Global (re)insurers' H1 2022 financial results

Underwriting performance remains strong, but ROE and shareholders' equity impacted by investment markets

Gallagher Re

Strategic & Financial Analytics

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Key themes from Q2 and H1 global (re)insurance results[1]

- Premium growth averaged 12% in H1, supported by continued favourable pricing for commercial lines and reinsurance business.
- H1 underwriting results remained strong with a 94.1% combined ratio (H1 21: 93.8%), supported by higher premiums, lower natural catastrophe loss impact, higher prior year reserve development, and a lower expense ratio. These positive factors were offset by a higher attritional loss ratio.
- Unrealised investment depreciation contributed to a drop in average ROE to 9.3% at H1 (H1 21: 13.9%).
- European solvency improved to 235% (H1 21: 222%), supported by rising risk-free interest rates and retained profits.
- Shareholders' equity reduced by an average of 22% in H1, driven by lower market values of bonds and equities held by global (re)insurers.
- Consensus 2023 earnings per share (EPS) estimates were broadly flat following H1 results.
- Additional analysis: Our annual review of reserve adequacy for five US long-tail lines of business shows that workers' compensation continues to show strong redundancy. The remaining four lines are positioned close to reserve adequacy.

Robust premium growth continued in H1

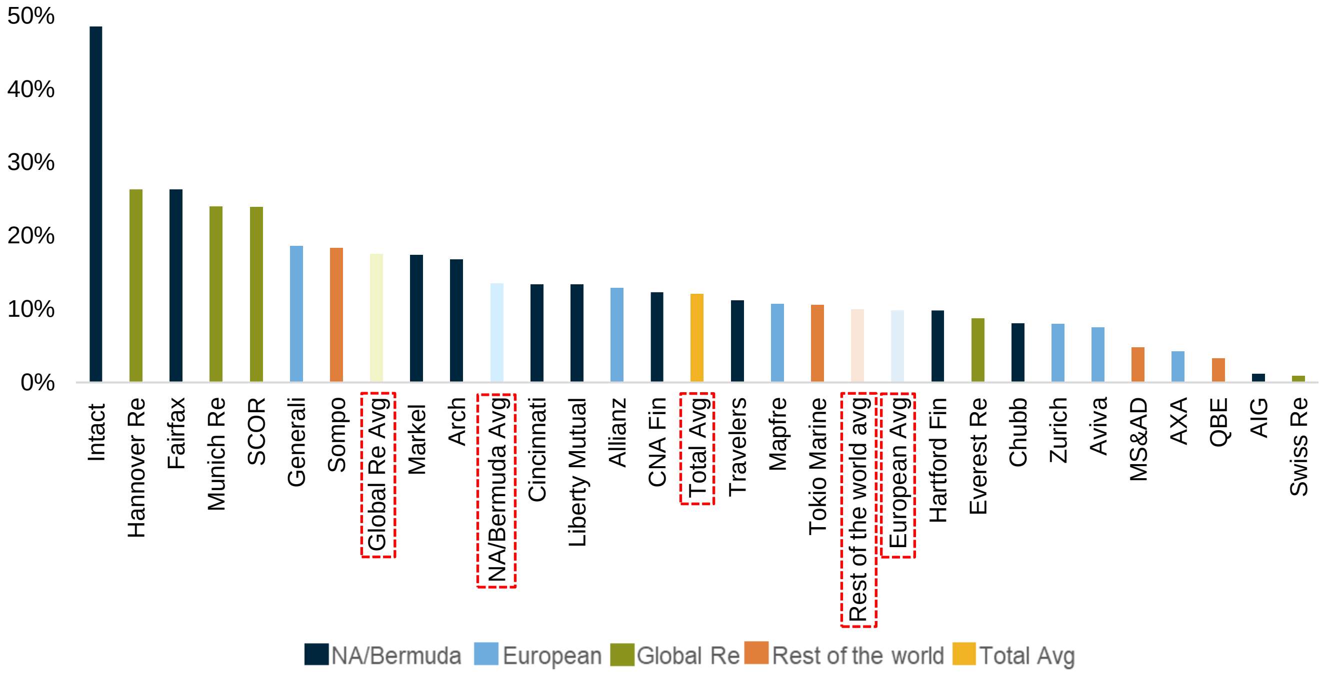
The (re)insurers which we track reported average premium growth of 12% in H1, with the strongest increases coming from the Global Reinsurers (+18%) and North American and Bermudan (re)insurers (+14%). Intact's 49% increase in premium at H1 reflected its acquisition of RSA's Canadian and UK operations and organic growth driven by commercial lines.

Continued pricing gains for commercial lines business remained the key driver of premium growth in Q2. Apart from Swiss Re which was down 4%, all companies we track showed a year-on-year increase in premium. Additionally, Q2 premium increases tended to be higher than those in Q1. During Q2, 9 of the 25 companies in our data set reported a greater than 20% premium increase year on year, versus just 5 of 25 at Q1.

Some management teams commented they expect commercial premium increases to continue to outpace loss cost trends into 2023. While that is positive, and a trend that has continued for some time, the next section of this report will note that the average attritional loss ratio this quarter ticked up by 1 percentage point versus the prior year.

