TRUST RE

PERSPECTIVES

2017 ROUND-UP

A TALE OF DISAPPOINTED EXPECTATIONS

TRUST RE'S OPINION/INSIGHT INTO MARKET CONDITIONS IN 2017

Introduction

2017 was both a tough and a sobering year for the global reinsurance industry. The year started off as a continuation of 2016 with double-digit rate reductions across the board. In the second half, the sector had to digest a series of major natural disasters, causing global insured losses of an estimated US$ 130 billion and making 2017 one of the costliest loss years on record. However, the severity of these events did little to address the demand and supply imbalance which has been plaguing the global reinsurance markets for years. As at the end of 2017, according to JLT Re, the sector's excess capital position remains high at US$ 45 billion or about 17% above gross premiums, having fallen by just US$ 15 billion during the second half of the year. As a result, the widely anticipated market hardening has largely remained elusive.

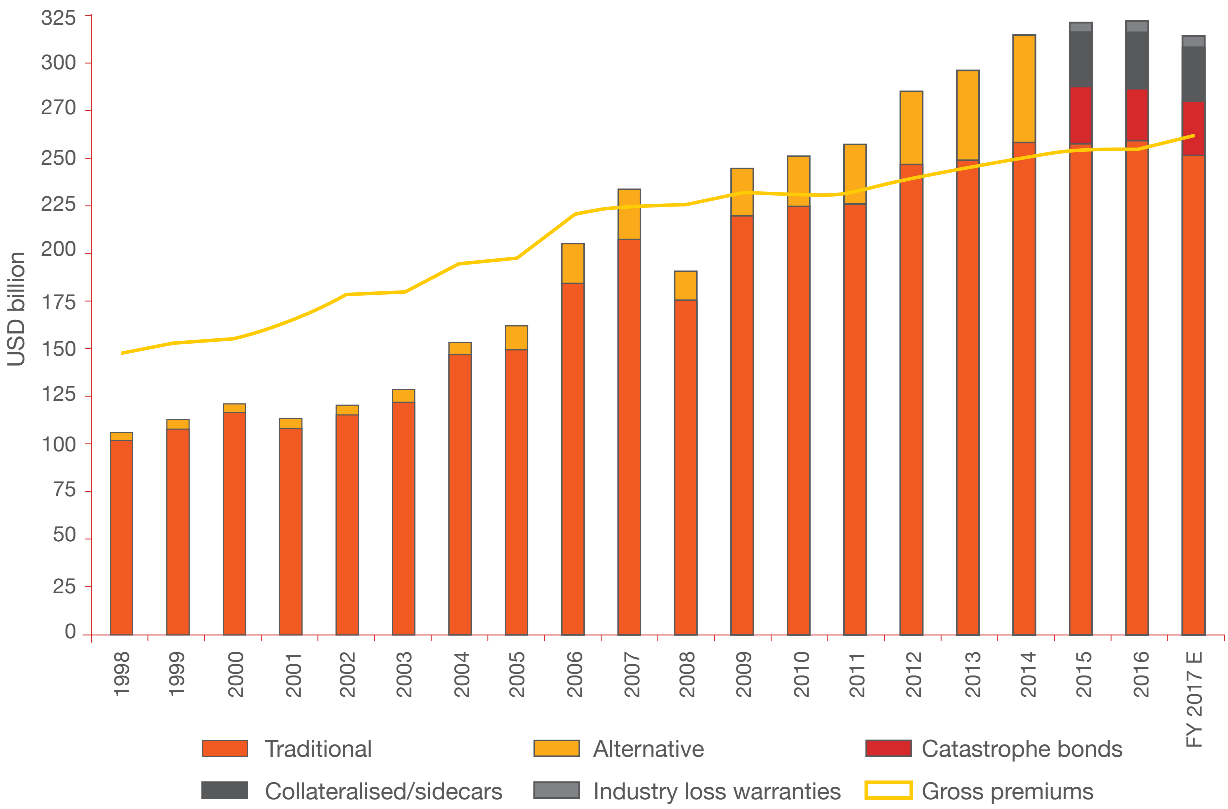


Fig. 1: Dedicated reinsurance sector capital and Gross Written Premiums – 1998 to FY 2017E (Source: JLT Re)

