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Casualty Reinsurance Capacity Remains Plentiful Amid Concerns

Reinsurers have been incentivized to write more casualty business to expand operations, lower their cost of capital, and leverage returns

Principal Takeaways

- The casualty (re)insurance industry is being unfavorably impacted by adverse reserve development and narrowing margins, driven primarily by US social inflation trends.
- Reinsurers continue to offer needed capacity to casualty insurers, despite concerns about potential for development.
- Publicly traded reinsurers are incentivized to continue writing casualty business, even at poor margins, to grow their business and optimize the cost of capital.
- The market has the potential to develop an availability crisis if interim actions are not taken.

The global reinsurance market has undergone significant shifts in recent years, as many reinsurers scaled back property exposures, which brought about hard market conditions. Although property reinsurance became more restricted, casualty reinsurance capacity has been relatively consistent and even increased in areas such as workers' compensation. Casualty has long been a cornerstone of the global reinsurance industry, offering a crucial risk transfer mechanism for primary insurers and providing financial stability in the face of large claims. However, recent years have seen significant shifts in the casualty insurance landscape, particularly in the US. The primary driver of these changes has been adverse reserve development linked to social inflation—a phenomenon that has fundamentally altered the underwriting environment.

A recent AM Best briefing (January 1 Renewals and What to Expect in 2025) noted US reinsurers with a casualty reserve portfolio that gain 8%-10% in rate increases are not keeping pace with loss cost trends. The markets that are pushing 15%-20% rate increases will be the ones that may overcome challenges, according to the panel discussion. Social inflation remains a key driver of casualty loss trends on past years and continues to create uncertainty across the casualty landscape amid negative social sentiment.

Social inflation refers to the rising costs of insurance claims due to a combination of factors such as increased litigation, higher jury awards, and a broader interpretation of policy coverage. Related legal advertising has doubled since 2013 and the AM Best panel also noted litigation funding is projected to reach almost $31 billion by 2028. This questions whether rates can outpace social inflation loss trends. Uncertainty about overall inflation is another consideration for casualty lines underwriters. Although it has decelerated in some parts of the world, two key components—wage and health inflation—have not tapered off at the same pace.

This trend has had a profound impact on casualty reinsurance, leading to significant adverse reserve development. Reinsurers have found themselves facing higher-than-expected claims costs, necessitating upward adjustments to their reserves. Casualty reinsurance, for the most part, is driven by quota share contracts. Thus, reinsurers rely heavily on ceding insurers to deploy prudent measures to combat these trends, with minimal tools on their end to fix troubled accounts.

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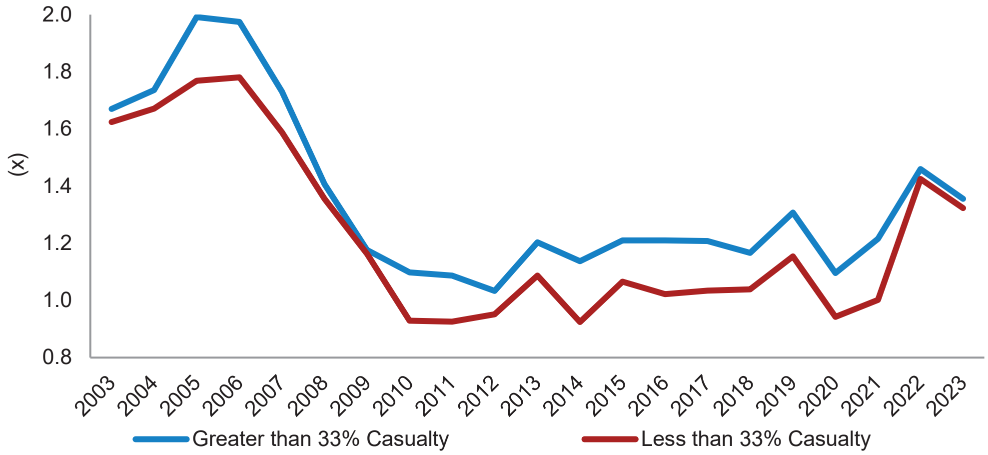
Exhibit 1
Reinsurers' Stock Price to Book Value Movements



Sources: Bloomberg and AM Best data and research

These factors have placed substantial pressure on reinsurers, forcing them to reassess their reserve adequacy. In 2024, many global reinsurers reported reserve strengthening efforts to combat adverse development. Some companies indicated that they would also be scaling back casualty exposures in upcoming renewals. As the January renewal cycle closed, capacity remained abundant and there was no talk of hardening rates or dramatic shifts in terms and conditions. Reinsurers have apparently not had the same sense of urgency they did just a few years ago with property lines. The lack of urgency could be driven by several factors, but it likely begins with investor sentiment.

