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Trend Review  
October 31, 2024

## Significant Increase in Global Reinsurers' ROE Due to Investment and Underwriting Results

Net investment income, underwriting gains, and unrealized capital gains pushed ROEs well above the cost of equity capital

### Principal Takeaways

- The considerable improvement in the return on equity of AM Best's Top 25 Global Reinsurance Composite was due to net investment income, underwriting gains, and unrealized capital gains.
- Net investment income led the contribution to surplus growth, followed closely by underwriting gains and unrealized capital gains. These three components pushed ROEs well above the cost of equity capital.
- Net investment income remains a key way to increase surplus and compound returns on equity capital, as underwriting margins tend to be relatively low on average.

AM Best's DuPont analysis for 2023 indicates that reserve leverage for the composite dropped, led by non-life reinsurers, other than the Big Four, whose reserve leverage was relatively stable. The fall in reserve leverage was offset by a significant increase in operating margins.

The analysis in this report uses the 5-Stage DuPont ROE formula (**Appendix**) to break down the sources of the composite's ROE. The main source—loss reserve leverage—declined and was offset by significant net investment income, unrealized and realized capital gains, and underwriting profit, which resulted in a marked increase in the operating margin. Lower taxes and proportionally lower interest on debt also contributed to the favorable ROE. Unrealized capital gains and investment returns remain the primary source of the composite's operating income. In 2023, the composite's ROE finally surpassed its cost of equity.

The composite includes companies reporting using US GAAP or IFRS 17 standards, which differ markedly. The intent of this report, however, is to analyze the aggregate figures of the Top 25—not to compare them. Despite the differences due to the accounting standards, AM Best considers the analysis directionally valid.

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### Global Reinsurance Composite

AM Best's Global Reinsurance Composite is composed of global reinsurers, leveraging group financial statements for the 25 largest reinsurers groups. The composite is reviewed annually to reflect M&A and other events. To keep data consistent year over year, previous years' data is adjusted when companies are added or removed from the composite. The Top 25 reinsurers' gross premiums written represented almost 90% of total reinsurance industry gross premium written (as measured by the Top 50 reinsurers) in 2022.

### Composite's ROE Reaches Five-Year High

In 2023, a year in which premium rates continued to move up, interest rates remained high, and capital markets performed well, the composite recorded its highest ROE in five years (**Exhibit 1**; the **Appendix** shows the formula used for the calculations). Retained earnings were bolstered by strong underwriting and favorable net investment income. Unrealized capital gains, muted dividends, and share buybacks also propelled increases in surplus, strengthening balance sheets. Secondary natural

catastrophe events were the norm in 2023, but reinsurers adjusted their policies to move away from lower layers close to the primary peril, posting the lowest combined and operating ratios in five years.

According to various industry sources, Hurricanes Milton and Helene in aggregate have the potential for incurred insured losses of \$25 billion to \$50 billion, a significant proportion of which is likely to be transferred to the global reinsurance market. However, stricter reinsurance terms and conditions, which led to higher attachment points, are expected to make reinsurers' losses manageable.

Based on FY2023 results for the global reinsurance companies, and ignoring tax implications, it would take net claims losses of around \$15 billion for the composite's ROE to equal the cost of capital in excess of 15% (please refer to the report cited below for more information on the cost of capital). AM Best considers the impact of the two hurricanes to be more of an earnings rather than a capital event. Fourth-quarter 2024 results will be negatively affected, but full-year earnings should still be favorable. Further reinsurance market hardening is unlikely, but Helene and Milton will probably stall any softening of the market cycle.

Additionally, AM Best takes into account the challenges to settle claims, with added complexity from extended flood losses, significant tornado activity, and areas that were hit by both hurricanes. These issues will likely test the terms and conditions of reinsurance contracts.

