Corporate news

Hannover Re anticipates significant price increases in property and casualty reinsurance

- **Insurers and reinsurers under strain from low interest rate environment, large losses and Covid-19 pandemic**
- **Rising demand for coverage from financially robust reinsurers**
- **Market environment supports already discernible trend reversal towards higher prices**
- **Hannover Re sees profitable growth opportunities across a broad front**

Hannover, 14 September 2020: Hannover Re expects to see significant price increases spanning the various lines of property and casualty reinsurance in the treaty renewals as at 1 January 2021. The key drivers here are the strains incurred by primary insurers and reinsurers in connection with the Covid-19 pandemic, a further drop in interest rate levels and the large losses recorded over the past three years.

"Our sympathies go out to everyone who has lost family or friends or been impacted by the virus in any other way," Jean-Jacques Henchoz, Chief Executive Officer of Hannover Re, said. "We stand shoulder-to-shoulder with our customers and emphasise sustained, partnership-based relationships. Our business model and our capital resources are geared to managing extreme scenarios. Low interest rates are here to stay for a long time. This necessitates considerable pricing discipline, because technical profitability will have to do even more to offset declines in investment income. With this in mind, price increases on both the insurance and reinsurance side are absolutely essential in January and beyond."

Along with generally stronger demand for high-quality reinsurance protection, primary insurers are increasingly seeking tailor-made solutions offering solvency relief. This is where first and foremost reinsurers with a particularly large risk-carrying capacity and above-average ratings have a pivotal role to play.

In the various rounds of renewals held during 2020 Hannover Re secured improved conditions and price increases in some areas. Particularly for treaties that had suffered losses, price increases mostly running into double-digit percentages were obtained. Owing to the low level of interest rates, however, these are not always technically adequate and further price increases are therefore needed.

The effects of the Covid-19 pandemic on worldwide reinsurance markets vary in scale from region to region. The largest losses to date are anticipated from covers in the areas of business interruption, trade

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credit and event cancellation, although the spectrum of possible scenarios remains too broad for concrete forecasts. A further consideration is that many government assistance programmes are limited in duration. Against this backdrop, the level of risk awareness among primary insurers and hence the importance attached to high-quality risk protection have risen sharply over the past few months.

Specifically, Hannover Re anticipates the following developments in the treaty renewals as at 1 January 2021:

Europe

Business in *Germany* has been significantly shaped by Covid-19, among other factors, over the course of the year. The measures implemented to contain the pandemic and their impacts on many companies' operations have been felt particularly acutely among small and mid-sized enterprises (SMEs). Appreciable losses have been seen here in business closure insurance. This is similarly true, albeit to a less marked extent, of event cancellation insurance.

For 2021 Hannover Re anticipates sharply lower growth in the primary insurance market compared to prior years. The repercussions of the pandemic-induced economic downturn will be felt especially keenly in the SME segment. On the other hand, the effects on business with private customers should be more limited in scope.

The need for remediation in commercial and industrial property lines continues to grow more pressing on account of the burden of losses. Reinsurance conditions are expected to improve, particularly under loss-affected programmes.

Overall, the consequences of a pandemic – which constitutes a systemic risk – can be borne only to a very limited extent by the insurance industry. Clarifications or exclusions in relation to coverage for the pandemic risk have therefore been adopted both in the primary insurance market and in the reinsurance market.

Motor insurance appears set to enjoy some relief in the current year due to the temporary reduction in traffic volumes and correspondingly lower losses. Given that this is rather a one-time effect and 2021 is likely to see normalised loss expenditure with continued rising costs for spare parts and repairs, insurers and reinsurers alike have little margin for further improvements in conditions.

In the *United Kingdom and Ireland* appreciable market hardening can be observed among primary insurers.

Lloyd's of London continues to adopt a more restrictive approach for selected lines as well as for syndicates that do not deliver profitable results. This, in turn, has led to an ongoing supply shortage. Most notably, the market for contingency covers is showing significant rate increases despite pandemic exclusions. Driven by, among other things, the uncertainty surrounding the scale of Covid-19 losses, liability business is also seeing sharp reactions on the pricing side and improved conditions. The international property business written by Lloyd's syndicates had already recorded price increases in recent years on the back of worldwide natural catastrophe losses. This trend is continuing and is additionally being driven by current issues surrounding the coverage of Covid-19 losses as a consequence of business interruption without associated property damage.

These changes in the original business are analogously reflected – and sometimes even more accentuated – in the book of non-proportional reinsurance written by Hannover Re.

