

# Commercial Insurance Market Is Hardening

## Coronavirus Pandemic Delays Recovery to 2H21

“The coronavirus pandemic will burden 2020/1H21 results, but will ultimately accelerate the hardening of the commercial insurance market.”

Robert Mazzuoli

### Insurer Financial Strength (IFS) Ratings

Allianz SE	AA/Stable
AXA SA	AA-/Stable
Swiss Reinsurance Company Ltd	A+/Stable
Talanx AG	Not rated
Zurich Insurance Company Ltd	AA-/Stable

Source: Fitch Ratings

### Related Research

[Fitch Ratings 2020 Outlook: German Non-Life Insurance \(December 2019\)](#)

[London Market Insurance Dashboard: 2020 Outlook \(January 2020\)](#)

[Fitch Ratings 2020 Outlook: UK Non-Life Insurance \(November 2019\)](#)

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Fitch Ratings expects continued rate hardening in the commercial insurance market. Non-life commercial insurance providers have reported double-digit price increases for a variety of lines of business across all major global regions for 2019. Prices have been rising for nine consecutive quarters as peak losses and accelerating claims inflation have forced the industry to respond.

### Pandemic Losses Burden 2020/1H21 Results

Fitch expects that commercial insurers will be hit hard by pandemic-related losses that affect event cancellation as well as credit and surety policies in 2020 and 1H21. The industry is confronted with mounting political pressure to pay for business interruption claims as well, irrespective of whether the relevant policies cover pandemics or not.

### Return to Profitability Postponed to 2H21

Fitch expects most commercial insurers to return to underwriting profit by 2H21 as they take advantage of improving pricing and recover from pandemic-related losses.

Some insurers have increased prices drastically in loss-affected lines and some have even decided to withdraw completely from certain lines or geographies. These various actions have had a positive impact on the overall rate environment.

### Pandemic Claims Credit Negative

Fitch considers the expected pandemic-related losses in commercial lines of business to be credit negative for the groups involved, as overall earnings resilience is weakened and capital is potentially reduced.

Most European commercial underwriters belong to large insurance groups with significant diversification, so expected losses may be absorbed internally without a significant rating impact.

### Low Pricing Power and Barriers to Entry

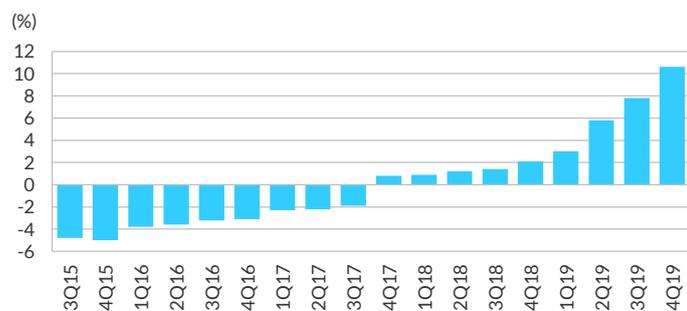
Fitch believes that commercial insurers often lack pricing power in the large corporate insurance sector. The segment remains fragmented and is the most contested area of commercial insurance. Insurers compete on a global scale for large corporate customers and the market is highly competitive.

Fitch considers barriers to entry to be low compared to retail insurance. New capital can enter the market easily using brokers and fixed costs are limited. This can quickly lead to overcapacity in the respective market segment and a lack of underwriting discipline.

## Market Is Hardening

The global commercial insurance market has now had nine consecutive quarters of rising prices with an accelerating upward trend. High industry losses have forced most insurers to rethink their strategy, with many cutting back on capacity or even withdrawing from certain lines of business or countries entirely.

### Global Commercial Insurance Composite Pricing Change



Source: Fitch Ratings, Marsh Global Analytics

The soft commercial insurance market reached a trough in 2017 following several years of falling prices. As a result, major insurance groups active in commercial insurance reported very high combined ratios for their commercial business, which were also affected negatively by natural catastrophe losses.

The commercial insurance market has attracted a couple of new entrants, such as large reinsurers, over the last 10 years. These new entrants wanted to diversify by geography or line of business or simply grow revenues faster than before and often bought their way into the market by offering lower prices than incumbents.