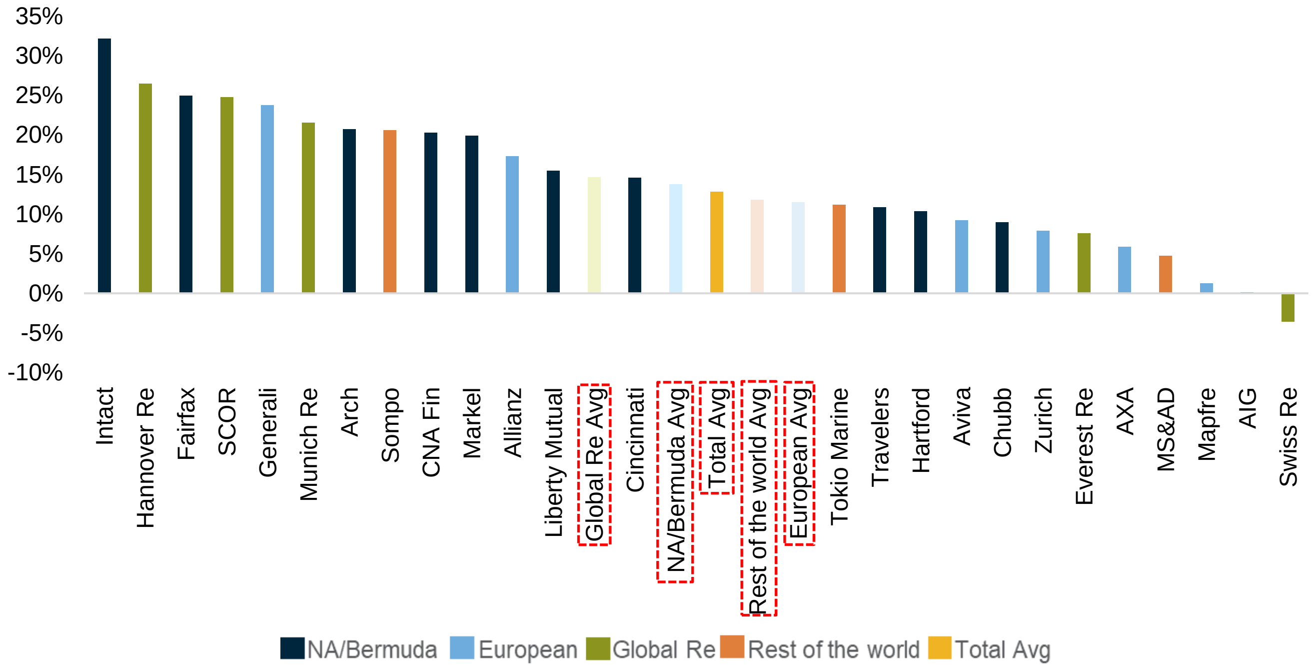
[1] We track the biggest (re)insurers globally who have meaningful commercial lines or reinsurance operations. Unless otherwise indicated, we are referring to the January-June 2022 period.

Growth in P&C premiums – H1 2022 vs H1 2021[2]



Source: Company disclosures, Gallagher Re

Growth in P&C premiums – Q2 2022 vs Q2 2021[3]



Source: Company disclosures, Gallagher Re

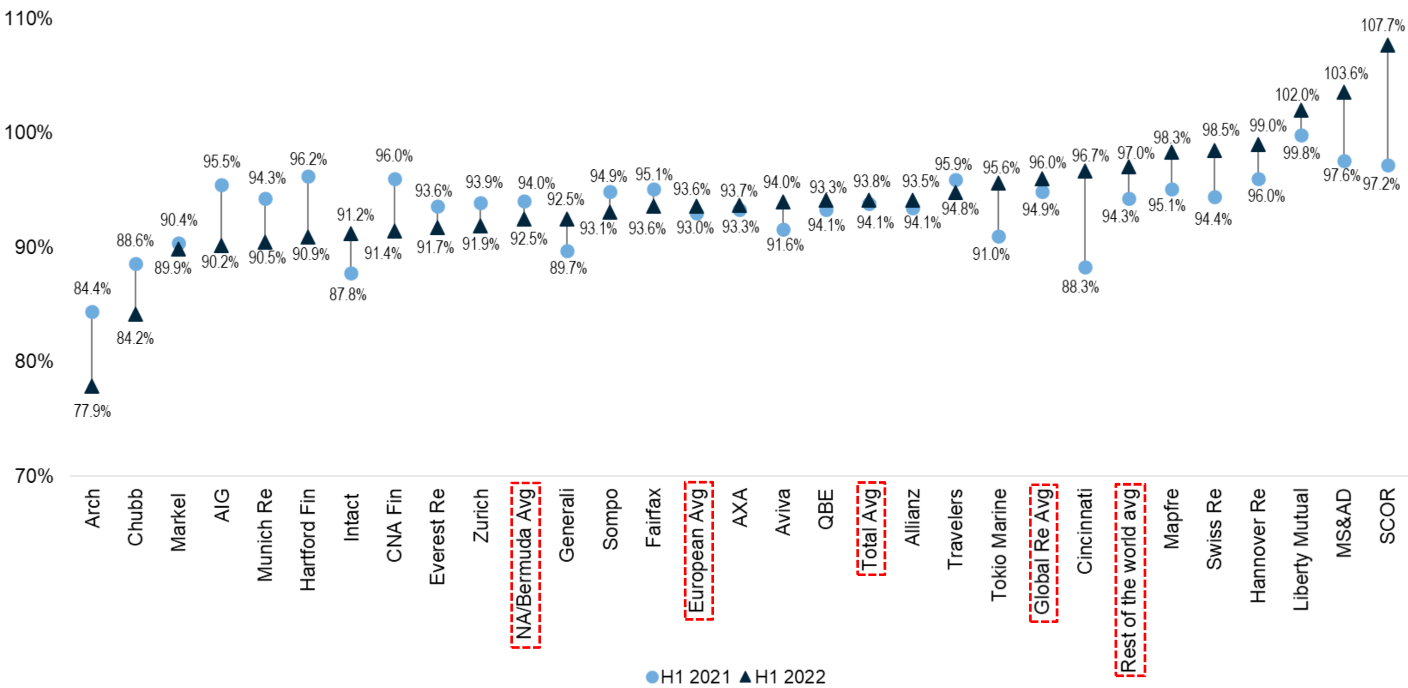
[2] Premiums are P&C net premiums written, except as follows: for Mapfre, Munich Re, Swiss Re and QBE, premiums are net earned premium; for Aviva, Generali and Zurich premiums are P&C segment gross premium written; and for AXA, premiums are gross revenues. MS&AD, Sompo and Tokio Marine figures have been re-calendarised.
[3] Excludes QBE

Strong underwriting results in Q2, with challenges ahead

H1 2022 underwriting results, as was the case in Q1 and H1 2021, were exceptionally strong with an average combined ratio of 94.1%, with all but three (re)insurers posting a sub-100% combined ratio. This level of profitability is broadly in line with the 93.8% from H1 2021, supported by the above noted 12% growth in H1 premium, lower natural catastrophe loss activity (partly due to a lighter Q1 compared to the Texas Freeze affected 2021), higher prior year reserve development, and a lower expense ratio. These positive factors were offset by a higher attritional loss ratio, due in part to a rise in personal lines loss trends.

