Trends in U.S. Reinsurance Trade

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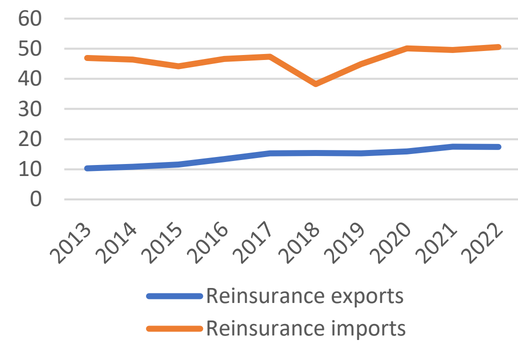
Several recent regulatory, economic, and environmental shocks have affected reinsurance trade. This EBOT provides an overview of recent trends in U.S. reinsurance trade and discusses how these shocks have impacted trade patterns.

Reinsurance and Trade

Reinsurance is an insurance product under which a primary insurer cedes a portion of their risk profile (e.g., their property insurance policies in a region) to a reinsurer.[1] U.S. cross-border reinsurance trade posted an overall increase during 2013-22, with U.S. reinsurance exports and imports reaching $17.4 and $50.6 billion, respectively, in 2022. Trade in reinsurance accounts for a large share of overall U.S. trade in insurance services, with 76.7 percent of U.S. insurance exports and 85.0 percent of imports in 2022.[2] In the United States, a U.S. commercial presence is required for a foreign company to provide cross-border life and nonlife insurance services but is not required to provide reinsurance or marine, aviation, and transport insurance.[3] This regulatory requirement may explain the high share of reinsurance in overall U.S. insurance trade.

Figure 1: U.S. Cross-border Trade in Reinsurance Services ($billions)



Source: Table 2.1. U.S. Trade in Services, by Type of Service*,* BEA, accessed 8/17/23.

U.S. reinsurance imports exceeded exports by a substantial margin throughout 2013–22 (figure 1). While the BEA currently records all trade in insurance services as unaffiliated, these transactions can—and frequently do—include trade between affiliated parties.[4] As such, U.S. imports of reinsurance services likely include substantial imports by U.S. firms from their foreign branches, subsidiaries, or other affiliated entities — and the same may be true for exports.

In keeping with the high levels of U.S. reinsurance imports, industry data indicate that U.S. insurance companies purchase most of their reinsurance from companies located outside the United States (or "offshore" companies). According to the Reinsurance Association of America (RAA), offshore companies accounted for 63.8 percent of reinsurance premiums ceded by U.S. insurance firms in 2022 – a notable increase from 44.3 percent in 1999. Industry data also show a substantial shift in the share of affiliated offshore companies over time. Affiliated offshore companies accounted for 37.2 percent of the total premiums ceded by U.S. insurance companies to offshore reinsurance firms in 2022, down from 55.6 percent in 2011 (figure 2).[5]

Foreign reinsurance affiliates are often set up as "captives," which are wholly owned affiliates that assume a portion of their parent company's risk profile. Among other things, captives can bundle the risks of different business units to diversify risk within an insurance company. These reinsurance arrangements— also called "shadow insurance"—are increasingly common as they aid firms' efforts to meet statutory reserve requirements and enable firms to shift profits to affiliates in jurisdictions with

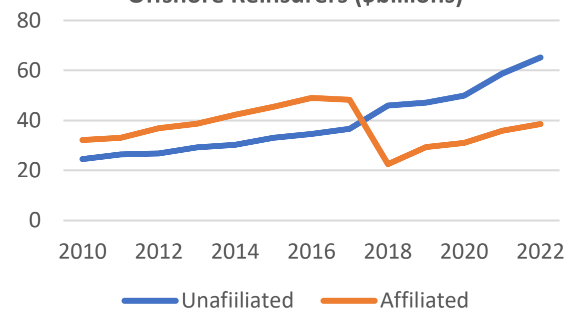
[1] A reinsurance import, for example, occurs when a U.S. based insurance company purchases reinsurance from (i.e., cedes risk to) an insurance company based outside the United States.
[2] USITC calculations. USDOC, BEA, "USITC calculations. USDOC, BEA, "Table 2.1. U.S. Trade in Services, by Type of Service," July 6, 2023.
[3] *OECD Services Trade Restrictiveness Index (STRI) - Insurance Services*, February 2023; In the United States, insurance is mostly regulated at the state level. Many states have a local commercial presence requirement, for example, New York state law states that "an alien insurer must enter this country and conduct business through a United States branch NYSDFS", "No Physical Presence in NY Requirement for Foreign Insurers," accessed December 7, 2023.
[4] BEA Representative, email message to Commission staff, August 25, 2023.
[5] USITC calculations. RAA, *Offshore Reinsurance in the U.S. Market*, 2023, 2017, 2014, 2012, 2, 13, 19.

