Corporate news

Hannover Re expects further price increases next year

- **Large loss trend, pandemic and rising inflation require further improvements in prices and conditions**
- **Positive effect of higher interest rates on investment income will only be seen after a time lag**
- **Strong demand for coverage from particularly financially robust reinsurers remains undiminished**
- **Focus continues to be on long-term partnerships even in uncertain market conditions**

Monte Carlo, 12 September 2022: Against the backdrop of a trend towards more expensive large losses, Hannover Re expects further price increases and improved conditions in property and casualty reinsurance.

The first half of 2022 proved challenging for primary insurers and reinsurers alike. Soaring inflation, major losses and an accumulation of mid-sized frequency losses were as much a factor in property and casualty reinsurance as pandemic-related expenditures were in life and health reinsurance. When it comes to new investments or reinvesting activities there will be a time delay before higher interest rates have a favourable impact.

Yet all these challenges are dwarfed by the war in Ukraine and the associated human suffering. It is still too soon to make any reasonable estimate of the extent to which this may result in losses for the insurance industry.

"The inflation rates in many regions are higher than they have been in decades. Combined with the war in Ukraine and given that the pandemic has still not been overcome, this is fuelling the long-standing trend towards ever-higher loss burdens for insurers and reinsurers," said Jean-Jacques Henchoz, Chief Executive Officer of Hannover Re. "Further risk-adjusted rate increases in property and casualty reinsurance are therefore unavoidable. This is the only way for us, as a reinsurer, to continue to offer our clients reliable risk protection in an increasingly challenging market. In this context, an underwriting policy that emphasises quality is more important than ever if we are to preserve the profitability of our business."

Hannover Re continuously updates its inflation assumptions and includes these in its risk-adjusted pricing. Given that the inflationary environment is persisting longer than originally anticipated, due mainly to the war in Ukraine, additional adjustments will have to be made for future renewals. While the effects of inflation could already be felt in

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the previous year in connection with natural catastrophe losses, appreciable impacts are likely to be seen in other lines too going forward. When it comes to business interruption insurance, disruptions in supply chains are adversely affecting the availability of raw materials and construction materials, leading to longer repair times.

For the treaty renewals as at 1 January 2023 Hannover Re expects further price increases and improvements in conditions, not only in loss-affected lines and regions. Hannover Re sees a number of reasons for rising primary insurance rates including inflation and loss experiences and proportional reinsurance should benefit from that. There is considerably more ground to catch up in non-proportional reinsurance, and corresponding improvements of prices and conditions are therefore needed.

The capital adequacy ratio of Hannover Re in accordance with Solvency II amounted to 235.1% as at 30 June. Furthermore, the rating agencies attest to Hannover Re's very good financial strength. The company is rated "AA-" by Standard & Poor's and "A+" by A.M. Best. Both ratings have a stable outlook.

"Thanks to our excellent risk and capital management, Hannover Re offers reliably high-quality risk protection that is highly sought-after by our customers, especially in uncertain times," said Sven Althoff, member of Hannover Re's Executive Board with responsibility for property and casualty reinsurance. "Hannover Re is optimally positioned for the current market phase. Now as before, the redundancy level of our reserves is very robust. In order to ensure that this remains the case going forward and in light of the increasingly challenging conditions, we shall continue to put great emphasis on the quality of the business written."

Specifically, Hannover Re anticipates the following developments in the treaty renewals as at 1 January 2023:

Europe
In the space of roughly a week, a series of powerful low-pressure areas named "Ylenia", "Zeynep" and "Antonia" swept across northwest Europe and northern parts of central Europe in February of this year. According to the German Insurance Association GDV, the insured losses in Germany alone added up to around EUR 1.4 billion, making it one of the threemost severe winter storm events since 2002. Taken together with the extreme major losses of the previous year, the cost of which continues to rise in run-off due to persistent inflation, these events are having an impact on underwriting profitability in property and casualty reinsurance.

