



Swiss Re *sigma* study on non-life insurance: introducing the economic combined ratio for a better understanding of underwriting profitability

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Zurich, 30 March 2006 – The non-life insurance industry posted sound underwriting profits in 2004, according to Swiss Re’s latest *sigma* study. Over the last decade, however, the contribution of underwriting to overall profitability was small, and non-life insurers faced difficulties in earning their cost of capital.

Sound technical underwriting has become a prerequisite for overall profitability in the current low-yield financial environment. As a result, the combined ratio has received renewed attention as a key performance yardstick for the non-life industry. Swiss Re’s new *sigma* study “Measuring underwriting profitability of the non-life insurance industry” introduces the economic combined ratio as an alternative measure of underwriting profitability. Compared to the conventional combined ratio, it presents the following advantages:

- It isolates the underwriting results of a certain year (accident-year view), avoiding mingling with reserve additions or releases for prior years as traditional business-year underwriting figures do.
- It adjusts for distortions due to extraordinary losses (catastrophes).
- It takes the time value of money into account by discounting future cashflows, particularly future claims payments.

The economic combined ratio provides new insights into insurance cycles, as the US property/casualty industry figures for 1994–2004 demonstrate. The differences compared to the headline business-year combined ratios are:

- Economic underwriting profitability deteriorated from 1994 to 1997, although the reported headline business-year combined ratio improved.
- The cycle trough was reached in 2000, rather than in 2001.
- The accident years 1998–2001 were considerably worse than indicated by the conventional business-year combined ratio.
- Profitability in 2003/04 was comparable with 1994/95 despite a 5 percentage point lower combined ratio, because the current low interest rate environment reduces the impact of discounting for future claims payments.

The results in Japan, Canada, France, Germany and the UK indicate that the economic combined ratios for other countries were by and large consistent with those of the US. While the years 1994–1997 and 2002–2004 were profitable, though often only moderately so, the period 1998–2001 exhibited poor underwriting performance. Thanks to substantially improved underwriting results in the period 2001 – 2004, economic underwriting profitability was restored to the level of 1994–1997.

In all the countries examined, the 10-year average economic underwriting margins before taxes were positive, implying a positive profit contribution from insurers' underwriting activities. Nevertheless, since profits must also cover tax and capital costs, the margins obtained in the period 1994–2004 hardly allowed the insurance industry to earn its underwriting cost of capital.

In 2004, business across the board was profitable. Underwriting contributed 6–9% of premiums to overall profitability in the US, the UK, Germany and France.

Notes to editors

Swiss Re is one of the world's leading reinsurers and the world's largest life and health reinsurer. The company operates through more than 70 offices in over 30 countries. Swiss Re has been in the reinsurance business since its foundation in Zurich, Switzerland, in 1863. Swiss Re offers a wide variety of products to manage capital and risk. Traditional reinsurance products, including a broad range of property and casualty as well as life and health covers and related services, are complemented by insurance-based corporate finance solutions and supplementary services for comprehensive risk management. Swiss Re currently has the following ratings: (i) from Standard & Poor's: long-term counterparty credit, financial strength and senior unsecured debt ratings of "AA (CreditWatch negative)", and a short-term counterparty credit rating of "A-1 +", (ii) from Moody's: insurance financial strength and senior debt ratings of "Aa2" (on review for possible downgrade), and a short-term rating of "P-1" and (iii) from A.M. Best: a financial strength rating of A+ (superior) (under review with negative implications).

How to obtain a copy of this *sigma* study:

The English, German, French, Italian and Spanish versions of the *sigma* study "Measuring underwriting profitability of the non-life insurance industry" are available electronically on Swiss Re's website: www.swissre.com/sigma

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