Moody's INVESTORS SERVICE

SECTOR IN-DEPTH
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Reinsurance – Global

Weak half-year earnings highlight uncertainties around coronavirus claims

Summary

Global reinsurers reported weak earnings for the second half of 2020. Although investment returns recovered in the second quarter, pandemic-related claims increased at most companies, driving the average combined ratio to 102.8% for the half-year, from 92.8% in the first half of 2019. Strong pricing momentum is a bright spot and capital remains healthy; however, a high degree of uncertainty remains around future coronavirus claims, particularly in life insurance. Reinsurers are also contending with an active hurricane season and ultralow interest rates.

Coronavirus-related claims rise significantly in Q2. Although the first six months had lower global natural disasters compared to the 10-year average, reinsurers reported significantly higher pandemic-related claims, particularly in non-life business lines, mostly due to reserves for claims incurred but not reported (IBNR). Our reinsurance cohort reported coronavirus-related claims of $8.6 billion for the first half of 2020 including $7.6 billion from non-life and $1 billion from life compared to around $3.1 billion in the first quarter.

Pandemic-related non-life claims rise significantly, ongoing uncertainty around business interruption. There was significant variation in pandemic-related claims between individual insurers, with the large multi-line reinsurance groups typically hit the hardest. Travel insurance and event cancellation claims rose substantially over the six months**,** while business interruption claims and litigation started to arrive in the second quarter**.** Business interruption is the most hotly contested line of business and uncertainty around claims remains high as policy forms and contract litigation vary by country.

Life earnings weakened in the second quarter with more claims to come. A significant time gap between claims occurrence and claims reporting has created uncertainty for reinsurers. Lack of data hampers the firms' ability to identify coronavirus-related mortality claims, with many firms using excess mortality as a gauge. We expect mortality rates in the insured population will fall short of that for the general population because of risk selection as part of medical underwriting.

The positive pricing environment is a singular bright spot. Pricing momentum is positive across the board due to rising demand and constrained supply, with rate increases varying by line of business. On a risk-adjusted basis, more rate increases are needed, particularly on casualty business given rising loss cost trends and low interest rates. The average capital base has recovered in the second quarter and some companies are strengthening their capital to take advantage of prospective growth opportunities.

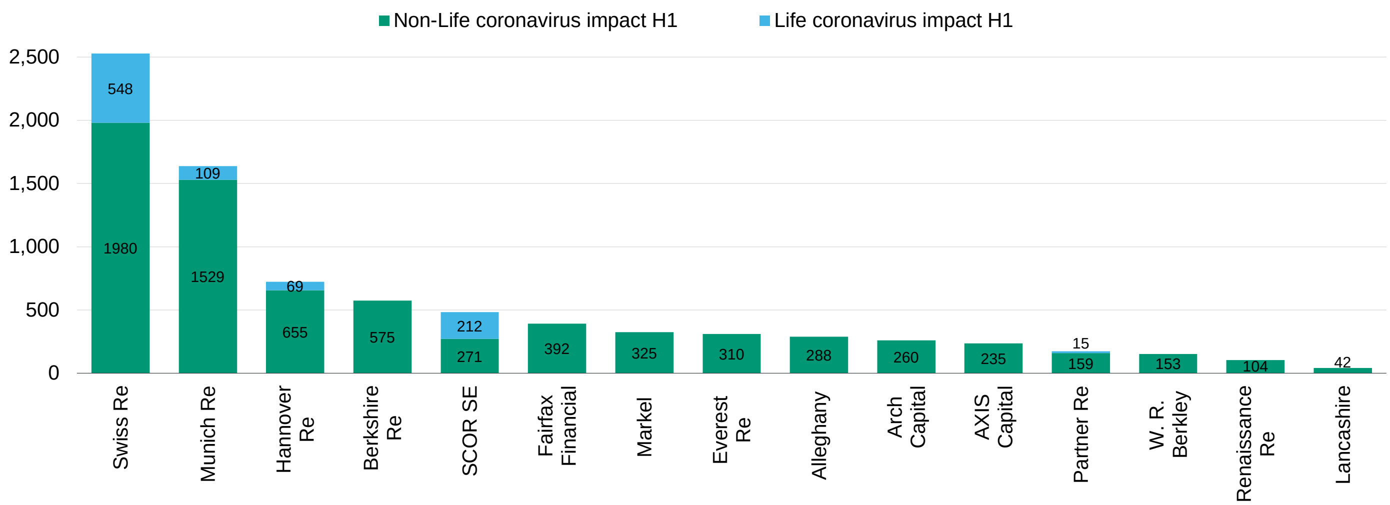
Coronavirus-related claims rise significantly in Q2

