News release

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EY “Dying, Surviving or Thriving 3 – Global Reinsurance Market”

Reinsurers have a unique window of opportunity to reshape the industry or perish

- It is imperative that reinsurers systematically review and realign their strategic positioning
- We observe unremitting pressure on margins and a looming transformation of the insurance value chain
- Reinsurers might find themselves struggling to survive

ZURICH, 30 August 2017 – For decades, reinsurers have operated without major changes to the way they do business or collaborate with others in the industry. And so far, their conservative strategies have served them well. That might explain why they are reluctant to challenge the long-standing status quo, despite growing signs of profound change and difficult times ahead.

A recent study by advisory firm EY offers compelling evidence that reinsurers are inexorably moving toward a “dead end” with their legacy business models. Premiums are contracting, new risks are surfacing and the industry is undergoing radical transformation. Adrian Halter, Reinsurance Leader Switzerland at EY says: “The risk of running aground in an ebbing business is underscored by clear signs that reinsurers face a long-term structural phenomenon rather than a short-term fluctuation of the insurance cycle.”

Eroding premiums
In the past, reinsurers were used to waiting out periods of low premiums in what they referred to as “soft markets”. Such soft markets were a result of modest payouts in prolonged periods
with below-average catastrophe events. Despite the temporary accumulation of excess capital and the resulting pressure on premiums, reinsurers felt safe in the knowledge that major loss events would sooner or later usher in rallying premiums and recovering margins. In short, what they saw were natural cyclical movements between hard and soft market conditions, in what is commonly referred to as the insurance cycle.

However, a loss event of the magnitude needed to deplete the masses of capital currently accumulated in the sector is increasingly unlikely. Whereas a USD 26 billion loss event like Hurricane Andrew caused a major upswing in insurance premiums in the early 1990s, the record economic losses of USD 235 billion from the 2011 Tohoku earthquake and tsunami had little effect on premiums. “What we are observing is the cycle’s gradual flattening over time as capital continues to stockpile, eradicating upper peaks in particular,” says Adrian Halter.

**Reinsurers’ clients are changing**

Primary insurers – the traditional clients of reinsurers – are undergoing radical change. On the one hand, they are faced with plummeting premiums: primary insurers closed the second quarter of 2017 with premiums in decline for the seventeenth consecutive quarter. On the other hand, new market entrants from other industries armed with innovative business models and advanced capabilities are encroaching on their territory. As a result, EY estimates that roughly 45% of Swiss primary insurers will be squeezed out of saturated markets by 2030 in the most likely scenario. “We also expect that other countries will experience similar developments in the near future,” says Adrian Halter. “Never before have reinsurers had to deal with such sudden and dramatic changes to their client base.”

**New risks and greater downside**

Risks are also changing. Reinsurers are seeing risks that had previously been of low relevance suddenly appearing on their radar. Forced migration, for example, which did not even feature on the list of top 30 risks in 2012, was identified as the world’s most severe risk in 2016, and still ranked third in 2017. Cybersecurity is another example of a risk category that has rapidly grown in importance within a short period, driven by the unremitting increase in the frequency and sophistication of cyberattacks.
Aside from the changing relevance of individual risk categories, the severity of loss in the event of occurrence (or downside) is also growing rapidly for some risks. Consider global urbanization trends and their implications for risk. Projections indicate that some 60% of the world’s population will live in urban centers by 2030. Such megacities and dense conurbations bear an enormous risk potential. Suddenly, weather events with a limited geographic scope can cause damage to assets and personal injury on a massive scale. “Another megatrend that will have a huge impact on business continuity and data protection risks will be hyperconnectivity driven by Industry 4.0 and the Internet of Things, particularly in light of targeted cyberattacks,” says Tom Schmidt, Cybersecurity Leader Switzerland at EY. “However, reinsurers have so far been slow to reshuffle their portfolios and adapt their models to the changing risk landscape, leaving their clients painfully exposed.”

**Unique window of opportunity to reshape the industry**

Despite the rapid and profound changes around them, the majority of reinsurers lack ambitious plans for tapping new revenue streams and generating profitable growth, preferring instead to pursue a “me too” strategy, according to EY’s strategic analysis. Yet the advisory firm sees a number of promising opportunities for sustained and profitable growth by entering new regions, insuring new risks, or repositioning on the (re)insurance value chain, for instance.

According to the study, aspects about emerging and developing economies, such as the wide protection gap and the high growth of gross domestic product and direct written premiums, indicate these countries offer a great opportunity for reinsurers to expand their business. Reinsurers targeting developing economies are not only serving currently unmet risk protection needs, they are also creating a strong brand value, building a client base with high potential and supporting growth of the local insurance sector and the economy as a whole.

Reinsurers can also differentiate their value proposition by addressing new client needs for risk coverage. A multitude of complex risks have surfaced in recent years that companies are finding difficult to manage. Consider cyberthreats: although there is no shortage of demand for insurance protection, only 10% of companies hold a cyber insurance policy due to a lack of suitable products in the market. This reticence to bridge the gap between supply and demand is leaving the door open for players from other industries: Symantec, the company that developed Norton Antivirus, has been quick to recognize the inherent potential. In 2015, the cybersecurity service provider recruited a team of actuaries, insurance specialists and risk
analysts, and established Symantec Cyber Insurance (SCI) in a bid to offer bundled cybersecurity protection and insurance coverage.

Adrian Halter concludes: “The reinsurance business is on the verge of tectonic change. Aside from unrelenting pressure on margins, the risk transfer value chain is set to undergo dramatic transformation in the coming years. This is a reality that requires an immediate and concerted response. Reinsurers have to decide where and how they intend to compete in the new insurance landscape.”

LINK TO THE STUDY

About the study
The third issue of EY’s “Dying, Surviving or Thriving” study series deep-dives into the reinsurance sector and explores the strategic growth opportunities emerging on the horizon. EY’s analysts and industry specialists conducted a hypothesis-driven analysis of numerous financial reports and investor presentations of leading reinsurers, brokers, primary insurers as well as fintechs, supplemented with specialist interviews and insights obtained in the course of numerous domestic and international reinsurance-related advisory and audit engagements. The aim of the study is to capture the prevailing market dynamics, inform debate in the industry and build a fact-based and thought-provoking case that challenges the sector’s predominant strategies and operating models.

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