Although not a significant driver of overall H1 results, some (re)insurers established reserves for claims exposure relating to the war in Ukraine. Significant uncertainty remains around ultimate loss estimates and we will continue to monitor these exposures as claims emergence becomes clearer.

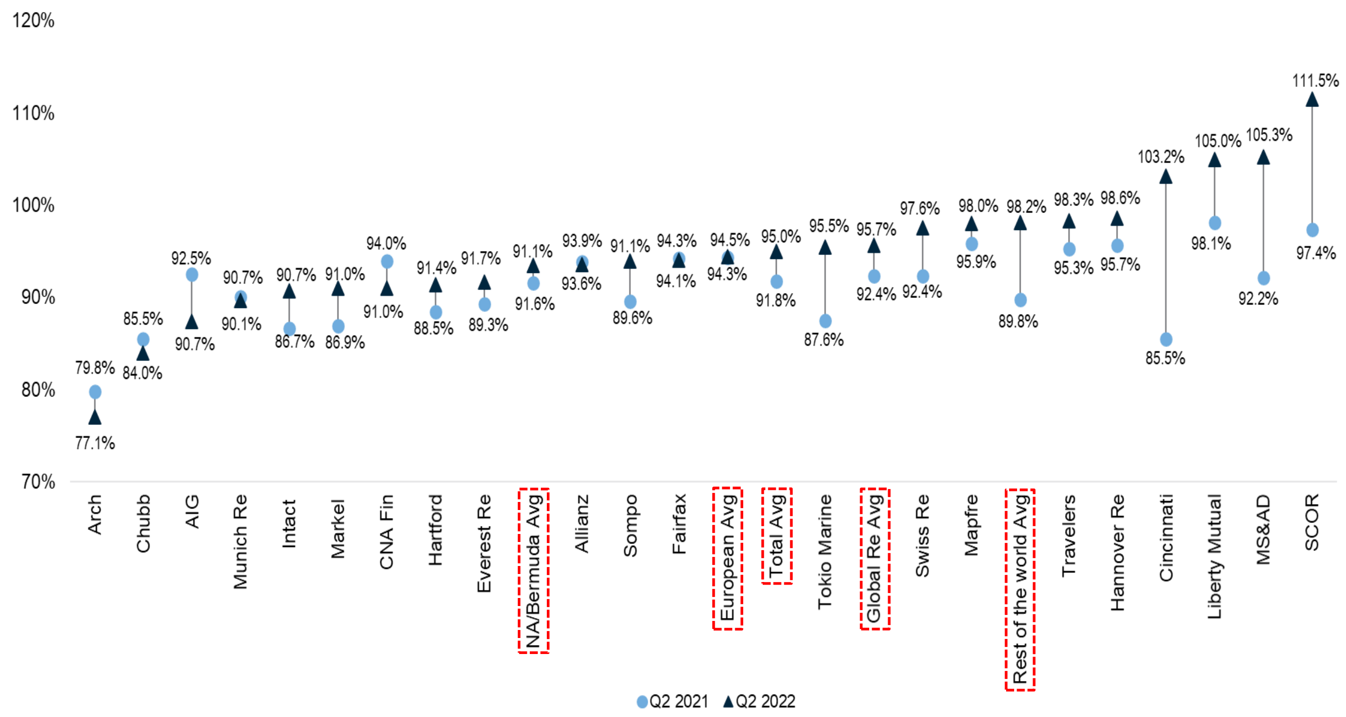
Combined ratios – H1 2022 vs H1 2021[4]



Source: Company disclosures, Gallagher Re

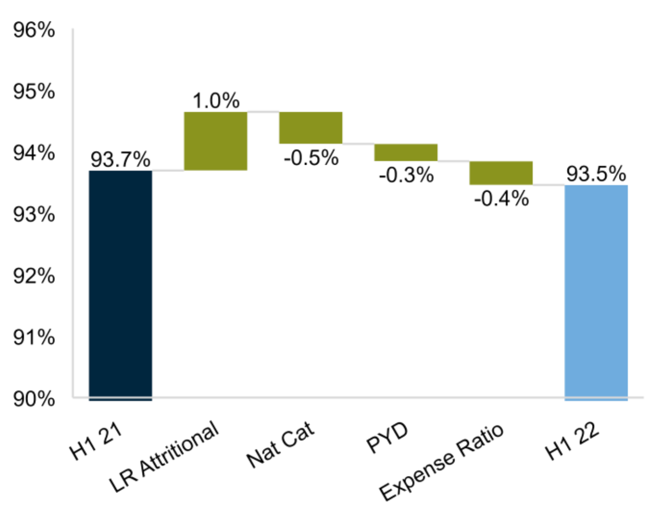
[4] Combined ratios are: P&C reinsurance segment for Munich Re, Swiss Re, Hannover Re, Everest Re, and SCOR; general insurance for Aviva; domestic and international re-calendarised figures for Sompo and Tokio Marine; domestic and MS Amlin re-calendarised figures for MS&AD.

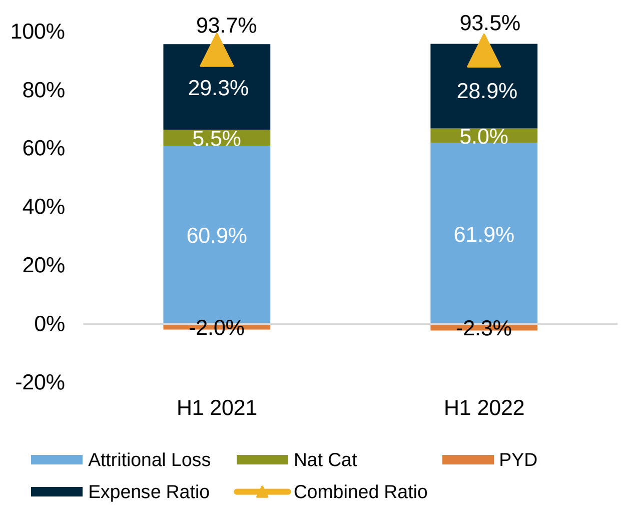
Combined ratios – Q2 2022 vs Q2 2021[(4)(5)]



