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Research

January Reinsurance Renewals
Same way but different directions!

Strong rate increases I Shift from proportional to non-proportional I Positive sector outlook

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- Strong rate increases following hurricane Ian and the rise in inflation during 2022
- Significant shift from proportional to non-proportional
- Unusually diverse renewal outcome –reinsurance market still has to find equilibrium
- Positive reinsurance sector outlook for 2023

Hardest market in a generation

Market conditions in the reinsurance market are now the most attractive in a generation. The hard market meets a reinsurance sector with plenty of excess capital waiting to be deployed into underwriting. All four major reinsurers have substantial excess capital and Solvency II ratios are well above their minimum targets despite a series of events last year.

In particular, rates in property catastrophe business have skyrocketed since Hurricane Ian as reinsurers attempt to recover their losses. Terms and Conditions improved significantly as well. But unlike in most previous cycles, the market did not find a real equilibrium of supply and demand. Inflationary pressures let reinsurers become wary of proportional business and all major reinsurers reduced their proportional business in favour of non-proportional business, in particular in higher layers in order to reduce earnings volatility. At the same time, they reacted to climate change and increased cedent retentions. In Florida, the recent changes in local legislation came in favour of the insurance sector, but according to a number of insurers, these have yet to be priced (i.e. by means of lower pates) which should support underwriting profitability at least in FY23. Overall, we observed less capital being deployed into property reinsurance.

On the ILS side, the total CAT bonds market recently declined by around USD 0.8bn[1] and trapped collateral in the case of Collateralized/Private ILS transactions is likely to amount to USD 5-10bn according to Hannover Re[2]. In our view, this shrinking of ILS capacity is rather an opportunity for CAT Bond investors who can now benefit from very attractive market conditions without facing trapping of collateral. But the moderate shrinking of the CAT bond market and soaring reinsurance rates also meant that cedents increased their retentions significantly in order to save reinsurance cost, i.e. the cycle appears to approach its peak.

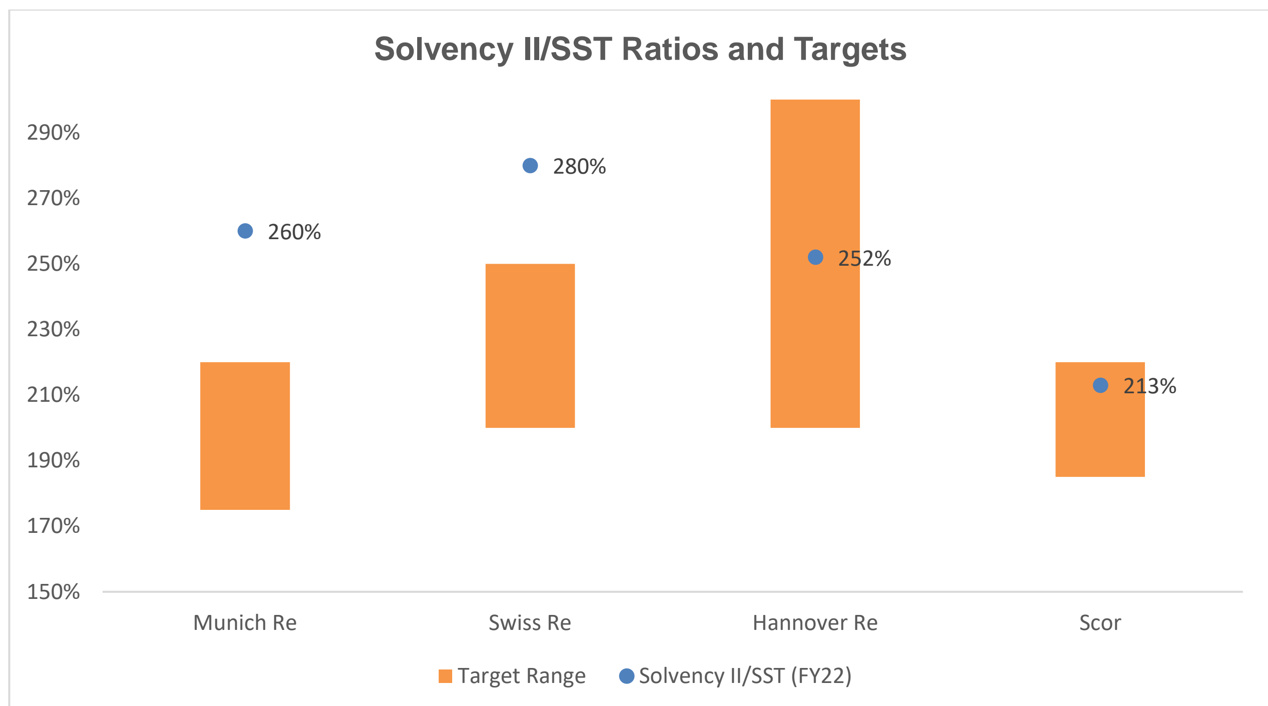
Also Aviation and Marine business reported substantial rate increases. These rate hikes were to a certain extent a reaction to losses from the Ukraine war. In Casualty, Motor and Credit&Surety, we observed either a reduction or reduced growth of the renewed book. Regionally, the highest rate

