New reinsurers thriving where others fear to tread

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The financial strength of reinsurers has been under a sustained period of pressure, according to A.M. Best's in its latest report, Global Reinsurance.

A range of interacting issues are driving these market conditions, A.M. Best , including:

· Reductions in capital following losses on equity portfolios, adverse development in casualty lines and the World Trade Center loss.

· Limited willingness of institutional shareholders to restore capital reflecting both the demand for maximum returns on capital provided and fear of further adverse development.

· Low levels of likely investment returns given the interest rate environment.

· Improved underwriting performance but doubts that this will be sufficient to support high levels of risk-adjusted capital adequacy over the cycle.

These factors are leading to radical changes in the industry, according to A.M. best's . In particular, some major insurance or financial services groups have reduced their commitment to reinsurance, leading to market withdrawals and reduced ratings where parental commitment is a rating factor.

In addition, to defend their own risk-adjusted capital position, some professional reinsurers have been reducing risk exposure by moving out of some lines, territories or even businesses.

The upside, however, is the ongoing global hard market. While property pricing may be beginning to soften, this is typically from rates well above the technical level. Casualty, meanwhile, continues to firm in many lines, although absolute quality of current pricing remains uncertain given the ongoing potential for adverse development from the 2002 and 2003 accident years.

Major beneficiaries of this environment have been the start-up reinsurers. Pricing levels have allowed business plans with very conservative current and prospective capital, supporting both market acceptance and ratings. Moreover, the lack of historical tail means underwriting performance is a pure play on 2002 and 2003 pricing, leading to extremely good initial results.

At this point, any softening appears largely controlled, although some strong regional competition is emerging. But the next 12 to 18 months will be crucial. If the major players start using their scale in the market to put pricing pressure on smaller rivals, then discipline could evaporate.

Equally, if the start-ups use their clean balance sheets to enter new lines via pricing, especially casualty, the move back to irrational prices could all too easily be triggered.

The senior management teams of both groups are adamant such developments will not occur. But the industry has been here before, and there must be some doubt. If significant softening does happen, then the current reduced levels of financial strength will come under still further pressure. ❐