Insurance business in *Germany* has therefore already come under considerable strain in the current year due to catastrophe losses. In motor insurance the claims frequency – which had fallen in previous years owing to the pandemic – has largely normalised again. At the same time, the general rise in inflation further accelerated the long-standing trend towards higher costs for spare parts and repairs. Results in the motor line are therefore likely to take an appreciable turn for the worse.

In the area of cyber covers, the progressive march of digitalisation and sustained growth, in combination with more widespread cyber attacks, are leading to greater risk awareness as well as further price increases and improvements in conditions.

All in all, against the backdrop of heavy loss expenditures and persistently high inflation Hannover Re expects to see significant adjustments to conditions in property business in Germany, especially for catastrophe covers. In the high-volume motor line, adjustments are needed in response to sharply increased claims frequencies and amounts.

The primary insurance market in the *United Kingdom and Ireland* saw continued rate increases in 2022. While the potential for further price rises is limited in some liability lines, such as directors and officers insurance (D&O), rates in cyber business are still moving sharply higher. This can be attributed to, among other things, a tight capacity situation on the reinsurance market, where the growth in demand among primary insurers is outpacing the risk appetite. Outside the liability lines, rising inflation is also a major factor affecting property covers in both primary and reinsurance business. In UK motor insurance, which Hannover Re reinsures on an exclusively non-proportional basis in traditional business, the conservative approach to pricing and underwriting remains unchanged.

Insurance business in *France* has once again been notable for exceptionally high losses from natural catastrophe events in the current year. From the end of May until early July, heavy thunderstorms in many parts of France caused hail damage to vehicles and especially residential buildings. According to the French Insurance Association FFA, the insured losses could reach EUR 3.9 billion. Surging inflation in France will likely add to the expenditure. On the whole, this will probably be negatively reflected in the underwriting profitability of property and casualty reinsurance and a significant improvement in reinsurance prices and conditions can be anticipated.

In the markets of *Central and Eastern Europe,* the war in Ukraine had an appreciable effect on the region's economic development owing to its geographical proximity. As a sign of solidarity with Ukraine, Hannover Re continues to stand by its Ukrainian customers even in these difficult times and is upholding its coverage commitments. Only a small number of loss advices have been received from Ukraine so far. Renewals of treaties with clients in the Russian Federation and Belarus, however, have been suspended until further notice. In view of the challenging macroeconomic environment, Hannover Re anticipates further price increases and growth opportunities in Central and Eastern Europe.

North America

In contrast to Europe, North America was largely spared any exceptional large losses in the first half of the year and is showing strong underwriting profitability. At the same time, a sustained high level of inflation is to be expected with the associated economic challenges. Combined with a higher frequency of mid-sized losses, the future profitability of the property and casualty lines is therefore very much under pressure.

Industrial insurance continues to be heavily affected in the current year by disrupted supply chains due to the war in Ukraine and restrictions associated with Covid-19. The risks are considerable, and the actual losses cannot yet be foreseen, putting additional strain on profitability in this line.

The price increases obtained in the United States from earlier renewals have therefore continued. In this context, it should be noted that loss-free reinsurance treaties were also renewed with significant increases.

Against this backdrop, most market segments in North America remain attractive from the reinsurance perspective. In response, Hannover Re has continued to grow profitably in both property and casualty insurance. The biggest price increases recorded in the renewals during the year were for cyber and natural catastrophe covers.

From Hannover Re's standpoint, the challenging market conditions make further rate increases and limitations on the scope of coverage absolutely essential. In this environment the capital resources of reinsurers remain a point of emphasis, with the result that Hannover Re's position in this market will continue to strengthen.

Latin America

Latin America is slowly recovering from the pandemic and benefiting from vigorous economic growth in line with other countries that have bounced back to pre-Covid levels. Nevertheless, the pandemic has demonstrated the vulnerability of an economic system in which many people work in the informal economy and where social support programmes are few and far between. This is where insurers have a part to play in improving living conditions. One example here is the handling of the disastrous drought in the south of Brazil and Paraguay, where Hannover Re compensates impacted farmers and is thereby contributing to economic and social stability.

