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Market Segment Outlook: Global Reinsurance

Underwriting discipline and healthy profit margins are among factors supporting the Positive outlook

AM Best is revising its outlook for the global reinsurance segment to Positive from Stable. Key supporting factors include the following:

- Profit margins are robust, following a period of drastic repricing, higher attachment points, and tighter terms and conditions.
- Even as reinsurance rate increases decelerate, underwriting discipline is being maintained and profit margins remain healthy to absorb higher loss activity than recently experienced.
- The segment remains well capitalized, with no new players expected to disrupt current market discipline. Consolidation and flight to quality are more likely.
- Demand for coverage remains strong due to heightened natural catastrophe loss activity and general economic uncertainty.
- Expectations of a slower reduction in interest rates than originally anticipated are likely to support strong returns in the short term.
- Top performers continue to expand and generate robust results, while recent underperformers have turned the corner.
- Concerns about adverse reserve development on US casualty books have been mitigated by strong underwriting results on property lines.

Technical Margins Sustainable Following Repricing and De-risking of Reinsurance Portfolios

In 2023, for a third year in a row, the global reinsurance segment generated positive underwriting results, with several reinsurers reporting combined ratios below 90.0. In 2022, similar results were heavily countered by unrealized investment losses in fixed income portfolios. These losses have been mostly recouped due to higher reinvestment rates. In 2023, most players produced excellent ROEs, in several cases exceeding 20%.

Recently improved and stabilized underwriting margins followed a string of disappointing results in the years after heavy weather-related losses in 2017 (notably Hurricanes Harvey, Irma, and Maria). Repricing efforts were compounded by actions aimed at tightening terms and conditions, with a diminished appetite for aggregate protection, a focus on named perils, a shift from proportional to excess of loss covers, and a sharp increase in attachment points. Along with several companies reducing their exposures to natural catastrophe perils, especially in the high frequency layers, these actions translated gradually into positive and more stable underwriting profits.

Stabilized underwriting profits became visible in 2021, with the hardening of the market confirmed by the dislocation of the renewal season in early 2023. Cedants and reinsurers realigned their roles, with reinsurers retaking their historical role as providers of balance sheet protection rather than earnings stabilizers.

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AM Best believes that the exceptional returns on equity experienced in 2023 are unlikely to be repeated at such a high level, although reinsurers are expected to maintain underwriting discipline in the near term. Despite some signs of deceleration or slight rate softening at the most remote layers of protection, pricing is still robust and there remains limited appetite for higher frequency layers. The tightening of terms and conditions is a critical factor—at least as important as rate increases—contributing to the sustainability and stabilization of technical margins.

New, Disrupting Entrants Unlikely

Reinsurance books for the largest players continue to expand owing to a combination of higher rates, flight to quality, and increased reinsurance demand. Although loss ratios during the first quarter of 2024 were impacted by large losses, including the collapse of the Francis Scott Key Bridge in Baltimore, underwriting margins and annualized ROEs remain strong.

Since primary carriers are being forced to increase retention levels in a highly active claims environment, reinsurance demand remains strong. Despite the attractive returns experienced in recent periods, we do not foresee any significant new entrants to the market. Well-respected management teams have been unable to raise capital to set up the new start-ups that we would have seen in prior hard market cycles. This lack of disruption by new entrants enables the preservation of discipline by seasoned players still recouping losses from previous years.

From an investor's perspective, there is a critical distinction between an established enterprise with a proven track record, scale, and diversification, and a new company formation starting with a limited business profile. Signs of consolidation and flight to quality are clear, with selected major reinsurers attracting new capital, acquiring other businesses, and expanding their scope (new product lines or geographies), while maintaining underwriting discipline. These trends are being reinforced by cedants favoring not only financial strength but also a comprehensive offering to cater to their complex needs.

A Disciplined Segment

Unlike previous hard market cycles, the current one is not characterized by a shortage of available capital. Negative rating actions on reinsurers in recent years have not been triggered by surplus declines but rather by technical underperformance. The best performers continue to expand on the back of oversubscribed capital raises and retained earnings but are still deploying resources in a very prudent manner. The largest European players maintain very active special dividend and share buy-back policies. Investors are more likely to allocate new funds either in rated balance sheets with scale and a proven track record or, opportunistically, in ILS structures where liquidity is critical.

The end of a long period of record-low interest rates drastically changed the economic landscape, with heightened competition for resources between the reinsurance segment and other investment alternatives. This was exacerbated by the past underperformance of the segment and its perceived volatility, particularly given current climate trends and geopolitical instability. Despite the de-risking measures on reinsurance portfolios, it will take some time for investors to reduce the risk premium they are currently applying to reinsurers.

