

Asian Reinsurance Markets

Structural Demand Creates Attractive Growth Proposition

Special Report

Enduring Market Appeal: The robust growth of Asian economies brought about by stable domestic consumption and the expansion of the domestic insurance market due to improving penetration rates will continue to spur reinsurance activity in the region. Greater government infrastructure spending will deliver opportunities for reinsurers, while the emergence of cyber insurance may also offer modest upside in the near to medium term.

Varying M&A Drivers: The benign low interest-rate environment and over-capacity continue to provide the backdrop for M&A activity. Nonetheless, corporate action motivators differ across Asian markets due to country-specific factors and incentives. In some countries, government agendas and economic policy objectives also help shape consolidation activity.

Bond Issuances Beget Cautious Optimism: The prolonged low interest-rate environment has prompted Asian reinsurers to adopt debt capital as a funding source in the past few years. Larger players, such as China Reinsurance Corporation and Korean Reinsurance Company, have led the way in the nascent market and Fitch Ratings expects the market to gain traction in the near to medium term.

China Adapts to C-ROSS: Chinese insurers continue to rejig their reinsurance arrangements in favour of greater risk-based capital efficiency. Differential between onshore and offshore risk charges and further tightening of offshore premium ceding credit risks encourages local insurers to weigh the benefits of offshore reinsurance more carefully against associated costs, especially from a capital-charge perspective.

Localisation Prevalent: A number of Asian countries have adopted a protectionist stance in a bid to encourage domestic ceding of risks and limit capital outflows from reinsurance. Governments and regulators typically employ compulsory cessions and other forms of regulatory tightening. This may encourage the development of domestic reinsurance capacity, but could also result in under-diversification and inadequate capacity of domestic insurers to handle sudden growth in retained risks.

Protection Cover Remains Inadequate: Asia's protection gap stood at USD74 billion in 2016, more than doubling from USD31 billion in the previous year, as economic losses outgrew a modest appreciation in insured losses. The region accounted for almost half of the world's economic losses in 2016, but a mere 16% of the insured amount.

Catastrophe Coverage Shows Improvement: Catastrophe-prone countries show signs of improving coverage. Recent trends in Japan point towards higher earthquake insurance penetration among residents, while domestic reinsurers in Indonesia have taken up catastrophe retrocession cover well in excess of regulatory requirements.

Rates and Pricing Pressure: Premium rates in Asia continued to decline through 1H17 and Fitch expects the softening trend to continue – albeit on a milder trajectory – through the rest of the year. The trend follows increasing capital abundance and competition, as established reinsurers look to build their presence in the region and start-ups seek to join the industry.

Related Research

[Global Reinsurers: 2017 Forecast and 2016 Results \(May 2017\)](#)

Analysts

Christopher Han, CFA
+65 6796 7224
christopher.han@fitchratings.com

Siew Wai Wan
+65 6796 7217
siewwai.wan@fitchratings.com

Asia remains an appealing destination for global reinsurers. Infrastructure spending and cyber insurance may also provide further upside to premium growth in the region

Asia Remains Attractive, M&A Drivers Vary

Steady economic expansion and insurance market growth will remain the fundamental reinsurance driver in Asia-Pacific. Knowledge transfer and human capital build-up will sustain the sector's development momentum and spur reinsurance premium growth as globally established reinsurers continue to scale-up in the region.

Foreign counterparts recognise Asia's business potential and have increased their focus and commitment to the region. Swiss Re Ltd (A/Stable) announced in April 2017 that it is setting up its general reinsurance business regional headquarters in Singapore after opening an office in Kuala Lumpur, Malaysia, in March. Similarly, Munich Reinsurance Company (AA-/Stable) kick-started a restructure of its Asian operation in September 2016 to strengthen its presence in key hubs, including Tokyo, Beijing and Singapore, with an eye on potential expansion to India. In addition, Lloyd's of London's (AA-/Negative) Indian reinsurance branch commenced operations in April 2017 to tap into accelerating onshore market growth opportunities.

In China, PICC Re, Taiping Reinsurance Co.Ltd (A/Stable) and Qianhai Reinsurance Co., Ltd received approval from the China Insurance Regulatory Commission (CIRC) to set up reinsurance operations in 2016. This offers non-life insurers more choice when ceding out their business to domestic reinsurers. PICC Re and Qianhai Re will have registered capital of CNY1 billion and CNY3 billion, respectively. Qianhai Re received further approval to commence business in the southern city of Shenzhen in December 2016. Fitch expects competition in China's reinsurance market to intensify. This may benefit non-life insurers by providing them greater ceding options and flexibility given the current undersupply of reinsurance capital. Together with China Re, the country now has four domestic reinsurance companies.