The impact of climate change is also evident in the heavy rainfall and floods across the entire region. Hannover Re consequently anticipates growing demand for catastrophe covers.

Asia-Pacific region

The APAC region remains the world's largest growth market and thus offers significant business opportunities. Given the comparatively low insurance density still seen in many markets, this is especially true for insurers and reinsurers. Hannover Re therefore continues to profitably grow its portfolio in the region.

In recent months APAC markets have faced numerous challenges. Along with pandemic-related problems affecting global supply chains, these included devastating natural disasters such as floods in Australia, earthquakes in Japan and typhoons. The historic scale of the destruction in Australia, combined with the growing inflationary trend, are reinforcing the need for further price increases across multiple lines of business.

For the upcoming rounds of renewals in the APAC region on 1 January 2023 and 1 April 2023, Hannover Re expects that the global trend towards market hardening will also extend to the Chinese market.

Natural catastrophe business

The trend towards more frequent and costlier natural disasters continued in 2021. While Hurricane "Ida" was the most expensive event, more than half of the worldwide losses resulted from more commonly occurring secondary perils such as severe convective storms, wildfires and extreme winter weather. With growing prosperity, greater urbanisation and progressive climate change, losses from natural catastrophes will likely continue to increase at a disproportionately high rate.

In response to the elevated loss experience, prices for catastrophe covers have risen steadily in recent years. This upward trend looks set to continue.

Going into 2023, Hannover Re anticipates the following developments in key markets for natural catastrophe risks – based on the assumption that there won’t be any further market-changing events this year:

North America: Tornadoes as well as hail, winds and precipitation from convective storms and severe thunderstorms have become one of the most crucial factors for the loss exposure of the insurance and reinsurance sector in the United States. Most notably, the market in Florida is facing particular challenges. Here, the combination of losses, reduced reinsurance capacity and – as Hannover Re sees it – historically underpriced business will challenge the sustainability of the business in the coming months. Hannover Re's appetite for risks in Florida remains underweight.

Inflation will play a major role in the renewals in 2023. This applies not only to the costs of losses that have to be settled. The anticipated sustained rise in inflation will also necessitate an expansion of the limits of liability. This is happening at a time when some providers are restricting their reinsurance capacity, especially for catastrophe covers. With this in mind, Hannover Re anticipates a robust suppliers' market and is looking for double-digit rate increases in 2023.

Europe: After a long period in which Europe was spared sizeable catastrophic events, the situation has changed in recent years. Losses and potential losses for programmes connected with Covid-19 were only marginally factored into the pricing because the scale of the losses and questions around coverage under the reinsurance treaties were still unclear. What's more, the considerable losses due to the increase in natural disasters, which made 2021 the most expensive year ever in Germany for natural perils business, will drive prices for European catastrophe business even higher in the current financial year. In February 2022, parts of Europe were again impacted by severe winter storms, and the latest hail events in France have further added to the loss expenditure. In conjunction with the general inflation estimate, it is Hannover Re's expectation that the overall costs for reinsurance will rise through a combination of rate increases and larger limit purchases.

Japan: After relatively little change in the 2022 renewals, cedants are expected to restructure certain programmes in 2023 so as to stabilise their total spending on reinsurance after a number of years of gradual rate increases. While inflationary pressure will likely be less on some programmes, many providers have revised their risk assessment after the latest series of typhoons. While Hannover Re expects the upward pressure on rates to be sustained, it will continue with its long-term focused and partnership-based approach.