[1] Source: artemis.bm - https://www.artemis.bm/dashboard/catastrophe-bonds-ils-issued-and-outstanding-by-year/
[2] Source: artemis.bm - https://www.artemis.bm/news/hannover-re-estimates-us-5bn-to-10bn-of-ils-capital-still-trapped/

increases were unsurprisingly achieved in North America followed by Europe, Latin America and Asia.

Cancellations and restructurings of reinsurance programs tended - compared to prior years – to be relatively high indicating that insurers take the hard market as an opportunity to actively re-underwrite their portfolios.

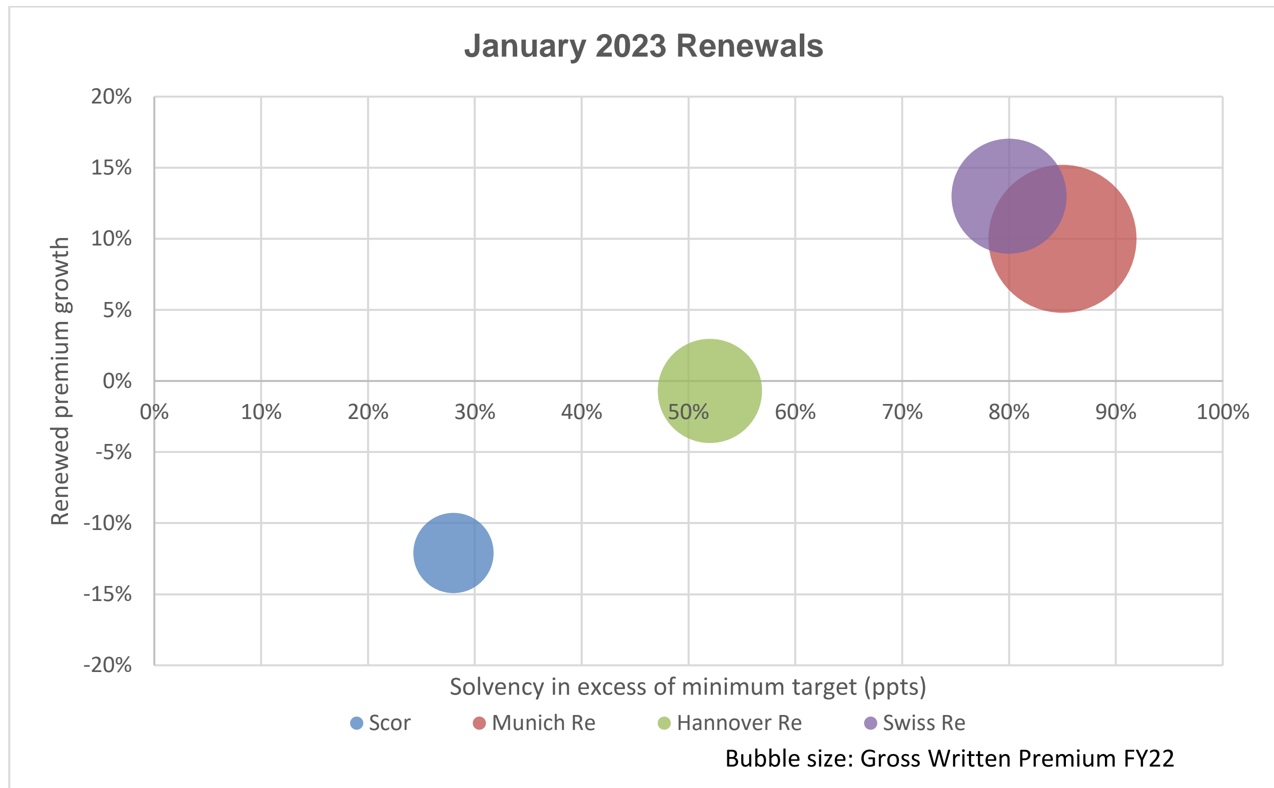
Normally, reinsurers would now deploy excess capital into new business and show strong top line growth like in 2022. However, many reinsurers this year to maintained a capitalisation above target and limited their top line growth, most likely reacting to high market uncertainty.



