SOCIETY OF ACTUARIES

Article from:

Reinsurance Section News

August 2005 – Issue 56

CONSOLIDATION IN FINAL STAGES LEADS TO IMPROVED PRICING—A RATING AGENCY'S PERSPECTIVE

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Significant consolidation has occurred in the U.S. reinsurance market over the last five years. The number of companies operating in ordinary life reinsurance has continued to decline—13 primary companies (excluding retrocessionaires) contributing to the Munich American Reassurance Survey in 2004, compared to 20 companies in 1999. Table 1 and Table 2 indicate the change in market share as well as the change in the composition of the leading participants in the U.S. market for 2004 versus 1999.

Table 1

U.S. Ordinary Reinsurance In Force
($Mil.)

Rank			Total In Force		YOY %	Market Share	
2004	1999	Company	2004	2003	Change	2004	1999
1	1	Swiss Re	1,887,966	1,572,663	20.0	29.3	15.6
2	N.A.	Scottish Re	995,139	272,182	265.6	15.4	NA
3	2	RGA	992,446	895,574	10.8	15.4	11.2
4	9	Munich American Re	603,297	515,625	17.0	9.4	3.5
5	5	Transamerica Re	600,832	525,986	14.2	9.3	10.2
6	4	Employers/ERC	418,312	405,128	3.3	6.5	10.6
7	13	Generali USA Life Re	229,837	229,431	0.2	3.6	2.7
8	14	Revios Re	139,403	135,645	2.8	2.2	0.8
9	18	Canada Life (Great-West)	129,469	102,236	26.6	2.0	1.0
10	11	General Re Life	128,442	126,394	1.6	2.0	3.3
		Total Top 10	6,125,143	4,780,864	28.1	95.1	80.5*
		Industry Total	6,441,701	5,653,583	13.9		

*Sum of Top-10 in 1999. N.A. – Not applicable. YOY – Year over year. Source: Munich American Reassurance Company Life Reinsurance Survey, Fitch Ratings.

Table 2

U.S. Ordinary Reinsurance Assumed (Recurring)
($Mil.)

Rank			Total Assumed		YOY %	Market Share	
2004	1999	Company	2004	2003	Change	2004	1999
1	N.A.	Scottish Re	240,258	63,366	279.2	23.3	NA
2	1	Swiss Re	184,172	234,308	(21.4)	17.9	15.0
3	5	RGA	156,431	164,172	(4.7)	15.2	9.3
4	8	Munich American Re	131,438	108,397	21.3	12.8	5.0
5	4	Transamerica Re	124,200	120,900	2.7	12.1	9.5
6	13	Generali USA Life Re	48,483	58,778	(17.5)	4.7	2.6
7	15	Canada Life (Great-West)	38,223	31,014	23.2	3.7	1.9
8	3	Employers/ERC	36,019	34,157	5.5	3.5	11.5
9	19	SCOR Life Re	32,275	37,510	(14.0)	3.1	0.1
10	11	Revios Re	19,758	17,168	15.1	1.9	3.3
		Total Top 10	1,011,257	869,770	16.3	98.3	86.1*
		Industry Total	1,029,134	1,043,402	(1.4)		

*Sum of Top-10 in 1999. N.A. – Not applicable. YOY – Year over year. Source: Munich American Reassurance Company Life Reinsurance Survey, Fitch Ratings.

Several European companies, whose primary business is reinsurance, have expanded market share in the United States over the past five years, and view life reinsurance as an important means of diversification away from their more dominant P&C reinsurance business. Swiss Re has achieved inforce market share dominance in the United States primarily through acquisition. Munich Re has preferred to expand in the United States through organic growth in more recent years, but purchased CNA's business in 2000.

For other European company participants, reinsurance may not be considered a core business. The dutch parent of ING America Insurance Holdings, Inc.'s (ING) concluded that life reinsurance returns were less attractive than its other North American businesses. In a pivotal transaction for a relative newcomer formed in 1998, Scottish Re Group Limited acquired the individual life reinsurance of ING at year-end 2004 (following its acquisition of ERC Life Reinsurance in 2003). Due in part to a different view on the capital required to support the business, Scottish Re's valuation resulted in ING's payment of a ceding commission of $560 million to exit the business.

Allianz Life sold its life reinsurance lines to Reinsurance Group of America, Inc. (RGA) in 2003 to focus on its P&C lines where prices had hardened. Generali's core business, Italian personal lines and life reinsurance, contributes only modestly to its total gross premium written. Still, Generali has made gains in market share, albeit fairly small and remains a medium-sized player in U.S. life reinsurance.

Revios Re, another German company, took over the life reinsurance operations of Gerling Group. Revios Re has announced it is expecting to raise EUR500 million from private investors with the goal to increase capital for an improvement in its insurer financial strength (IFS) rating. Since strong IFS ratings are important, and with inforce in the U.S. market, which has more than doubled in the last five years, Revios Re appears committed to stay. SCOR Life Re bought their platform in the United States from Partners Re, a former owner of Winterthur's business. Despite a decline in new business assumed in 2004, SCOR's market share advanced sharply over the last five years.