Although financial markets recovered in the second quarter and natural and man-made disasters were below the 10-year average, global reinsurers reported weak earnings for the first half of 2020 as pandemic-related claims increased significantly in the second quarter. For our cohort of reinsurers, pandemic-induced claims amounted to $8.6 billion during the first six months of 2020 (Exhibit 1) comprised of $7.6 billion in non-life claims, which added 10 percentage points to the average reported combined ratio. Companies with life reinsurance operations reported $1.0 billion in losses from their mortality books, mostly stemming from the US and the UK. This compares with zero or minimal losses in the first quarter.

Exhibit 1

Pandemic-related losses rise significantly in Q2

First half losses by reinsurer ($ millions)



Reported € figures have been converted into $
Source: Companies' financial reports, Moody's Investor Service

Swiss Re indicated that coronavirus-related insured losses could total between $50 billion and $80 billion globally while other insurers said that it will be 'one of the biggest insured losses in history'. Significant uncertainty remains around the further trajectory of claims, both in non-life and in life reinsurance.

Pandemic-related non-life claims rise significantly, ongoing uncertainty around business interruption

Our cohort of reinsurers reported weak net income of $1.7 billion in the first half of 2020 compared to almost $16 billion in the prior year period (Exhibit 2). The P&C (non-life) sector reported significant additional coronavirus-related claims in the second quarter with the majority of the estimates for incurred but not reported claims and, to a lesser extent, case reserves. Paid claims remain low. Although the equity markets rebounded in the second quarter of 2020 and credit spreads tightened, some reinsurers such as Fairfax Financial and Markel reported significant unrealised losses on their equity portfolios.

In addition, global insured natural disaster and man-made losses totaled $31 billion in the first half of 2020, higher compared to $23 billion in the prior year period but below the 10-year average of $36 billion according to Swiss Re Institute.

Exhibit 2

Net income recovers in Q2 but remains weak

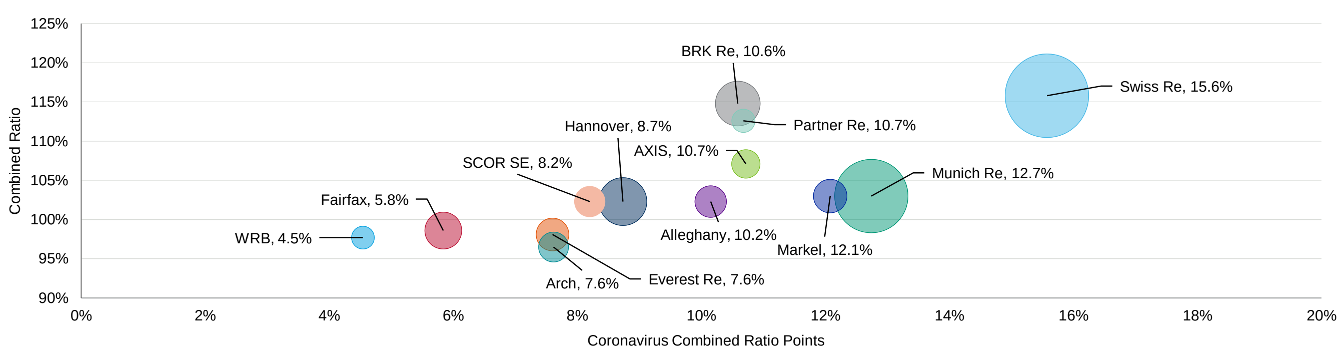
Company	Moody's IFS Rating	Net Income Available to Common Shareholders				Combined Ratio			
		Q2 2020	Q1 2020	H1 2020	H1 2019	Q2 2020	Q1 2020	H1 2020	H1 2019
Alleghany Corporation	A1/STA	177	(361)	(184)	736	102.8	101.7	102.3	92.5
Arch Capital Group Ltd.	A2/STA	288	134	422	897	101.8	91.5	96.5	81.0
AXIS Capital Holdings Limited	A2/NEG	112	(185)	(73)	265	94.7	119.8	107.1	96.5
Berkshire Hathaway Reinsurance Group	Aa1/STA	(188)	2,407	2,219	5,449	123.7	105.9	114.8	97.4
Everest Re Group, Ltd.	A1/STA	191	17	207	687	97.5	98.6	98.1	88.9
Fairfax Financial Holdings Limited	A2/STA	400	(1,259)	(996)	1,264	100.4	96.8	98.6	96.9
Hannover Re	NR	111	332	439	731	104.8	99.8	102.3	97.7
Markel Corporation	A2/STA	922	(1,406)	(484)	1,074	88.0	118.0	103.0	95.0
Munich Re	Aa3/STA	633	245	876	1,793	99.9	106.0	103.0	92.8
PartnerRe Ltd.	A1/STA	229	(433)	(204)	782	121.3	103.8	112.6	95.0
RenaissanceRe Holdings Ltd.	A1/STA	576	(82)	494	642	78.5	93.0	85.4	77.8
SCOR SE	Aa3/NEG	(149)	179	28	316	102.3	94.5	102.3	93.7
Swiss Re, Ltd.	Aa3/STA	(910)	(225)	(1,135)	953	120.8	110.8	115.8	100.5
W. R. Berkley Corporation	A1/STA	71	(4)	67	397	98.7	96.9	97.8	94.1
Cohort Total / Average		**2,464**	**(644)**	**1,677**	**15,983**	**102.5**	**102.7**	**102.8**	**92.8**