The data disclosed by the individual reinsurers are usually not easily comparable and disclosures of Scor and Hannover Re are much more detailed than Munich Re's or Swiss Re's. But among the four large reinsurers only Swiss Re reported a renewed premium increase of 13% and Munich Re of 1.3%. Munich Re's renewals were impacted by the decision of a major cedent to retain substantially more risk. Excluding this effect from a single large client, renewed premiums would have gone up by around 10%. The renewed premium of Hannover Re decreased by 0.7% and Scor by 12.1% So this time it is not the two smaller market leaders who are more nimble and flexible but the two largest players who grew the most! Usually, we would expect that the two smaller players would reallocate more capacity in a hard market while the two largest players would grow at a much smaller pace. The reasons were in our view of an idiosyncratic nature.

We should note in this context that Hannover Re did not define any upper limited of its Solvency II target range leaving the issuer more flexibility. Munich Re's and Swiss Re's Solvency II/SST positions are despite high distributions still well above the upper end of the target range. This puts a bit more pressure on both to deploy or distribute the excess capital. Scor's Solvency II position is close

to the upper end of its Solvency II target range and this was in our view also a contributor to the outcome of their renewals.



Scor

Scor was under pressure from the agencies and investors to reduce its earnings volatility and catastrophe exposure. The renewals showed the most pronounced re-underwriting off all major players. Profitability remediation actions and - to a lesser extent - the move of the CAT Excess of Loss (XL) portfolio reduced renewed premiums by 29% which was only partly compensated by price and volume changes and share increases/new business (+23%). The most drastic actions were the reduction of earnings volatility by reducing proportional property by 24% and agriculture by 39%! In order to improve profitability, Scor cut back 48% of US proportional casualty business and 29% of proportional motor business.

Overall Property Cat business went down from 38% to 35% of total Estimated Gross Premium Income (EGPI) as did Casualty&Motor from 26% to 22% as the weight of Global Lines in Scor's portfolio increased. Within the latter, Cyber business went up by 41%. This reflects a trend we see across the market.

Scor shifted its business mix towards reinsuring higher layers with Cat XL retentions increasing between 34% in the US and 149% in Canada. Rates on Line (ROL) increased by 71% in North America, 44% in Europe, 37% in LatAm&MEA and 18% in APAC.

While we understand the motives for this shift in business mix, especially out of US property cat business, the move is in our view to some extent premature given the very attractive market conditions. As fixed income investors, we see value in a risk profile of a reinsurer that is skewed towards underwriting risks rather than market and credit risks and hence Scor paper has become fundamentally slightly less attractive although we appreciate a potential positive rating impact.

Hannover Re

Hannover Re showed a marginal decline in renewed premiums and again we are a bit surprised about the limited growth of the issuer in such a hard market. In our view, Hannover Re took a more cautious approach by rather improving the underwriting quality of the portfolio than aiming for volume growth.

