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Reinsurance industry results analysis

According to the AON 2023 Weather, Climate and Catastrophe Insight report[1], the Kwa-Zulu Natal floods experienced in April 2022 were identified as one of the deadliest and costliest flood events on record in South Africa. It is estimated that USD3.6 billion in economic losses and USD1.8 billion in insured losses were experienced and that there were 455 fatalities. This event was also listed in the top ten global human fatality events related to natural catastrophe events for 2022.

The following additional notable flooding events occurred in South Africa as published by AON on its list of 2022 global disasters[2]:

Date(s)	Deaths	Economic loss (USD)
8 Jan – 9 Jan 2022	10	70+ million
15 Jan – 16 Jan 2022	1	105+ million
3 December 2022	14	Unknown
10 Dec – 11 Dec 2022	0	Unknown

The financial results of reinsurers' that participated in this year's survey are largely characterised by the impact of these loss events, and the recovery of mortality levels experienced by the industry following the stabilisation of the life insurance environment that was plagued by the impacts of the COVID-19 pandemic.

The latest insurance sector data published by the South African Reserve Bank indicates that there are nine professional reinsurers in South Africa at December 2022[3].
In this year's survey, we analyse the results of four registered reinsurers, representing approximately 64% of the South African market. These results include three composite reinsurers and one composite branch.

Last year saw a number of changes in the legal structures of South African reinsurers due to the enactment of the Insurance Act in 2018:

- African Reinsurance Corporation (South Africa) Limited (Africa Re) relicenced as a composite reinsurer;
- Hannover Re South Africa Limited (Hannover Re) consolidated its life and non-life operating licences into a single composite reinsurance licence; and
- SCOR SE (Incorporated in France) - Africa Branch (SCOR Africa Branch) commenced business operations as a composite licenced branch.

In addition to the impacts of the Kwa-Zulu Natal floods and other natural catastrophe events that transpired over 2022, the results of the reinsurance industry need to be reflected on against what has transpired over the course of 2022 for the reinsurers' customers – the South African non-life insurance and life insurance industries.

The life insurance industry went from a profit of R17.0 billion in 2021 to a profit of R26.1 billion in 2022. This is reflective of the recovery and stabilisation experienced by life insurers to normalised mortality levels post the COVID-19 pandemic.

The non-life insurance industry went from a profit of R13.1 billion in 2021 to a loss of R16.4 billion in 2022. These results include those of Sasria SOC Limited (Sasria). Sasria's 2022 results were largely characterised by the losses from the April 2021 Kwa-Zulu Natal riots. After excluding the results of Sasria, the non-life industry generated a profit of R7.0 billion in 2022, a decline compared to the profit of R11.6 billion earned in 2021. The impact of the Kwa-Zulu Natal floods, hardening of reinsurance rates and rising inflationary environment are reflected in these results.

1 https://www.aon.com/getmedia/f34ec133-3175-406c-9e0b-25cea768c5cf/20230125-weather-climate-catastrophe-insight.pdf

2 https://www.aon.com/getmedia/f34ec133-3175-406c-9e0b-25cea768c5cf/20230125-weather-climate-catastrophe-insight.pdf

3 https://www.resbank.co.za/content/dam/sarb/publications/prudential-authority/pa-selected-south-african-insurance-sector-data/2022/Selected%20South%20African%20insurance%20sector December%202022.pdf

The gross domestic product (GDP) growth rate for 2022 was 2.0%[4], just less than half of the growth experienced in 2021 of 4.9%[5]. According to Stats SA, "Although GDP reached an all-time high in 2022, the economy has only grown by 0.3% from the 2019 pre-pandemic reading of R4.58 trillion; this lags behind the 3.5% rise in the country's population over the same period"[6]. Average consumer inflation was 6.9% in 2022, higher than the average recorded for 2021 of 4.5%[7]. While a slight decrease was observed compared to 2021 at 35.3%[8], the unemployment rate settled at 32.7%[9] in the last quarter of 2022. Coupled with the increased level of pressure on the national power supply (with water supply challenges increasingly being experienced) and the increase in the prime interest rate from 7.25%[10] at the start of the year to 10.5%[11] at the end of 2022, these factors placed immense pressure on the disposable income of consumers and policyholders with cascading impacts on premium renewals, rate increases and lapse rates.

