Gallagher Re

It's a Hard Market — So Where Are All the New Entrants?

Past periods of tightening reinsurance market conditions have led to start-up reinsurers coming onto the scene. Why is it different this time?

Key Findings

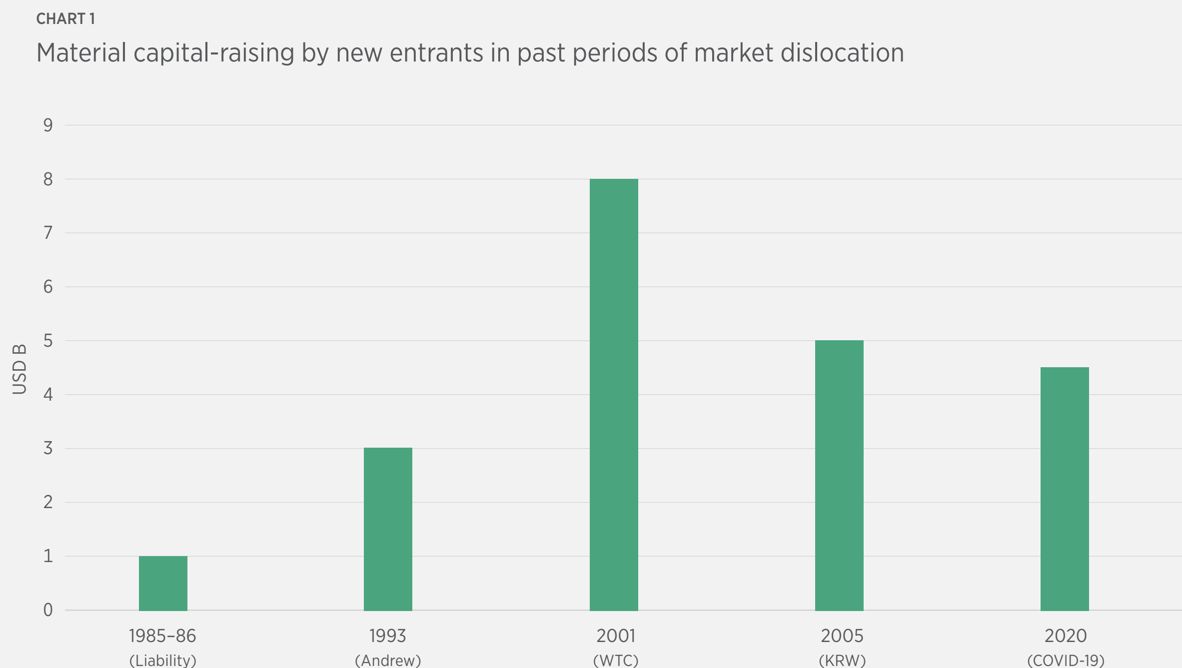
- We identify four reasons for the lack of new entrants over the past 18 months.
- With the possible exception of start-ups focused on casualty, we don't see that changing.
- In the meantime, new capital has been entering the alternative capital space, with record cat bond issuance in 2023 and likely again in 2024.
- Moreover, despite a lack of new entrants, reinsurance supply has become more diversified.
- The bottom line is that the reinsurance market has ample and well-diversified supply, and reinsurance buyers have the ability to flex nimbly across different sources of capital.

Introduction

A striking feature of the reinsurance hard market we've been in over the past 18 months has been the lack of new entrants. New entrants were prominent in past phases of market hardening — there were the Bermudian classes of 1985–86, 1993, 2001, and 2005, and more recently, a material amount of new capital was raised in 2020 following the COVID-19 outbreak.

CHART 1

Material capital-raising by new entrants in past periods of market dislocation



Source: Dowling & Partners, Gallagher Re

So why doesn't the 2023–24 hard market fit the pattern? Arguably it is the strongest and most synchronized market hardening the reinsurance market has seen since 2001.

The only material capital raises in the current hard market were for incumbents. Beazley raised USD0.4B of equity in November 2022 and Everest Group issued USD1.5B of equity in May 2023. RenaissanceRe also raised USD1.2B of equity in May 2023 to part-fund its acquisition of Validus from AIG, but this did not represent new capacity entering the market — rather, a transference of cash and capacity between buyer and seller.

