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Economic insights

The re/insurance underwriting cycle: hard market conditions go on

Key takeaways

- Rate hardening in re/insurance is expected to continue through 2022.
- Tighter capacity has been mostly the result of reduced risk appetite rather than capital shortage.
- Reduced risk appetite is caused by elevated modelling uncertainty arising from social inflation, nat cat losses, and pandemic-related losses.
- Macro risks are elevated with an increasing focus on rising inflation and interest rate scenarios, which can trigger adverse reserves development and losses in asset valuations.

About Economic insights
Analysis of key economic developments and their implications for the global re/insurance industry.

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In a nutshell

We expect re/insurance rate hardening to continue through next year. The tightening of capacity is largely the result of lower risk appetite by re/insurers rather than a shortage of capital. Uncertainty from social inflation, natural catastrophe losses and pandemic-related losses have reduced risk appetite. Macro risks to re/insurers' balance sheets are high, with rising inflation and interest rate risks.

Re/insurance rates have been hardening since 2018 and the price momentum picked up at this year's January renewals.[1] The current market is characterised by tighter capacity, mostly due to reduced risk appetite on the part of re/insurers, rather than a shortage of capital per se. Indeed, last year's capital losses were temporary as asset valuations recovered quickly from the lows of March 2020. Global reinsurance incumbents and a few new players raised close to USD 15 billion of capital in 2020 to take advantage of the hard market opportunities created by attractive rates, according to Aon.[2]

The reduction in re/insurers' risk appetite is driven by modelling uncertainty in an environment of ambiguity about macro developments and volatile capital markets. Elevated modelling uncertainty arises from multiple factors including social inflation, which has pushed up US liability claims; prior-year adverse reserves development, uncertainty around COVID-19 business interruption (BI) losses; successive years of above-average cat losses; continued uptick in secondary peril losses; and increased scrutiny of the modelling of climate change impacts (see Figure 1).[3] Recent top-down market estimates of global industry losses for COVID-19 claims range from USD 30-60 billion.[4] The 2020 North Atlantic hurricane season brought a record 30 named storms, of which 12 made landfall in the US. These avoided densely populated areas but still caused insured losses of USD 20 billion in the US. The consensus view for 2021 is for "above average" storm activity in the North Atlantic. Reported US nat cat losses through May 2021 are already above USD 20 billion.

US liability claims growth has been trending higher since around 2015.[5] The current episode of social inflation relates to single-claimant cases rather than mass tort and is not caused by legislative changes. Key drivers of recent social inflation include the trial bar increasingly using psychology-based strategies, data analytics, digital media advertising and litigation funding. Other factors relate to jurors' attitudes to issues like social injustice, rising inequality and negative sentiment toward corporations. The uncertainty about liability reserves and pricing new business is particularly affecting excess liability and liability reinsurance treaties.

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[1] Market Conditions Harden Further at January 2021 Renewals, *fitchratings.com*, 13 January 2021.
[2] *Reinsurance Market Outlook*, AON, January 2021.
[3] On social inflation, see *US social inflation amid the COVID-19 recession – here to stay?*, Swiss Re Insitute, 3 December 2020; on natcat and secondary perils, see *sigma* 1/2021: *natural catastrophes in 2020*, Swiss Re Insitute, 30 March 2021.
[4] Actual industry losses are still highly uncertain. The loss tally from company disclosures currently range from USD 29 - 34bn. E.g. Dowling at USD 29 bn (IBNR weekly 10/2021), Peristrat at USD 34 bn incl. Lloyd's.
[5] *US social inflation amid the COVID-19 recession – here to stay?*, op. cit.

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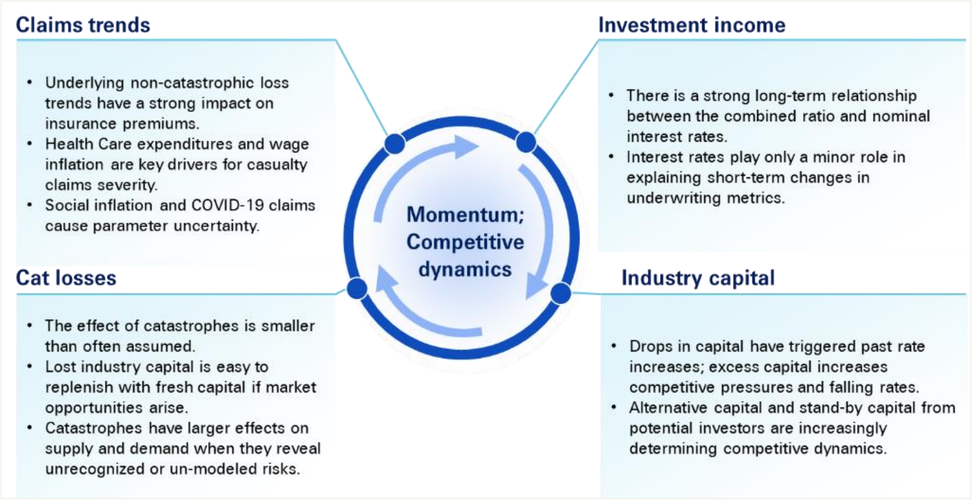
Figure 1
Driving forces of the underwriting cycle



Source: Swiss Re Institute

There is also property-insurance-related social inflation, particularly in connection with the assignment of benefits in Florida, which is driving up homeowners' attritional claims costs.

The impact of low investment returns on re/insurer earnings is a further factor pushing up re/insurance rates. Aon's January 2021 reinsurance market outlook reported that investment returns were lower at all reinsurers in its analysis. Even after rises in the first quarter this year, interest rates and consequently investment returns remain low by historic standards. This places more focus on underwriting profitability to make up for the lost investment income in order to compensate investors for their cost of capital. Meanwhile, macro risks are elevated, with an increasing focus on rising inflation and interest rate scenarios, which can trigger adverse reserves development and losses in asset valuations.

The reinsurance capacity provided by third-party capital is an important contributor to property cat lines of business. A reduction in capacity in collateralised reinsurance (CR), which has suffered poor returns in recent years, is contributing to selective tightening in the retrocession market and is also a factor in rate hardening in the reinsurance market.[6]

These market conditions indicate price rises are likely to continue both this year and next. Rate increases in 2022 would further increase the profitability of new business.

[6] *Hard Times*, Howden, January 2021.