Government Infrastructure Spending Offers Opportunities

Fitch expects China's large-scale Asian infrastructure projects to be a source of reinsurance demand. The country's "One Belt, One Road" initiative is expected to involve more than USD900 billion in infrastructure spending across more than 60 countries, with insurance premiums from already-announced projects potentially reaching USD7.0 billion, of which USD5.5 billion will go to Chinese reinsurers¹.

The infrastructure boom is also likely to deliver positive externalities to reinsurers in south-east Asia. Indonesia plans to increase its budgeted infrastructure spending by 22% yoy in 2017, to more than IDR350 trillion (USD26 billion). Similarly, Thailand has increased infrastructure spending to up to THB896 billion (USD25 billion) for the year. These large-scale projects will have to be covered against substantial risks and catastrophes throughout their construction and operating cycles. Direct insurers are unlikely to have the capacity to underwrite such exposures alone and reinsurers will have opportunities to step in and address this gap.

Cyber Risks Present Potential for Reinsurance Growth

The economic appeal of achieving greater internet and mobile penetration leaves cyber security infrastructure – which should be developed in tandem – inevitably lagging in most developing and emerging Asian markets, allowing cyber risks to permeate. Even in developed markets, cyber insurance has not caught on, and significant protection gaps exist. Asia is the world's most vulnerable region to cyber threats, yet its share of cyber insurance premiums is less than 6% of the global total.²

Asian insurers have small cyber insurance books of business. Fitch expects the segment's reinsurance arrangements to gain importance as it expands and insurers tap on reinsurers for capacity and diversification, to glean underwriting expertise and plug coverage gaps – especially from global players with experience and insight from European and US markets.

Related Criteria

[Insurance Rating Methodology \(April 2017\)](#)

¹ Swiss Re, *China's Belt & Road Initiative, and the impact on commercial insurance*, October 2016.

² Marsh & McLennan Companies, *Cyber Risk in Asia-Pacific – The Case for Greater Transparency*, April 2017.

M&A: In Search of Expansion, Diversity and Consolidation

The broad canvas underpinning insurance sector M&A remains an environment of persistently low interest rates and overcapacity. Particularly in Asia, acquirers have different incentives to engage in M&A that depend on local industry dynamics and the maturity of the insurance sector in their home market.

Japanese acquirers continue to seek high-quality cross-border transactions to improve investment yields or pursue expansion amid low domestic growth due to the country's stagnating operating conditions, dwindling demographics and negative interest rates. The acquisition of Endurance Specialty Holdings Ltd. by Sompo Holdings, Inc. in March 2017, is one such example. Chinese acquirers, on the other hand, aim to diversify their business beyond their country's borders with a focus on the business's long-term potential and synergies. The proposed acquisition of ACR Capital Holdings Pte. Ltd. by a Shenzhen-based consortium of investors in October 2016 was one such deal where a reinsurer was the target. Nonetheless, the deal-making sentiment has been tempered down somewhat by increasing regulatory pressure and scrutiny of overseas acquisitions by Chinese investors.

Indonesia also completed a series of corporate actions in 2H16, merging two local reinsurers to create the country's largest reinsurer. The immediate focus is on stemming capital outflows due to outward reinsurance ceding by insurers, but the government's longer-term vision is to create a reinsurer with the capacity and presence to do business on an international scale.

Bond Issuances to Support Global Ambitions of Asian Reinsurers

Most Asian reinsurers are predominantly equity-funded, but debt as a capital source has become more popular due to the low interest rates and sustained demand from yield-seeking investors. The issuance market is still in its infancy, but Fitch expects it to gain traction in the near to medium term, with the larger players having led the way. Thus far, China Re executed two issuances of USD800 million and USD700 million in March and June 2017, respectively, backed by strong investor demand. Proceeds will be used for overseas acquisitions as it moves to capture opportunities beyond the domestic market and diversify its business. Korean Re issued a USD200 million hybrid in October 2014 and has also expressed an intention to increase usage of non-equity capital – including catastrophe bonds – to optimise its capital structure as it seeks to establish itself as a global player.

Regulatory Developments Influence Operating Landscape

Asian insurance markets have seen improvements and enhancements in their regulatory environment on both local and regional levels. The overarching objective is to promote reinsurance market development, but approaches differ among countries. Several countries are also in the midst of revising their solvency frameworks. Such regulatory-driven initiatives serve to raise industry operating standards and compel insurers to reassess their approach to capital and risk management – creating opportunities for reinsurers to meet their needs.