Source: Company disclosures, Gallagher Re

Combined ratio components – H1 2022 vs H1 2021[6]

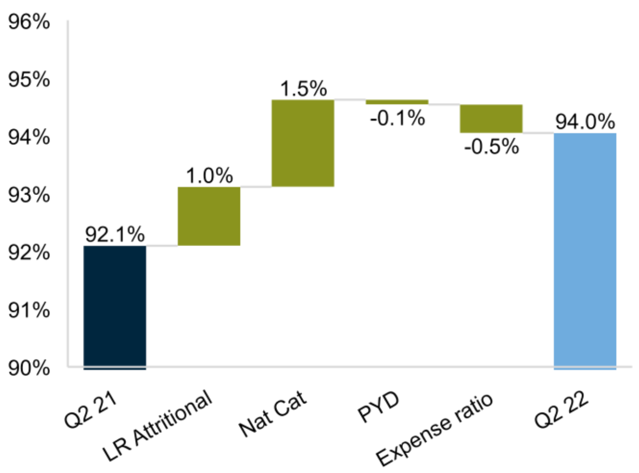


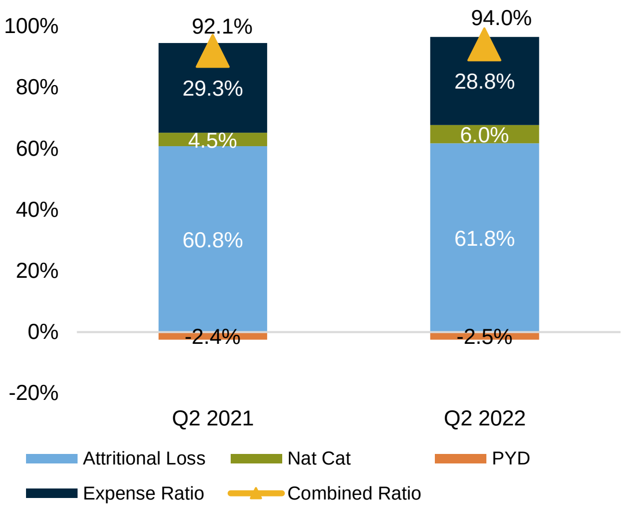


Source: Company disclosures, Gallagher Re

[5] Excludes Aviva, AXA, Generali, QBE, Zurich
[6] Relates to the subset of companies which provides relevant disclosure on combined ratio components. The subset excludes Aviva, Mapfre, Tokio Marine, Sompo and MS&AD.

Combined ratio components – Q2 2022 vs Q2 2021[7]





Source: Company disclosures, Gallagher Re

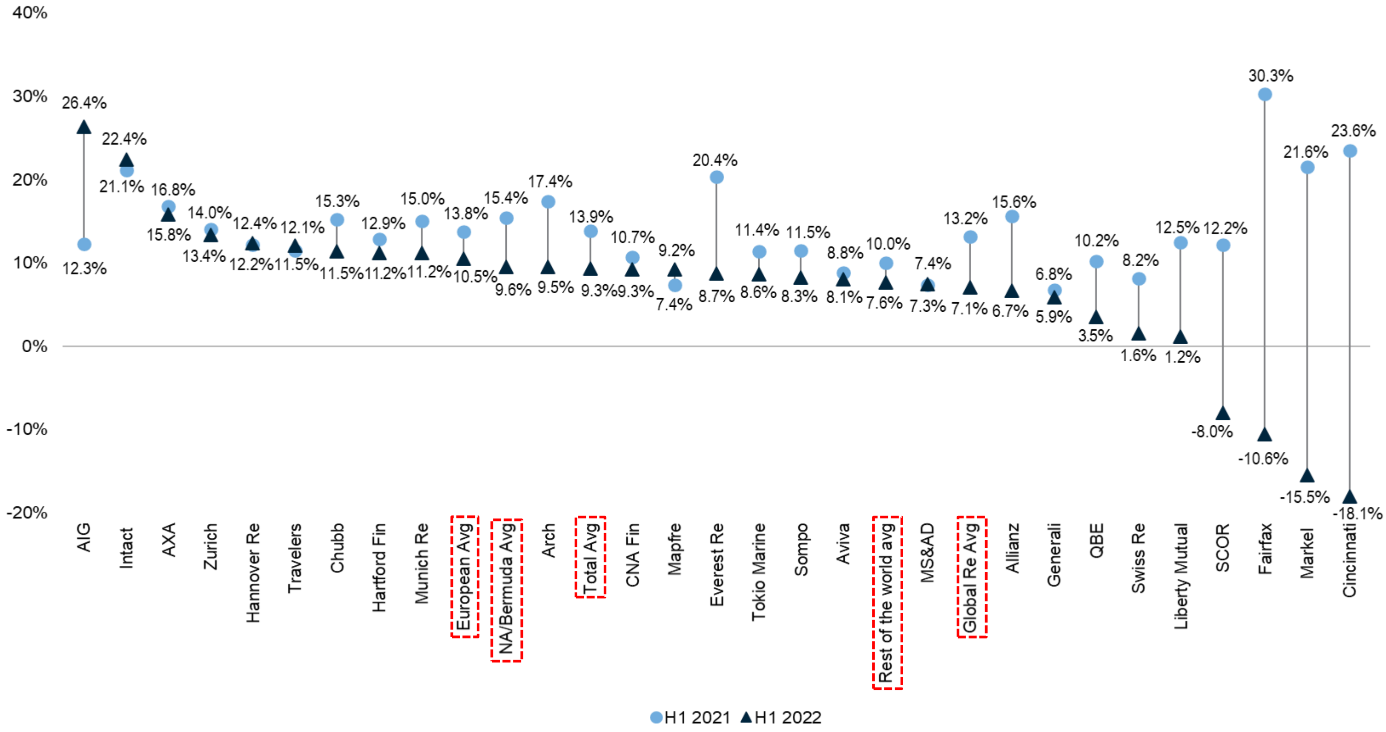
H1 22 average ROE impacted by unrealised investment depreciation

The average ROE reduced to 9.3% at H1 (H1 21: 13.9%), pulled lower by all segments. This was most notable at certain North American/Bermudan (re)insurers for which, under US GAAP, significant unrealised investment depreciation flowed through the P&L. This was the main driver of the net losses reported by Markel, Cincinnati and Fairfax.

