German Non-Life Insurers’ Focus on Rates Improves Profitability

The German non-life insurance market has proved to be resilient, as it continued to enjoy growth in 2011 and is expected to remain robust in 2012.

In 2011, the sector recorded its strongest annual percentage increase in premiums since 2003. The primary contributor to such growth was motor business, with motor gross premiums written (GPW) increasing by an estimated 3.6% in 2011 as rates were lifted after years of inadequate pricing.

Insurers have also been able to increase rates for liability insurance. After the global financial crisis, it appears that insurers are evaluating risks more closely before underwriting. Pricing for most other property/casualty (P/C) risks has been stable.

Non-life insurers are increasingly focusing on underwriting profitability as the low interest rate environment in Germany continues to suppress investment income. Additionally, insurers are adjusting their investment portfolios to take account of this new reality, concentrating on sectors that offer higher yields.

Motor Market Drives Non-Life Insurance Growth

The German non-life insurance market expanded by 2.5% to reach EUR 56.6 billion of premium income in 2011 (see Exhibit 2). This reflected Germany’s continued economic recovery since 2009, with gross domestic product (GDP) increasing by 3.1% in

Exhibit 1


<table>
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<tr>
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Source: <BestLink> Global Statement File
2011, although the International Monetary Fund predicts GDP will grow at a slower rate, expanding by just 0.6% in 2012 and by 1.5% in 2013. Germany’s economic upturn has been supported by a decline in unemployment and low inflation, which is forecast to decline to 1.9% in 2012 from 2.3% in 2011. However, weakening global demand for German exports and the continued uncertainties regarding the Eurozone sovereign debt crisis may dampen economic growth prospects.

Motor insurance underpinned the growth in non-life premiums in 2011 as the sector strengthened rates. According to data from the German insurance trade association, Gesamtverband der Deutschen Versicherungswirtschaft (GDV), in 2011 GPW for motor risks was EUR 20.9 billion (36.9% of total non-life premium in 2011), compared with EUR 20.2 billion a year earlier (see Exhibit 3).

In some cases, insurers were able to push through rate increases of as much as 10% for motor third-party liability after years of inadequate rates. Rates for motor fleets were also increased, while some insurers cancelled policies that were attracting high losses. It is worth noting that the motor fleet insurance market in Germany is unique in comparison with other European markets, as insurers are able to increase rates in some instances — or even cancel policies — midway through the year.

Motor rate rises are expected to continue throughout 2012, although claims remain high. Despite rate increases, motor business remains unprofitable, and in 2011 this class of business incurred the greatest losses. Exhibit 4 shows combined ratios...
have been increasing for motor, reaching 107.4% in 2010 and 2011. The motor market remains very competitive, and motor physical damage claims were high in 2011 after flooding at the beginning of the year and heavy regional hailstorms during the summer.

Other Non-Life Rates Remain Stable
As was the case with motor, virtually all other lines of business enjoyed increases in GPW in 2011. The exception was credit and surety, for which premium income remained stable (see Exhibit 3). In 2011, credit and surety was among the smallest classes of business, accounting for just 2.7% of total non-life premium. Nevertheless, as Exhibit 4 shows, it proved to be the most profitable sector with a combined ratio of 67.3%.

Property, which is the second largest line of business – accounting for 27.3% of non-life premium in 2011 – experienced 2.1% growth in GPW (see Exhibit 3). In comparison, property GPW grew by 1.2% in 2010. Although rates for private home insurance remain under pressure, particularly for non-catastrophe-exposed risks, insurers are attempting to reduce limits and increase rates for catastrophe-exposed commercial property risks. Combined ratios for both private property insurance and commercial business improved by 2.6 and 1.2 percentage points, respectively, in 2011 (see Exhibit 4).

A greater focus on achieving underwriting profitability and understanding risks underwritten was apparent for liability lines, particularly for directors’ and officers’ insurance and policies for financial institutions. While rates have remained fairly flat in 2011 and 2012 for these lines of business, insurers have been requesting more detailed information before committing to underwriting such risks. In view of recent events, a notable trend has been the reduction in capacity for complex accounts or those with a poor loss history.

Profitability Improves
The German non-life insurance market posted an improved total combined ratio of 97.9% in 2011 (see Exhibit 4). In comparison, 2010’s combined ratio was 98.2%, although this was a particularly poor year for losses, with freezing weather conditions at both the beginning and end of the year resulting in increased attritional claims, as well as claims resulting from windstorm Xynthia. Exhibit 5 shows the claims ratio in 2010 reached 80.3%, improving to 79.4% in 2011. Nevertheless, 2011’s total loss ratio was higher than those from 2007 to 2009.
A.M. Best believes the non-life insurance sector is conservatively invested, with the current weak investment environment forcing insurers to focus on profitable underwriting as the yields on German government bonds remain at historic lows. German motor insurers registered investment returns in 2011 of EUR 1.9 billion, compared with EUR 3.1 billion in 1999. The average return on investment for motor insurers was 3.5% in 2011, down from 4.3% in 2010 and 7.3% in 2002.

As the low interest rate environment is likely to persist, some of the larger insurers are investing more actively in corporate bonds and commercial real estate financing projects as they seek better yields. At the end of 2011, property investments accounted for EUR 5.5 billion out of a EUR 138.0 billion investment portfolio. Data from the German insurance regulator, Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), show that in 2010, direct investments in property and property funds represented EUR 5.1 billion out of EUR 138.0 billion of total investments. According to figures from BaFin, property investments have been relatively stable, representing 3.7% to 3.8% of total investments from 2007 to 2010, increasing to 4.0% at the end of 2011.

BaFin noted in its second-quarter 2012 report that German insurers are increasingly investing in infrastructure projects (including renewable energies). BaFinQuarterly explained that insurers were attracted by the long-term nature of these investments, which normally generate attractive yields.

**German Insurers Well Placed, but Uncertainties Remain**

Overall, A.M. Best believes non-life German insurers are robust, with companies anticipating a modest increase in premium in 2012. Provided there are no major catastrophes for the remainder of the year, the sector should be well positioned to post an improved combined ratio. In the first half of 2012, it appears motor rate increases have been sustained, although combined ratios are expected to remain in excess of 100%, reflecting years of competitive pricing.

Offsetting factors for premium growth include the cautious income expectations of private households. The growing use of comparison portals over the past few years has increased competition and places further downward pressure on prices. In particular, aggregators are growing in popularity for personal lines such as motor, where margins are already tight. Consequently, the market share of tied agents has been reducing for these lines of business.

Insurers additionally faced a number of major loss events in 2012, including a long period of freezing weather at the beginning of the year that caused burst water pipes. Floods in January also resulted in property claims, as well as motor damage.

The German financial system has not directly experienced the economic crisis that has affected the southern European countries, although it is not immune. On the whole, capitalisation for the sector is strong, with companies having a long tradition of conservative reserving. However, continuing turbulence in investment markets and the weakening macroeconomic outlook for Germany may put strains on insurer capitalisation going forward.
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