Investor sentiment, at least towards the incumbents, has been positive. Everest had initially planned a USD1B raise before increasing it to USD1.5B following strong investor demand. More generally, reinsurers have been in favor amongst investors. Sentiment began to shift in the latter part of 2022, when there was a sense that Monte Carlo hype would actually translate into significantly tighter conditions at the 1.1.23 renewals. Munich Re, a bellwether for the sector, is up 83% since September 2022, comfortably outpacing the European insurance sector's 30% performance and the 24% rise in the overall European equity market.[1] Similarly, RenaissanceRe is up 66%, well ahead of the 32% rise in the S&P 500.

We see four principal reasons why this time it's been different.

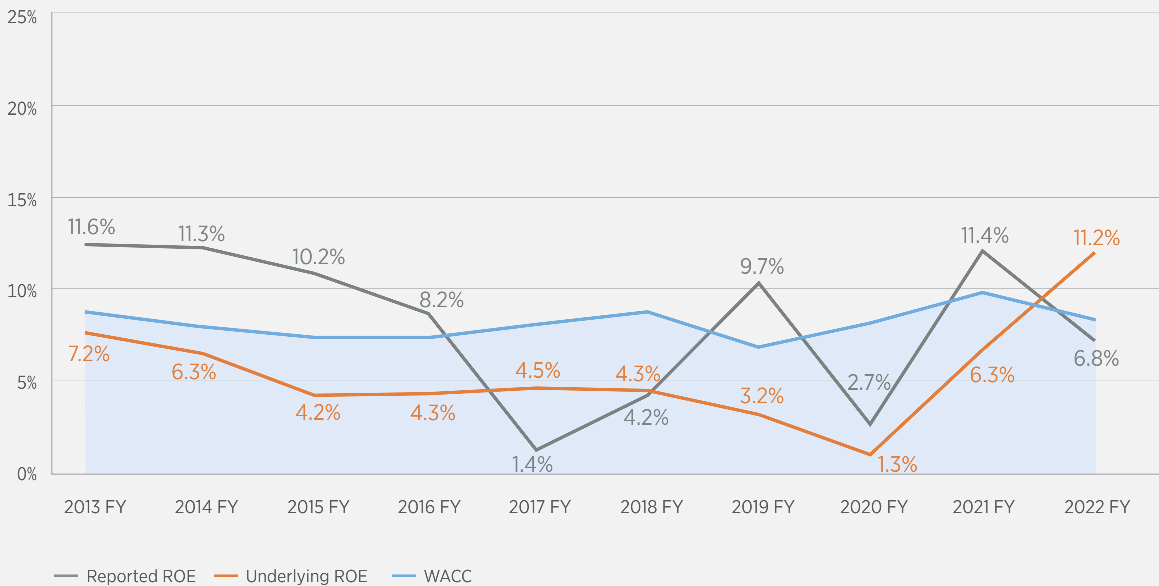
1 No capacity gap for new entrants to fill

First, the current cyclical upturn has been earnings-led. As set out in Gallagher Re's Reinsurance Market Report, in the 10 years up until the end of 2022, the global reinsurance sector generally failed to generate an ROE in excess of its cost of capital.

Looking at the reinsurance market as a whole, there has not been a capital shortage. So, for the most part, incumbents have not needed to raise capital to participate in better market conditions, and there has not been a capacity gap that new entrants could fill.

CHART 2

Through 2022, reinsurers generally failed to generate ROEs in excess of cost of capital



Source: Gallagher Re
Note: WACC is weighted average cost of capital, as estimated by S&P.

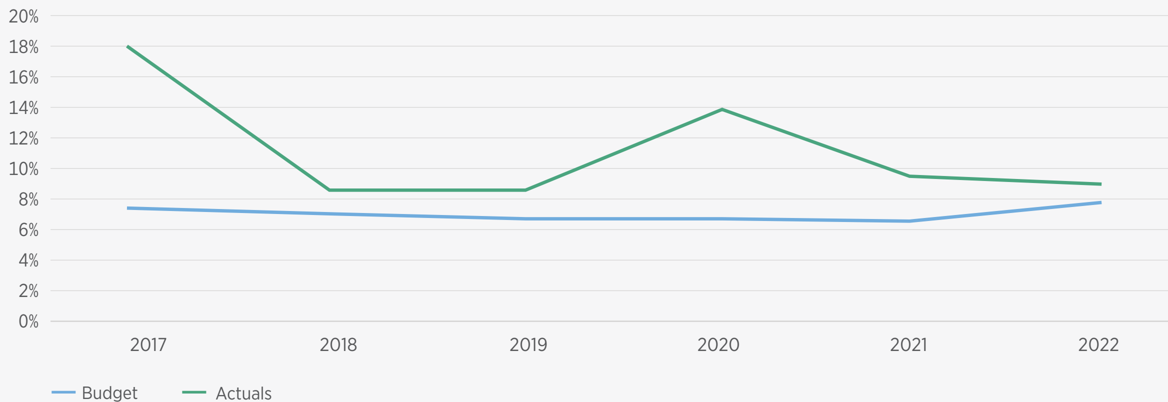
2 Skepticism on profitability

Secondly, there has also been residual skepticism about structural profitability in the global reinsurance sector. In the run up to the 1.1.23 renewals, investors could smell a whiff of what was cooking.