More recent price rises have been most pronounced in the UK and Australia/New Zealand. In these countries, as well as in the US, financial and professional liability has had the highest price increases; in isolated cases a doubling of prices has been observed. Litigation cost is the main cause, increasingly spreading across industries.

A lower-than-expected increase of the Ogden rate (a discount rate that is used in the UK to calculate how much money insurance companies pay out as a compensation in personal injury cases) has led to higher prices in UK motor insurance as insurance liabilities had to be increased. In mainland Europe, property insurance prices have increased the most as poor underwriting results led to a reduction in capacity.

Tighter terms and conditions have often accompanied the most pronounced price increases. Fitch expects further price increases for 2020 as claims inflation in some lines of business, such as professional liability, remain high and most commercial underwriters still show combined ratios above 100%.

## Large Losses from Coronavirus Pandemic in 2020/1H21

Fitch expects that commercial insurers will experience high pandemic-related losses, including those due to event cancellation as well as credit & surety policies in 2020 and 1H21. Fitch believes that other niche businesses, such as media or travel insurance, will also see large losses.

The industry is confronted with mounting political pressure to pay for business interruption claims irrespective of whether the relevant policies cover pandemics or not. While in general pandemic-induced business interruptions have not been covered by commercial insurers since the SARS pandemic in 2003, unclear policy wording and political pressure now raise increasing doubts how successfully commercial insurers can fend off claims now. Fitch expects no immediate clarity about the size of total losses for the industry as litigation between insurers and commercial customers may take several months to resolve.

The whole insurance industry will also have to deal with investment losses, calls for rebates in those lines of business that see a significant fall in claims, such as motor, and an increasing number of defaulting customers, Fitch believes. Reinsurance coverage may prove to be ineffective as pandemics are usually excluded from business interruption reinsurance policies, too.

Fitch believes that the commercial insurance industry will most probably report significant losses in both 2020 and 1H21, postponing the return to profitability to 2H21. Fitch expects that commercial insurers will try to amend terms & conditions and raise prices for new policies, reinforcing the hardening of the market. While demand may shrink in absolute terms as the recession weighs on insured volumes, prices will move higher to reflect the perceived increase in riskiness and lower available capacity.

## Large Market; Low Barriers to Entry

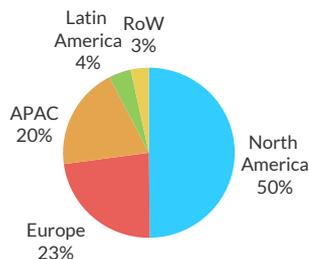
Fitch believes that the global commercial insurance business is one of the most hotly contested insurance markets. There are several reasons why this is the case.

Firstly, the commercial market is huge, contributing roughly 45% to the global non-life business. It accounted for approximately EUR675 billion of net earned premiums in 2018.

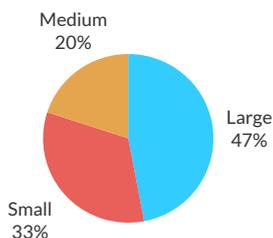
Secondly, the market is highly fragmented in most major countries. Local market leaders may command a market share of more than 10% with small and medium-sized corporates (small: turnover below USD25 million, medium: USD25 million-USD500 million), but the large corporate client segment (turnover above USD500 million) contributes roughly 50% of global premiums written. Competition in this segment is on a global scale, including the Lloyd's of London market place for specialty lines of business. The North American market represents half of global earned premiums and is dominated by the large corporate clients segment.

Fitch believes that pricing pressure is highest in the large corporate client segment as insurers compete not only with each other, but also with the clients' captives. In years with good business conditions, large corporates may be more inclined than small corporations to keeping risks on their own books and can afford to do so more easily.

**Global Commercial Insurance by Geography**



**Insurance by Client Size**



Source: Fitch Ratings, McKinsey Global Insurance Pools

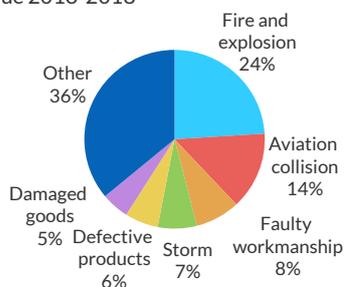
Barriers-to-entry are low in the large corporate client segment in particular. While technical expertise and sophisticated underwriting skills are certainly required, the important broker channel allows new capital to enter the market easily. Fixed costs are relatively low compared to the retail business facilitating potential expansion plans in this segment. Commercial insurers may already have a business relationship in one region and plan to expand globally. Large volume contracts with price-sensitive clients may make the market segment look attractive to aggressive players that want to grow market share rapidly.