More than a year ago, in light of the January 2017 renewal results, reinsurers were facing an unabated erosion of margins, across all geographies and lines of business. According to Trust Re's proprietary market intelligence, our target markets in the high-growth countries of Africa, Asia, the Middle East, Central and Eastern Europe and the Commonwealth of Independent States were no exception. Terms and conditions continued to soften as additional capital poured into the market. At the same time, economic growth remained subdued in key emerging markets as low levels of commodity prices continued to take their toll. Meanwhile, operating expenses moved on an upward trajectory as regulatory requirements tightened and acquisition cost increased further. For many reinsurers, a broadly acceptable headline performance was simply a result of positive prior year reserve developments and benign catastrophe losses. It was clear to any underwriter that this state of affairs was unsustainable and, ultimately, the choice was between two evils: either retaining market share at the expense of profitability or shrinking the footprint in order to preserve margins.

By mid-year, the pace of erosion started to slow, on the back of a growing recognition that rates in many areas had fallen to levels that tested technical profitability after successive years of declines. During the July renewals, rates continued to slide in the single digit range but terms and conditions partially hardened. In the Middle East, several large man-made catastrophe losses contributed to this trend. Large losses were close to or in excess of US$ 3 billion, most prominently, in January 2017, there was a fire blaze at a refinery of the Abu Dhabi National Oil Company (ADNOC) and Aluminium Bahrain (ALBA) was hit by a severe power outage. In addition, in August, Oman based Sohar Aluminium experienced a loss where all pots were frozen.

Following the mid-year renewals, an almost unprecedented series of natural catastrophes sent shockwaves across the global reinsurance industry. Three major hurricanes Harvey, Irma and Maria, in August and September, resulted in insured losses of approximately US$ 80 billion. In addition, further natural catastrophes such as typhoons and floods in China, earthquakes in Mexico and a string of wildfires in the US added another US$ 55 billion to the total natural catastrophe bill in 2017.