While this did provoke interest in the sector, this enthusiasm was tempered by the lack of delivery reinsurers had shown in the recent past. In particular, Nat Cat losses were consistently higher than reinsurers had budgeted for.

CHART 3

Nat Cat losses consistently exceeded budget for European reinsurers until 2022



Source: Gallagher Re

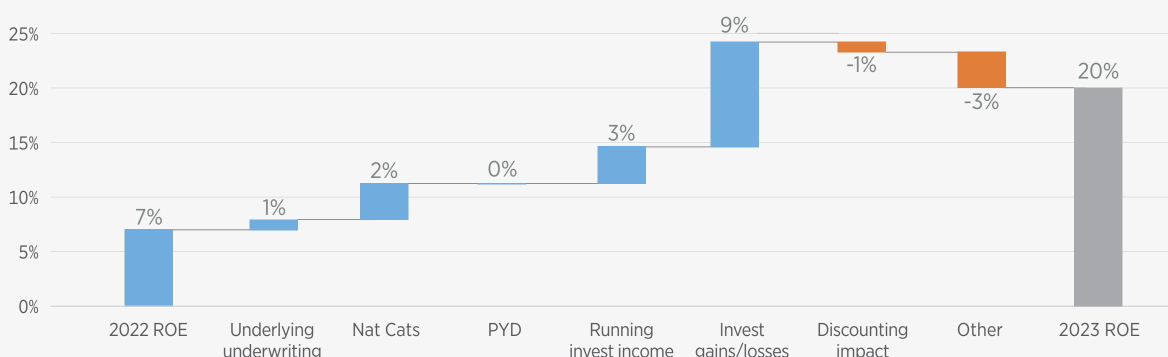
Note: Average of Hannover Re, Munich Re, SCOR, and Swiss Re. Hannover Re includes man-made as well as Nat Cat, others are Nat Cat only. Actuals include COVID-19 losses.

This all changed in 2023, as the very high Nat Cat burden was largely borne by primary insurers, and Nat Cat losses at the reinsurers generally came in below budget. On the whole, 2023 was a banner year for reinsurers. As well as light Cat losses, improved pricing and T&Cs produced much healthier underlying underwriting performance, and investment returns were strong too.

Importantly, the latter included strengthened running investment income, as well as higher (but more ephemeral) investment gains. We put the full-year 2023 ROE for the global reinsurance sector at 20%, comfortably in excess of its cost of capital, which S&P puts at approximately 8%.

CHART 4

Reinsurer ROEs improved dramatically in 2023



Source: Gallagher Re

Note: Average of Hannover Re, Munich Re, SCOR and Swiss Re. Hannover Re includes man-made as well as Nat Cat, others are Nat Cat only. Actuals include COVID losses.

Such a strong 2023 has served to further strengthen the capital base of the incumbents — we calculate that the global reinsurance capital base grew 12% in 2023 to reach its highest ever level. This reinforces our point on capacity and leads us to our third.

3 Concerns around the market duration

In our view, the lack of new entrants stems not only from investor scepticism about structural profitability, but growing questions about the duration of the current upturn.

One way that investors can back the hard market cycle, without making such a commitment to duration, is to invest in insurance-linked securities (ILS) — rather than fund a start-up with permanent equity capital.

