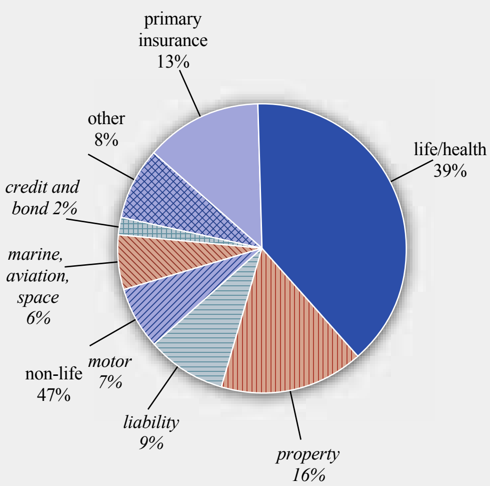
Box 17

WHAT ARE EURO AREA REINSURERS INSURING AND WHERE?

Reinsurers are important for the stability of the financial system mainly because they are of systemic importance to the primary insurance market. This is because they facilitate risk-spreading, mainly of extreme losses, from primary insurers. The systemic importance of reinsurers is, however, also due to the fact that the global reinsurance sector is dominated by a limited number of large companies (some of which are domiciled in the euro area) and the failure of one reinsurer would therefore have a significant impact on its many counterparties. In addition, reinsurers have the potential to affect asset prices since they are large investors in financial markets. To diversify risk concentrations, most reinsurers are active globally and in a multitude of insurance segments.[1] This allows reinsurers to reduce the volatility of claims payments and thereby lower the sum of total risk capital required. To accurately identify potential losses facing euro area reinsurers it is therefore of importance to have information on reinsurers' underwriting risk exposures. This box presents information from reinsurers' annual reports on what reinsurers are insuring and where.[2]

Chart A Type of insurance reinsured by selected euro area reinsurers

(2007; % of total gross premiums written)



Sources: Reinsurers' annual reports and ECB calculations.
Note: Data for Cologne Re, Hannover Re, Mapfre Re, Munich Re and Scor.

Euro area reinsurers mainly reinsure non-life insurance (47%), followed by life/health insurance (39%). Some, however, also provide primary insurance (see Chart A). The non-life reinsurance segment can in some ways be seen as the most risky part of the reinsurance business, as losses and probabilities are often more difficult to assess and potentially very large. For example, natural catastrophes or terror attacks can cause very large losses on properties, which account for 16% of total insurance. Similarly, the insurance of ships, oil platforms, aeroplanes and satellites (6% of total insurance) can also result in extreme losses that are very difficult to predict. Furthermore, the financial market turmoil that erupted during the summer of 2007 is likely to trigger significant litigation against investors and investment advisors and is an example of how liability reinsurance (9% of total insurance) can affect reinsurers. Motor reinsurance (7% of total insurance) can, however, be seen as a more stable source of losses for reinsurers, as it is typically easier to estimate potential losses due to the more stable nature of motor insurance claims.

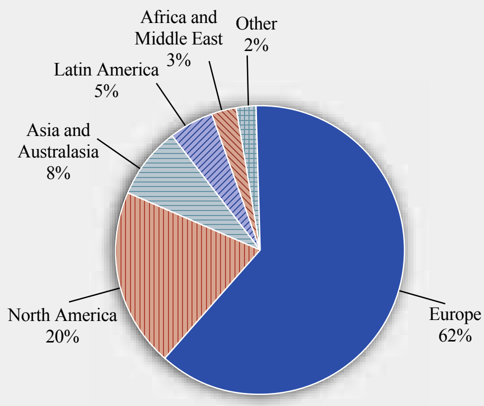
1 Reinsurers can also cede risks to other reinsurers (called retrocession) – euro area reinsurers retroceded about 10% of gross premiums written in 2007 – or to capital markets by issuing insurance-linked securities.
2 This box is based on information for five large euro area reinsurers. They are Cologne Re, Hannover Re, Mapfre Re, Munich Re and Scor. They have combined total assets of about €290 billion, and they represent about 30% of total global reinsurance premiums.

Also life/health reinsurance losses are often easier to estimate and can often be seen as more of a capital management tool for primary life insurers. For example, life insurers reinsure annuity books where longevity risks have the potential to cause claims above what was predicted when policies were written. Significant death and morbidity losses can, however, occur as a result of extreme events, such as terrorist attacks or pandemic influenza, and give rise to unexpected losses for reinsurers.

Some reinsurers also provide primary insurance, mainly in the form of life/health insurance. The motivation for this is mainly to diversify the underwriting and to benefit from knowledge gained and products created for reinsurance.

Chart B Regional distribution of gross premiums written for selected euro area reinsurers

(2007; % of total gross premiums written)



Sources: Reinsurers' annual reports and ECB calculations.
Note: Data for Cologne Re, Hannover Re, Mapfre Re, Munich Re and Scor.

Turning to the geographical diversification of reinsurers' insurance underwriting, euro area reinsurers derive 62% of their total gross premiums written from Europe. 20% of total underwriting is, however, in North America, so the losses that euro area reinsurers could face as a result of, for example, hurricanes in the Atlantic are significant (see Chart B). Premiums written in other regions account for 18%.

Not only are euro area reinsurers active globally, but reinsurers located outside the euro area also underwrite business for euro area primary insurers and are therefore also of importance for euro area financial stability and the stability of the global financial system. For this reason, a complete euro area financial system stability assessment should also include the monitoring of major reinsurers outside the euro area.

To sum up, although domiciled in the euro area, euro area reinsurers are global companies, but with most of their underwriting in Europe and North America. In addition to their global diversification, reinsurers are also diversified in terms of what they reinsure. Diversification is generally positive from a financial stability perspective as it reduces risk concentrations. Nevertheless, the business of reinsurers is mainly to insure against extreme losses, which are often difficult to estimate and could severely impair reinsurers' solvency. The potentially extreme losses, together with reinsurers' systemic importance for the insurance sector as extreme risk absorbers and their important role as investors in financial markets, create a need to monitor the conditions of and risks facing reinsurers for the purpose of financial system stability assessments.