18 The Global Reinsurance Market

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18.1 INTRODUCTION

Insurers buy reinsurance for risks they cannot or do not wish to retain and to benefit from the capital relief reinsurance provides. Reinsurance and primary insurance represent two separate elements in the insurance value chain. By providing coverage against adverse fluctuations in claims, reinsurance protects the capital base of the primary insurer and creates a more diversified portfolio, thus reducing the volatility of the underwriting result. Another important benefit of reinsurance is that it allows insurers to accept more business with a given amount of capital, e.g., an insurer can afford to accept larger individual risks or risks exposed to larger loss accumulations from a single event.319

Reinsurance is a global business, covering risks from insurers in many geographic locations. Although some primary insurers are international, most operate through local subsidiaries in different territories. Large reinsurers write business in all major markets in order to maximize the geographic diversification of their portfolios. The diversification of risks is enhanced by retrocession, the reinsurance of reinsurers. By increasing the efficiency of the insurance industry’s use of its capital base, reinsurance facilitates the insurability of risks which are characterized by major uncertainty or large, potential losses.320 This chapter gives an introduction to the reinsurance market, which is driven by international trends and cycles. The worldwide reinsurance market serves as a force which synchronizes primary market

319 For a comprehensive discussion of the history, main product types, key lines of business, and other fundamental aspects of the reinsurance market refer to Gastel (2004), Gerathewohl (1983), Scheppeke (2004), or Swiss Re (2004c, 2005a).

320 For a discussion of the efficiency of the insurance industry’s use of capital see Cummins and Weiss (2000).
developments across the world along with interest rates and worldwide stock markets.\textsuperscript{321}

In 2003, primary insurers ceded business worth $170 billion to reinsurers worldwide, of which 83% was non-life insurance and 17% was life insurance.\textsuperscript{322} The average cession rates, or ceded premiums as a percentage of direct premium volume, were 13.1% in non-life insurance and 1.9% in life insurance. Around 84% of ceded business is generated in the mature insurance markets of North America and Western Europe, reflecting those regions' importance as sources of primary insurance revenue. Only 2% of ceded business comes from Japan, a fact that can be explained by the high concentration and large average company size in the Japanese insurance industry, which accounts for 11% of global direct premiums. By contrast, the emerging markets tend to show strong demand for reinsurance due to the relatively lower capitalization of many local insurers and high proportion of industrial risks in their portfolios. Their share of worldwide cessions is 13%, compared with an 11% share of direct insurance premiums.

From 1990 to 2003, cessions in non-life insurance rose from $60 billion to almost $141 billion. This rise was fueled mainly by increased demand from North American insurers. Thanks to a rapid growth in direct premiums, the relative importance of emerging markets grew as well. Global non-life cessions posted an annual average real growth of 5%, exceeding the 3% real growth rate for primary insurance. The ceded premiums of the life reinsurance market rose from $7 billion to $29 billion, an annual average real growth rate of 9%, well in excess of non-life cession growth as well as the average 4% real growth rate of direct life premiums.

The crisis in U.S. liability insurance in the mid-1980s and the accumulation of natural catastrophe losses at the start of the 1990s prompted significant changes in the reinsurance market. The subsequent capacity shortage and withdrawal of many providers from the market provided a market entry opportunity, of which Bermuda firms took advantage. Since 2001, severe underwriting and investment losses have prompted another wave of structural changes in the industry. The number of domestic market players declined, especially in the United States and Europe, while another generation of Bermuda startups rapidly gained market share. The entry of billions of dollars of fresh capital and the ability of the new market entrants to gain significant market share both indicate that the barriers to entry in many reinsurance markets are low.

\textsuperscript{321} For a discussion of international underwriting cycles see Cummins, et al. (1991), Cummins and Outreville (1987), or Swiss Re (2001b).

\textsuperscript{322} The data used in this report have mostly been taken from the relevant market statistics published by insurance associations, regulatory authorities, and rating agencies. They are based on the business of those insurance companies domiciled in the countries in question. The subsidiaries of foreign companies are usually included as well. The overall market figures are generated by summation of consolidated company data. There are several issues with regards to double counting. The first is when the business activity of the subsidiary is recorded in the country where a subsidiary is based and once again as part of the consolidated annual accounts of the parent company. Second, to avoid double-counting of ceded premiums and retrocessions, retrocession figures are excluded from the calculation for each country. Finally, the study attempts to deal only with “free” market transactions, excluding intragroup reinsurance. For countries where no explicit distinction for intragroup reinsurance is available in the market statistics, estimates are used.