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Asia-Pacific's Major Reinsurers Deliver Stable Performances Amid Growing Competition and Uncertainty

Alternative capital solutions can offer growth opportunities and bring regional players to par with global peers

Principal Takeaways

- Major Asia-Pacific reinsurers continued to deliver more stable operating ratios and return on equity in 2021 as compared to global peers.
- Regional players hold stable home market positions while pursuing organic and inorganic growth through overseas expansion and M&A.
- In addition to having robust risk-adjusted capitalisation, companies have been actively diversifying capital sources, such as tapping into the alternative capital market to support retrocession needs.

Despite the growing threat of climate risks, global economic uncertainties, as well as increasing competition from global reinsurers, major reinsurers in Asia-Pacific have generally remained resilient. According to AM Best's Asia-Pacific reinsurance composite (a grouping of selected Asia Pacific domiciled reinsurers from the Top 50 Reinsurers) (**Exhibit 1**), most major reinsurance companies in the region continue to deliver more stable returns than global peers. For Asia-Pacific, the composite's five-year average return on equity is 5.8%, having ranged from 4.9% to 6.6% between 2017 and 2021. While the loss ratio shows an increasing trend, this is offset by a decreasing expense ratio, resulting in a stable combined ratio that hovers around the technical break-even point. Investment returns remains stable, hence the composite operating ratio has been stable at around 94%.

Exhibit 1
Global Reinsurance — Asia-Pacific Market Financial Indicators

	5-Year Average	2021	2020	2019	2018	2017
NPW Growth (Total) [2]	9.0%	6.6%	12.3%	14.9%	2.2%	N/A
NPW Growth (P/C Only)[2]	8.7%	5.1%	13.9%	8.8%	7.2%	N/A
Reinsurance % of NPE	92.6%	94.0%	93.4%	93.4%	91.0%	91.0%
Shareholders' Equity Growth[2]	6.7%	0.5%	19.0%	8.0%	-0.8%	N/A
Loss Ratio	72.8	75.7	74.7	73.4	70.3	69.7
Expense Ratio	27.9	25.6	26.2	27.5	30.1	30.2
Combined Ratio	100.7	101.4	100.9	101.0	100.4	99.9
Net Investment Ratio[1]	6.6	7.3	7.2	6.5	6.0	5.9
Operating Ratio	94.1	94.0	93.7	94.4	94.4	94.0
Return on Equity	5.8%	6.6%	5.7%	5.6%	4.9%	6.0%
Return on Revenue	3.6%	4.1%	3.4%	3.4%	3.2%	3.9%
NPW (P/C only) to Equity (End of Period)	149.2	153.3	146.6	153.2	152.2	140.9
Net Reserves to Equity (End of Period)	181.8	205.5	179.1	181.4	176.4	166.9
Gross Reserves to Equity (End of Period)	221.6	248.1	224.2	221.6	215.4	198.7

[1] Net investment ratio based on P/C NPE.
[2] Composite established in 2017
Source: AM Best data and research

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Based on the operating performance of reinsurers in the composite, 2022 is shaping up to be another profitable year thanks to benign natural catastrophe activity in the region during the first half of the year. Reinsurance pricing momentum in most markets is expected to firmly support premium rate increases for the 2023 renewal seasons, given the recent years of underperformance and retrocession capacity reduction in the global reinsurance market, particularly for retrocession aggregate coverage. For instance, property reinsurance rates in Japan continued to harden for a fourth year to pay back losses sustained from typhoon events in 2018 and 2019, albeit at a moderate pace relative to the past three years.

China's implementation of its China Risk-Oriented Solvency System (C-ROSS) Phase 2 in December 2021 presents opportunities for Asia-Pacific reinsurers to provide capital relief support to cedents potentially facing solvency pressures. Nevertheless, factors that may offset operating performance include China's economic slowdown as a result of its zero COVID policy; poor equity market performance in 2022 year to date; and higher retrocession costs after pricing in the high global inflation and a strong US dollar.

The underwriting results of Korean Reinsurance Company and China Property & Casualty Reinsurance Company (China Re P&C), the P/C subsidiary of China Reinsurance (Group) Corporation (China Re), dominate the underwriting performance of AM Best's composite of Asia-Pacific reinsurance companies given their ranking among the top 50 global reinsurers. Most reinsurers in the composite have benefitted from strong economic growth in their home markets in the past decades, by providing capacity to cedents for capital relief via proportional treaties. Because of a large book of proportional treaties, the overall combined ratio is generally very stable and hovers around 100%, attributed to loss absorbing features in proportional treaty commission schemes, such as a wide sliding scale and loss participation. These secure a stable but thin profit margin in the domestic reinsurers' proportional treaty book.