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Of North American players, Canada Life's increased participation in the U.S. life reinsurance market has been dramatic since its purchase by Great-West Lifeco in 2003. Reinsurance operations are core, an effective use of capital and a source of diversification for Great-West. As such, an increase in contribution from life reinsurance provides balance to reinsurance operations which had previously been focused on P&C retrocession.

On the other hand, market share for Employers Re has declined over the last five years, and Fitch believes Employers Re is unlikely to be a contributor to further consolidation, despite its purchase of the life reinsurance business of American United Life Insurance Company in 2002. Fitch believes that the earnings volatility inherent in the reinsurance sector makes Employers Re—which operates in both the P&C and the life reinsurance sectors—a poor strategic fit for General Electric (GE) and, as a result, GE will likely restructure or divest the company in the medium term. Another younger company, Annuity & Life Re, reported no ordinary reinsurance assumed in 2004, as it faced financial and liquidity concerns over the last two years.

CONSOLIDATION RESULTS IN THE ABILITY TO NEGOTIATE MORE FAVORABLE TREATY TERMS AS WELL AS MORE DISCIPLINE IN TERMS OF HOW RISK IS ACCEPTED.

Although Fitch believes consolidation may continue, the process is in the latter stages. Concentration among the top 10 players has increased by almost 15 percentage points and the top 10 competitors are increasingly stratified into large, medium and small companies. Large reinsurers control the market in a semi-oligopoly; the top five companies held 79 percent of life reinsurance in force and wrote 81 percent of reinsurance assumed in 2004. A handful of specialty companies, focusing on retrocession, particular geographic regions or product segments, are likely to continue to be successful.

Life reinsurance consolidation means less choice for direct writers and results in the loss of per-life capacity. Scottish Re notes that it will not move its retention levels up to ING's higher levels, evidence that acquiring reinsurers have not increased their retentions sufficiently to make up for the loss of capacity. Thus, while smaller companies will get a share of the business as primary companies look for reinsurance carrier diversification, these same companies may also get reinsurance deals in which the larger reinsurers are not interested.

Consolidation and the concentration of reinsurance capacity puts constraints on capital. Rating agencies and regulators, in addition to shareholders and analysts, have put capital into focus and are examining the returns on capital, as well as capital availability, quality and efficiency. Further, some life reinsurance capital and capacity were underpriced during a period of aggressive reinsurance pricing in the late 1990s and early 2000s, as evidenced by the ING ceding commission paid to Scottish Re. Fitch believes that other reinsurers writing business during that period also have underperforming blocks of business.

This has resulted in a reevaluation by some reinsurers of the cost of capital needed to support reinsurance businesses, as well as the amount of capital required to support the risks underwritten. Some reinsurers have become more selective in capital utilization by curtailing capital intensive product offerings such as XXX reinsurance, and reinsurance for long-term guarantees on universal life or variable annuities.

Consolidation results in the ability to negotiate more favorable treaty terms, as well as more discipline in terms of how risk is accepted. Most reinsurers look much more closely at underwriting quality and step up underwriting audits in an attempt to improve control over the quality of ceding company business. This followed a period when direct writers were less stringent in their underwriting standards as their retention levels plunged during a major shift in mortality risk sharing in the second half of the 1990s.

Fitch expects the consolidation which occurred in the U.S. life reinsurance market to ultimately result in more rational pricing and improved margins for market participants going forward. Evidence that some reinsurers are taking a more conservative posture in pricing was reported by primary companies. Fitch believes this trend will initially be most visible among companies that were either active acquirers in the early 2000s (Swiss Re) or acquired companies that were growing rapidly during the period of aggressive pricing (Scottish Re's purchase of ING), as they work to improve returns on inforce business. This is likely to be followed by price increases from some widely diversified companies in which returns on other businesses may have subsidized lower returns on life reinsurance, while target returns on the entire business were achieved. Companies which demonstrate pricing discipline throughout the period and achieve target returns will benefit by riding the wave of increasing prices and margins.

The improved pricing outlook has already attracted new and nontraditional players, which entered or are considering entry into the life reinsurance business. In December 2004, Marsh & McLennan Companies' private equity arm announced a plan to raise $600 million to fund a new U.S. life reinsurance company. New entrants will again place downward pressure on rates and thus the cycle will continue.

However, Fitch believes that barriers to entry are still relatively high and that capital-raising can be challenging for start-up companies. Primary companies will continue to look for the knowledge and expertise of experienced reinsurers with which to partner for the longer term. Direct writers will be wary of partnering with younger firms after the downfall of Annuity and Life Re which faced financial and liquidity concerns over the past two years and assumed no recurring business in 2004.

The securitization market, whereby banks and investment firms partner with direct writers to provide XXX and AXXX reserve relief, may take off and offer an effective substitute for certain needs for reinsurance. However, Fitch does not believe this is a significant threat to traditional mortality reinsurance. ✺

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