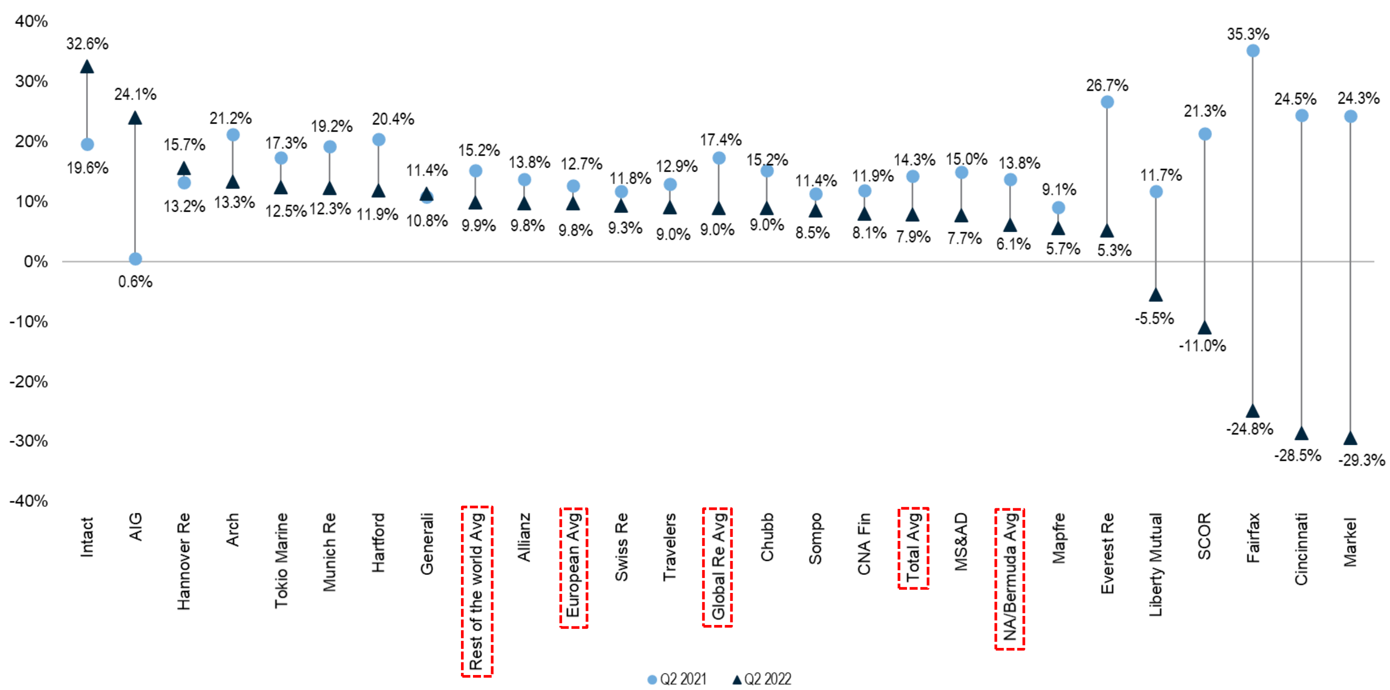
AIG, Travelers and Intact reported higher ROEs, supported by continued strong underwriting profitability, particularly for commercial lines business, and higher realised investment gains in the case of AIG.

[7] Relates to the subset of companies which provides relevant disclosures on combined ratio components. The subset excludes Aviva, AXA, Generali, Mapfre, MS&AD, QBE, Sompo, Tokio Marine and Zurich.

Return on Equity – H1 2022 vs H1 2021



Return on Equity – Q2 2022 vs Q2 2021[8]



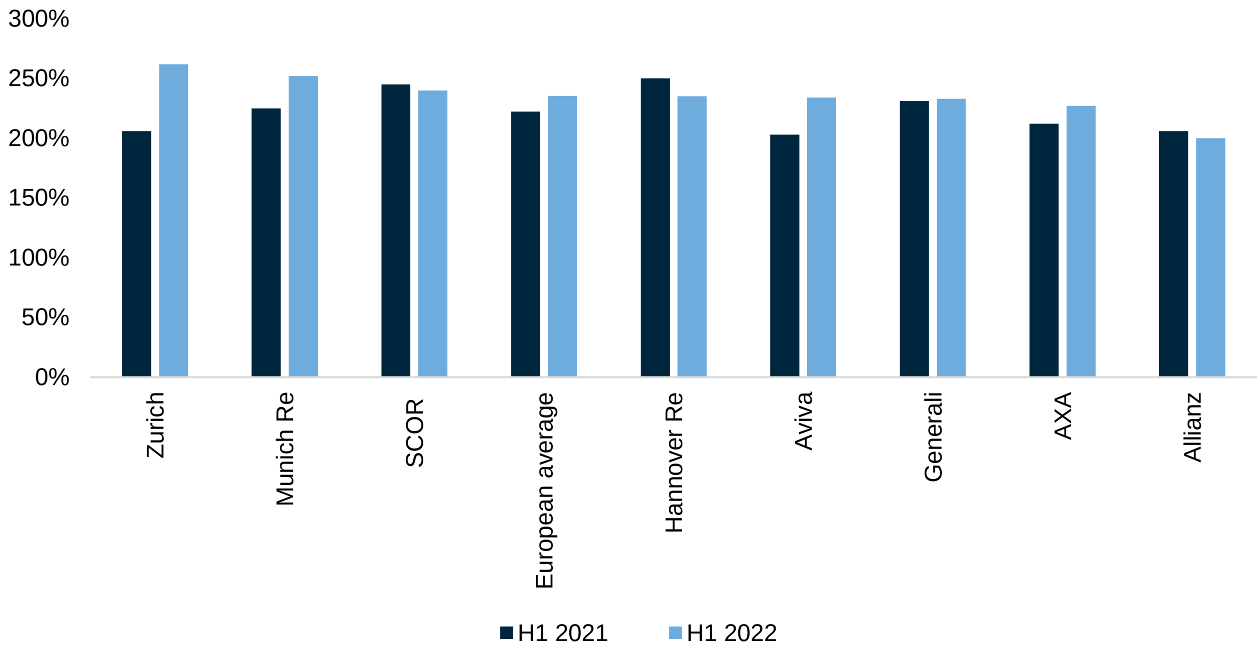
[8] Excludes AXA, Aviva, QBE and Zurich

Capital positions in Europe strengthened further in 2022

Average solvency for the European (re)insurers we track improved to 235% (H1 21: 222%), supported by rising risk-free interest rates and retained profits[9]. This level of sector solvency is comfortably above the c.200% upper end of guidance levels, providing a buffer to absorb potential market volatility and earnings shocks, and a strong base for capital returns.