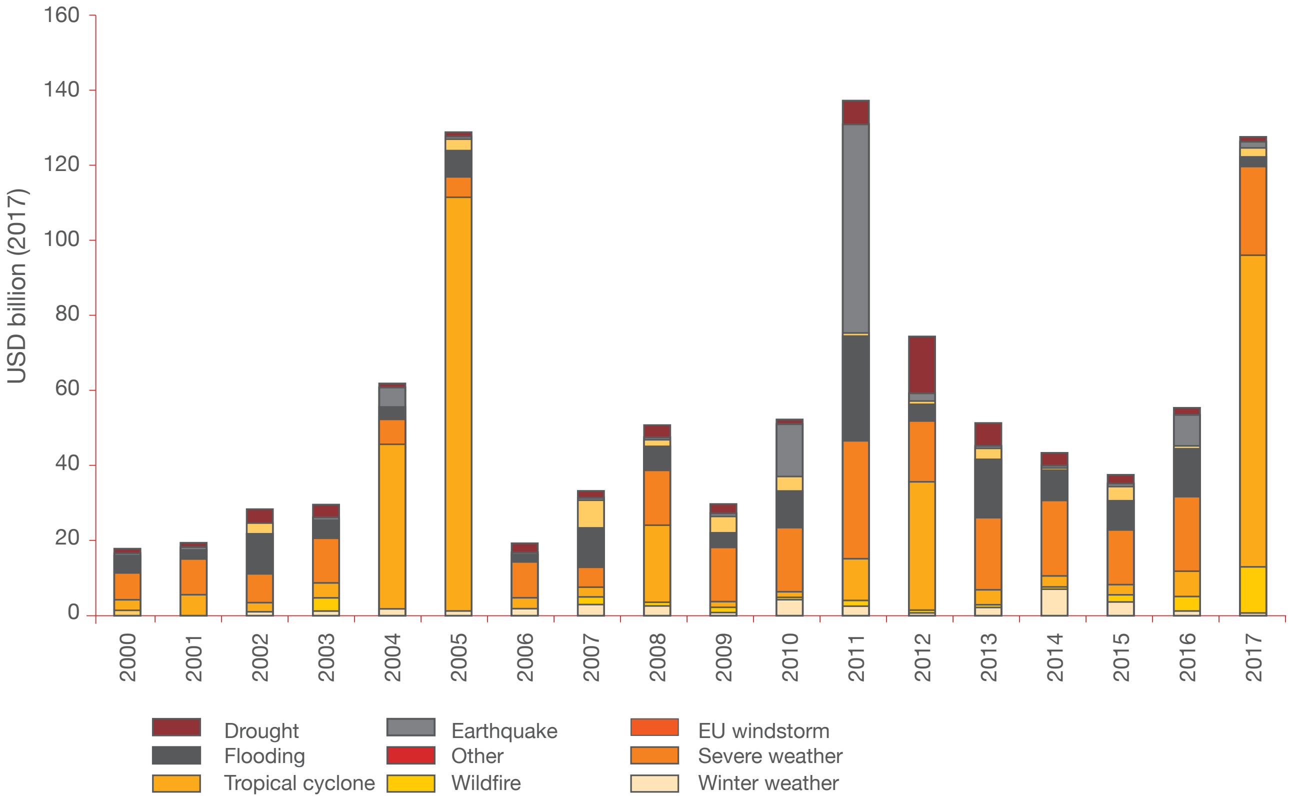
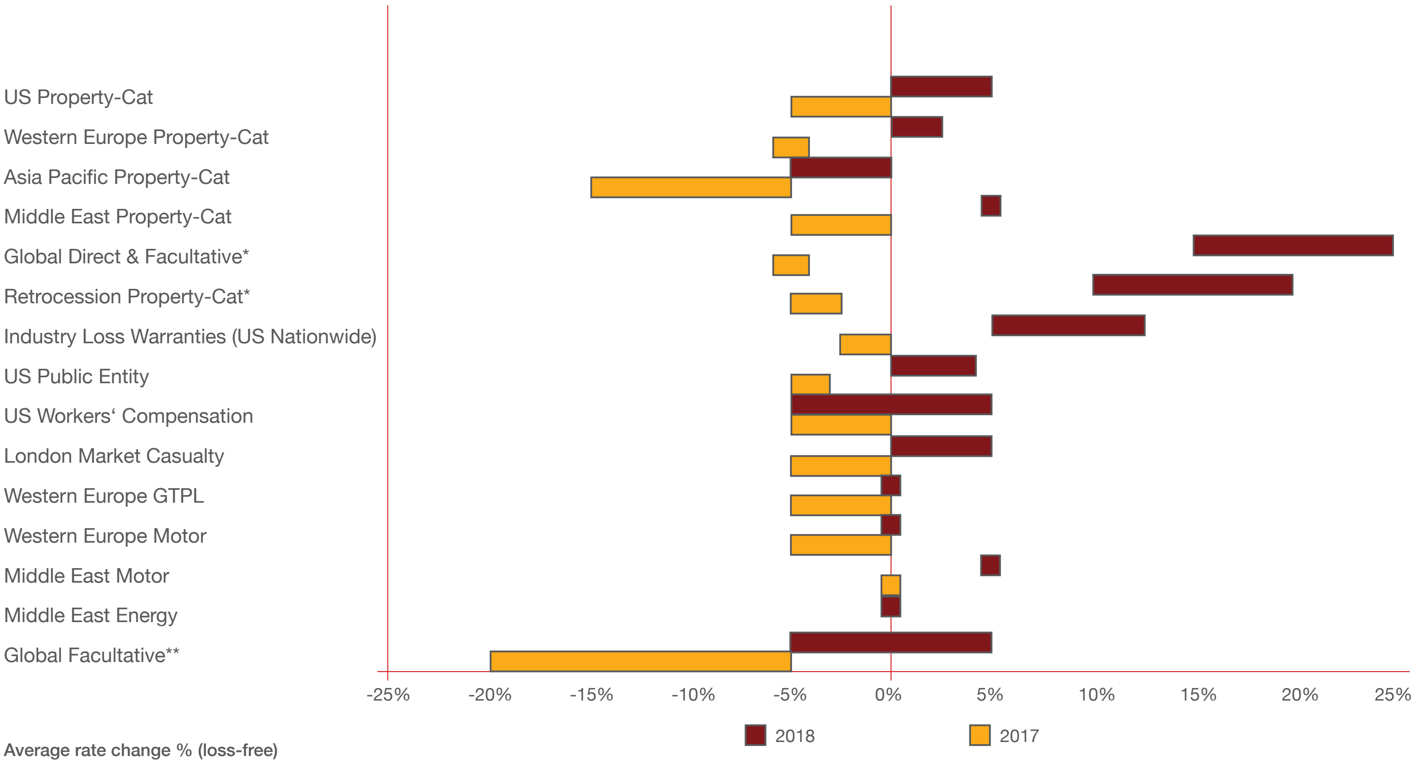