UK motor business, which Hannover Re writes on a non-proportional basis, has seen substantial price increases. Last year's adjustment to the Ogden rates, which fell short of the expectations of insurers and reinsurers, triggered price corrections. Significant price increases are similarly anticipated for UK motor business in the coming year.

Based on its good business relationships with long-standing customers, Hannover Re is able to defend its market position and is enjoying very healthy demand.

In *France* price increases are to be anticipated on the primary insurance side. This can be attributed, among other things, to the continued decline in income from investments as well as the sustained level of claims expenditure. At the same time, rising demand for industrial insurance covers is a further supportive factor. This should also have positive implications for movements in reinsurance prices, not least in view of the additional strain here from large losses in prior years caused by run-off results that fell short of expectations.

In the markets of *Central and Eastern Europe* the Covid-19 pandemic has, as in many other regions, had an added adverse impact on what was already a challenging economic situation, even though no or only minimal Covid-19-related losses are to be expected from this region. Price increases can be anticipated under loss-affected treaties and for programmes that were not adequately priced to reflect the risks. Over the medium to long term Hannover Re is looking for the economy here to bounce back and for stronger growth rates in primary business so as to close the protection gap.

North America

The primary insurance market in North America continues to develop favourably, notwithstanding the uncertainties associated with Covid-19 and the resulting economic constraints. All lines of business with the exception of workers' compensation are showing appreciable rate increases. The damage inflicted by tornados, hailstorms and hurricanes in the course of the year has led to a relatively large number of claims. Following on from the fire losses seen in California in recent years, this means that other parts of North America will see adjustments to rates and conditions.

The challenges associated with the Covid-19 crisis – when it comes to scope of coverage and the potential losses from various lines of business – have prompted many primary insurance customers to take a closer look at the financial strength of their reinsurance partners. A clear focus on excellent capital resources and long-term reinsurance relationships can be observed. Appreciable price increases or more precisely defined coverage restrictions are the norm in both the property and liability lines.

Latin America
The growth trend in demand for primary insurance covers in Central and South America is set to continue, even against the backdrop of the current pandemic. Natural catastrophe risks and social unrest have caused a surge in demand for high-quality risk protection in Latin America. The underlying growth in some countries combined with the withdrawal of other market players is currently leading to harder insurance and reinsurance conditions.

Individual markets in Latin America continue to see brisk growth in demand for insurance products, especially in areas associated with coverage for motor vehicles, production facilities and real estate.

Hannover Re is similarly recording sustained strong interest in the development of coverage concepts based on parametric indices. Most recently, for example, the company supported coverage for coral reefs in Mexico in partnership with Global Parametrics. Parametric covers are especially suited to countries with a low insurance density. Governments are able to improve protection for their population against catastrophic events with the aid of these solutions.

Asia-Pacific
The APAC region is the highest-growth economic region in the world and it is evolving into one of the largest global insurance markets. This growth holds the promise of further significant business opportunities, in part because the insurance density here is still lower than in more mature markets. Not only in property and casualty reinsurance but also in the health and provision sector appreciable growth rates can be anticipated over the medium to long term, which will also benefit reinsurers.

Hannover Re has continuously grown its footprint in the region in recent years and now has an efficient network of local subsidiaries, branches and representative offices. It is thus already very well placed to take advantage of business opportunities and to further extend and reinforce its market positioning through targeted measures in specific subsegments.

In this growth region Hannover Re supports its customers in their development and in facing up to the challenges of the coming years, whether through concepts designed to provide capital relief or by optimising the distribution and structuring of their products. In part with an eye to the increasing urban densification of Asia's metropolitan centres, it is imperative to design suitable insurance solutions as protection against natural disasters and to further boost insurance density. Narrowing these protection gaps opens up opportunities for insurers and reinsurers alike to underscore their social relevance.

Furthermore, Hannover Re has launched a strategic initiative intended to maximise even more intensively the growth potential offered by its business in the APAC region.

Hannover Re is looking ahead with optimism to the upcoming renewals as at 1 January 2021 and 1 April 2021 in the Asia-Pacific markets, even though price movements will likely vary from region to region depending on the burden of losses. The impacts of the Covid-19 pandemic must be kept in mind here as an element of uncertainty.