lower tax rates.[6] The U.S. Tax Cuts and Jobs Act of 2017 (TCJA) established the Base Erosion and Anti-Abuse Tax (BEAT) that attempted to make offshore affiliated insurance more costly and initially led to decreases in both U.S. reinsurance imports and cessions to offshore affiliates (figures 1 and 2).[7] However, U.S. reinsurance imports resumed their upward trajectory following the release of the U.S. Treasury Department's BEAT regulations in December 2018, which exempted many affiliated foreign insurers from this tax.[8]

Factors Affecting the Property Reinsurance Market

2017 set the record for global insured losses in a year, as the BEAT provision and the TCJA were being crafted and debated.[9] Global property reinsurance rates have been rising since 2018 and reached near 20-year highs at the January 2023 renewals, likely due to several interrelated conditions.[10] First, global average insured losses due to natural catastrophes have increased in the last five years, exceeding the average for the previous 5- and 10-year periods. Reasons for these losses include the increasing frequency and severity of extreme weather events, urbanization and population shifts into more risky areas such as coastlines and floodplains, and the increasing insurable values of buildings and other physical assets.[11] Second, inflation can lead to increased insured losses, particularly as insurance contracts often insure policyholders against the replacement value of their property, which can rise over time.[12] Furthermore, repair and other costs can increase significantly over the course of a contract. For example, U.S. prices for several construction materials (like glass and paint) increased between 12 and 26 percent from November 2021 to November 2022.[13] Also, average hourly wages in construction steadily increased from $31.34 in April 2020 to $35.60 in December 2022.[14] Third, as central banks increased interest rates to bring inflation down, some financial asset values decreased, which affected the fixed income portfolios of reinsurance companies. These balance sheet losses (alongside insured losses) have led to reinsurance supply constraints.[15]

Figure 2: Total Ceded Premiums to Offshore Reinsurers ($billions)



Source*: Offshore Report*, RAA, accessed 10/3/23.

If reinsurance becomes unaffordable for U.S. property insurers, imports and exports of (re)insurance services could be negatively affected. For example, costly reinsurance could impact the affordability of U.S. firms to undertake risk (insure more) overseas. Furthermore, because reinsurance prices tend to be correlated with primary insurance prices, a protection gap in U.S. property insurance could arise and negatively affect the financial resilience of the U.S. economy.[16] However, a global reinsurance

[6] Hepfer, Wilde, and Wilson, "Tax and Nontax Incentives in Income Shifting," July 1, 2020, 219–20.
[7] U.S. Tax Cuts and Jobs Act of 2017, 26 U.S.C. § 59A.
[8] Lopez P., "The Impact of BEAT on U.S.-Foreign Affiliated Reinsurance," December 2020.
[9] The year with the most insured losses on record is still 2017 and these losses were primarily driven by the increased severity of losses resulting from catastrophic events. Swiss Re, "Continued High Losses from Natural Catastrophes in 2022," March 29, 2023.
[10] Reinsurance renewals refer to critical points throughout the year when most reinsurance contracts (that typically last one year) are renegotiated.
[11] Banerjee et al., Natural Catastrophes and Inflation in 2022: A Perfect Storm, March 22, 2023, 5; A large insurance broker has reported that U.S. property catastrophe reinsurance rates have continued to increase, rising by as much as 50 percent at the January 2024 renewals. Cohn, "U.S. Property Reinsurance Rates Rise by up to 50% on Jan 1-Broker Says," January 2, 2024; The increasing insurable values of property includes factors other than inflation such as proximity to schools, home renovations, and features such as pools or home security systems, among others. Howard, McGinley, "11 Factors That Affect Homeowners Insurance Premiums," October 20, 2023.
[12] Curtis, "Actual Value vs. Replacement Cost," August 21, 2023.
[13] Vanderford, "Inflation Means Businesses Face Insurance Woes When Rebuilding," March 14, 2023.
[14] FRED, "Average Hourly Earnings of All Employees, Construction," August 2023.
[15] Banerjee et al., *Natural Catastrophes and Inflation in 2022: A Perfect Storm*, March 22, 2023, 21, 24.
[16] Bevere, "How Big Is the Protection Gap from Natural Catastrophes,"March 22, 2023.

firm indicated that the January 2023 renewals may have helped to rebalance the supply and demand equilibrium going forward, as they claimed that there had previously been too much capital (or oversupply) in the reinsurance market.[17]

[17] Sheehan, "Stresses of 1/1 Should Disappear at Later Renewals," January 23, 2023.