Guy Carpenter 2018 Risk Benchmark Research

Balance Sheet Expansion: Opportunities and Challenges

From 2014 to 2017, the property and casualty (P&C) industry in the United States grew its collective capital position from USD 686 billion to USD 767 billion, a 3.8 percent compound annual growth rate*. This expansion in capital was achieved during a period when the normalized return profile of the P&C underwriting business was considered to be below the cost of capital. The growth of industry capital during this period of subpar underwriting returns provides insights into the expectations for carriers’ opportunities and challenges through 2018 and into the years ahead.

Gains were driven by investment returns, not underwriting profitability

* In 2018 through the end of the 3rd quarter, industry Surplus had grown by 3.3%.
Opportunities for 2019 & Beyond

The expansion of the industry balance sheet could provide opportunity for growth in premium or exposures should favorable pricing conditions continue.

Improved Pricing – A primary utilization of more capital could be to take advantage of improving pricing trends. The industry experienced modest pricing improvement through 2018 in most major lines with the notable exception of workers compensation. The growth in capital could indicate that management teams might be to expect this trend to continue.

New Perils – Another use for the larger balance sheet may be growth opportunities around recently emerged perils such as cyber and the growing market for mortgage insurance credit risk cover – growth opportunities may be encouraging carriers to hold onto additional capital. New products that cover emerging perils have a lack of an underwriting track record and may require new capital to write against and a necessary conservatism in holding more capital against each dollar of risk compared to more traditional lines of business.

Challenges for 2019 & Beyond

Alternatively, the expansion of the capital base may help provide a buffer to potential challenges on the horizon. Raising capital during favorable times is more cost-effective than raising capital once the investment and interest rate environment has changed. There are several risks on the horizon for which a larger capital cushion would be beneficial.

Rising Interest/Inflation Rates – Rising rates and particularly a sudden spike in rates, can prove particularly challenging for insurers, as both sides of the balance sheet can be negatively affected. On the liability side rising inflation, which often moves in tandem with interest rates, poses challenges for long tail liability reserves. In an environment of increasing loss cost trends, it is prudent for carriers to manage their need for additional capital and liquidity that serves as a buffer against the deteriorating effects of higher inflation. On the asset side of the balance sheet rising interest rates often put pressure on the valuation of both fixed income and equity investments, which could off-set a major source of industry capital growth in 2016 and 2017, though statutory accounting treatment of held to maturity bonds somewhat mitigates fluctuations in value.

Increased Severity – Increases in loss severity and frequency in many lines, including commercial auto, workers compensation and property have impacted the P&C industry in recent years. If (re)insurers expect the increases in loss severity to continue or accelerate, they may be compelled to continue building their capital positions and improving rate adequacy. (Re)insurers may need to hold additional capital against the risks they write or alter their reinsurance buying to limit balance sheet exposure should rising frequency and severity trends continue.

Reserve Deficiencies – Over the last decade, carriers have benefited from reserve releases, much of which originated during the last hard market underwriting years of 2003 to 2006. As the industry moves further away from those strong performing underwriting years, the potential pool of reserve redundancy continues to diminish. Carriers may benefit by starting to build-up capital ahead of time before routine reserve releases potentially become reserve deficiencies.

Historical balance sheet – All companies

USD billions (above 0: assets, below 0: liabilities & surplus) by year.

Guy Carpenter’s Analytics and Strategic Advisory units are dedicated to providing clients with the latest market resources available in order to help them develop the necessary strategies. Guy Carpenter’s 2018 Insurance Risk Benchmarks Research report is a tool that includes the financial data and information necessary for important strategic decision-making. The report includes information covering all P&C lines. Click here to request your copy of the 2018 Risk Benchmark Report.
About Guy Carpenter

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