Natural catastrophe business

The reinsurance market has experienced three successive years of major natural catastrophe losses from 2017 through 2019. This has impacted both traditional reinsurers as well as capacity providers from the ILS market. Despite the absence of sizeable natural catastrophe losses in the first half of 2020 the global impact of the Covid-19 pandemic is adding further challenges to an already distressed reinsurance market. When it comes to property catastrophe business, this has resulted in an overall favourable trading environment for reinsurers throughout all renewals in 2020 so far. Pricing momentum was particularly pronounced in territories and programmes that had sustained significant losses recently such as the US, Japan and the Caribbean.

Going into 2021, Hannover Re anticipates the following developments in individual markets for natural catastrophe risks – based on the assumption of no further market-changing events:

North America: Overall, rates for US property catastrophe business have reached a satisfactory level. However, since the US is the peak zone for most reinsurers Hannover Re expects continued upward pressure on rates, particularly for loss-impacted programmes. The combination of losses and restricted capacities brought the market as a whole to a price inflection point in 2019. The environment is expected to show further improvement in 2021.

Europe: In 2020 Hannover Re noted a stable rating environment and in some instances improved pricing. With Europe currently being a centrepoint of the Covid-19 impact on the insurance and reinsurance market, material hardening is expected for 2021, particularly for those accounts that sustain significant losses from the pandemic.

Japan: Following the severe typhoons of 2018 and 2019 Hannover Re had already achieved significant price increases for Japanese wind and flood catastrophe reinsurance programmes in the 1 April 2020 renewals. Major reinsurers have used the recent events to update their risk models and hence their view of the Japanese typhoon risk and associated exposures. This is expected to lead to further substantial price increases in 2021 and should help bring about technical adequacy, the fundamental basis for reinsurers' long-term support for this market.

Australia/New Zealand: With significant and repeated frequency losses in Australia in the last couple of years, there was considerable pressure to generate prices commensurate with the risks in order to improve terms in 2020, especially for aggregate covers and lower programme layers. For 2021 Hannover Re expects this trend to continue for all natural catastrophe covers.

Specialty lines
Activities in the global *aviation sector* have been heavily impacted by Covid-19, as reflected in a significant slump in passenger numbers. These developments also have implications for the associated insurance market. It should, however, be borne in mind here that part of the premium contraction is offset by the fact that the trend towards rising rates – which was already observed in previous years – has continued undiminished and even gained added impetus in some areas.

Hannover Re has consistently succeeded in improving treaty conditions in proportional business to its advantage and in substantially raising premiums for non-proportional reinsurance solutions. Despite this favourable development, it is nevertheless important to remember that the reinsurance market is only at the beginning of a correction phase – which is why Hannover Re is maintaining unchanged its disciplined underwriting approach geared to the long term.

The *marine market* suffered a sizeable number of frequency losses in 2019. Reflecting also the poor results of prior years, this development created a further need for insurers to raise prices. This trend gained added momentum in the first half of 2020 owing to the effects of Covid-19.

An appreciable hardening of the reinsurance market was already perceptible in the renewals during the year.

Rates in the *offshore energy line* remain stable on both the insurance and reinsurance side. This is particularly noteworthy against the backdrop of declining volume flows, attributable to reduced air and maritime traffic in connection with the Covid-19 crisis, as well as the absence of large loss events. Hannover Re is seeing stronger interest among its customers in becoming more heavily involved in insurance solutions for renewable energies and in purchasing specific reinsurance covers for this purpose.

For the 2021 round of renewals Hannover Re anticipates stable reinsurance conditions and an improved pricing structure.

Despite the worldwide recession, merely modest rises in loss ratios compared to previous years have been recorded in *credit and surety insurance* as well as in the area of political risks. Increased loss expenditure must nevertheless be anticipated over the coming months on account of the general state of the economy. With this mind, prices in primary insurance and reinsurance should move appreciably higher.

In the area of *agricultural risks* the growing need for agricultural commodities and foodstuffs as well as the increased prevalence of extreme weather events continue to stimulate greater demand for appropriate reinsurance solutions, especially in emerging and developing countries. Hannover Re's involvement here encompasses not only traditional reinsurance but increasingly also cooperation with customers and various partners on the development of innovative insurance tools. Potential areas for growth include index-based products and parametric covers as well as public-private partnerships.

The market for *insurance-linked securities (ILS)* has contracted over the past two years by around 10% to a volume of currently roughly USD 90 billion. This decline can be attributed to dissatisfaction with the results and to trapped collateral for possible negative loss run-offs that at least temporarily is unavailable for new investments. Just as in the reinsurance market, conditions are improving and new record highs can be expected in the medium term.

