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The Lead Runners In The Reinsurance Race Look To Separate From The Pack, CEO Panel Says

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NEW YORK (S&P Global Ratings) June 8, 2018--For the global reinsurance industry, 2018 could be a year of greater separation between coverage providers that are in the market for the long haul and those that will lose sight of the lead pack, a panel of chief executives told attendees at S&P Global Ratings' 2018 Insurance Conference in New York.

S&P Global Ratings maintains a stable outlook on the global reinsurance sector and the majority of the reinsurers we rate. As of May 31, 2018, average credit quality for the reinsurers we rate in the sector was 'A+' and 77% of ratings had stable outlooks. Despite 2017's historic catastrophe (cat) losses, reinsurers' capital adequacy remains robust, although lower than at year-end 2016.

"In the aggregate, the industry is still well-reserved," said Brian Young, president and CEO of Odyssey Group, adding that "Most property-cat programs are still profitable even after the events--but it would be interesting to see what happens" if we have a similar situation this year.

Certainly, 2017 brought a number of challenges to reinsurers, including soft pricing, a heightened competitive environment with a record influx of alternative capital, and, most importantly, the cat events that racked up more than $138 billion in insured losses globally--by at least one estimate, the most ever recorded in a single year since 1970.

In this light, S&P Global Ratings believes that so-called alternative capital passed its stress test and continues to come of age, reaching $89 billion as of year-end 2017.

"Alternative capital is a permanent part of the ecosystem that we all live in," Joe Brandon, executive vice president of Alleghany Corp., told conference attendees. "It's going to exist whether we like it or not. Smart companies are adapting themselves to that reality, finding ways to profit from it and not view it as a threat."

"Alternative capital is another vehicle for us to increase our relevance," John Doucette, president and CEO of the reinsurance division of Everest Re Group, said. "Our view is that a rated vehicle with unrated third-party capital, that combination is one plus one is greater than two."

At the same time, Mr. Young said that alternative capital's presence is essentially limited to a very narrow part of the market: U.S. catastrophe reinsurance. Given that cat underwriting represents roughly 10% of overall underwriting for reinsurers, the threat posed by alternative players may be overstated, he noted.

"It's still pretty small and narrowly focused," Mr. Young said. "You don't run into alternative capital if you go outside the U.S. or if you go outside of cat."

Still, given that, in the words of Mr. Young, "There's just too much capital and not enough pain" in the market, pricing has been affected. As alternative capital's influence in the reinsurance sector grows, especially in property catastrophe and more recently, life reinsurance, the recent upward pressure on reinsurance pricing could be short-lived. After last year's events, global reinsurance pricing was slightly up to about 5%, in aggregate, during the year-to-date renewals. Specific increases varied by line of business, whether the policy had experienced any losses, and region.

Mr. Brandon suggested that, if you had told market experts in August 2017 what was about to happen with regard to natural catastrophes, their expectations of what would have happened to pricing during the important January 1 renewals would have been higher than what the reality turned out to be.

Still, "While the rate increases were in total less than expectations--and some would use the word disappointing, I believe the industry's book… is a more profitable book of business than it was on June 7, 2017," Mr. Brandon said. "Property cat has been a disproportionate profit contributor… on a risk-adjusted basis for reinsurers over the past decade or two."

Mr. Young agreed, saying that, at the June 1 renewals, there seemed to be slightly more downward pressure than at the beginning of the year.

"I think the market still is kind of fragile, and reinsurers have had enough and given enough to ceding companies," he said. "My expectation, in the absence of meaningful cat losses, or any financial dislocation, is that for the rest of the year and next year, things will be flattish."

"Until the industry starts showing adverse developments… it's going to be tough to see any demonstrative change in pricing," he continued. "As long as there's too much capital in the system and there isn't fear in the market, you're not going to see a meaningful correction."

That said, "It's tough to generalize in a globally diversified market," he added.

Mr. Brandon agreed, suggesting that while "What's going to happen for the rest of the year depends on events, you need to paint with a thin brush: line by line, territory by territory, client by client."

As it stands, Mr. Brandon said, "We've been in a very mild claims environment for over 15 years now--certainly in comparison to the 15 years that preceded it."

"We don't assume that that claims environment, when we're putting up our reserves, to persist forever," he continued. "The state of your balance sheet can turn on a dime--you can't get complacent."

In this light, Mr. Brandon said he feels, "Like I'm watching a marathon where the lead pack is getting stretched out," and the competitive environment is going to separate those that will remain for the long haul from those that won't.

Regarding growth opportunities, Mr. Doucette said, "The global clients--the multinationals--are buying more reinsurance."

"They're using reinsurance to derisk and lower volatility," he continued. "They want to buy from well-rated companies that trade with them all over the world, and there's increased scrutiny about not just the ratings but the longevity of the counterparty."

"There's exposure growth around the world--in South America, in Asia. And wherever there's exposure growth, insurers and reinsurers will be there," he added.

Meanwhile, roughly two-thirds of respondents to a polling question said they expect reinsurers' returns on equity (ROE) to come in at 7%-9% this year and next given the economic and pricing environments and assuming average cat-loss years.

"Who am I to disagree?" asked Mr. Young. "If the cat experience is light, and you see five or six points of reserve release, then it's conceivable reinsurers could get above 10--but you'd need a significant tailwind in underwriting for that."

"Either way, I think you're going to see greater separation between winners and losers," he added.

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