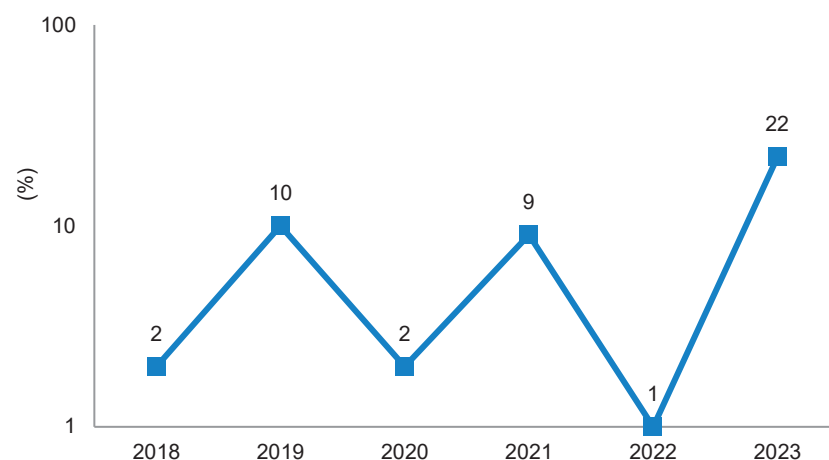
In AM Best's view, ROEs should also be compared with the forward-looking cost of capital metric, such as the Market-Derived Capital Pricing Model (MCPM) discussed in [Reinsurers Meet Cost of Capital for First Time in Four Years](#) (August 22, 2024). This metric may better align with investors' forward-looking views of the market. AM Best considers that ROEs are likely to continue to exceed the cost of capital over the medium term, as new capital seeks enterprises with established track records or with the liquidity of the insurance-linked securities market, which provides investors quicker entry and exit points in the reinsurance industry.

### Leverage Declines, Is Highest at the Big Four

The return on assets (composed of return on investments, including unrealized capital gains, and underwriting income) rose significantly, as **Exhibit 2** shows, more than offsetting the modest fall in loss reserve leverage. AM Best does not expect material changes in loss reserve leverage for the

Exhibit 1

### Global Reinsurance Top 25 Composite – Returns on Equity



Source: AM Best data and research

composite. AM Best also expects the composite to maintain its operating profitability, with persistently strong investment income—albeit with lower unrealized capital gains—and strong underwriting profitability.

**Net Margin Increase Was Steep in 2023**

Exhibit 3 shows the effects of net margin and asset turnover. The composite’s net margin improved significantly due to the underwriting and investment factors discussed above, helped by the creation of deferred tax assets for Bermuda-domiciled companies.

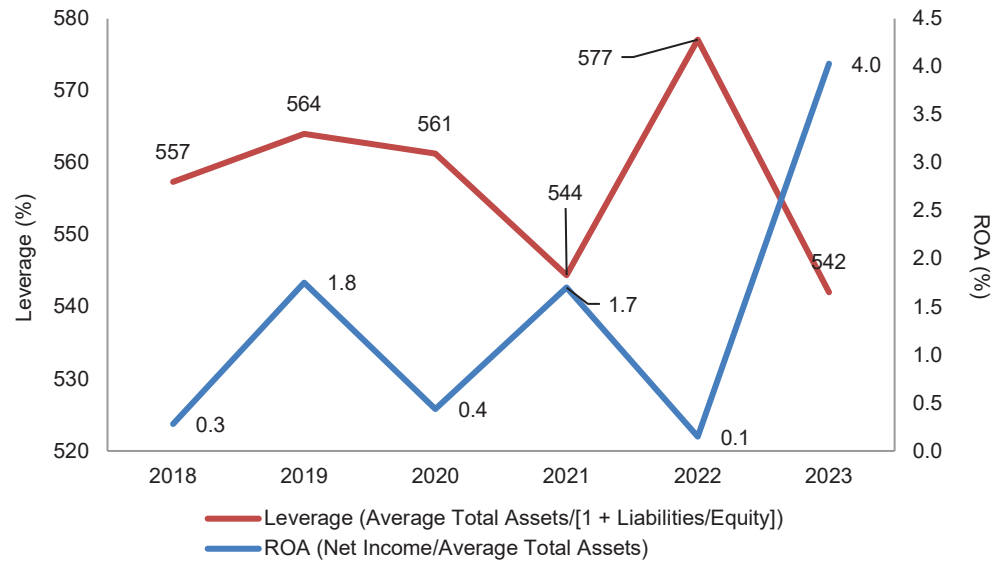
Despite not being a common key performance

indicator for the (re)insurance industry, the increase in asset turnover can be explained mostly by growth in earned premiums, which derived primarily from the ongoing premium rate increases in 2023. AM Best expects the reinsurance market to remain favorable on a risk-adjusted basis, taking into consideration pricing and terms and conditions.