Financial indicators

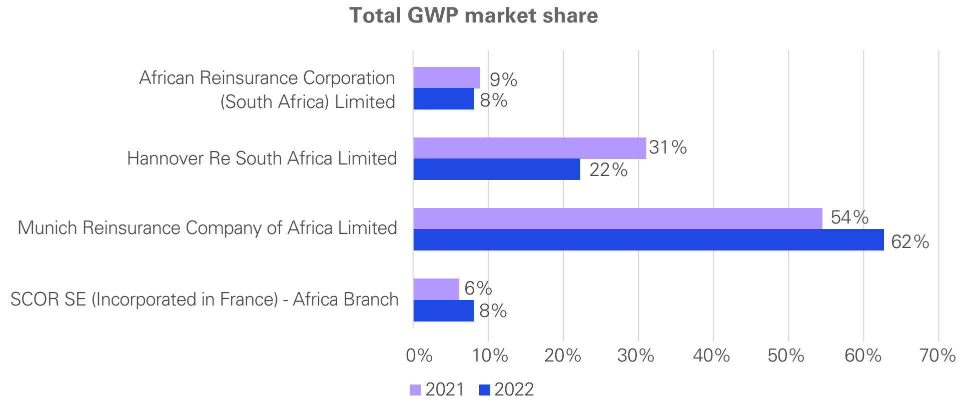
We conducted a series of interviews with various reinsurers to better understand their results and obtain their insights into what the future holds for the South African reinsurance industry.

The 2022 financial year strategy for reinsures was one of growth, recovery and refocus. The continued constrained economic environment, lagging remnants of COVID-19, unreliable power supply and unprecedented and unpredictable levels of natural catastrophes have influenced the 2022 results of reinsurers surveyed.

Growth

Gross written premium (GWP) grew by 18% (2021: 1%) over 2022, a welcome reprieve following a downward trend experienced in the previous three years. The biggest contributors to this increase are the hardening of reinsurance rates, particularly from July 2023 renewals, repricing, organic growth and new business. Following an unstable and unpredictable environment from many fronts over the last few years, the 2022 reinsurers' results are largely reflective of the growth in GWP experienced by life insurers of 4.4% and non-life insurers of 9.7%. In terms of reinsurance premiums incurred by the primary market, the life insurance industry saw an increase of 17% from 2021 with the non-life insurance industry reporting a 14% increase. All reinsurers interviewed have implemented stricter underwriting principles.

Illustrated below is the share of the reinsurance market by GWP based on the reinsurers that participated in this survey, as reported in their audited financial statements.



4 https://www.statssa.gov.za/?p=16162#:~:text=The%20South%20African%20economy%20grew,trillion%20to%20R4%2C60%20trillion.&text=Although%20GDP%20reached%20an%20all,reading%20of%20R4%2C58%20trillion.

5 https://www.statssa.gov.za/?p=15214

6 https://www.statssa.gov.za/?p=16162#:~:text=The%20South%20African%20economy%20grew,trillion%20to%2R4%2C60%20trillion.&text=Although%20GDP%20reached%20an%20all,reading%20of%20R4%2C58%20trillion.

