Hard / Soft Market

By
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Agenda

- Insurance cycles for the last 40 years
- Where are we in the underwriting cycle?
- What characterizes/influences changes in the cycle?
- What has happened in the last couple of years?
- What are/will be the triggers for the next upturn in the market?
We all know that...

- Soft Market, premium rates are stable or falling and coverage is readily available.
- Hard Market, premium rates significantly increase and less coverage is available.
- The movements between one and other cannot be fully explain by the traditional standard economic models.
A look at the past 40 years

- A good measure of profitability in Insurance from **Investment and Underwriting activities** is the RoE (net gain from operations divided by its adjusted surplus)
- For investment activities, 10yr treasury rate is a reference parameter
- The ongoing low interest rate in the foreseeable future will put pressure on companies’ earnings, premium rates & product pricing
- As the investment income is already low, **insurers must be able to make an attractive underwriting profit.**
Where are we in the underwriting cycle

Combined Ratio

Market softening begins
Peak market profitability
Party is over, losses becoming the norm

Source: Lloyds, III, AM Best
What has happened in last couple of years

• There are still prior year releases, but they’re running out fast...

Source: AM Best & Barclays Capital
What has happened in last couple of years

1) Global Cost for CAT losses, around $107Bn (AON Benfield).

2) Bear in mind not all types of CAT events are modeled (flood)

3) Increased focus on modeling and influencing prices

4) Clients continuing to evaluate retentions / risk transfer resulting in less of a premium pool to pay losses
• Premium eliminated from the market
• Trend will continue
What has happened in last couple of years

- 2001-2 saw weak investment performance, 2011-12 could look similar. Deutsche Bank sees today’s low interest rate environment causing the lowest margins for 30 years.

Source: ISO, Insurance Information Institute
What will be the triggers for a hard market

- Poor accident year loss ratios → increasing
  - Willis Energy Loss Database indicates that the energy industry has recorded its worst ever year for non-windstorm losses
  - The sector continues to feel the impact of recent natural catastrophe and mining losses far more keenly than the upstream sector, and there can be little doubt that recent events, including the tragic flooding losses in Thailand, have had a more significant effect on market conditions – Willis Energy Review

- Prior year reserve shortfalls → burning fast

- Poor investment climate → worst ever

- Withdrawal/destruction of surplus capital → beginning to occur
  - There is now as much officially stated capacity in the International area as there was at the height of the “great soft market” of 1997-2001 (although the reinsurance market capacity to protect this portfolio is nowhere near as robust and competitively priced as it was 12 years ago) – Willis Energy Review
“Hardening Triggers”

- Natural Catastrophes
- Second worst year for natural disasters
- Worst 12 months ever for Lloyds
- Surplus capital burned off by attritional and/or CAT losses
- Regulatory requirement Models
- Prior year deficiencies
“Hardening Triggers”

- Combined ratios for Energy Insurance market above 100%
- Lines cut, capacity restricted
- Coverage restrictions, contraction in limits?
- Business Interruption? No more surprises - WTI/BRENT Spread
- Reinsurance costs increasing average up 10% plus
“Hardening Triggers”

- Need to differentiate risk
- CAT / Non CAT exposures
- Focus on supply chain management
- Loss affected accounts – higher rate movements
- Rate increases spread across all clients – with obvious differentiation
- Management has every line of business under a microscope
- Market in a “hardening phase” – What next??