European (re)insurers continue to reposition their ALM strategy in respect of rising interest rates by generally lengthening durations and making use of hedging instruments. European (re)insurers remain most sensitive to risk free rates, followed by sovereign bond spreads.

European solvency ratios – H1 2022 vs H1 2021[10]



Source: Company disclosures, Gallagher Re

Shareholders' equity falls at H1 driven by reduced asset values

Shareholders' equity reduced by an average of 22% in the first half of 2022. All the segments which we track declined, with Europeans (-28%) and Global Reinsurers (-25%) dropping most significantly.

The main driver of this decline was a rise in interest rates which resulted in lower market values of bonds and equities held by global (re)insurers. The most impacted companies are those with long duration bond portfolios and high allocation to equities. Capital return through dividends and buybacks also contributed, albeit less significantly, to lower shareholders' equity.

It is worth noting the contrast between capital on an accounting basis and capital adequacy on an economic basis. As noted above, average European solvency has increased at H1 despite significant decreases in shareholders' equity.

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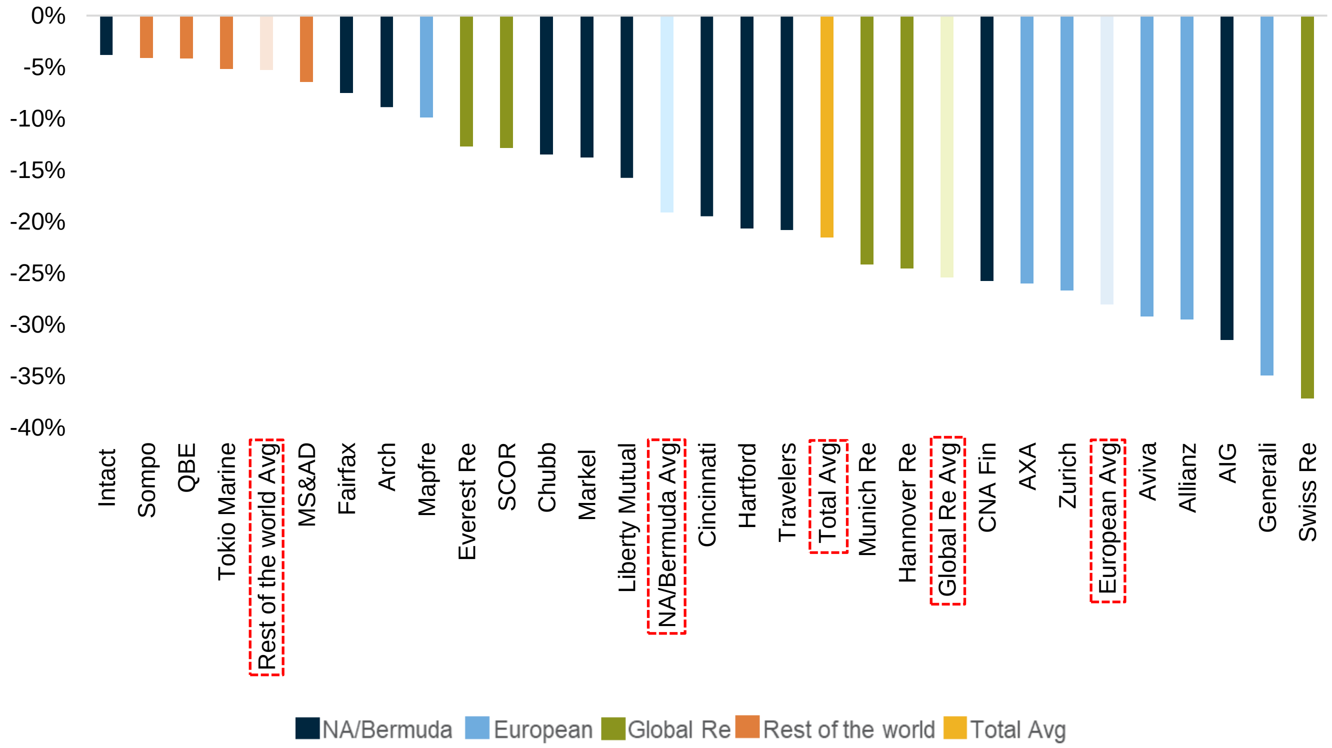
[9] Rising risk-free rates result in higher solvency ratios as the reduction in liabilities, which are discounted at risk-free rates under Solvency II, exceeds the reduction in bond portfolio values. Similarly, the main driver of the large increase in Zurich's SST coverage ratio was rising interest rates.
[10] Coverage ratios are on a Solvency II basis other than for Zurich (SST basis).