**Investments Were the Main Reason for Net Margin Increase**

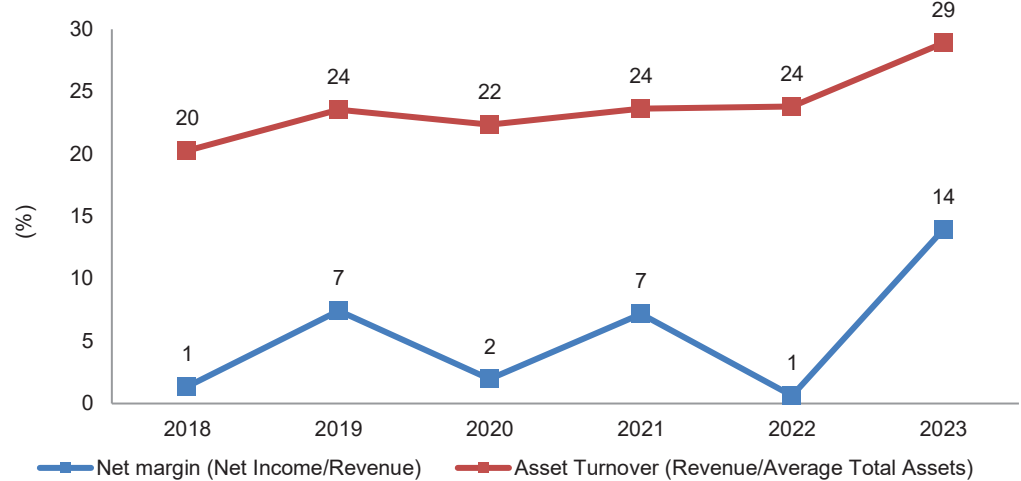
Underwriting income was key to the rise in ROE in 2023, but lost participation in the total return on investments, which include unrealized capital gains (Exhibit 4). Also worthy of notice was the lower negative participation of taxes, due to the Bermuda deferred tax asset (DTA) effect.