Reinsurers, however, may want to use their underwriting expertise to reach out to large corporates, in particular, bypassing primary insurers.

These insurance portfolios may provide different claims patterns and pricing cycles to reinsurance. Most losses in commercial insurance are man-made losses, while reinsurance claims are heavily affected by weather-related events. January 2020 renewals show that primary insurance rates have risen more than excess-of-loss reinsurance rates. Most large reinsurance groups are active in primary insurance through either their subsidiaries or parents, providing diversification from the reinsurance operations.

**Corporate Insurance Claims by Cause**

Based on claims value 2013-2018



Source: Fitch Ratings, Allianz Global Corporate & Specialty

The supervisory treatment of commercial non-life insurance may be another good reason to expand into that line of business. Capital requirements are reduced due to diversification benefits across client groups or geographies, lowering the hurdle rates for the required return on capital.

The business cycles of commercial insurance are characterised by times of huge overcapacity and therefore need to be handled with

extreme care. Fitch believes that niche strategies that either target complex lines of business, such as engineering, or address well-defined client segments, such as very small corporates, may prove to be the most successful in the long run.

Insurtech companies have an increasing impact on the competitive landscape as they help to digitalise distribution channels and streamline operating processes. Incumbent insurers may have to fight for client access more strongly in the future or use cost savings to offer lower prices. Fitch expects that the competitive pressure will rise as a consequence.

**Growth Opportunities in Commercial**

There are some pockets of growth in commercial insurance, although price pressure has caused only modest growth over the past decade. Growth of business lines related to globalisation and global trade such as credit insurance or business interruption coverage was good in the first half of this decade, but has decreased recently because of a rise in protectionism.

Other lines of business have seen increasing demand due to climate change. Crop insurance (market size approximately USD30 billion as of 2019) has been propelled by higher state subsidies, a professionalisation of the agricultural sector in emerging markets and rising weather-related losses. Demand for environmental insurance (market size USD4 billion-USD5 billion as of 2019) is growing as the claims frequency rises alongside natural catastrophe events.

Premiums of professional liability such as director & officer's insurance (D&O) is also rising premiums as litigation cost increases across more and more industries. Tightening legislation and a higher willingness to go to court are two major drivers for this.

The underwriting of cyber risk covers is included in professional liability and offers an important growth opportunity through an increasing market. Premium volumes of more than EUR4 billion globally (2019), double-digit premium growth and excellent underwriting results make this line of business look attractive. Risks such as privacy and data breach, business interruption or network break-downs are increasing driven by the growing interconnectedness of modern society.

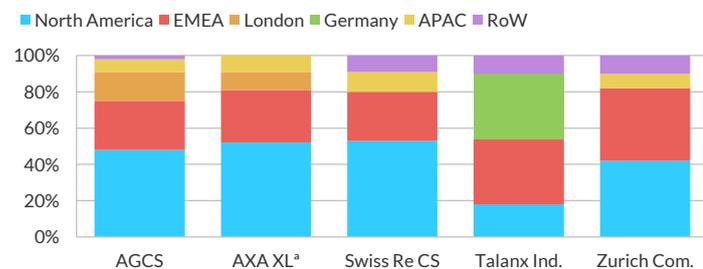
However, there are some caveats. Cyber insurance is still a US-centric business with a focus on large corporate clients. A lack of legislative pressure outside of the US and some APAC countries, a limited awareness among small and medium-sized enterprises, a still-evolving product design and so-called 'silent cyber' covers in traditional policies have prevented a higher penetration of cyber policies. The industry cannot solely rely on legislative changes to grow business. Educational efforts are needed to increase penetration over time.

Another caveat is the limited availability of historic claims data to properly assess the riskiness of the business. Cyber insurance is still relatively new and the risks involved are constantly changing. This heightens the need to underwrite carefully as cyber insurance may be different to other lines of business and also explains the relatively high cession rates of almost 40%. The insurers' reserving and pricing policies have not yet been put to the test by catastrophic cyber events. Nonetheless, the number of underwriters is constantly rising, which leads to increasing pressure on prices.