Global Expansion Strategies Shaped by Nat Cat Risks in Home Markets

Domestic/national reinsurers typically have a concentration on nat cat risks in their respective home markets due to their sizeable traditional property portfolios that include motor, commercial and residential property, and engineering lines. Consequently, nat cat risk accumulation in home markets was previously one of the most significant top risks. Therefore, major Asia-Pacific reinsurers tend to share a common theme in their business strategies with regard to global expansion and portfolio diversification.

AM Best notes that reinsurers in the region have put in years of effort to diversify growth, including China Re's acquisition of Chaucer Group, as well as several regional reinsurers converting their overseas branches to subsidiaries to perform active marketing and underwriting. China Re's acquisition of Chaucer Group (which include The Hanover Insurance Holdings Ltd., Chaucer Insurance Company Designated Activity Company, and The Hanover Australia Holding Company Pty Ltd) expanded its international footprint to account for one third of its P/C reinsurance book. Regional market players are now reaping the benefits from a business profile that is more balanced between domestic and overseas contributions, as well as life and non-life business. If one geographical area, such as their home market, performs badly in a year—for example, due to natural catastrophe events—the operating performance could be offset by good performance from another class of business or region. Diversification enhances returns stability, cost of capital and pricing competitiveness.

However, Asia-Pacific reinsurers' overseas portfolios are often allocated differently from many global and US-Bermuda peers given their conservative appetite for overseas nat cat risks. This is evident from significant global loss events including the US hurricanes (Harvey, Irma and Maria in

2017) and COVID-19 business interruption losses in 2020, which led to technical losses for many global reinsurance companies. But the impacts from those events were not quite as severe on major Asia-Pacific reinsurers. **Exhibit 2** shows a list of the reported major nat cat and loss events in and outside the region that have impacted Asia-Pacific reinsurers over the past few years.

As mentioned, the technical balance of reinsurers in the Asia-Pacific composite hovers around break-even point, with a stable and positive return on equity (ROE) (five-year average of 5.8%, 2017-2021) that is supported by a stable stream of investment returns. Although investment portfolios and strategies vary among reinsurance companies, fixed income securities typically account for a majority of their investment allocations.

In view of the low interest rate environment, several reinsurers have taken advantage of favourable bond valuations due to declining interest rates in 2020, and recognised capital gains from the disposal of the bonds. Part of those proceeds were reinvested into higher risk asset classes, including public and private equities, as well as alternative assets (such as real estate funds, trust plans and debt investment schemes) that provide stable but better returns.

Apart from The Toa Reinsurance Company, Limited, which holds half of its investment portfolio in foreign securities, many major domestic reinsurers in the region maintain investment portfolios that are concentrated on their respective home markets. In particular, the foreign securities held by major Chinese and South Korean reinsurers consist mainly of foreign currency denominated Chinese or South Korean bonds. Given the lack of geographic diversification, investment returns from these holdings are highly correlated with the home market's capital market volatility.

Catching Up to Global Peers

From 2017 to 2021, reinsurers in the composite recorded a solid annual average growth of 8.7% in net premium written (NPW). While domestic/national reinsurers have managed to maintain stable shares in their home markets, most have sought to drive growth either through organic expansion overseas or by acquisitions.

China Re's acquisition of Chaucer in 2018 allowed the reinsurer to gain a meaningful presence in the international primary and reinsurance markets. The overseas non-life reinsurance book now accounts for roughly one third of its non-life reinsurance portfolio, while its overseas branches

Exhibit 2

Major Natural Catastrophe and Loss Events

	Asia-Pacific Events	Non Asia-Pacific Events
2017	Hong Kong/Macau typhoon (Hato) Vietnam typhoon China floods	US hurricanes (Harvey, Irma, Maria) California wildfires
2018	Japan typhoon (Jebi, Trami) Hong Kong typhoon (Mangkhut)	US hurricane (Michael) California wildfires
2019	Japan typhoon (Faxi, Hagibis) China typhoon (Lekima) Livestock swine flu	US hurricance (Dorian)
2020	China heavy rain	Beirut port explosion Midwest derecho US hurricane (Laura) COVID-19 pandemic
2021	India cyclone (Tauktae) Australia floods China Henan floods	Europe floods Europe hailstorm US hurricane (Ida) US winter storm (Uri)

Source: AM Best data and research

expanded to include 11 countries and regions. With the acquisition, China Re joins a growing number of global reinsurers which have adopted a hybrid model of writing both reinsurance and specialty insurance business to hedge against performance volatilities. At the same time, China Re is able to benefit from Chaucer's technical expertise in political and nuclear risks as it supports the Chinese government's Belt and Road Initiative.