**Exhibit 2  
Global Reinsurance Top 25 Composite – ROE (ROA x Leverage)**



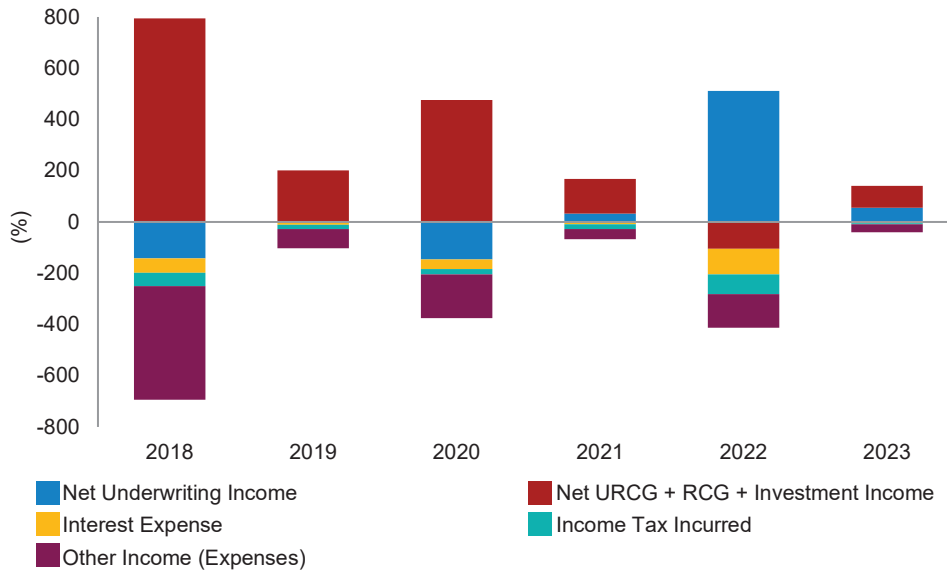
Source: AM Best data and research

**Exhibit 3  
Global Reinsurance Top 25 Composite – ROA (Net Margin x Asset Turnover)**



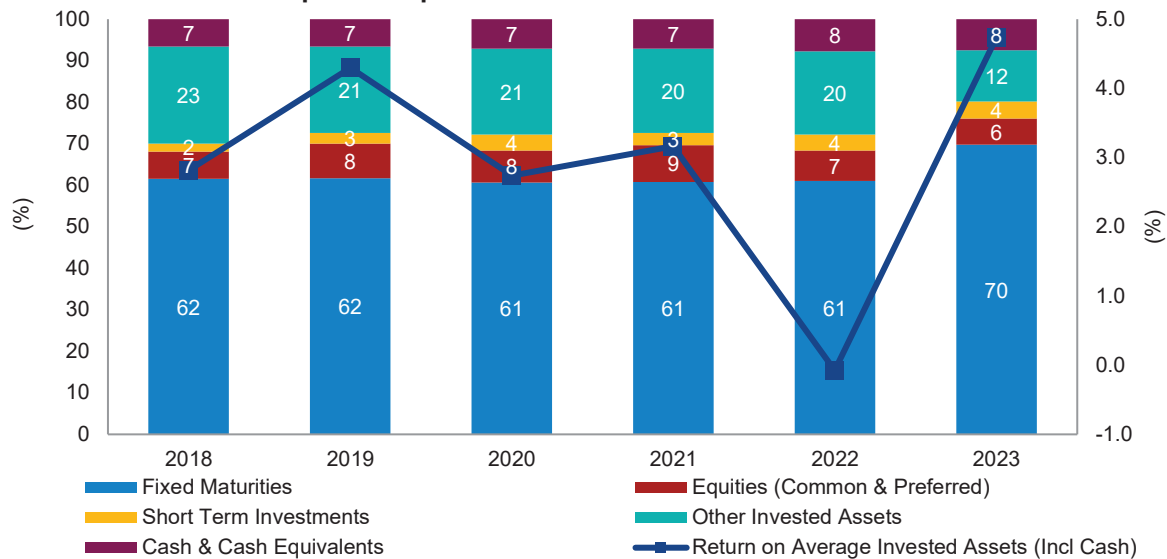
Source: AM Best data and research

**Exhibit 4  
Global Reinsurance Top 25 Composite – Net Income Components**



Source: AM Best data and research

**Exhibit 5  
Global Reinsurance Top 25 Composite – Investment Portfolio Allocations**



Source: AM Best data and research

Given the nature of the investment allocations over time and risk profiles, as well as the fact that companies’ actions to earn higher interest rates generally have a limited impact on investment income, AM Best continues to see underwriting profitability as the essential in the composite’s operating performance assessments and analysis.

**Bermuda Helps Lower the Tax Burden**

Total tax payments for the composite were proportionally less in 2023 than in 2022, due to the DTA credit given by the Bermuda Ministry of Finance, which lowered income taxes by a significant amount

in 2023 and in future years. Due to global acceptance of a 15% minimum corporate tax rate, Bermuda introduced changes in its tax code, allowing for companies to establish DTA accounts, with 2023 taxable income set as an intangible asset. During a typical 10- to 15-year period, the DTA account will be amortized and offset taxable income.

#### **Change in Investment Allocations Was Discrete but Essential**

Over the last six years, the Top 25's allocations to other invested assets, which are essentially composed of private equity and hedge funds, declined by 11 percentage points (**Exhibit 5**), with most of these resources redirected to fixed-maturity investments such as US government and corporate bonds. The remainder was allocated to short-term investments and to cash and cash equivalents. The reason for the change in investment allocations was the rise in interest rates in 2022, leading the shift to be concentrated almost entirely in 2023.

The shift has brought about stable and steady investment income generation for the Top 25 composite, helping them recover from the unrealized losses recorded in 2022 when interest rate increases negatively affected their medium- and long-duration, fixed-income investments.

AM Best sees a shift to a more defensive portfolio, with high liquidity, shorter durations, and high credit quality investments as beneficial to the composite's operating performance and balance sheet strength assessments over the short to medium terms.

## Appendix

**Global Reinsurance Top 25 Composite — ROE Calculations**

$$\left(\frac{\text{Net Income}}{\text{EBT}}\right) \times \left(\frac{\text{EBT}}{\text{EBIT}}\right) \times \left(\frac{\text{EBIT}}{\text{Total Revenue}}\right) \times \left(\frac{\text{Total Revenue}}{\text{Average Total Assets}}\right) \times \left(\frac{\text{Average Total Assets}}{\text{Average Shareholders' Equity}}\right)$$

*Tax Burden x Interest Burden x Operating Margin x Total Asset Turnover x Leverage*

$$\text{EBT (Earnings Before Taxes)} = \text{Net Income} + \text{Income Tax}$$

$$\text{EBIT (Earnings Before Interest and Taxes)} = \text{EBT} + \text{Interest Expense on Debt}$$

$$\text{Total Revenue} = \text{Net Premium Written} + \text{Net investment income} \\ + \text{Total Net Realized and Unrealized Capital Gains or Losses}$$

$$\text{Average total assets} = \frac{(\text{Yearend Total Assets} + \text{Prior Yearend Total Assets})}{2}$$

$$\text{Average Shareholders' Equity} = \frac{(\text{Yearend Shareholders' Equity} + \text{Prior Rearend Shareholders' Equity})}{2}$$

Source: AM Best data and research

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