[1] Berkshire Hathaway Reinsurance Group: net income reflects statutory net income for National Indemnity Company, Columbia Insurance Company and General Reinsurance Corporation
[2] Alleghany Corporation: IFS rating reflects Transatlantic Reinsurance Company
[3] Fairfax Financial Holdings: IFS rating reflects Odyssey Reinsurance Company
[4] Swiss Re, Ltd. shows P&C Reinsurance combined ratios; simple unweighted estimate is being used for Q2 2020 combined ratio
Source: Companies' financial reports, Moody's Investors Service

The average combined ratio for the selected group of reinsurers (Exhibit 2) stood at 102.8% for the first half of 2020, to which coronavirus-induced claims added an average of around 10 percentage points. There is significant variation between individual insurers (Exhibits 3 and 4), with the large multi-line reinsurance groups typically hit the hardest.

Exhibit 3

Coronavirus impact on reinsurers' reported combined ratios (percentage points)



Source: Companies' financial reports, Moody's Investors Service

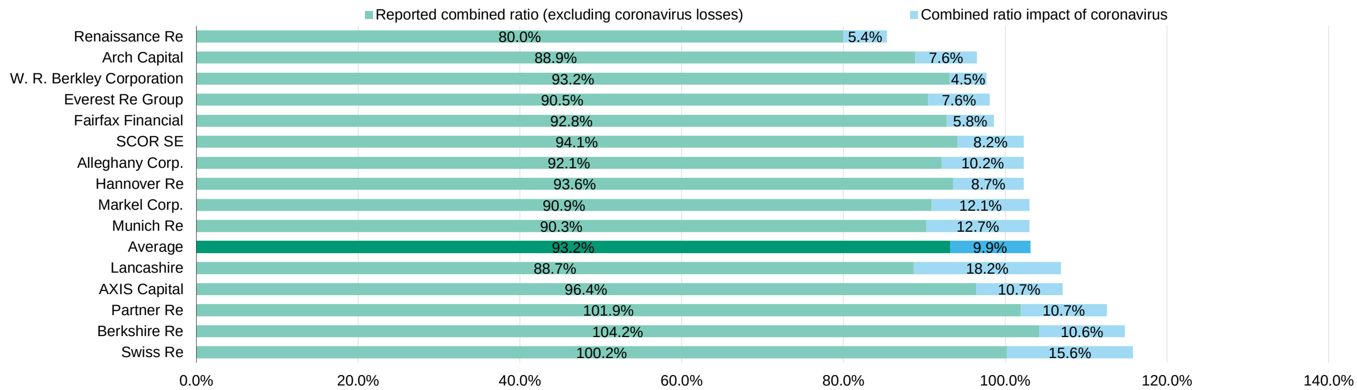
Pandemic claims increased significantly in the second quarter for some reinsurers compared to the first quarter of the year with significant variation between companies. This variation in recording claims in part reflects differences in how the companies' assessment of claims exposures has evolved since the end of the first quarter and in part differences in companies' exposure to lines of business that produced claims at an earlier or later stage of the pandemic. Claims estimation is particularly challenging given that the coronavirus is an ongoing catastrophe, and because of uncertainty around the duration and severity of the economic downturn.