Between 2017 and 2019, Peak Reinsurance Company Limited, Toa Re and Korean Re had converted their European branches to subsidiaries to support their growth strategy in Europe. Unlike its peers, Toa Re has had a history of expanding its footprint in the US since 1982 via Toa Re America, which accounted for over 20% of the Japanese reinsurer's total NPW in 2020.

Capturing Business Opportunities by Diversifying Capital Sources

All of the major Asia-Pacific reinsurers in the composite have robust risk-adjusted capitalisation to absorb potential losses, with a simple average Best's Capital Adequacy Ratio (BCAR) of 51% that is well above the 25% "strongest" assessment BCAR threshold at the 99.6% VaR confidence level. Most of these companies have strong parental support given their domestic reinsurer positions, and are either owned by the government, or have financially sound ultimate parents.

Large Chinese reinsurers were historically dependent on the Chinese government's capital injections to achieve their goal of supporting the country's economic growth. However, we note that reinsurers in the region are learning from international peers by actively diversifying their capital source for self-sustainability.

In 2020, the Asia-Pacific reinsurance composite's capital and surplus strengthened by 19%. Taiping Reinsurance Company Limited introduced a new strategic investor, Ageas Insurance International N.V., which injected HKD3.04 billion (USD392 million) to acquire a 25% stake of Taiping Re. This capital injection raised the company's capital and surplus by 34% from HKD9.04 billion (USD1.17 billion) to HKD12.07 billion (USD1.56 billion). Similarly, Peak Re's capital was boosted by a USD250 million issuance of perpetual subordinated guaranteed capital securities in October 2020, while in December 2020, China Re P&C issued capital supplementary bonds of CNY4 billion.

Notwithstanding, Asia-Pacific reinsurers are relatively late bloomers with regard to including insurance-linked securities (ILS) as an integral part of their retrocession strategies—a method that global reinsurance companies have adopted for some time.

AM Best is of the view that ILS capacity can support regional reinsurers in capturing rate hardening opportunities, such as in Japan's current rate environment. Although reinsurers in China enjoy relatively cheap retrocession capacity due to an abundant supply of capital, the ILS grant introduced by the Hong Kong Insurance Authority (HKIA) to subsidise upfront costs could raise the economic attractiveness of a catastrophe bond issuance over traditional reinsurance capacity.

Regulatory Push to Deepen Alternative Capital Markets

Both the Singapore and Hong Kong governments are keen to leverage their positions as financial powerhouses to develop their respective alternative capital markets for the issuance of ILS. In 2018, Singapore pioneered a grant scheme to subsidise upfront ILS issuance costs up to SGD2 million, which was extended to 31 December 2022. The grant scheme has proven to be very successful in attracting international sponsors to choose Singapore as an ILS domicile, subsequently leading to the provision of coverage for perils in Australia, Japan and North America.

Hong Kong's Legislative Council passed the Insurance (Amendment) Ordinance 2020 to provide for a regulatory framework to facilitate ILS issuance through special purpose vehicles, which will be regulated as a new type of authorised insurer. In May 2021, following Singapore's footsteps, the HKIA announced a new grant scheme to subsidise upfront costs of up to HKD12 million (USD1.55 million) per ILS issuance.

With HKIA's strong push and policy support from the Chinese central government, China Re established Greater Bay Re Limited and issued a typhoon cover of USD30 million, the first cat bond issued from Hong Kong. Subsequently in June 2022, Peak Re issued a USD150 million 144A cat bond via Black Kite Re Limited, a newly established special purpose insurer in Hong Kong, which provides Peak Re with a multi-year protection against typhoon risk in Japan. Earlier in 2018, Peak Re also launched Asia's first reinsurance sidecar via a newly established Bermuda-domiciled special purpose insurer, Lion Rock Re Ltd, which offered additional reinsurance capacity to support the company's property and engineering excess-of-loss treaties written in some peak zones. Given China's proximity to Hong Kong, AM Best notes that the ILS grant scheme could support the "proof of concept" for Asia-Pacific (re)insurers with significant nat cat accumulation, as well as to prepare for when the company may need to use alternative capital in post-event hard market conditions.

From an investor perspective, cat bonds that cover Asian risks present an attractive alternative for institutional investors looking to diversify their existing cat bond portfolios as current ILS issuances are largely focused on risks in the US and European markets. However, some education effort will be required for investors to gain a better understanding of Asian risks and pricing, as well as the interpretation of catastrophe modelling results.

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