C-ROSS Reshapes China's Reinsurance Demand

China's implementation of the China Risk Oriented Solvency System (C-ROSS) in 2016 led to a structural change in reinsurance demand within the country, as insurers revisited their reinsurance arrangements to optimise capital within the context of the new solvency framework. Many motor insurers revised their ceding structure and cession rates because the required capital for underwriting motor business was much less than for property insurance. To illustrate, China Re, China's most active reinsurer, saw its reinsurance premiums from the domestic motor market drop by 48% to CNY9.4 billion in 2016.

C-ROSS also creates an incentive for ceding to onshore reinsurers by having more punitive risk charges for cessions to offshore reinsurers. CIRC announced the final framework for regulating and minimising cross-border reinsurance credit risks in March 2017, proposing for collateral to be put up against offshore reinsurance contracts. The requirement would not be

Policies favouring domestic cessions are in vogue. However, the pros and cons of this government-driven agenda have to be weighed and considered

mandatory, but non-compliance would increase risk charges for affected transactions. Chinese insurers will therefore need to consider their ceding arrangements and weigh the business advantages against capital efficiency under C-ROSS.

Localisation a Prevalent Theme

Protectionism is a common stance adopted by many Asian countries. This may alter risk-reward dynamics and the extent of foreign interest in local markets, limiting the diffusion of knowledge, pricing know-how and risk diversification – key ingredients for stable long-term market expansion.

Indonesia's cession policy, introduced towards end-2015, increased domestic reinsurance premiums, which swelled by 38% in 2016 against a CAGR of 29% in the four years prior³. Consequently, the industry's retention ratio dipped to 67% in 2016 (2015: 71%), implying some degree of capital constraint as reinsurers dealt with elevated premium volume. Recognising this, the government has planned for a series of capital injections into state-owned reinsurers over the next few years. This may be positive in the long term, but the localisation of risks may affect the solvency of capital-starved domestic reinsurers during times of adverse claims development or catastrophes.

India imposed "order of preference" regulations for reinsurance placement in January 2017. These require local insurers to cede business to reinsurers according to a prescribed order, essentially giving local reinsurers and branches of onshore foreign insurers the first right of refusal. This could challenge the government's commitment towards opening up the insurance sector and may affect reinsurance costs and ultimately, insurers' underwriting capacity, creating an impediment to reinsurance market growth, albeit in the short term.

Catastrophe Losses Highlight Protection Needs

Catastrophe losses remain a key concern in Asia due the increased loss amounts and frequency of weather-related events, such as floods or typhoons. Continuing a trend since 2012, Asia accounted for the world's largest share of economic losses from catastrophes, at USD83 billion, in 2016. This represented 47% of the global total. Total insured losses, however, stood at just USD8.8 billion – a non-proportionate 16% of the global total and 11% of economic losses.

Asia's large protection gap presents opportunities for (re)insurers, though the environment presents challenges.

Insurance Penetration Data for 2016

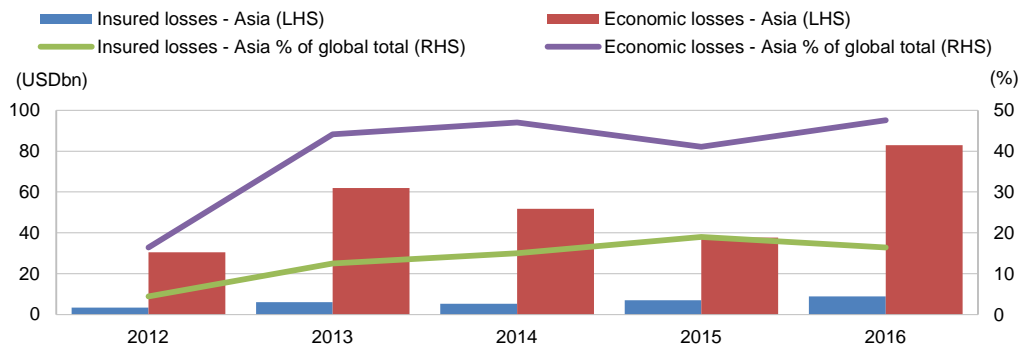
(USDbn)	Insured losses				Economic losses			
	2016	(%)	2015	(%)	2016	(%)	2015	(%)
Asia	8.8	16.4	7.0	19.1	83.0	47.6	37.7	41.1
North America	30.4	56.6	17.3	47.1	59.5	34.1	28.6	31.2
Europe	7.5	14.0	6.2	16.9	15.5	8.9	12.6	13.7
Latin America and the Caribbean	1.4	2.5	3.2	8.7	6.4	3.7	7.5	8.2
Australia and New Zealand	3.4	6.4	2.1	5.7	6.4	3.6	3.0	3.3
Africa	1.7	3.2	-	-	3.0	1.7	1.2	1.3
Others	0.5	0.9	0.9	2.5	0.8	0.4	1.1	1.2
Total	53.7	100.0	36.7	100.0	174.6	100.0	91.7	100.0