Australia/New Zealand: Devastating flooding on a historic scale has hit the Australian market this year. The spring floods in southeast Queensland and coastal areas of New South Wales were the most expensive in the country's history. These events were preceded by a series of significant major losses in prior years. Further material price increases are therefore needed, not least because insurers and reinsurers are well aware of the fact that the region of Australia and New Zealand is particularly susceptible to natural disasters that are accentuated by climate change, such as hail, floods, droughts and bushfires.

Specialty lines

In *aviation business,* the lifting of many measures put in place to fight the pandemic contributed to an initial recovery in passenger numbers, with positive implications for the premium volume. The resumption of operations presented the sector with logistical challenges, although these did not result in higher loss expenditure. On the other hand, lease arrangements with Russian airline companies have been affected by the war in Ukraine and associated sanctions, giving rise to new coverage issues between insurers and policyholders. It is important to closely monitor these discussions and keep in close dialogue with customers.

Similarly, *marine business* is also seeing a normalisation of global trade flows. Here, too, delays are still being experienced, among other things in connection with the loading and unloading of vessels due to a shortage of personnel. This is not, however, expected to result in significant expenditure for Hannover Re. On the other hand, the marine market may also be affected by the war in Ukraine. For example, there is a potential for losses in connection with merchant vessels, some of which are still being detained. In addition, possible losses from covers for political violence, which in some cases are reinsured in the marine market, have the potential to adversely affect the performance of Hannover Re's book of business. On the marine side this is predominantly written on a non-proportional basis.

Since the outbreak of the war in Ukraine, Hannover Re has agreed far-reaching exclusions in its treaties as part of both the aviation and marine renewals. Among other things, it was important to protect the portfolio against any expansion of the war going forward, even if this meant relinquishing business.

For the various rounds of treaty renewals in 2023, Hannover Re anticipates rising prices as well as some restructuring of reinsurance programmes in both aviation and marine business.

Loss ratios in *credit and surety insurance,* as well as in the area of political risks, have remained stable compared to previous years and are still below average. Increasing loss expenditure is to be anticipated in the coming months as a consequence of the war in Ukraine, persistent supply bottlenecks, surging energy prices, inflation and higher interest rates. With this in mind, the price level in primary insurance and reinsurance business should largely be maintained.

When it comes to *agricultural risks*, demand for insurance and reinsurance solutions continues to grow. Hannover Re offers not only traditional reinsurance solutions, but also innovative insurance tools such as parametric covers. Nevertheless, last year's enormous losses due to the drought in the south of Brazil once again highlighted the consequences of climate change. Improving profitability on both the insurance and reinsurance side is vital to sustainable development of the market for agricultural risks. The rising exposures must therefore be clearly reflected in rate movements.

Hannover Re’s *insurance-linked securities (ILS)* business enjoyed a banner year in 2021 and transferred catastrophe bonds worth more than USD 2.7 billion, spread across 11 issuances, to the capital market for its clients and thus booked a record volume. Covers were placed against losses from natural catastrophes including floods, windstorms, earthquakes and wildfires. Business was similarly boosted year-on-year in collateralised reinsurance, which remains the largest ILS segment.

The ILS market volume in 2022 appears to be holding steady overall, with both inflows and outflows of cash evident. Hannover Re will be able to continue the expansion of its collateralised reinsurance business. The further involvement of the capital market in financing transactions on the life (re)insurance side is also a highly gratifying development.

Business in the area of *structured reinsurance* is seeing sustained demand, from which Hannover Re is able to benefit thanks to its leading market position. Given the current state of the market and its numerous challenges, Hannover Re's innovative and tailor-made reinsurance solutions with a focus on capital management are particularly sought-after. In addition to the traditional clientele of primary insurers, structured reinsurance is generating growing demand among large corporate groups and their in-house captives. The premium volume booked by Hannover Re has now reached roughly EUR 4 billion. The transactions are, however, normally high-volume in nature, and this business can exhibit relatively extreme fluctuations. Since the somewhat lower margins are offset by significantly lower capital requirements, structured reinsurance continues to offer significant potential for profitable growth.