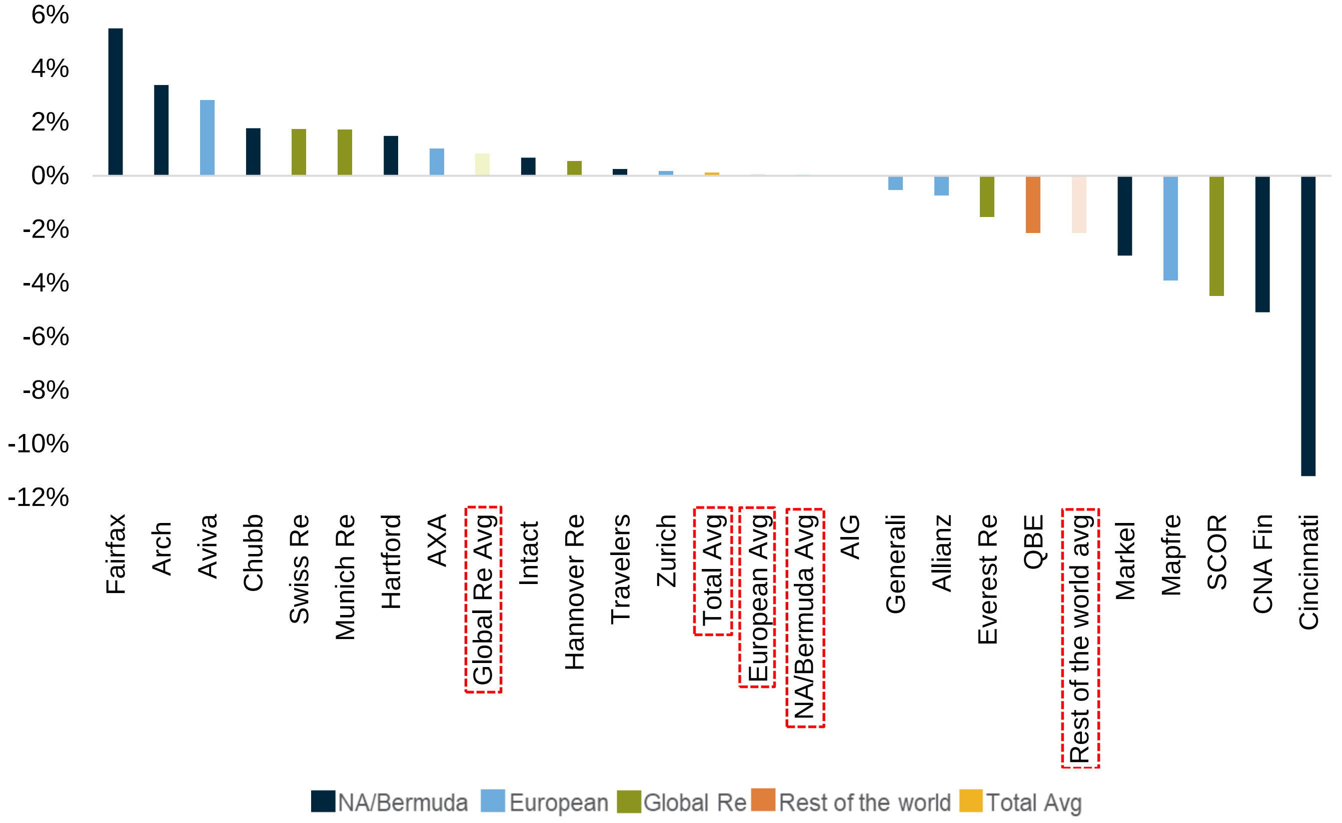
Shareholders' equity – H1 2022 vs Q4 2021



Consensus EPS estimates broadly flat as inflationary concerns continue to weigh

Consensus 2023 earnings per share (EPS) estimates were broadly flat following Q2 results. Estimates were pulled lower by downwards revisions for several companies due to factors which included investment driven losses, inflationary headwinds, higher than expected natural catastrophe losses, and adverse reserve development. Trends in inflation relative to pricing remained a key concern for analysts, particularly for personal lines business. Continued strong premium growth and technical profitability for commercial lines business, along with improved reinvestment rates, supported several upwards revisions.

Change in consensus 2023 EPS estimates[11]

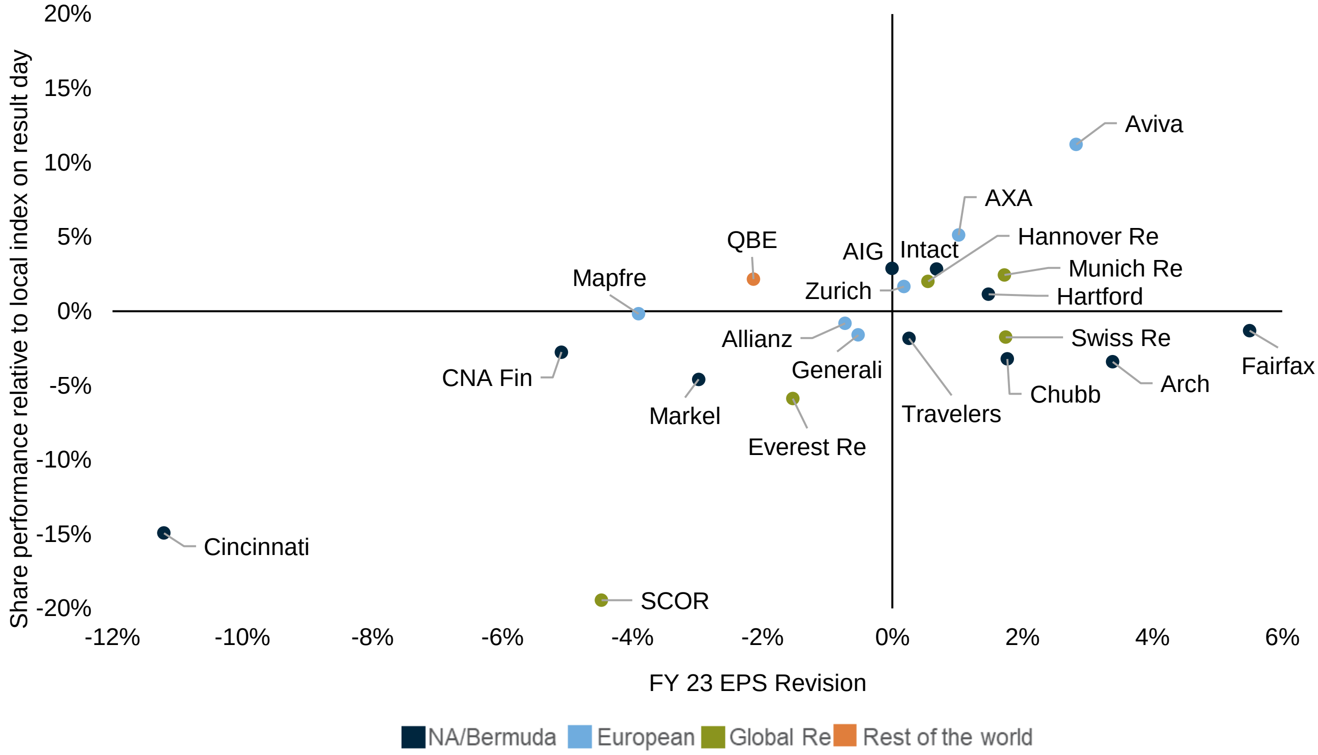


Source: Capital IQ

Share performance on results day relative to an insurer's local index is generally well correlated to EPS revisions. At H1 this was the case for both SCOR and Cincinnati whose share prices dropped following underperformance and downwards EPS revisions. On the positive side, AXA and Aviva had strong relative share price performance following well received results and an upwards EPS revision. The trend isn't perfect of course and share prices for some companies decreased relative to their local index despite strong results and raised EPS estimates.

