January 9, 2012

Global Reinsurance Ratings Outlook Remains Stable As Industry Weathers Catastrophes, Pricing Begins to Turn

Despite numerous challenges, A.M. Best's rating outlook on the global reinsurance segment is being held at stable, supported by continued strong risk-adjusted capitalization, prudent enterprise risk management practices and an improving pricing environment across a broadening spectrum of business classes. A.M. Best believes these strengths should provide reinsurers the ability to successfully navigate future obstacles that may arise from the increasingly uncertain and turbulent global macroeconomic conditions that currently confront the industry.

From a capital perspective, the global reinsurers are well capitalized and capable of absorbing significant losses from a combination of events. While the ongoing financial crisis in the eurozone presents an unprecedented amount of uncertainty and challenges, over the past year most global reinsurers have taken decisive measures to reduce or contain their direct exposure to the ongoing sovereign debt crisis. A.M. Best and indeed reinsurance companies themselves have performed various capital stress scenarios to be assured that risks associated with underwriting and investment activities are manageable from a capital perspective. Those organizations with life operations were noted to have a greater degree of asset leverage, but nonetheless, risk-adjusted capitalization remained at comfortable levels.

The sector has repeatedly proven its resilience. Over the past two years, numerous catastrophic events occurred around the world, inflicting approximately USD 50 billion of losses on the global reinsurance sector. These loss events proved to be manageable from a capital perspective. Earnings from life operations have helped to serve as a noncorrelated source of operating earnings throughout the period. Since year-end 2007, and despite 2008 and 2011, the overall market's capital has grown and at the start of 2012 is basically flat as compared with the start of 2011. This speaks to the strength of the segment's risk management capability and the resounding resilience of the market to withstand and rebound from live stress events.

Critically, the market seems poised for a turn. Over the past five years, reinsurers generally experienced declining demand for reinsurance capacity as primary companies increased retentions across the board. Recent events – global catastrophes, increased volatility of assets and updated catastrophe models – have brought about a change in primary companies' perception of risk. This increased awareness of risk, combined with growing regulatory pressures on solvency margins, appears to have turned the tide on demand for reinsurance, especially in loss-prone regions of the world. This increasing demand for reinsurance cover has helped to bolster current pricing for property catastrophe-related business. While shorter tail classes of business generally have remained more attractive from a pricing perspective, it now appears casualty pricing may be reaching a trough as well, as reserve margins come under pressure and interest rates remain stubbornly low. A.M. Best believes these dynamics, coupled with capital management strategies, will lead to improved pricing, terms and conditions that will support a low double-digit return on equity in 2012 and continue to support reasonable organic growth in capital, assuming a normal level of global catastrophe losses.

However, A.M. Best remains concerned that the positive momentum in reinsurance pricing may be short lived. History has proven that the market has a short memory, and if the sting of recent loss events quickly fades, the soft market may return. In that scenario, the capital strength of the segment would slowly erode, and A.M. Best would consider revising the ratings outlook to negative, as pressure on ratings would be expected to mount.

The issues overhanging the reinsurance market – pricing pressures, low investment yields and a limited cushion of loss-reserve releases available to mask deteriorating earnings – have lingered for several years now. The macroeconomic issues have created an environment where significant volatility in assets is considered the norm. At the same time, where there is risk, there can be opportunity. The reinsurance market is at a juncture where companies seek to anticipate potential negative scenarios while positioning themselves to seize opportunities. While a different set of market conditions certainly would be preferable, the reinsurance sector has been adaptable, resilient and stable during these challenging times.

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SR-2012-B-317