## European Competitive Landscape

Allianz, AXA, Swiss Re, Talanx AG and Zurich Insurance Company Ltd are some of the biggest Europe-domiciled commercial insurers. While the geographical footprint varies between insurers, they are all global, aligning their geographical exposure to their clients' needs.

### Gross Written Premium Split 2019



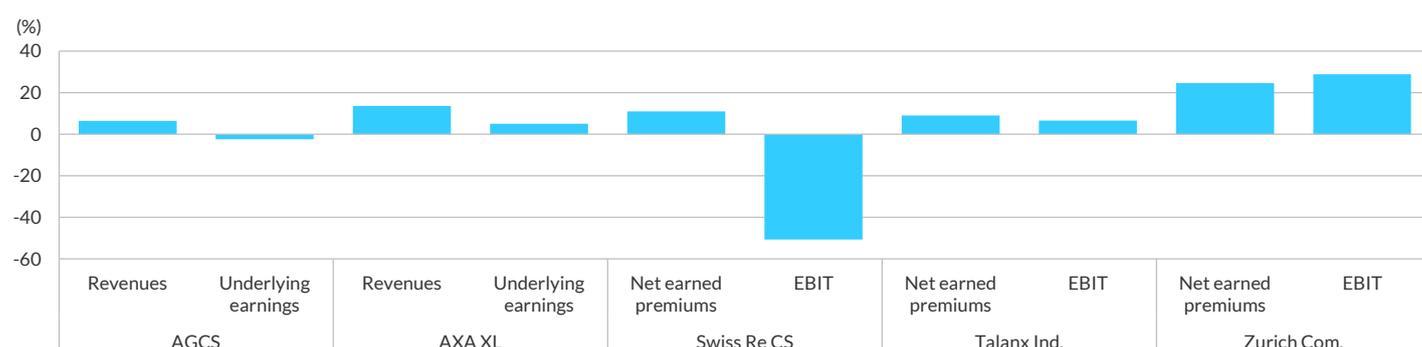
<sup>a</sup> AXA XL 2018 numbers  
Source: Fitch Ratings, Company data

Allianz SE has bundled its business with international corporate clients and specialty lines such as marine or engineering into a separate entity called Allianz Global Corporate & Specialty (AGCS). This had annual income of EUR9.1 billion as of 2019, representing 6% of Allianz's revenues. Medium- and small-sized corporates are predominantly serviced by the local Allianz units.

AXA was already a significant player in commercial insurance when it acquired XL Group in 2018 to become a leading insurer in the non-life commercial and reinsurance business globally. Subsequently, the new entity AXA XL was created and now includes the group's large- and medium-sized corporate business and specialty lines. In 2019, AXA XL generated EUR14 billion in primary insurance, equal to 14% of group revenues.

Swiss Re entered the commercial insurance business in 2010 to tap into new growth opportunities using its reinsurance underwriting expertise, and created the business segment Corporate Solutions (Swiss Re CS). An accumulation of large losses in 2017, 2018 and 2019 led to a pruning of the portfolio to re-establish the unit's profitability. In 2019, Swiss Re CS generated a net earned premium (NEP) of USD4.2 billion, equal to 11% of group NEP.

### Share of Commercial Insurance in Premiums and Profits 2019



Source: Fitch Ratings, Corporate accounts

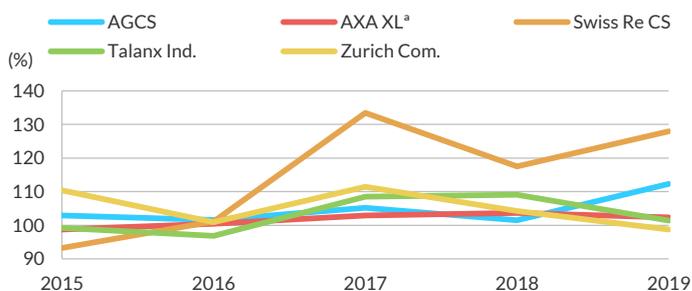
Talanx is one of the largest commercial insurers in Germany (10% market share) with a significant presence in Europe as well. The business segment Industrial Lines (Talanx Ind.) addresses all corporate client segments. The large exposure to Germany, a market that had been soft for more than 10 years before rates started to rise in 2018, has had a more negative impact on operating results than peers. In 2018, Industrial Lines generated EUR2.6 billion of NEP, equal to 9% of group NEP.