Source: Swiss Re Sigma No. 3/2017, No.3/2016

Two major catastrophes occurred in Asia during 2016. Japan's April Kumamoto earthquake, which claimed 137 lives, injured almost 2000 people and damaged up to 160,000 buildings, and China's July Yangtze River flood, which caused damage across 26 provinces and was of a magnitude last seen 18 years ago. According to Swiss Re, the two events accounted for around USD52 billion in economic losses, but only around 10%-11% of these losses were insured.

³ For Fitch-rated reinsurers in Indonesia.

Asia's Catastrophe Losses



Source: Swiss Re Sigma

In 2017, the May floods and landslides in Sri Lanka are likely to have smaller economic consequences than the previous year despite being of a higher intensity. This is because the affected regions were mostly sub-urban and rural, instead of industrial and commercial as previously. Consequently, economic losses are likely to be around USD0.2 billion, against USD1.0 billion in 2016. The national reinsurer – National Insurance Trust Fund Board (AA-(Ika)/Stable) – expects insured losses to be a fraction of total losses due to the country’s low insurance penetration.

Cyclone Debbie, which swept Australia in May 2017, was the strongest in three years and saw estimated insured losses of around AUD1.1 billion – slightly below average annual cyclone-related losses of around AUD1.2 billion since 1967. Economic losses are expected to be around the range of AUD2 billion.

Coverage in Catastrophe-Prone Asian Countries Shows Positive Signs

Trends in Japan point towards improving earthquake insurance penetration among residents, following the frequency of recent earthquakes and government initiatives to improve the residential earthquake scheme. However, commercial cover remains benign as corporates prefer to adopt non-insurance based approaches to minimise losses, such as spending on earthquake-proof buildings and geographically diversifying operations, as they consider premiums to be too costly.

China’s national insurer – China Re – launched a catastrophe research center in June 2017 to support the development of the country’s catastrophe insurance coverage. The center will focus on building a robust catastrophe database, modeling, product development and creating a platform for information sharing.

Indonesia’s domestic cession policy has led to more risks being retained domestically, with most local reinsurers holding catastrophe cover of around 1:400 return periods. This is above the 1:250 regulatory requirement, providing reinsurers’ with some ability to absorb catastrophe losses amid industry expansion.

Sri Lanka’s government increased its natural disaster cover with the National Insurance Trust Fund Board to LKR15 billion for 2017-2018, from LKR10 billion in the previous year, when the government obtained national natural disaster cover for the first time. The cover lowers the government’s burden of providing assistance and relief to uninsured citizens in a country with frequent floods and other monsoon-related events. Fitch expects reinsurance demand in Sri Lanka to increase in the medium term, as changing weather patterns lead to increased frequency and severity of errant rainfall, raising insurers’ risk profiles and the need for proper pricing and management of these risks.

Renewal Rates Continue to Soften

Overall, Asia's premium-pricing rates continued to fall through 1H17. Fitch expects the softening trend to continue throughout the rest of the year, albeit on a milder trajectory, due to continued capital abundance and competition from reinsurers and new players looking to build on their presence in the region.

Japan's catastrophe loss-free pricing was up to 7.5% lower for earthquake and wind perils during the April renewal season in 2017. Casualty loss-free pricing experienced a similar declining trend.

Australia showed softer property rates in the mid- to upper-layers and lower loss-free layers. However, reinsurer appetite remains limited for low-level catastrophe and loss-affected layers as well as for aggregate cover, with pricing remaining stable. The liability segment also showed abundant capacity, although appetite increased for cyber liability.

Overall, the loss-free rate declines in Asia-Pacific during early-2017 were broadly less severe compared with 2016. This may be attributed to an uptick in 2016 catastrophe losses after several years of below-average losses, higher reinsurance demand as pricing becomes attractive to marginal market participants and rising inflation expectations in major economies, which adds to reinsurers' claims inflation and reserving risks.