7 https://www.statssa.gov.za/publications/P0141/P0141December2022.pdf

8 https://www.reuters.com/world/africa/south-africas-unemployment-rate-hits-new-record-high-q4-2021-2022-03-29/

9 https://www.statssa.gov.za/?p=16113

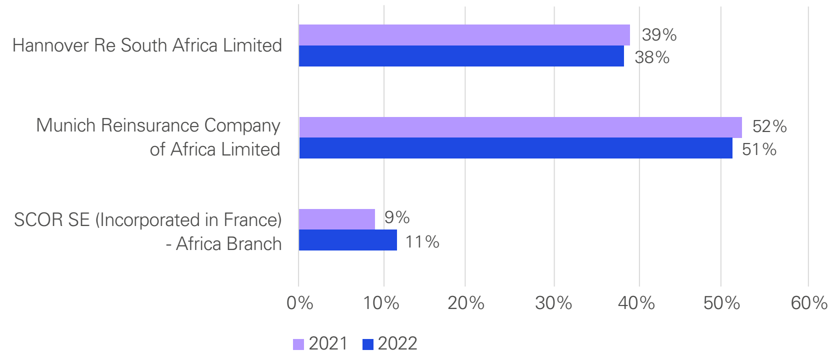
10 https://www.fnb.co.za/rates/LendingRates.html

11 https://www.fnb.co.za/rates/LendingRates.html

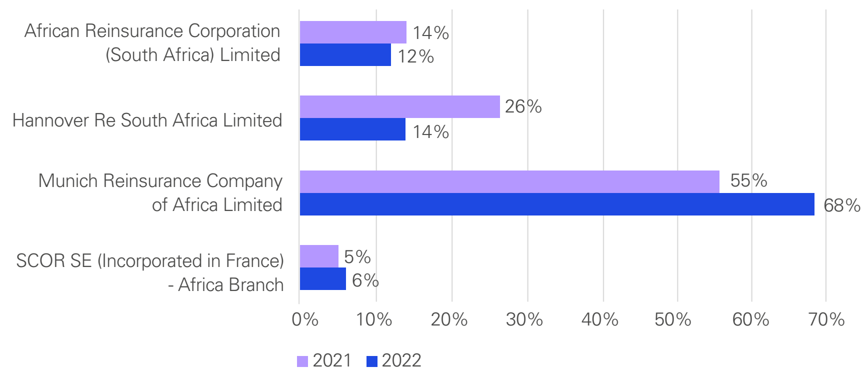
Munich Re and Hannover Re continue to lead the reinsurance market with their combined market share accounting for 84% (2021: 85%) measured by GWP volumes. The market share distribution across reinsurers continues to remain relatively consistent, with marginal movements noted across industry players.

Looking at the split of GWP between the life and non-life reinsurance industry, the comments noted above continue to hold true. We discuss the detailed movements per reinsurer further on in our analysis.

Life GWP market share



Non-life GWP market share



Other key performance indicators of the four reinsurers are as follows:

Performance indicator	2022	2021
Net commission to net earned premium (net commission ratio)	6%	11%
Management and other expenses to net earned premium (expense ratio)	16%	14%
Net policyholder benefits and entitlements to net earned premium (net loss ratio)	74%	115%
Underwriting loss[12]	R296 million profit	R3 782 million loss

The net commission ratio has almost halved from 2021 to 2022, largely attributable to Hannover Re's and Munich Re's acquisition cost increases being offset by higher reinsurance commission income increases, coupled with the overall increase in net earned premium of 5%.

The slight increase in the expense ratio is expected as business activities for 2022 were substantially back to pre-COVID-19 lockdown levels, coupled with more employees starting to have more of a physical presence in the office on a more frequent basis.

The 2021 financial year for reinsurers was largely plagued by the impacts of the Kwa-Zulu Natal riots and, to a smaller extent, the ongoing impact of COVID-19 and various benign natural catastrophe events. The net loss ratio and underwriting result reflect a vastly different scenario and a recovery in 2022 compared to 2021. This is a commendable result in the context of the Kwa-Zulu Natal floods in April 2022, which have been described as "the most catastrophic natural disaster yet recorded in Kwa-Zulu Natal in collective terms of lives lost, homes and infrastructure damaged or destroyed and economic impact"[13].

