). By assuming that 2018 will be an average catastrophe loss year, combined ratios and profits will likely improve as reinsurance rates adjust.[34]

Reinsurers have considerable holdings in related undertakings (40%) at solo level, primarily due to the specific group structure of reinsurance groups (Figure 3.4). In addition, reinsures have relatively large cash and deposits holdings (25%), followed by investments in corporate bonds (13%) and government bonds (12%). Overall, reinsurers' seem to invest more heavily in liquid assets compared to other insurers, which can be explained by the relatively short reinsurance contracts and the fact that reinsurers need liquid assets to cover reinsurance claims and obligations.

[34] http://institute.swissre.com/research/library/Global_insurance_review_2017_outlook_2018.html

Figure 3.4: Investment split for reinsurers (in %) in Q4 2017



Source: EIOPA Quarterly Solo. Look-through approach applied.

3.4. Solvency

Global reinsurer capital totalled USD 600bn as of September 2017, up by around 1 percent when compared with the end of 2016 (USD 595bn).[35] The share of traditional capital rose also by 1 percent to USD 518bn, driven mainly by unrealised gains on bond portfolios associated with declining interest rates during the period.

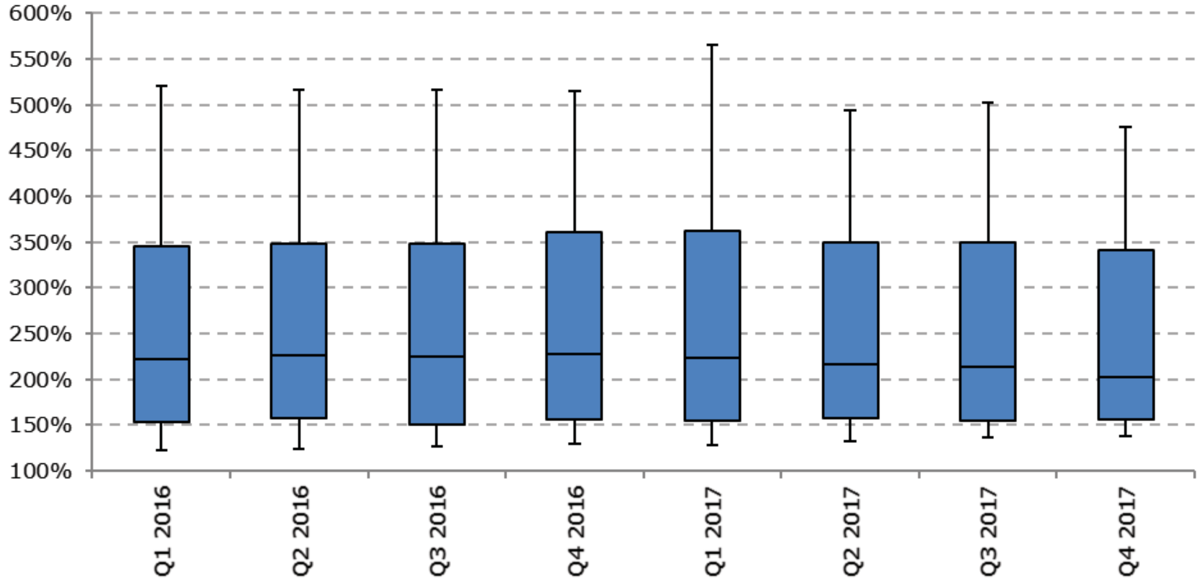
Over the last decade, however, overall reinsurer capital has increased by 76 percent. The January 2018 rate renewals reflected these soft market conditions. Against the background of record insured losses, the relatively modest price increases in the January 2018 renewals are somewhat surprising as they contradict the traditional reinsurance cycle. This is partly due to the persisting excess capacity and capital-inflow into the reinsurance market, which keeps a lid on prices.

The median reinsurance company is still very well capitalized in Q4 2017, despite the major catastrophe losses suffered in 2017 (Figure 3.5). The median SCR ratio is 202%, although it varies widely across reinsurance companies, ranging from 138% and 476% for the 10th and 90th percentile respectively. Overall, the reinsurance industry appears to have sufficient capital to absorb large catastrophe losses.[36]

[35] AON Benfield: Reinsurance Market Outlook January 2018, page 5.

[36] ARTEMIS Website: http://www.artemis.bm/blog/2016/09/15/reinsurance-rate-softening-to-continue-ils-to-grow-influence-sp-execs/

Figure 3.5: Reinsurers' SCR ratio (in %; median, interquartile range and 10th and 90th percentile) in Q4 2017



Source: EIOPA Quarterly Solo