SPECTRUM
Asset Management

Bermuda Re/insurance 2019 Field Trip

November 25, 2019

This month we met with re/insurance companies, brokers and industry participants in Bermuda, while also attending and participating in S&P's annual Bermuda Reinsurance Conference. Our top takeaways were:

1) *Property & casualty (P&C) re/insurance pricing is firming across many product lines despite strong industry capitalization*
2) *Climate change (an important ESG issue) supports the need to manage exposure to elevated severe weather activity*
3) *"Social inflation" — a trend of more frequent, severe legal payouts — is proving costly*

Industry capital constraints have historically been a key driver of improved P&C re/insurance prices/terms. Today, industry capitalization remains robust, but despite some price firming, it is too soon to characterize it as a hard market. One factor driving P&C pricing is underwriting discipline. After years of subpar returns, several large players have been shrinking exposure to certain perils and buying more reinsurance protection, which has affected industry supply and demand.

Another reason for rising prices has been record natural catastrophes (CATs) in 2017-18. Of note, payouts related to Hurricane Irma (2017) in Florida and Typhoon Jebi (2018) in Japan have been markedly higher than expectations, due to factors such as elevated US attorney involvement related to Irma and the surprise nature of Typhoon Jebi. Also, consecutive years of record wildfires in California, and climate change effects on future CATs, could slow capital allocations to new business. The availability of alternative forms of reinsurance capital (a material portion of total reinsurance capital) has become more uncertain.

Elevated US attorney involvement is a key factor behind social inflation. Other contributors include the rise of litigation finance and less pro-business demographic/judicial trends, which have supported heightened legal activity and more generous outcomes for plaintiffs. P&C lines such as commercial automobile, general liability and directors and officers insurance protect businesses against various liabilities. Re/insurers must reserve for estimated losses to cover future payouts for claims. Recent legal inflation has driven costly reserve increases for these product lines. P&C re/insurers are mitigating costs with higher prices and better terms and conditions on new business. However, rising tort costs coupled with several high profile, multi-billion-dollar legal situations (*e.g.,* glyphosate, talc, opioids and the NY Child Victims Act) creates ongoing loss uncertainty, thus adding pressure on reserves. *A recent Financial Times article highlighted social inflation as a key industry issue.*

Some product lines, such as workers' compensation, continue to experience favorable reserve trends. However, the earnings benefit of reserve releases over the past decade appears to be waning. The opposite effect of reserve increases would be a headwind to earnings, though likely not as onerous to the industry as legacy asbestos. Also, potential tort reform could cap the damages of future liabilities. **The industry today is better capitalized, and has enhanced risk sharing, information, technology and other tools to mitigate emerging risks. Leading P&C re/insurance companies remain disciplined.**

Chad Stogel, Vice President
Joe Urciuoli, Head of Research