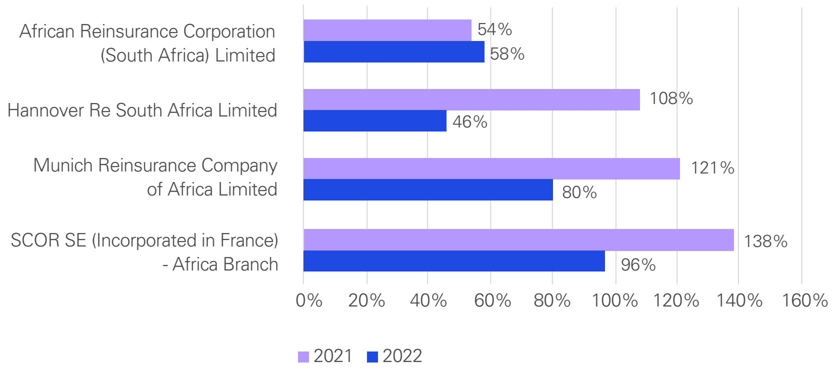
12 Net earned premium + reinsurance commission income – net claims incurred – acquisition costs – management and other expenses

13 https://www.wits.ac.za/news/latest-news/general-news/2023/2023-04/the-2022-durban-floods-were-the-most-catastrophic-yet-recorded-in-kwazulu-natal.html

It is interesting to note that, except for Munich Re, no other reinsurer declared dividends during the year, consistent with the financial results of 2021 and 2020. It is likely that many reinsurers will continue to take a conservative approach, in the context of the strength of their balance sheets, while the uncertainty around the frequency and severity of natural catastrophe events and the materialisation of the impacts of premium rate increases are yet to be assessed.

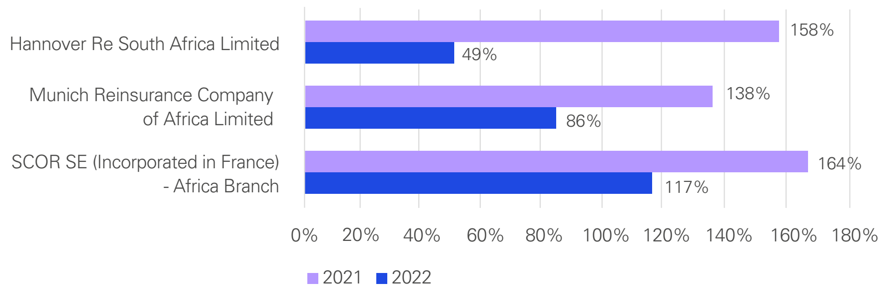
The graph included below illustrates the net loss ratio for each reinsurer. Except for Africa Re, the reinsurers experienced a substantial improvement in their loss ratios.

Net loss ratio

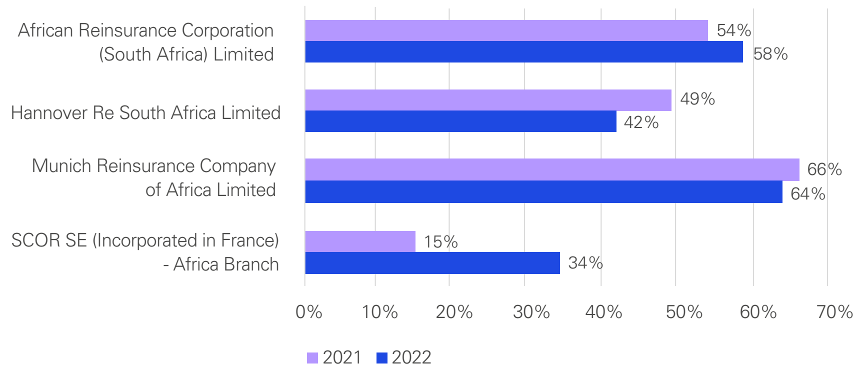


Breaking the results up further, it is clear that reinsurers writing life insurance risks showed the highest level of recovery in their loss experience compared to 2021, compared to reinsurers that wrote non-life insurance risks. This is largely attributable to the gains experienced from lower mortality losses experienced by the life insurance industry, where mortality levels have started to normalise to pre-pandemic levels, offset by the losses experienced from the Kwa-Zulu Natal floods.