Fig. 2: Insured losses by year by type
(Source: Aon Benfield Analytics)

With the onset of the year-end renewals season at the annual industry conferences in Monte Carlo, Baden-Baden and in Singapore, it became a matter of certainty that the global reinsurance industry would report an aggregate combined ratio for the year 2017 in excess of 100%. As a result, heated discussions began as to whether 2017 would go down in the annals of the industry as the turning point in what was perceived to be the longest lasting soft reinsurance cycle on record – or as the final proof that the reinsurance cycle is a thing of the past.

By November, A.M. Best projected an estimated combined ratio of about 110% for its composite of global reinsurers and a return on equity ranging from nil to minus five percent for the full year. Unsurprisingly, reinsurers pushed hard for rate increases. But the phalanx of reinsurers disintegrated when it became clear that the alternative capital market was here to stay, weathering expected catastrophe losses of US$ 20-30 billion and easily ‘reloading’. As a result, most reinsurers agreed to look at rates according to region and account rather than pursuing a global across the board approach.

Against this backdrop, the January 2018 renewals proved disappointing to most reinsurers. In the Middle East, a massive string of large losses in excess of US$ 2.5 billion was experienced as was stagnating economic growth, rising political risks and tighter, cost-driving insurance regulations. Market conditions remained largely unchanged, according to our perception. Similarly, in Asia, including the Indian Subcontinent, proportional treaties renewed on stable terms. Only in Central and Eastern Europe, some non-proportional treaties showed rate increases in excess of 5%. Generally speaking, sizeable rate increases were limited to a small number of programmes affected by large losses.



* Very few programmes were loss-free for global D&F and retrocession, so the ranges shown reflect loss-affected rate changes.
** Rate changes for global facultative apply to full year 2017 (orange) and early 2018 (maroon). Individual programee outcomes varied within the ranges shown for each class of business.

Fig. 3: Risk-adjusted rate movements for P&C programmes renewing at 1 January 2018 (Source: JLT Re)

Conclusion

The sobering conclusion is that, so far, the push for market change has proven short-lived. Of course, one can speculate on a global surge in inflation and risk-free rates which may eliminate the industry's excess capital position.
For us as reinsurers, it seems to be more promising to take our own fate in our own hands, revisiting our business model and aligning it to a new reality where losses alone may no longer turn the market.

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