Restraint in a Challenging Market Environment

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The Global Reinsurance market remains challenged by various market and macro-economic forces that will continue to mold the landscape over the near term. In spite of this, A. M. Best’s global reinsurance composite still illustrates reasonable results for 2016, aided by the lack of large U.S. cat losses, ongoing capital management strategies, and continued overall favorable reserve releases.

Conditions remain competitive, even as cession rates have begun to tick up, driven by the relatively stable terms and conditions available in the market. Some observers believe that we may be nearing the bottom of the soft market as brokers are experiencing greater difficulty filling out underpriced programs and demands for further concessions in terms diminish. Nonetheless, current accident year underwriting margins will remain pressured for the near term, as rates remain at historical lows.

Third-party capital continues to seek a larger piece of the pie, but the speed of capital market capacity entering the market seems to have slowed compared to prior years and some collateralized markets have held capacity flat, unable to find suitable opportunities. In A.M. Best’s opinion, this is a healthy response to the current market environment.

The global reinsurance sector remains by all accounts overcapitalized. For 2016, A. M. Best and Guy Carpenter estimate dedicated reinsurance capacity, which includes USD 75 billion of convergence capacity, will likely increase slightly to USD 420 billion when compared to 2015 (Exhibit 1). Convergence capital, which includes industry loss warranties, collateralized reinsurance, and cat bonds, continued to enter the reinsurance market, albeit at a slower pace.

Exhibit 1
Estimate for Total Dedicated Reinsurance Capacity

Source: Forecast by Guy Carpenter and A.M. Best
Cat bond issuance (Exhibit 2) continued to grow strongly through year-end 2014 but has gradually tapered off in 2015 and 2016. Likewise, capital continued to flow into some collateralized reinsurance vehicles and sidecars. The marginal growth trend for rated balance sheet capacity is expected to continue for 2017. This increase is attributable to earnings outpacing share buybacks and dividends, barring any extraordinary catastrophe losses, and is seen as a strategic move as reinsurance organizations appear to be positioning themselves for future opportunities. In this regard, there is some speculation that attractive business opportunities may be on the horizon in the U.S. as government policy changes emerge from the new Trump administration.

Traditional reinsurers are adapting to become the gatekeepers of insurance risk and manage the risk share and alignment with alternative capital for property and non-property classes of business. This is a trend that is expected to continue. There is a clear sense for the need to form larger, global, well-diversified operations with broad underwriting capabilities to assess risk and to serve as transformers of risk to the capital markets. Reinsurance companies are making the argument that they can best serve insurance companies in terms of matching risk with the most appropriate form of capital. Although, as all market players look to become more efficient, be it through disintermediation or going directly to sources of risk, this tug of war will result in fewer hands in the pot – ultimately making it better for the purchaser of protection but likely at the expense of some franchises that exist today.

While current market conditions appear to be stabilizing, competition remains intense and quality of earnings under pressure. This is sustaining the need for further M&A and A.M. Best believes that consolidation will continue, particularly among smaller players in the market as acceptable returns become increasingly harder to achieve. This is also fueling reinsurers’ charge to innovate. It is extremely difficult to build a better mouse trap, but that should not hinder the search for niche businesses or strategies that are difficult to replicate.
and therefore prove more stable over time. Over the past few years, reinsurers have made a number of strategic moves to position their organization for long-term survival. M&A activity is by far the most significant of these, but we have also seen formations of joint ventures, increased research and development to find ways to close the insurance gap, use of big data in underwriting, and entry into new data-rich classes of business.

The new reality for the reinsurance market will reflect an industry where returns are less impressive and underwriting will have to become a larger contributor to profits and returns, leading to a more cautious risk selection, more diversification of product offerings, a wider geographic reach, and conservative loss picks. That combined with the ability to take advantage of the new “cheaper” capital coming into the market from investors that do not have the reinsurance and underwriting expertise could actually lead to significant success for some, although not everyone will win in the end. The solid players will be those that have been conservative in underwriting and reserving, have been able to develop a book of business that will remain relevant for today’s market and allows for quick shifts in and out of lines of business depending on market conditions, as well as companies that have created expertise in managing third-party capital to their own advantage and are capable of participating in the new era of consolidation without being left out of the game.