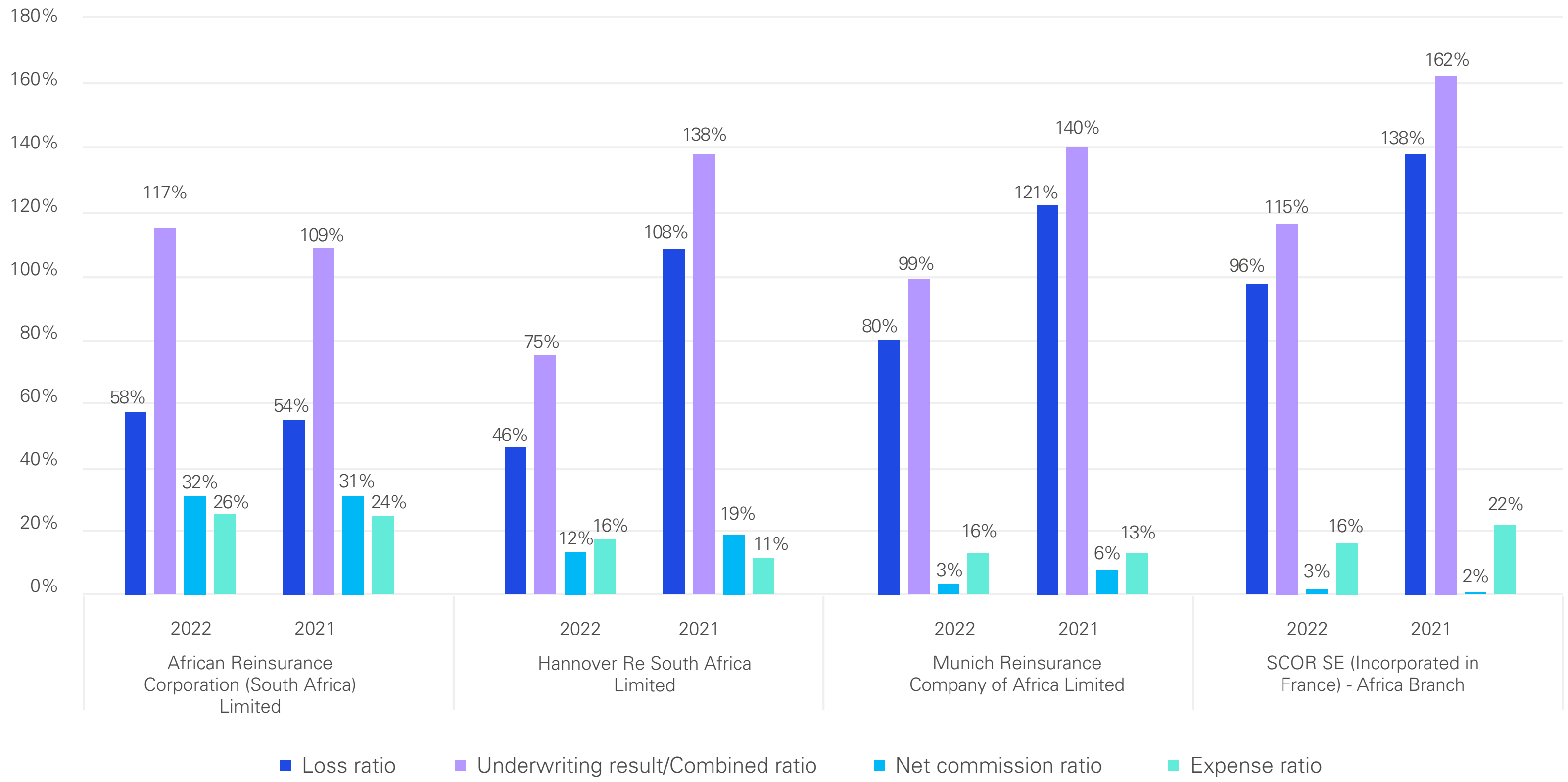
Life loss ratio



Non-life loss ratio



Underwriting performance per reinsurer



Except for Africa Re, all reinsurers experienced an improvement in their underwriting performance compared to 2021. The next section of our report provides deeper analysis into the results of each reinsurer.

Note: where reference is made to the loss ratio throughout this article, this represents the loss ratio net of reinsurance, i.e the net loss ratio.

Africa Re

Historically registered as a non-life reinsurer, Africa Re underwent a relicensing process and in 2022 it was registered as a composite reinsurer. This enables it to write both non-life and life reinsurance business, however no life reinsurance business was written during 2022. The results presented for 2022 therefore only relate to Africa Re's non-life reinsurance business.

During 2022 Africa Re experienced growth in GWP of 8%. This is a vast improvement from the decline in GWP experienced over 2020 and 2021 of 18% and 1% respectively. This is attributable to the impact of the implementation of the reinsurer's turnaround strategy which it embarked on in 2018 that aimed to de-risk and enforce better underwriting discipline in the quality of risks assumed and restructure of its retrocession programme. Other contributing factors are new business acquisitions as well as the start of the hardening of reinsurance rates, offset by the non-renewal of larger books of business.

"Natural catastrophe events are here to stay with us - the only direction that reinsurance rates can go is upwards. For reinsurers to be able to offer sufficient and appropriate capacity to the primary market, reinsurance rates will need to follow suit. We should expect difficult market conditions to continue into the near future."

- Ibrahim Ibisomi (Management Consultant) and Sudadi Senganda (General Manager: Finance and Administration) from Africa Re, reflecting on what the future holds for the primary and reinsurance markets.

Africa Re was significantly exposed to losses from the April 2022 Kwa-Zulu Natal floods, and to a lesser extent, COVID-19 related claims. The increase in the loss ratio from 54% in 2021 to 58% in 2022 was moderated by the impacts of the strategic restructuring of the retrocession programme coupled with the effects of the turnaround strategy.