Some reinsurers recognised limited or modest pandemic-related claims in the first quarter, but recorded claims in the second quarter (for example Swiss Re, SCOR, Partner Re). Other reinsurers recognised claims in the first quarter, as well as additional claims in the second (for example Munich Re, Berkshire Hathaway Re, Hannover Re). A third cohort recognised significant claims in the first quarter and did not record additional reserves in the second quarter, resulting in a significantly lower impact on the half-year combined ratio compared with the first quarter (for example Markel, AXIS, Renaissance Re).

Exhibit 4

Coronavirus related non-life claims add between five and 16 percentage points to first half combined ratios

Combined ratios for first half of 2020



Source: Companies' financial reports, Moody's Investors Service

In most developed countries, governments started to implement strict lockdown measures to contain the virus in March 2020. Travel restrictions, border closures and cancellation of large events immediately led to claims for travel insurance and event cancellation. Reinsurers reported expected claims from these two lines of business over the expected lockdown period, which was subject to uncertainty.

Business interruption claims, however, started to arrive in the second quarter, once the lockdown was fully in place. This line of business is the most contested one. Most primary carriers and reinsurers reported that pandemic events were generally not covered, particularly at the outset of the crisis, citing the need for property damage to trigger business interruption coverage. However, during the lock-down, it became clear that policy wordings and terms and conditions were not as clear-cut and consistent across companies, particularly across different jurisdictions.

Insurers in many jurisdictions are now under significant pressure from legislators, regulators and policyholders to pay claims for business interruption. Some insurers, owing to reputational concerns, chose to make ex-gratia payments. Legal disputes between insurers and policyholders are ongoing and the British Financial Conduct Authority (FCA) has asked a court to examine a sample of 17 business interruption insurance policy wordings to clarify whether they legally oblige the insurer to honour coronavirus-related claims. In other jurisdictions, such as the United States, the outcomes of legal proceedings so far have been inconsistent, with some courts ruling in favour of the insurer and other courts allowing cases to proceed. We believe that the current uncertainty in terms of expected claims will not diminish anytime soon. During midyear renewals beginning in May 2020, most reinsurers excluded pandemic risk from property catastrophe and property per risk treaties if they had not done so already.

In contrast to many primary insurers, reinsurers did not benefit significantly from lower frequency trends and fewer claims resulting from reduced economic activity. Exceptions were those groups with large retail primary insurance businesses, whose motor combined ratios benefited from lower claims frequency as a result of the lock-downs, partially offset by returning or rebating premiums.

Credit & surety lines of business will also be under pressure as the recession leads to higher insolvencies, but many governments, particularly in Europe, have limited the damage by implementing state covered reinsurance schemes or guarantees to protect the economy. In addition, there is the risk of spillover effects from the coronavirus impact onto other lines of business. More immediately, worker compensation and some casualty lines could be affected, while over the longer term a deep recession could result in greater social inequality and ultimately increase social inflation, which has afflicted lines in the US in past years.

Reinsurers' mortgage credit exposures continue to be a key item to watch as this line has seen strong growth in recent years. Thus far, fiscal stimulus and government policy measures, as well as historically low mortgage interest rates, have been successful in supporting the US housing market. Median home prices continue to move higher, despite high levels of unemployment. The forbearance rate on GSE mortgage loans has drifted lower in recent weeks to around 5% from about 6.4% in May, which is positive relative to our expectations earlier this year. While these initial indications suggest losses could be limited for excess of loss exposures, It may take another 6 to 12 months to determine the impact of the economic downturn on reinsurers' mortgage credit portfolios.