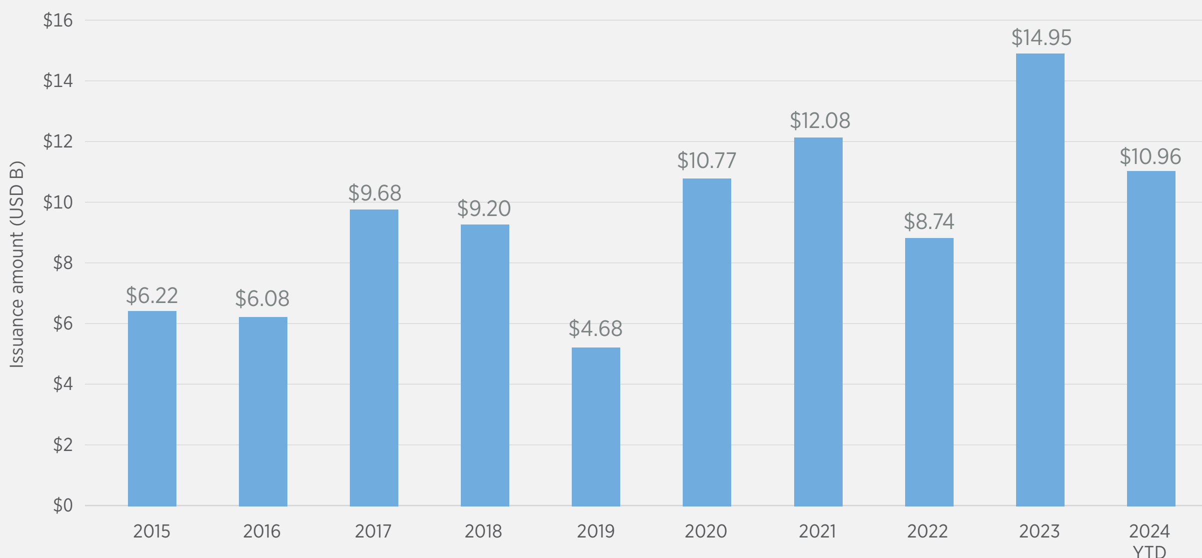
New capital has indeed been flowing into the alternative capital space; into both sidecars and cat bonds. For traditional cat bonds, 2023 was a record year with USD15B of issuance. Our ILS team estimates that the stock of outstanding non-life ILS AUM increased 12% during 2023 to USD107B, the strongest rate of growth since 2017. This growth in cat bonds resulted from mark-to-market gains, coupons comprised of risk premium and elevated collateral yields, lower loss activity, and net inflows largely but not exclusively from additional pension allocations to ILS managers.

2024 is also on a record pace for cat bonds with USD11B settled as of May 31, 2024, roughly a 50% increase through this time last year. While 2024 will likely not see the same mark-to-market gains, we are still seeing elevated collateral yields and additional net inflows not only from pensions but also from generalist fixed income managers and high-net-worth investors.

Beyond cat bonds, we have also seen hedge funds and private equity money returning to the sidecar market, and this might be soaking away some funds that in other years would have gone into start-ups.

CHART 5

New capital is flowing into the ILS space — property cat bond issuance by year



Sources: Market Commentary; Gallaher Securities Transaction Database as of May 31, 2024
Note: Issuance amounts include non-life underwritten rule 144A property cat bonds, excluding cyber risks, as of May 31, 2024.

4 Private equity keeping its powder dry

Finally, the deployment of private equity (PE) capital generally has been slow over the past two years across all industries. KPMG indicates that PE deal activity into financial services, including the (re)insurance sector, declined by 19% in 2022 and by a further 64% in 2023, measured by deal value.[2] Higher interest rates, and uncertainty over funding costs generally, have been factors behind the slow-down. There may also be a concern amongst PE backers about what the exit might look like, as PE-sponsored IPOs have also slowed significantly.

Bloomberg reports that, relative to a high of 110 PE-backed IPOs in 2021, there were only two in 2022, 10 in 2023 and only two so far this year.[3]

If and when funding costs come down, there is scope for PE appetite to pick up — as funds are sitting on ample 'dry powder'. The question, though, will be whether the conducive reinsurance market conditions will still be in place.

A Further Tightening of Casualty Capacity Could Change the Story

One thing that could extend and provide new legs to the reinsurance market's upturn is if reserving issues in casualty lines become more widespread. Some reinsurers have already pulled back capacity here. If that were to accelerate, new entrants and their backers might spot an opening.

Arguably, investors would sense a longer-lasting opportunity, and one where it is less easy to participate in alternative forms, such as ILS (notwithstanding some progress on casualty ILS innovation in recent years).

Possibly also, the environment for PE to invest would be easier. If the focus is casualty, new entrants would also be able to play to investors the 'clean balance sheet' story versus incumbents. On the other hand, a new entrant would need to present strong security to the cedant, given the long-tail nature of casualty claim payments.