The increase in the combined ratio is a direct reflection of the increase in the loss, commission and expense ratios. While the increase in the loss ratio of 4% is the largest contributor, the impacts of the commission and expense ratios require further analysis. The increase in the net commission ratio of 2% from 2021 has stabilised when compared to the increase experienced in 2021 of 17%. The higher commission ratio continues to be attributable to solvency relief contracts offered to cedants which attract higher profit commission payments on profitable business, also a consequence of the reinsurer's turnaround strategy.

The increase in the expense ratio from 24% in 2021 to 26% in 2022 is due to the increased extent of business activity in 2022, post the lifting of lockdown restrictions.

While Africa Re experienced the highest underwriting loss of R102 million across all reinsurers surveyed for 2022, it is important to note that it is the only reinsurer exposed only to non-life insurance risks without the benefit of these exposures being offset by the better performing life insurance industry results.

Hannover Re

Effective from 1 January 2021, Hannover Re operates as a compositive reinsurer writing both life and non-life reinsurance risks under one reinsurance licence.

Hannover Re was the only reinsurer of those surveyed that experienced a decline in GWP and net earned premium. Both declined from 2021 by 15% (2021: 23% increase) and 31% (2021: 5% increase) respectively. The decrease in GWP is attributable to the non-life business which experienced a decline of 37% from R4.0 billion in 2021 to R2.5 billion in 2022. A portion of this decrease relates to portfolio transfers in 2021 as a result of the consolidation of the life and non-life operations, as well as the non-renewal of larger books of business. The growth in the life business GWP is organic. While in prior years the mix of life and non-life business was largely stable based on GWP measures, the life business GWP now contributes 60% (2021: 47%) to overall GWP with the non-life business contributing 40% (2021: 53%).