[11] FY 2023 consensus EPS estimates are sourced from S&P Capital IQ. Pre-Release and post-release estimates are one day before results and five days after, respectively. Excluded companies are Tokio Marine, MS&AD, and Sompo.

Relative share price performance vs EPS revisions[12]



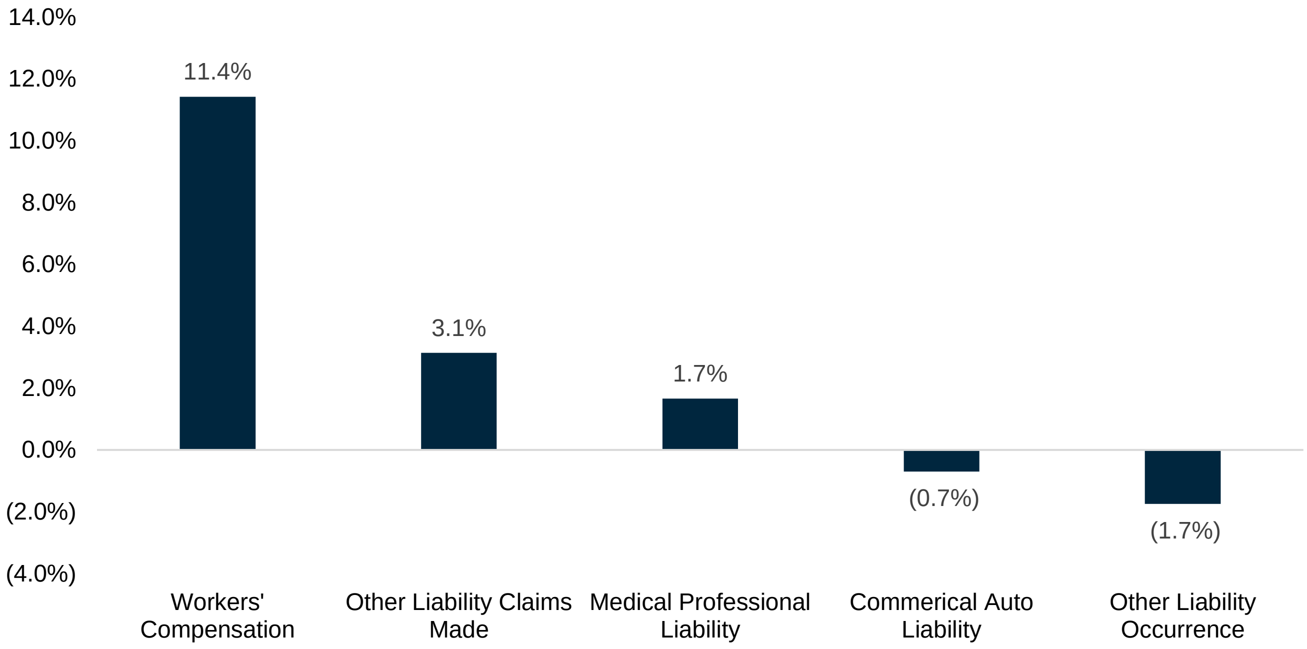
Source: Capital IQ

Additional analysis: Annual review of reserve adequacy for major US long-tail lines

With inflation in the headlines, external stakeholders are focused on the sustainability of reserve releases to contribute to earnings. As such, on an annual basis Gallagher Re assesses the reserve adequacy across five major long tailed Schedule P lines of Business: Workers' Compensation, Other Liability Claims Made, Medical Professional Liability, Commercial Auto Liability, and Other Liability Occurrence. From our analysis we concluded that there was a slowdown in claims reporting because of the Covid-19 pandemic and subsequently adjusted our ultimate loss estimates. With the adjustment we produced the following results.

[12] Consensus EPS estimates used are five days after results versus one day prior. Local indices used: S&P 500 for Chubb, AIG, Travelers, Liberty mutual, Hartford, CNA, Cincinnati, Markel, Arch, Everest Re; S&P/TSX for Fairfax and Intact; STOXX Europe 600 for Allianz, Aviva, AXA, Generali, Mapfre, Zurich, Munich Re, Swiss Re, Hannover Re, and SCOR; Australian 200 for QBE.

Redundancy/(deficiency) as % of held reserves



Workers' Compensation continues show a strong redundancy which is consistent with past years' evaluations. This redundancy has consistently helped push calendar year loss ratios to stay profitable. This redundancy will also help threats going forward with uncertainty in how general inflation may affect medical inflation in the long term.

The remaining four lines are positioned close to reserve adequacy. As such, 2022 industry calendar year loss ratios are more likely to be driven by 2022 accident year loss ratios, than by prior year reserve development as has been the driver in the recent past. Both Commercial Auto Liability and Medical Professional Liability have struggled with profitability in more recent years while Other Liability Claims Made and Occurrence have been able to achieve significant rate increases putting both in a better accident year position. In the absence of significant reserve redundancies, increased medical inflation could have a pronounced adverse effect on Commercial Auto Liability, Medical Professional and Other Liability – Occurrence.

Please reach out to Adam Carvalho, Adam_Carvalho@ajgre.com for more information on this reserve study.

How can we help?

Gallagher Re's Strategic & Financial Analytics teams advise clients on strategic and capital management issues. To find out more, please contact your local client advocate or reach out to our specialists.

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