Back to basics: underwriting results must improve significantly to bring non-life insurance back to profitability

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Swiss Re's latest sigma study, "Profitability of the non-life insurance industry: it's back-to-basics time," outlines current and future trends in the major non-life insurance markets. The major finding of this sigma edition is the need for improved underwriting results. After a prolonged soft market and with investment prospects diminished, premium rates and underwriting results need to improve significantly to achieve widespread profitability.

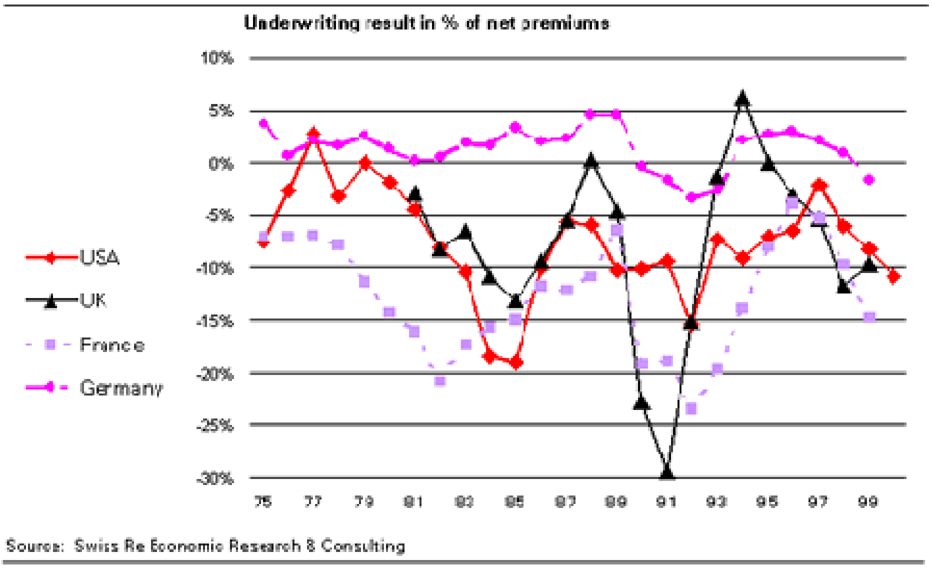
This study analyzes and compares the main factors driving the profitability of the non-life insurance markets of the Group of Seven (G7) countries (Canada, France, Germany, Italy, Japan, United Kingdom, and the United States). The main profitability drivers – investment results and underwriting results – are compared between countries and across lines of business. It examines long-term profitability trends, their interdependence, and gives a short-term outlook. The main questions addressed in this sigma:

What are the main drivers of profitability?

- How does the long-term profitability of non-life insurers compare to benchmarks?
- How important is investment activity as a driver of profit, capacity, and volatility?
- What are the patterns of the insurance cycle regarding length, between countries, and across lines of business?
- How much do underwriting results have to improve to return to a situation of widespread profitability?

Given the complexity of the September 11th terrorist attacks on the US, it was not possible yet to include a reliable and thorough analysis of these losses. However, the Swiss Re sigma study provides the framework and mechanisms to conceptualize how loss shocks of that magnitude impact the insurance industry. These are the main findings:

- Insurers' long-term profitability has been comparable to broad market indices. However, non-life insurers recently underperformed significantly. Worldwide, non-life insurance markets are currently in a period of declining profitability, reflecting the trough of a soft underwriting cycle combined with a weakening investment performance.
- Up until 1999, falling interest rates and robust stock markets had increased insurers' capacity to historically high levels and created strong investment returns. As a result, competition heated up, premium rates fell and underwriting results declined in all major markets. Non-life insurance markets are currently in a transition period between a severe soft market and a hard market. Commercial lines and reinsurance premium rates started to rise in 2000, and have gained momentum in 2001. Prices in the personal lines have lagged slightly, but are now increasing as well.
- In order to return to average profitability, underwriting results must improve in the major markets by at least 7 to 14 percentage points of net premiums, depending on the market. A contraction of insurers' capital base — due to catastrophic claims costs and recent losses in equity investments – will urge insurers to realize further rate increases over the next few years.
- Despite the improving underwriting conditions, reported technical results will be undermined in 2001 — particularly in the US — by the September 11th catastrophic loss occurrence.
- Underwriting results follow a cyclical pattern with an average length of about six years. These cycles are increasingly synchronized across countries and to some extent across lines of business (see figure).



- Investment performance has increased in importance to insurers. The two factors determining the improved investment results were the strong capital market performance from 1995 to 1999 and a long-term trend towards more asset leverage. Asset leverage, the ratio of invested assets to net premiums, has increased in all the major markets primarily because of a structural increase in loss reserves. In all the major markets, loss reserves have risen stronger than premiums along with the increasing importance of liability lines of business.
- In the near term, the equity markets of the major economies will remain volatile and uncertain. After a long period of robust returns, equity markets are unlikely to produce strong investment results in the short run. The declining values of equity portfolios also weakened the capital base of non-life insurers in 2000 and 2001. With investment returns uncertain, insurers are increasingly striving to boost profitability through improved underwriting.

How to access *sigma*:

The English, German, French, Spanish and Italian versions of the sigma study are available electronically in the **sigma section** of the website.

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