Zurich is one of the few true global participants in commercial insurance with leading positions in the US and Europe. The business segment Zurich Commercial (Zurich Com) comprises large and medium-sized corporates, while small corporates are serviced through the retail units of Zurich. The Swiss insurer improved the operating result earlier than peers by decreasing the relative weight of its long-tail casualty lines and reducing its exposure to the volatile large corporates segment. The commercial business is of high importance for Zurich as it contributed USD10 billion, or 25%, to NEP in 2019.

## European Insurers Had Technical Losses

While every group provides a different client segmentation, profitability trends are similar and therefore comparable in Fitch's view.

### Combined Ratio

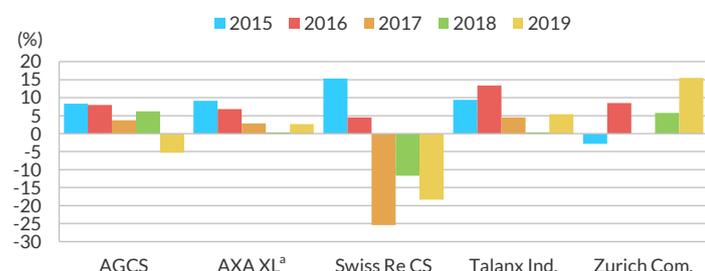


<sup>a</sup> AXA XL: 2015-17 numbers for AXA Corporate Solutions  
Source: Fitch Ratings, company data

The graph above shows the combined ratio developments for commercial insurance over the last five years, clearly highlighting that the soft market bottomed in 2017. High technical losses in 2017 led to a reassessment of business strategies. Portfolio

pruning and price increases such as the “20/20/20” initiative of Talanx improved the profitability of the commercial insurance business. High natural catastrophe losses, a high exposure to US liability and the need to bolster reserves for this business line have led to very high combined ratios at Swiss Re CS for the past three years.

**Operating Margin**



<sup>a</sup> 2015-17 AXA Corporate Solutions; operating margin = operating profit/revenues  
Source: Fitch Ratings, company data

Poor technical results are also reflected in low operating margins (operating profit/net earned premiums) as investment income has not been able to provide compensation given the very low interest rate environment.

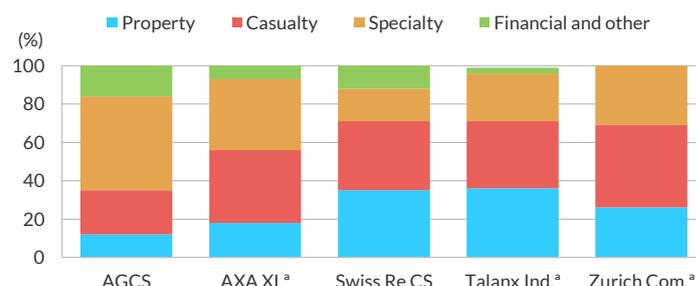
Diversification within commercial insurance has not helped the profitability of the companies either, as underwriting results were poor across companies no matter how their business is split (see graph below). This proves that the industry suffers from structural problems such as overcapacity.

The impact on group results varies from one company to another, as can be seen in the graph above. This is a function of relative

importance of respective business segment for the group and the relative profitability of other lines of business such as non-life retail or life insurance, which may have compensated for the sub-par profit contribution of commercial insurance.

Fitch considers the below-average profitability of commercial insurance in past years credit negative, although the volatility of the strong business cycle of commercial insurance offers some diversification benefits. Fitch expects most European commercial insurers to report technical losses again for 2020 and 1H21 due to pandemic-related losses and high claims inflation in US liability, but they may return to profitability in 2H21.

**Premium Split by Lines of Business 2019**



<sup>a</sup> Zurich Com. 1H19; AXA XL and Talanx Ind. 2018  
Source: Fitch Ratings, company data

Fitch does not expect new capacity to enter the market over the next two to three years as the pandemic-related losses need to be recovered from first.

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