Renewed premiums were marginally down by 0.7% to EUR9,798m. Like peers, the issuer shifted its business mix away from proportional to non-proportional as pricing is according to Hannover Re outpaced by inflation. Hannover Re therefore cancelled or restructured 13.9% or EUR1,376m of the business up for renewal of which around EUR950m was proportional. New business was 5.8% while changes in renewed business increased the premium volume by 7.4% of which 8.0% were due to price increases. Terms and conditions also improved materially.

The 8.0% price increase was primarily driven by the Americas (+12.9%), EMEA (+7.2%) and Aviation and Marine (+17.2%). In the non-proportional business, Hannover Re reported price increases of 20.7% on average across all regions. In proportional business, prices were up only 3.4%. Premium volume was down 8.7% in proportional but up 21.4% in non-proportional.

Hannover Re also reported a reduction of Possible Maximum Losses (PMLs). This was a bit surprising as the renewals indicated a move into higher layers. However, this shift in business mix was offset by retro cover purchased in 2023 which is targeted at peak perils and hence the PMLs have come down.

In our view, Hannover Re's renewals are credit positive. Hannover Re is probably a bit too conservative and could potentially deploy more capital into growth in these market conditions. Still, we appreciate the improvement of the quality of the portfolio arising from this more reluctant approach.

Munich Re

At the January 2023 renewals, renewed premium income was up only 1.3% to EUR11.9bn. Prices were up 2.3% on average (fully risk-adjusted). As mentioned above, the numbers are effected by one large cedent who has significantly increased its retention in the current market environment. Excluding this effect, renewed premiums would be up by around 10%. Cancellations amounted to 6.7% of renewable premiums and new business accounted for 6.2% which is as expected below the levels of Hannover Re or Scor.

Like peers, Munich Re increased its exposure to property XL while reducing proportional business. I.e. in property XL rates went up 16.5% and volumes 35.4%, compared to 0.6% and -0.2% in proportional business. Interestingly, Munich Re's business mix shifted towards more exposure to Europe and Asia/Pacific/Africa and has now significantly less exposure to North America. However,

we note that these numbers are very much effected by the above mentioned increased retention by a one large client.

The renewals were in our view credit positive for Munich Re, but we are somewhat surprised not to see more growth in the US.

Swiss Re

Swiss Re reports traditionally less detailed on its renewals than the other three large reinsurers and this year's renewals reflected also the issuer's negative rating outlook. The issuer reported a 13% increase in renewed premium on the back of price increases of 18% on average or 5% net of higher loss assumptions and model updates. Cancellations amounted to 10% of renewed premium and was more than offset by new business (+11%). Rate increases of 21% were the most pronounced in Natural Catastrophe business. Swiss Re also applied a more cautious approach in North America where premium volume was flat despite strongly rising rates. Instead, premium volume rose 21% in Europe and 35% in Asia.

Swiss Re reduced aggregate covers in the renewals and participated more in higher layers of risk. Unlike peers, the issuer was a bit more reluctant to deploy additional risk capital in the renewals and in our view the issuer could have written more business during these renewals, but that growth potential was not fully exploited in favour of higher earnings quality and stability in light of the negative rating outlook.

Outlook

Market conditions in the reinsurance market are in our view the best in a generation. The reinsurance sector has substantial excess capital to deploy but we note that most issuers remain on the cautious side maintaining some excess capital in uncertain times, which is generally credit positive. Negative rating outlooks and rating actions were also factors limiting growth potential.

In our opinion, Hannover Re and Munich Re outperformed Swiss Re and Scor in these renewals. However, all players should expect a material positive earnings impact in FY23 assuming that catastrophe losses do not exceed the catastrophe budgets. Hannover Re's earnings could become more volatile going forward given its higher natural catastrophe exposure on the back of the renewals but that the issuer can well afford this additional volatility. The reinsurance sector is positioned as the best capitalised in the insurance industry and is likely to be strengthened further.

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