Hannover Re accesses the ILS market both to obtain protection for its own catastrophe risks and to transfer its clients' life & health and property & casualty risks to the capital market. The latter primarily takes the form of collateralised reinsurance, which is still the largest business segment within Hannover Re's ILS activities, but is also supplemented by the issuance of catastrophe bonds.

In 2020, for example, Hannover Re has so far brought five catastrophe bonds to the capital market for US clients with a total volume of around USD 1.2 billion. Over the coming years the company expects demand to show moderate growth overall. Hannover Re is also itself an investor in catastrophe bonds, thereby maximising all the opportunities offered by the ILS market.

Business in the area of *structured reinsurance* continues to develop in line with expectations in the current year. Going forward, too, Hannover Re expects to see further growth in demand for innovative and tailor-made reinsurance solutions.

In this context new business opportunities are opening up first and foremost in North America, Europe and Asia. The purchasing habits of many clients have changed in recent years, reflecting a move towards holistic reinsurance solutions. This trend shows no sign of abating, with more and more customers seeking structured reinsurance solutions. The exceptional market circumstances associated with the Covid-19 pandemic are supporting a further shift towards a provider's market in this segment on a virtually global basis.

The planned implementation of IFRS 17 will cause demand for bespoke reinsurance solutions to trend higher, driven by the further increase in the complexity of capital and risk management faced by customers.

Outlook

For both insurers and reinsurers, 2020 remains dominated by the ongoing Covid-19 pandemic and the associated losses as well as by the sustained low interest rate environment and resulting impacts on profits. In both the primary and the reinsurance market, therefore, technical profitability will move centre stage on a lasting basis – also with a view to preserving the industry's future risk-bearing capacity. Against this backdrop, rate increases are absolutely essential.

"From our perspective, Covid-19 is a market-changing event that can be compared with the terrorist attacks of 11 September 2001 or hurricanes Katrina, Rita and Wilma in 2005," Sven Althoff, a member of Hannover Re's Executive Board responsible for property and casualty reinsurance, commented. "The true scale of the losses caused by the pandemic will only become clear over the long term. We see the Covid-19 pandemic as a catalyst for fundamental adjustments to prices and conditions at insurers and reinsurers alike. Just how these manifest themselves will, however, vary by region and line of business."

It is Hannover Re's expectation that the growing momentum of the price increases recorded in past rounds of treaty renewals will be sustained in the year ahead. Sharply rising prices across the various segments can be expected as at 1 January 2021. Appreciable improvements in conditions are similarly likely in view of the effects of the pandemic and the associated considerable uncertainties.

"The Covid-19 pandemic confronts us with a systemic, worldwide risk. Simply given its capital resources, the insurance industry alone cannot shoulder such an accumulation risk," Jean-Jacques Henchoz said. "Partnership-based approaches between governments and the insurance sector are needed to create promising solutions for the coverage of systemic risks such as cyber attacks or pandemics. We are optimally placed to support the development and realisation of such coverage concepts and hence to ensure that a larger share of the costs resulting from future pandemics are covered at premiums commensurate with the risk."

Due to the restrictions on physical contact adopted to contain the pandemic, digital working has gained in acceptance and significance. Cyber covers, digital services and products will therefore continue to make headway and innovative insurtechs will enjoy a surge in demand. In this context, Hannover Re is committed to partnership-based cooperation with its clients on the development of digital solutions as well as to supporting insurtechs with know-how and reinsurance backing.

In the second half of the year, a series of major loss events has occurred. The massive explosion in the port of the Lebanese capital Beirut at the beginning of August claimed numerous lives and caused severe devastation. Together with losses from natural catastrophes in the United States and Asia, large loss expenditure for the third quarter (excluding Covid-19) is therefore likely to remain at the anticipated level.

Bearing in mind the continuing considerable uncertainty surrounding the further course of the Covid-19 pandemic and the mechanisms through which government support measures make themselves felt, it is too early to provide any reliable profit guidance for the Group. Nor is it possible yet to precisely quantify the concrete effects of the pandemic on reinsurance markets and investments. Hannover Re makes the relevant scenario calculations on an ongoing basis as part of its risk management and will specify new earnings targets as soon as the underlying probabilities are sufficiently robust.

With its positioning as a reliable reinsurer with a long-term orientation, Hannover Re is a partner to its clients. The current market environment offers Hannover Re, with its consistent business approach and capital strength, attractive opportunities for further profitable growth and the continued expansion of business relationships. The company's broad range of products, its willingness to support new approaches to digital solutions and its focus on the customer will continue to generate increasing business opportunities in the near term.