The overall loss ratio showed significant improvement from 108% in 2021 to 46% in 2022. The life business was the largest contributor to this improvement with the loss ratio moving from 158% in 2021 to 49% in 2022. This was largely attributable to normalised mortality levels off the back of the COVID-19 pandemic era, as well as the benefit materialised from restructuring of retrocession agreements. The loss ratio on the non-life business improved by 7% from 49% in 2021 to 42% in 2022, attributable to the strength of protection provided by retrocession cover. This improvement is a commendable feat in the context of the significance of the losses emanating from the Kwa-Zulu Natal floods, albeit to a lower extent than that experienced from the Kwa-Zulu Natal riots, which was more widespread.

The impact of the results set out above culminates in an improvement in the underwriting result from a loss of R1 019 million in 2021 to a profit of R470 million in 2022, with the largest contributor attributable to favourable claims exposure.

Munich Re

Munich Re experienced significant growth in GWP of R4.9 billion when compared to 2021. The non-life book of business contributed 71% (2021: 64%) to total GWP with the remaining 29% (2021: 36%) attributable to the life book of business. GWP from the life business increased by 10% while GWP from the non-life business increased by 52%. This translated into a 17% increase in net earned premium for the period (2021: 9%).

The loss ratio improved from 121% in 2021 to 80% in 2022. The largest contributor to this improvement emanates from the life book of business whereby an improvement of 52% in the loss ratio is observed, from 138% in 2021 to 86% in 2022. The non-life loss ratio improved by 2% from 66% in 2021 to 64% in 2022.

SCOR Africa branch

The 2022 financial year represents the second year of operations of SCOR Africa Branch in South Africa.

Similar to Munich Re, GWP and net earned premium increased sharply by 37% (2021: 8%) and 50% (2021: 42%) respectively. The mix of life and non-life business is largely consistent with 2021 with the life business contributing 50% (2021: 53%) and the non-life business contributing 50% (2021: 47%) to overall GWP. Life GWP increased by 29% (2021: 8%) due to new business and premium rate increases, while non-life premiums increased by 46% (2021: 8%) due to premium rate increases, particularly emanating from the July 2023 renewal period.

Like Hannover Re and Munich Re, the reinsurer's net loss ratio improved from 138% in 2021 to 96% in 2022, the highest loss ratio experienced across all reinsurers surveyed. Dissecting the loss ratio into its components, the life loss ratio showed an improvement from 164% in 2021 to 117% in 2022 and the non-life loss ratio deteriorated from 15% in 2021 to 34%. This experience is consistent with the results observed in respect of Hannover Re and Munich Re whereby the life book of business contributed to an improved total loss ratio and the non-life book having been impacted by the Kwa-Zulu Natal floods increased the ratio.

The improvement in the expense ratio from 22% in 2021 to 16% in 2022 is as a result of a higher once-off increase experienced in 2021.

Consequently, an improvement in the underwriting result was achieved, from a loss of R452 million in 2021 to a loss of R164 million in 2022.

Investment performance

Reinsurers achieved an average return on investments (including cash and cash equivalents) of 6.3% (2021: 6.5%). This is less than the average prime rate of 8.59%[14] (2021: 7.25%[15]) and the average 10-year government bond yield of 10.102%[16] (2021: 9.098%[17]).

However, this performance is commendable in light of an overall decrease in investments and cash and cash equivalents of 2%, to enable reinsurers to fund claims and/or commission payments.