Life earnings weakened in the second quarter with more claims to come

Reinsurers with life reinsurance operations started reporting pandemic-induced claims in the second quarter, after reporting zero to minimal losses in the first quarter. Most claims stem from mortality protection policies in the US, where this type of protection, usually as part of estate planning (bequests of assets to heirs and settlement of estate taxes etc.), is taken out by policyholders. According to reinsurers, mortality claims are being reported with a considerable time lapse of up to six months, making claim assessment challenging. Accordingly, most claims reported in the second quarter are expected claims that have not yet been reported.

Identifying coronavirus-related mortality claims is hampered by a lack of reliable data. Some companies attribute excess mortality (mortality rates above the longer-term averages) to the pandemic rather than focusing on reported cause on death certificates. We believe mortality claims will rise in the months ahead, given the latency in reporting claims and the trajectory of infections in the US.

We expect mortality rates in the insured population will be below that of the general population because of risk selection as part of medical underwriting by reinsurers. Nevertheless, sums insured under some of the policies are very significant, so that a relatively low number of claims can mount to very large payouts.

The positive pricing environment is a singular bright spot

Global reinsurers reported a broad-based improvement in pricing, extending beyond previously loss-making lines of business. Price increases in recent policy renewals are in the mid-to-high single digits on average, and significantly higher natural catastrophe-exposed business in the US and Asia-Pacific.

Although the price increases will be beneficial, on a risk-adjusted basis they will be offset to some extent by a reassessment of risk exposures in many lines of business and the considerable drop in interest rates since the beginning of the year. Most reinsurers have reported significantly lower investment yields for the first half of the year, down between 50-100 basis points from full-year 2019. Lower yields pressure margins, particularly on longer-tail casualty lines that are settled long after policies expire. The sector's reassessment of risk exposures has also resulted in a tightening of terms and conditions, part of which is the exclusion of pandemic risk in property catastrophe and property per risk covers or the refining of coverage clauses, where the contract wording in the past has not been explicit regarding pandemics.

As a result, the sector is reporting solid revenue growth on average (see Exhibit 5) with gross written premiums up 6.4% for our cohort in the first half of 2020 compared to the prior year period. However, growth is not consistent, as companies with large books of natural catastrophe exposed business are typically benefiting the most from price increases. Given the coronavirus pandemic and economic uncertainty, some companies are paring back selected business lines where risk-adjusted returns are not meeting internal hurdles. In US casualty business, more rate is need given rising loss cost trends (notably stemming from rising litigation and higher jury awards) coupled with low interest rates.

The capital base of our selected reinsurers, as measured by shareholders' equity, has recovered during the second quarter of 2020. The improvement reflects a rebound in equity markets, tightening credit spreads and falling interest rates that increased fixed income valuations. However, shareholders' equity for our reinsurance cohort remains below year-end 2019 levels (Exhibit 5). Many companies have taken steps to further bolster capital by reducing dividend payments, curtailing share buyback programs or by raising capital. These capital management actions have been taken to strengthen capital and/or to take advantage of the currently favourable market conditions with a focus on organic growth.

Exhibit 5

Growth in gross premiums written driven by favourable reinsurance rates and increased demand