The unrealized investment losses in fixed income portfolios that followed sharp increases in interest rates and reduced the capital and surplus of global reinsurers in 2022 had been largely reversed by the end of 2023. Except for that particular year, dedicated capital for the global reinsurance segment has steadily expanded over the last decade. The recovery might have been even more pronounced if not for sizeable dividend distributions by the largest groups.

ILS capacity, flat for the last five years, has also shown some signs of expansion, mainly driven by record issuance of catastrophe bonds in 2023. ILS previously was seen as a direct competitor to rated balance sheets, but is now perceived as more of a strategic partner. This is particularly true given the ILS segment's focus on the most remote layers, as well as retro capacity needed to support traditional reinsurers' risk appetites.

Dedicated reinsurance capital has been expanding steadily, but the buffers previously in place during periods of extremely low interest rates have shrunk, with companies managing their capacity more efficiently. Until 2021, AM Best estimated capital utilization (the percentage of existing capital needed on average to support a Best's Capital Adequacy Ratio (BCAR) of 25% at a 99.6% VaR, considered "Strongest") at around 80%. Going forward, we expect that indicator to hover around 90%. We believe that the existing margins remain sufficiently healthy, especially considering the current levels of profitability and the amounts of capital being returned to investors.

Reinsurers Well Positioned to Convert Challenges into Opportunities

AM Best's Positive outlook takes into account the existing challenges the global reinsurance segment still faces. Heightened natural catastrophic activity, the increasing relevance of cyber risks, geopolitical uncertainty, and economic and social inflationary pressures remain key topics of discussion crucial in the ratings assessment. Global reinsurers generally have been able to leverage their enterprise risk management (ERM) frameworks to dynamically adjust strategies to a changing market environment.

Global reinsurers tend to easily adapt their business mix and risk profiles to evolving market conditions. Well diversified organizations can use a number of levers to timely enter and exit particular pockets of the market based on performance expectations. Examples include the shift away from high frequency layers in the property natural catastrophe arena, increased caution recently when writing certain US casualty lines, repricing, and tightening of terms and conditions to reduce the uncertainty linked to unforeseen events such as global pandemics or international armed conflicts.

A key challenge for global reinsurers is finding the right balance between prudently deploying capital to support only those risks that can be priced adequately while maintaining a relevant role in an increasingly uncertain world due to geopolitical factors, climate trends, and societal or technological changes. Reinsurers historically have demonstrated their ability to innovate and to refine underwriting tools. That has been the case with both natural catastrophe models and the development of ILS instruments. This trend is expected to continue given the rising importance of new risks in the cyber, secondary perils, and certain casualty lines.

Moving in the Right Direction

The hardening of the current cycle is quite different from previous ones. The main trigger behind a return to market discipline this time has been sustained underperformance, compounded with abundant capital due to a prolonged low interest rate environment rather than capital erosion. Improved profit margins are not only a consequence of higher rates but, most importantly, adjusted terms and conditions. Total insured natural catastrophe losses remain elevated but are mainly comprised of numerous small to medium sized events, including secondary perils. Given the higher attachment points in place, most of the impact is being retained by the primary segment.

The leading performers continue to expand their capital base, either through new inflows or earnings retention. Acquisitions and diversification into primary specialty lines is contributing to a strengthening of their business profiles and sustainability of earnings. Those hit disproportionately by the volatility of their property cat books or adverse development in US casualty lines are turning the corner. Overall, profit margins are healthy and sustainable for the foreseeable future.

Rate increases are decelerating, and there may be early signs of softening at the highest layers in the protection tower. However, AM Best believes that the de-risking measures put in place in the last few years are unlikely to be loosened. This factor, combined with few new entrants, makes the preservation of underwriting discipline more likely than not.

Concerns regarding adverse development of US casualty books seem to be limited to particular years. Reserve strengthening charges have been comfortably absorbed by profit margins in other lines of business. In addition to this, unlike in previous years and despite companies not taking undue credit in their projections, higher investment returns are providing an additional layer of comfort in bottom line results.

GUIDE TO BEST'S MARKET SEGMENT OUTLOOKS

Our market segment outlooks examine the impact of current trends on companies operating in particular segments of the insurance industry over the next 12 months. Typical factors we would consider include current and forecast economic conditions; the regulatory environment and potential changes; emerging product developments; and competitive issues that could impact the success of these companies.

A Best's Market Segment Outlook can be Positive, Negative, or Stable.

Best's Market Segment Outlook	
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BEST'S MARKET SEGMENT REPORT

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