Consistent with 2021, Munich Re was the top performer in terms of investment returns in 2022 at 8.3% (2021: 8.3%). Hannover Re followed closely with 7.7% (2021: 6.9%). Africa Re achieved a return of 5.0% (2021: 5.0%) and SCOR Africa Branch a negative investment return of 2.5% (2021: 1.7%). This is primarily due to interest expenses recognised on funds withheld (opportunity cost of funds withheld by ceding companies to mitigate credit risk for cedants) in excess of investment income earned. Removing the impact of the interest expense, SCOR Africa Branch's investment return is within a similar range as the rest of the reinsurers surveyed at 4.4% for 2022 (2021: 4.7%).

14 https://www.fnb.co.za/rates/LendingRates.html

15 https://www.absa.co.za/indices/prime-rate/

16 https://za.investing.com/rates-bonds/south-africa-10-year-bond-yield-historical-data

17 https://za.investing.com/rates-bonds/south-africa-10-year-bond-yield-historical-data

What the future holds for reinsurance operations

On 7 September 2023 Fitch Ratings released its most recent outlook for the global reinsurance market:

"Fitch Ratings has revised its global reinsurance sector outlook to 'improving' from 'neutral' to reflect the sector's strengthening financial performance into 2024. Near-term price rises are likely to outpace increases in claims costs and we expect underwriting margins to peak next year. Meanwhile, rising reinvestment yields and strong demand for reinsurance should increasingly support earnings. We believe pricing for natural catastrophe risks will better reflect the impact of climate change on claims, particularly as several reinsurers are cutting back on cover for medium-sized natural catastrophe risks, making pricing less competitive.[18]"

Around the same time S&P Global raised the reinsurance sector view to stable from negative due to higher reinsurance rates and increasing investment income, while Moody's kept its outlook for the sector stable[19].

Our discussions with reinsurers indicate that South African (re)insurers are currently faced with the added pressure that comes from the instability brought on by local political uncertainty, infrastructure challenges and potentially contentious foreign relations with Russia. These factors place strain on an already vulnerable and volatile civil sentiment, which increases the risk of another social unrest event.

Reinsurers are currently focussing efforts on finding the right balance between enforcing appropriate underwriting discipline, creating value and return to shareholders and ensuring stability of results. The outlier events of the recent past such as COVID-19, political riots and natural catastrophe events have highlighted the need to closely monitor exposures and treaty wording to achieve the best outcome. This has led to reinsurers considering the provision of alternative reinsurance products in light of increased exposures that primary insurers are taking on.

The view of the market is that sufficient capacity is available to the primary market, on the basis that that this is reflected in pricing structures. As a result, a hardening of reinsurance rates is expected to continue into the near future.

The provision of insurance cover over crytopassets, cryptocurrency, non-fungible tokens and the like is still seen as a high risk area with none of the reinsurers surveyed considering providing reinsurance cover for these risks in the near future. This is being guided by their international parent companies.

The impact of ESG continues to be monitored across the industry. Reinsurers have acknowledged that the availability and quality of data is important to this process to be able to provide the right solutions balanced with appropriate risk exposures.

Reinsurers are continuing to navigate their digitisation journey in various ways and forms such as collaborating with external partnerships and insuretechs, exploring the implementation of artificial intelligence and the use of blockchain technology.

The collective effort of insurers and reinsurers alike over an exceptionally challenging past few years has ensured a sound outcome for policyholders and the common good. While the results of 2022 reflect a strong recovery, the road ahead is expected to be challenging with the advent of new and emerging risks, global and local economic and political turbulence and South African specific challenges. However, as we have observed time and time again, the strength, resilience and trustworthiness of the reinsurance industry continues to provide stability in an everchanging environment.

Please refer to page 182 for the detailed financial results in respect of each reinsurer that participated in the survey.

18 https://www.fitchratings.com/research/insurance/global-reinsurance-sector-outlook-revised-to-improving-07-09-2023

19 https://www.reuters.com/business/sp-global-raises-reinsurance-sector-view-stable-negative-2023-09-05/