Company	Gross Premiums Written					Total Shareholders Equity (Incl. NCI)		
	Q2 2020	Q2 2019	H1 2020	H1 2019	Change	6/30/2020	12/31/2019	Change
Alleghany Corporation	1,721	1,671	3,492	3,277	6.5%	8,684	8,981	-3.3%
Arch Capital Group Ltd.	2,318	1,938	5,151	4,016	28.3%	12,727	12,316	3.3%
AXIS Capital Holdings Limited	1,716	1,648	4,147	4,231	-2.0%	5,298	5,544	-4.4%
Berkshire Re Group	4,311	3,707	8,578	7,253	18.3%	187,408	204,919	-8.5%
Everest Re Group, Ltd.	2,369	2,167	4,940	4,294	15.1%	9,286	9,133	1.7%
Fairfax Financial Holdings Limited	4,703	4,335	9,478	9,062	4.6%	16,440	17,907	-8.2%
Hannover Re	6,739	5,979	14,357	13,140	9.3%	12,739	12,748	-0.1%
Markel Corporation	2,373	2,247	4,696	4,502	4.3%	11,410	11,256	1.4%
Munich Re	14,009	13,259	29,610	28,289	4.7%	33,031	34,328	-3.8%
PartnerRe Ltd.	1,558	1,909	3,600	4,026	-10.6%	6,903	7,270	-5.0%
RenaissanceRe Holdings Ltd.	1,702	1,477	3,728	3,041	22.6%	10,734	9,043	18.7%
SCOR SE	4,409	4,523	8,950	9,001	-0.6%	7,093	7,156	-0.9%
Swiss Re, Ltd.	9,461	9,385	23,558	22,672	3.9%	29,778	31,037	-4.1%
W. R. Berkley Corporation	2,132	2,090	4,364	4,136	5.5%	5,845	6,118	-4.5%
Cohort Total	**59,521**	**56,334**	**128,648**	**120,941**	**6.4%**	**357,378**	**377,756**	**-5.4%**

[1] Berkshire Hathaway Reinsurance Group and Swiss Re, Ltd. are Net premiums earned. Shareholders' equity for Berkshire Re Group reflects statutory surplus for National Indemnity Company, Columbia Insurance Company and General Reinsurance Corporation
[2] Hannover Re, Munich Re and SCOR are FX-adjusted
Source: Companies' financial reports, Moody's Investors Service

Recent events

Active 2020 hurricane season

On July 25, Hanna, the season's first hurricane, made landfall in the United States Gulf Coast and Mexico and resulted in damage to buildings, flooding and loss of electric power. Insured losses are estimated to be moderate, at around $500 million.

On 3 August, Hurricane Isaias hit the United States East Coast. After having resulted in only moderate losses in the Caribbean, it brought severe storm surge and flooding to more than 12 states on the United States East Coast. Experts estimate that insured losses in the United States alone will likely amount to up to $5 billion.

With a record number of named storms this early in the season, previous forecasts of a very active 2020 Atlantic hurricane season appear to be on target. In late spring, numerous weather research organizations projected tropical cyclone activity above long-term historical averages for the Atlantic Ocean, where hurricane season runs from June 1 to November 30. The forecasts called for between 13 and 20 named storms during the 2020 season, with seven to 10 of these storms becoming hurricanes, of which three to five hurricanes are projected to reach major hurricane status (Category 3, 4 or 5 hurricanes) with wind speeds greater than 111 miles per hour. So far there have already been 13 named storms during the season, and some forecasts have been revised upward.

Lebanon port explosion

On 4 August 2020, a large explosion occurred in the international sea port of Beirut, Lebanon, devastating the port and the surrounding area and resulting in tragic loss of life. Insured losses, mainly from property and business interruption, are currently estimated in the mid-single digit billion dollar range, significantly lower than economic losses due to low insurance penetration. Some (re)insurers will report losses to this event in their third quarter results. As seen in the past with similar events, there is significant risk of loss creep, with the full extent of related claims only known at a later stage.

Moody's related publications

» January reinsurance renewals confirm firmer price outlook for 2020, 21 January 2020

» Reinsurance Monitor, Issue No. 39, April 2020, 1 April 2020

» Warm waters, possible weak La Niña point to active 2020 Atlantic hurricane season, 2 June 2020

» Reinsurers report coronavirus losses as hurricane season looms, 9 June 2020

» European state-backed reinsurance is positive for trade credit insurers, 10 June 2020

» UK regulator's plan to clarify legal validity of BI claims is credit positive, 10 June 2020

» Catastrophe bond issuance surging as reinsurance pricing moves higher, 30 June 2020

» High unemployment and low interest rates weigh on profitability, 30 June 2020

» Reinsurance Monitor, Issue No. 40, June 2020, 30 June 2020

» Insurers face increasing social and legal risks arising from coronavirus, 4 August 2020

» Insurance – Europe: Covid claims rise sharply in Q2; P&C claims will slow, life claims will accelerate in H2, 6 August 2020

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