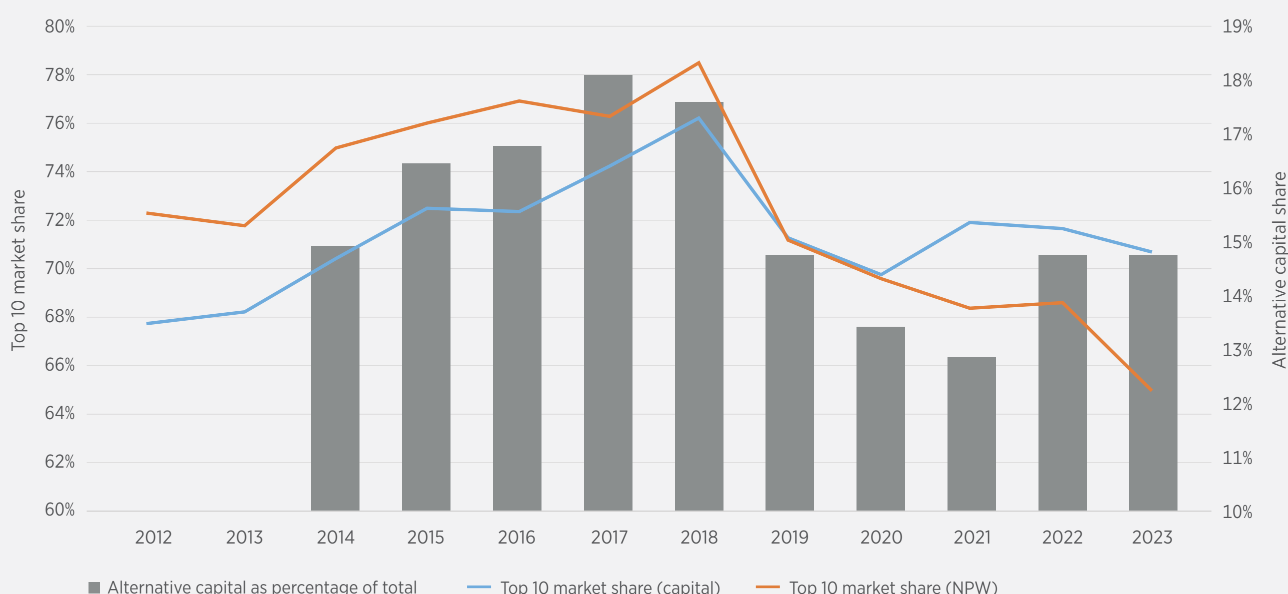
Despite Lack of New Entrants, Reinsurance Supply Has Become More Diversified

Despite the lack of new entrants, and one consolidation transaction (RenaissanceRe buying Validus), reinsurance supply has actually gotten more diversified over the past several years. Our analysis indicates that the top 10 reinsurers' share of the total traditional market, having reached a high water mark in 2018, has come down again.

Based on net premiums written (NPW), it now stands at a 10-year-plus low of 65%. Measured by capital, the message is similar. Likewise, there is now more alternative capacity sitting alongside the traditional market. As of the end of 2023, alternative capital amounted to 15% of total reinsurance capital, up from a low reached in 2021 (albeit still short of the 18% peak reached in 2017).

CHART 6

Reinsurance supply has become more diversified



Source: Gallaher Re

Conclusion: This Time Really is Different

There are some good reasons why this dramatically hardening reinsurance market has not been accompanied by a slew of new entrants. With the possible exception of start-ups focused on casualty, we don't see that changing.

But going forward neither do reinsurance buyers need that incremental capacity, in our view. Capital strength amongst incumbents has gone from strong to stronger. And diversification of reinsurance supply has improved. Gallagher Re's analysis, as presented in our April 1st View report, is that increased reinsurer capacity, coupled with increased appetite, should lead to an easing of reinsurance market terms and conditions.

Moreover, if reinsurance capacity allocated to casualty risks were to be withdrawn, there may be a more conducive environment for replacement capital to enter the sector.

In the meantime, robust flows into cat bonds, sidecars and other ILS offer good opportunities to diversify capital supply. A trusted adviser, offering timely and relevant information, can help cedants flex nimbly between different sources of capital.

References

[1] Share prices as of 30 May 2024. Comparisons are to the STOXX insurance and STOXX 600 indices.

[2] "2024 M&A Outlook for Private Equity" (P3 Exhibit 1), *KPMG*, accessed 28 May 2024.

[3] Or, Amy. Private Equity Largely Absent From US IPO Market's Recovery. *Bloomberg*, 30 April 2024.

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