Insurance Industry And Country Risk Assessment:

Global Life Reinsurance

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Rationale

S&P Global Ratings assesses industry and country risk in the global life reinsurance sector as low. Our assessment reflects our positive view of the sector which is dominated by a few large international groups (see table 2). We believe the sector benefits from a stable operational environment with high barriers to entry, a high level of expertise, and prudent underwriting, leading to healthy and stable earnings. This was particularly highlighted in 2017: While the global property/casualty (P/C) reinsurance business suffered from natural catastrophe (nat cat) events, the life reinsurance business provided strong earnings, offsetting for many international groups the losses from the P/C sector.

Country Risk: Low

In our view, global reinsurers typically enjoy a high level of geographic diversification thanks to writing business in multiple countries around the world. This helps the companies to mitigate potential economic downturns in one region. Furthermore, the domicile of the reinsurer has relatively little impact on the aggregate industry and country risks it faces.

From our perspective, the global reinsurance sector is influenced by wider macroeconomic trends. For major countries and regions where life reinsurers operate (U.S., eurozone, U.K., China, Canada, and Australia), we expect positive economic growth (see table 1). Furthermore, divergent growth trends between developed and emerging economies could open opportunities for life reinsurers to increase their market penetration in the faster-growing emerging markets, at least in the long term.

Table 1

GDP Forecast For Major Life Re Markets

	2015	2016	2017	2018f	2019f	2020f
Real GDP (% change)						
Eurozone	2	1.8	2.5	2.3	1.9	1.7
Asia-Pacific*	5.5	5.5	5.5	5.6	5.6	5.4
U.S.	2.9	1.5	2.3	2.9	2.6	2
Canada	1	1.4	3	2	1.9	2

Table 1

GDP Forecast For Major Life Re Markets (cont.)

	2015	2016	2017	2018f	2019f	2020f
U.K.	2.3	1.9	1.7	1.3	1.5	1.6

*Asia-Pacific: Australia, Japan, and emerging markets in Asia. Source: S&P Global Ratings. f--Forecast.

Industry Risk: Low

A key strength of the sector is its high operational barriers to entry, in our view. The sector is highly concentrated among the top well-established global players, which benefit from longstanding relationships with their cedents. This supports strong and sticky business with stable profitability. Furthermore, we believe there are sound growth prospects in emerging markets with a growing middle-class.

Our positive view is somewhat offset by potential risk volatility stemming from for example longevity and disability products. Moreover, we will closely monitor if new capacity via alternative capital such as the recent market entry of Langhorne Re in January 2018 affects the sector's barriers to entry as well as the rising interest of life reinsurance players in the longevity swap market where the sector competes with primary insurance companies and banks.

Positive Factors

- A few internationally diversified groups dominate the global life reinsurance market. We estimate that the top players (by premiums) listed in table 2 make up about 90% of the total market.
- The life reinsurance players have developed, often over decades, specific international market expertise and underwriting capacities, including access to key underwriting data. These skills enable them to develop and support long-standing, trustful relationships between primary life insurance companies.
- We therefore believe it is rather unlikely that new entrants could easily build organically the know-how and client relationships to operate successfully in this sector. We also feel that the market holds few viable targets that would enable a new entrant to develop a foothold through acquisition.
- The recent market entry of Langhorne Re earlier this year does not alter our view for now. This vehicle is sponsored by two major reinsurers Reinsurance Group of America Inc. (RGA) and RenaissanceRe Holdings Ltd. (RenRe) with about $780 million of equity capital commitments, including investments from RGA, RenRe, and third-party capital. Langhorne Re will be targeting large in-force life and annuity blocks allowing cedents to de-risk and optimize their capital management.
- The high barriers to entry and concentrated market are also key aspects for the healthy and stable profitability of the global life reinsurance sector. Furthermore, we believe a set of sophisticated underwriting, actuarial, and risk transfer capabilities offered by the reinsurance companies ensures stable margins.
- In 2017, we calculate the return on equity (ROE) for the sector to be 13.3%, benefitting from RGA's extraordinary ROE of 21.9% thanks to tax benefits. However, even excluding these

extraordinary effects, we estimate the sector's ROE to be 10.2%, still slightly above the result for 2016, and our estimate for last year. One supportive income source is so-called financial-motivated reinsurance (e.g. reinsurance solutions with a focus on capital management) which is a growing area for life reinsurers.

- We expect the sector will maintain an ROE in the low double-digit area annually over 2018-2020.

Table 2

Gross Written Premiums (GWP) Of The Top Rated Reinsurers, 2017

(Mil. $)	2017	2016	% change (with FX adj.)	% change (without FX adj.)
Munich Re	16,468	14,341	14.8	0.7
Swiss Re	13,313	12,801	4.0	4.0
Reinsurance Group of America	10,704	10,107	5.9	5.9
SCOR Re	10,515	8,609	22.1	7.0
Hannover Re	8,494	7,518	13.0	(1.0)
China Re	6,811	4,514	50.9	41.3
General Reinsurance Corp.	3,306	3,068	7.7	7.7
Partner Re	1,399	1,168	19.8	19.8
Total	71,010	62,126	14.3	6.5

FX--Foreign exchange.

Neutral factors

- We regard potential volatility in earnings and profitability as limited. Compared with the primary insurance sector, the reinsurance industry generally focuses on writing mortality or protection business, and writes limited amounts of savings products that have related guarantee risk. Consequently, we view asset-liability management risk as low.
- Nonetheless, material changes in key actuarial assumptions for calculating premiums, such as mortality and morbidity rates, can create some earnings volatility. For instance, Australian disability business written in prior years has experienced some dislocation, including higher-than-expected claims and lapses in 2013, with an estimated pretax loss for the global life reinsurance industry of about $1 billion. For the Australian disability business, however, we assume that most adverse developments were reflected in 2012-2014 results.
- In our view, market growth prospects for the sector are neutral, despite sound growth in 2017. In the last year, we have again observed strong growth in Asia. This holds in particular for China where we have seen premium growth of about 30% in 2017. The overall sector increased by about 14%, benefitting from foreign exchange fluctuations, and by about 7% based on local currency by our calculation.
- Besides the Asia market, we also see sound growth prospects in financial-motivated reinsurance and longevity protection. Based on our estimates, the exposure to longevity swaps for the global life reinsurance sector amounts to more than $60 billion, and is further growing. The U.K. remains an important market, but continental European markets are also gaining traction.

- Growth prospects are somewhat offset by the U.S. mortality market, which is a key market for the overall sector. The U.S. market itself has contracted by nearly two-thirds in the past 10 years due to higher retentions by the primary insurance market. While cession rates in the U.S. have gained some momentum, increasing to over 25% in 2017, we do not expect them to increase to more than 30% over the short-to-medium term because many U.S. primary insurers continue to express a strong preference for mortality risk relative to other types of risk on their balance sheet (for example, market, spread, or longevity).
- Overall, we expect worldwide growth rates for the sector to be around 3%, barring any extraordinary foreign exchange fluctuations.
- In our view the sector's institutional framework is moderately strong and neutral to our overall assessment. Accounting standards and disclosure practices are generally of high quality and reliable, in our view. Furthermore, we do not see any general weaknesses in governance or transparency.

Related Criteria

- Insurers: Rating Methodology, May 7, 2013

Related Research

- Chances Outweigh Challenges in Global Life Reinsurance, Aug. 3, 2017

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