New Swiss Re sigma study: Non-life insurance industry to face a time of lasting capacity shortage

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The non-life insurance industry is adjusting to two major shocks - the catastrophic losses of 2001 and the ongoing stock market meltdown. Swiss Re's latest sigma study outlines the reactions in the major non-life insurance markets: The need for improved underwriting results continues in a market environment of shrinking insurance capacity and diminished investment prospects. Further price increases are to be expected for the coming years.

The last two years have been quite strenuous for the non-life insurance industry. Since their peak in the first quarter of 2000 declining stock markets significantly reduced capital funds. Then, losses jumped to a record high in 2001, further diminishing the ability of insurers to write business. Risk capital, which was abundant in the second half of the 1990s due to robust gains from equity markets and falling interest rates, became scarce. Moreover, the prospects for a rebound of the stock markets are uncertain and interest rates are expected to remain low for the foreseeable future.

The driving forces behind the hardening market have been reinforced.

The severe bear market since 2000 and record losses in 2001 have reinforced the cyclical upturn of the non-life insurance market. According to Swiss Re's study "Global non-life insurance in a time of capacity shortage" non-life insurance prices are rising globally. The price increases are necessary for insurers to shore up their balance sheets, given weak investment returns and the heavy losses in 2001. Though September 11 clearly accelerated this trend, the hardening of the P/C insurance market already started in late 2000, early 2001. The hard-ening of the market is expected to last longer than in previous cycles, given the global shortage of quality capital and increased risk expo-sures.

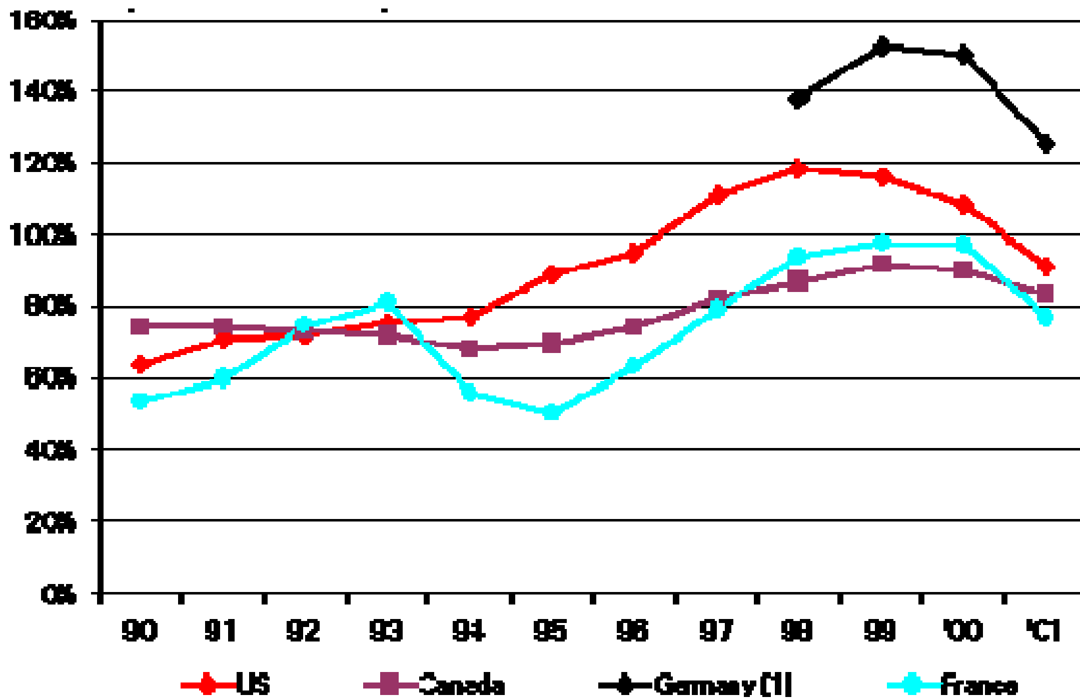
Global capacity has declined by about 25% since 2000.

The soft market and the decline in equity markets have reduced the industry's capital base and turned excess capital into a tight capital base, particularly in commercial lines and reinsurance. Solvency ratios started to decline in 2000 in most major markets. New capital, about USD 30 billion, was not able to fill the gap left by lost capacity. Worldwide non-life capital funds decreased by about USD 90 billion in 2001, mostly due to valuation losses in equity portfolios. Similar or larger losses have to be expected for 2002 if the current state of stock markets continues. This would mean approximately a USD 180 billion or 25% decline in global capital funds of the non-life insurers since their historical peak in early 2000.

The investment environment is uncertain.

After a short, post-September 11 recovery, by August 2002 many stock markets had fallen below their post-September 11 lows. De-spite lower valuations, price/earning ratios are still high compared to historical levels and a realistic projection of earnings. In addition, recent financial scandals (eg Enron, WorldCom, and Xerox) are keeping investors away from the financial markets. There is a risk that stock markets will go through a period of overshooting on the downside before reverting to normal growth, which is 3-4% over risk-free returns, compared to 7-10% during the 1990s. Consequently, investment returns for the insurance industry may remain low for a long pe-riod of time.

Capital funds as a % of net premiums



The shifting risk landscape is neces-sitating a reallocation of invested assets.

During the second half of the 1990s, non-life insurers often leveraged their capital funds with substantial investment risks. The share of assets invested in equities increased accordingly from 1990 to 1999. However, equity shares are falling now due to declining equity valuations and asset sales made in order to realise capital gains. From a risk/return perspective, it is now more attractive to allocate capital to non-life insurance and the credit markets, where the prospects are good.

The ART market will focus on increasing capacity.

The hardening of the market has changed the focus of the ART market from expanding the limits of insurability towards increasing capacity. Under current conditions, tighter limits are being placed on traditional insurance covers and the demand for ART solutions has shifted towards products that provide solutions for risks that are now difficult to transfer.

Notes for editors:

Swiss Re is one of the world's leading reinsurers with over 70 offices in more than 30 countries. For 2001, Swiss Re reported a net loss of CHF 165 million, largely due to the September 11 event. Gross premiums in 2001 were CHF 28.5 billion. At the end of June 2002, Swiss Re's shareholders' equity amounted to CHF 18.3 billion and the total balance sheet stood at CHF 168 billion. Swiss Re is rated "AA+" by Standard & Poor's, "Aaa" by Moody's and "A++" by A.M. Best.

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