Appendix

Fitch's Ratings on Selected Asian Reinsurers

Name	Country	Insurer financial strength Rating	Rating Outlook
Malaysian Reinsurance Berhad	Malaysia	A-	Stable
PT Maskapai Reasuransi Indonesia Tbk	Indonesia	A+(idn)/BB	Stable
PT Reasuransi Indonesia Utama	Indonesia	AA(idn)	Stable
PT Reasuransi MAIPARK Indonesia	Indonesia	A-(idn)	Stable
PT Tugu Reasuransi Indonesia	Indonesia	A+(idn)	Stable
PT Reasuransi Nasional Indonesia	Indonesia	AA-(idn)/BB	Stable
Taiping Reinsurance Co.Ltd	Hong Kong	A	Stable
SCOR Reinsurance Co Asia Ltd	Hong Kong	AA-	Stable
SCOR Reinsurance Asia-Pacific Pte Ltd	Singapore	AA-	Stable

Source: Fitch

Insurance Penetration Data for 2016

Country	Life premiums (USDbn)	Non-Life premiums (USDbn)	Insurance penetration life (premiums as % of GDP)	Insurance penetration non-life (premiums as % of GDP)	Population (m)
Japan	354.1	117.2	7.2	2.4	126.3
China	262.6	203.5	2.3	1.8	1,382.9
South Korea	104.2	66.7	7.4	4.7	50.8
Taiwan	84.5	17.0	16.7	3.3	23.5
India	61.8	17.5	2.7	0.8	1,328.8
Hong Kong	51.9	4.5	16.2	1.4	7.4
Singapore	17.6	3.5	5.5	1.7	5.6
Indonesia	15.3	4.7	1.6	0.5	260.9
Thailand	15.1	6.9	3.7	1.7	68.2
Malaysia	9.2	4.7	3.2	1.6	30.8
Philippines	3.7	1.7	1.2	0.6	102.4
Vietnam	2.1	1.6	1.0	0.8	94.4
Sri Lanka	0.4	0.5	0.5	0.6	20.8
Asia total	1,000.3	493.3	3.7	1.9	4,353.7
Australia	37.7	44.5	3.0	3.5	1,260.1
United States	558.9	793.5	3.0	4.3	324.0
Europe	858.6	611.4	4.0	2.7	820.9
World	2,617.0	2,115.2	3.5	2.8	7,414.2

Source: Swiss Re, Sigma No. 3/2017

Statistics of Selected Asian Insurers

	Gross premiums (USDm)		Loss ratio (%)		Combined ratio (%)		Net premiums written/ shareholder equity (%)		Retention ratio (%)		Return on equity (%)		Shareholder equity/ total assets (%)	
	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
ACR Capital Holdings	739	763	72	74	109	104	39	43	50.5	48.9	-2.0	2.4	34.2	30.3
China Reinsurance Group	12,476	12,396	62 ²	61 ²	99	99	115	105	95.9	92.8	7.3	13.0	34.2	21.6
Taiping Reinsurance Co.Ltd	1,183	1,033	73	60	94	91	131	103	91.1	79.6	1.7	6.8	25.3	31.7
Central Reinsurance Corporation	435	430	63	65	95	98	138	142	93.5	93.6	8.1	8.1	28.3	28.1
Korean Reinsurance Company	5,535	5,580	81	80	99	97	221	217	70.2	68.7	8.2	10.2	22.1	22.5
Malaysian Reinsurance Berhad ¹	348	354	74	61	107	94	106	97	89.2	91.6	0.2	12.9	34.7	39.9
PT Maskapai Reasuransi Indonesia Tbk	108	78	61	64	90	93	40	50	76.2	79.7	32.0	24.0	46.1	47.6
PT Reasuransi Indonesia Utama	385	278	51	56	88	96	170	160	76.0	79.0	12.5	16.2	38.6	34.6
PT Asuransi MAIPARK Indonesia	14	21	4	7	65	65	50	60	72.0	70.4	20.0	23.2	71.8	68.8
PT Tugu Reasuransi Indonesia	168	109	52	55	88	97	170	158	63.0	61.3	29.0	40.0	36.0	36.0
National Reinsurance Corporation of the Philippines	68	46	61	75	99	128	35	19	50.0	42.5	1.6	3.6	34.2	36.5
Singapore Reinsurance Corporation Limited	117	91	69	62	105	103	21	23	30.0	41.4	3.7	5.2	34.3	34.1
Toa Reinsurance Company ³	1,917	1,734	70	77	-	-	196	192	-	-	3.0	3.2	26.3	28.9
Thai Reinsurance Public Company Limited	145	146	44	44	92	95	64	61	65.7	63.0	5.2	15.0	36.9	35.8

¹ year end 31 March

² For P&C reinsurance business only

³ Toa Re's premiums and underwriting data are on a net basis

Source: Fitch, company calculations

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