

The economics of reinsurance

*Dr Alexander Ressos, TEP
Attorney-at-Law (Switzerland), Solicitor (Hong Kong),
Solicitor (England & Wales)*

Reinsurance is often described, in Swiss Re's own shorthand, as "insurance for insurance companies".¹ The formula is correct as far as it goes. A primary insurer, called the cedant or ceding company in reinsurance terminology, transfers part of the risks it has accepted from its policyholders to a reinsurer in exchange for a share of the premium. The policyholders usually know nothing of this transfer. Their contract remains with the primary insurer, which stays fully liable to them even if the reinsurer fails to pay. The reinsurance contract is a separate legal relationship between two professional parties. This separation explains much of the law discussed later in this chapter, since the protective rules that consumer insurance law has developed for policyholders are simply not needed between two insurers.

The economic functions of reinsurance can be grouped under four headings, which Swiss Re's guide presents in similar terms.² The first is capacity. An insurer whose capital is limited can accept a large risk, such as a power station, an airliner or a portfolio of houses in an earthquake zone, only if it can pass part of that risk on. Without reinsurance, only the largest insurers could cover the largest risks, leaving many markets without the capacity to insure major industrial or infrastructure projects at all. Reinsurance thus allows a small or medium-sized insurer to offer its clients cover far beyond its own balance sheet.

The second function is capital relief. Modern solvency regimes, the Swiss Solvency Test and the European Solvency II framework alike, require an insurer to hold capital in proportion to the risks it retains. By ceding risk, an insurer reduces its required capital and can use the capital thus freed to write new business or to return it to shareholders. For a growing insurer, reinsurance is often cheaper than raising new equity. For supervisors, the flip side of this function is the need to ensure that the transfer of risk is real. The Converium case discussed in Section XIII shows what happens when

reinsurance contracts are designed to create the appearance of risk transfer without its substance.

The third function is the stabilisation of results. An insurer that writes storm insurance in northern Europe knows that a severe windstorm will occur every few years but cannot know in which year. Reinsurance smooths the resulting fluctuations of its results by capping the loss it will bear from any one event or in any one year. Swiss Re's guide puts it in the language of prudence: reinsurance "helps reduce the likelihood that insurers would face potentially grave consequences as a result of a significant depletion in capital".³ Stable results reduce the insurer's cost of capital and the risk of a downgrade by the rating agencies, which can be decisive in commercial lines where brokers place business only with insurers of a minimum rating.

The fourth function is the transfer of knowledge. Reinsurers see the business of hundreds of cedants in many countries and accumulate data and experience that no single primary insurer can match. They advise their clients on underwriting, pricing, claims handling and product development while supporting entry into new lines of business or new markets.⁴ The Swiss Insurance Training Centre of 1960 was an early and formalised expression of this function. Today it takes the form of pricing tools, catastrophe models, medical underwriting manuals for life insurers and data on mortality and morbidity trends.

Beneath these functions lies the principle that explains why a reinsurer can bear risks that would ruin a primary insurer: diversification. A reinsurer that accepts storm risk in Europe, earthquake risk in Japan, hurricane risk in the United States, mortality risk in the United Kingdom and liability risk in Australia holds a portfolio whose components are largely independent of each other. A storm in Germany does not make an earthquake in Japan more likely. The capital needed to support the whole portfolio is therefore considerably smaller than the sum of the capital that would be needed to support each part in isolation. As the reinsurer's central economic advantage, diversification explains why the industry tends towards a small number of very large global companies. It also explains the business model's vulnerability to correlated risks, which strike many lines and regions at once: pandemics, financial crises, wars and, increasingly, the effects of climate change on several perils simultaneously.

The global reinsurance market is concentrated. Swiss Re's guide estimated about 200 reinsurers worldwide, of which the ten largest non-life reinsurers wrote roughly half of the premiums. It gave the annual premium volume as around 170 billion dollars in non-life and 53 billion in life

reinsurance, based on figures for 2012.⁵ The concentration is a consequence of the economics just described. Reinsurance clients buy a promise that must be kept in extreme circumstances, which favours reinsurers with large, diversified balance sheets and strong ratings. At the same time, the market is cyclical. After large losses, capital becomes scarce and prices rise. When capital is abundant, prices fall until the next catastrophe. The market speaks of “hard” and “soft” phases, while the annual renewal dates, above all 1 January for Europe and much of the world, are watched as indicators of the cycle.

Since the 1990s a further source of capacity has entered the market: capital from outside the insurance industry. After Hurricane Andrew, investors provided capital for new reinsurers in Bermuda and, through catastrophe bonds and other insurance-linked securities, for the direct assumption of catastrophe risk. Swiss Re is itself one of the main arrangers of such transactions and publishes the Swiss Re Global Cat Bond Index, a benchmark for the market, which returned 2.77 per cent in the first half of 2025. The legal and structural aspects of these instruments are discussed in Chapter V of this Part. Here it suffices to note that alternative capital has become an additional layer of capacity alongside traditional reinsurance. Used above all for peak catastrophe risks, it has made the reinsurance cycle less pronounced than it was in the twentieth century.⁶

1 Notes

1. Swiss Re, The essential guide to reinsurance, <https://www.swissre.com/dam/jcr:d06472ab-2625-48cf-8b4e-7c7ac8aa63f0/The-essential-guide-to-reinsurance.pdf>. ↩
2. Swiss Re, The essential guide to reinsurance, <https://www.swissre.com/dam/jcr:d06472ab-2625-48cf-8b4e-7c7ac8aa63f0/The-essential-guide-to-reinsurance.pdf>. The guide distinguishes capacity and risk transfer, capital relief, earnings stabilisation and knowledge transfer. ↩
3. Swiss Re, The essential guide to reinsurance, <https://www.swissre.com/dam/jcr:d06472ab-2625-48cf-8b4e-7c7ac8aa63f0/The-essential-guide-to-reinsurance.pdf>. ↩
4. Swiss Re, The essential guide to reinsurance, <https://www.swissre.com/dam/jcr:d06472ab-2625-48cf-8b4e-7c7ac8aa63f0/The-essential-guide-to-reinsurance.pdf>. ↩
5. Swiss Re, The essential guide to reinsurance, <https://www.swissre.com/dam/jcr:d06472ab-2625-48cf-8b4e-7c7ac8aa63f0/The-essential-guide-to-reinsurance.pdf>. The

figures are those of the edition consulted and have grown considerably since. ↩

6. Swiss Re, The essential guide to reinsurance, which describes insurance-linked securities as “a means of ceding insurance-related risks to the capital markets”. “Cat bonds deliver in 2025. Demonstrate low correlation, spreads exceed high yield: Swiss Re”, Artemis, 11 August 2025, <https://www.artemis.bm/news/cat-bonds-deliver-in-2025-demonstrate-low-correlation-spreads-exceed-high-yield-swiss-re/>. ↩

For general information only. This article does not constitute legal or tax advice, does not replace advice on an individual case and creates no lawyer-client relationship. It reflects the legal position as of September 2026.

Online version: helveticaregister.com/zurich-the-economics-of-reinsurance