Investors Favor Casualty Lines

The reinsurance market is often influenced by investor appetite. In prior hard markets, new investor capital has entered the market to help spark competition and soften rates. However, in 2022, the lack of investor willingness to absorb property market volatility on traditional reinsurance balance sheets led many reinsurers to reduce their capacity for higher volatility property lines. Much of that capacity was redirected into casualty lines, which the equity markets appear to favor. When examining publicly traded reinsurers' stock prices over the past 20 years, AM Best found that reinsurers with higher allocations to casualty lines saw a higher average yearly increase in stock prices compared with those with higher allocations to property lines. Additionally, those with higher property allocations generally traded at lower price-to-book value multiples over the same period (**Exhibit 1**).

This data contrasts somewhat with the drastic expansion of the insurance-linked securities (ILS) market, which writes property lines coverage almost exclusively, over the same period. However, ILS affords investors a vehicle to invest in customized levels of volatility, for a shorter time frame than may be available in traditional reinsurer/start-up models. As these models continue to evolve over time, it is becoming more evident they can offer investors similar, or even superior, levels of return on risk capital for property reinsurance business. What they struggle to compete with traditional reinsurers on is casualty lines, owing to the longer-tailed nature of the business, which can trap capital and lead to uncertain investment horizons. Therefore, investors' only access to casualty business is by investing in traditional reinsurers, which drives their value up as they write proportionally more casualty business.

Casualty Drives Results

Casualty business has a structural impact on a reinsurer's balance sheet. The longer duration and relative uncertainty of claims payments for most casualty lines results in higher levels of reserves on the reinsurer's balance sheet. These reserves are invested to generate additional investment income

Exhibit 2
Global Reinsurance Top 25 Composite – Returns on Equity
(%)

	2018	2019	2020	2021	2022	2023
Tax Burden (Net Income/EBT)	66	86	82	84	57	95
Interest Burden (EBT/EBIT)	73	93	77	93	63	96
EBIT Margin (EBIT/Total Revenue)	3	9	3	9	2	15
Total Asset Turnover (Total Revenue/Average Total Assets)	20	24	22	24	24	29
Leverage (Average Total Assets/Average Shareholders' Equity)	557	564	561	544	577	542
Return on Equity	**2**	**10**	**2**	**9**	**1**	**22**

Source: AM Best data and research

prior to claims being paid. In Significant Increase in Global Reinsurers' ROE Due to Investment and Underwriting Results (October 31, 2024), AM Best conducted a five-stage Dupont analysis if reinsurers' returns on equity (ROE) and found asset leverage (average total assets/average shareholders' equity) had the greatest impact on the industry's ROE (**Exhibit 2**).

Asset leverage should increase proportionally to the amount of casualty business a reinsurer writes. This is due to the generally long-tailed nature of claims payouts and relatively narrower underwriting margins. Even if a reinsurer is operating at a 100 combined ratio, this essentially becomes an interest-free loan. If the company is running at a slightly higher combined ratio, it will be able to run a profit through leveraged returns, as long as the investment returns are higher.

Growth and Diversification

As the expansion of ILS market took place, so did the evolution of the traditional reinsurer market. Many of the household names that once carried significant weight in the property catastrophe business began to diversify heavily into casualty and specialty lines of business. Even if lines of business are not necessarily generating profits, a low correlation with other lines of business will result in more stable returns and lower marginal costs of capital. This provides executives an opportunity to grow their business, without fundraising in many cases, which typically means higher compensation for themselves as well.

The other benefit to a growing balance sheet is that it further shields reinsurers from competitive forces. Historically, the reinsurance market has been dominated by a few companies, which remain at the top of the industry in products, research, and science, but some younger reinsurers have begun to grow to a size where they are beginning to narrow the gap. Still, the few giants at the top of the industry have the ability to move markets, demonstrating the power of a large balance sheet, which can be obtained only through growth and diversification in all lines of business.

What Comes Next?

The reinsurance market reported adverse development throughout 2024, and the problems are not anticipated to slow in the near term. The casualty market appears to be headed for a crossroads. A few years ago, the property reinsurance market underwent dramatic changes and has since performed generally well through active loss years. But the casualty issue is much more complex and cannot be resolved through simple changes to attachment points or underlying terms. The underlying business will continue to deteriorate as social inflation drives up loss costs. Insurers and reinsurers are essentially playing catch-up with rates as they report adverse development every few years. Despite these loss trends, many companies cite they will continue to get strong rate increases. The question becomes, when is enough going to be enough?

It is somewhat difficult to observe casualty performance year by year when adverse development takes place. However, AM Best examined developed accident-year loss ratios for the past 10 years and combined them with calendar year expense ratios for the associated year. That combined ratio was compared to the industry investment yield for that calendar year to generate an implied margin. What AM Best found was that certain casualty lines had negative margins in 2019 and prior, where most of the companies booked their development at year-end 2023 (**Exhibit 3**). Additionally, 2019 was the year in which paid reserves constituted more than 50% of developed reserves. For year-end 2024, many companies indicated some development from accident years 2020-2024. In AM Best's view, these margins could continue to deteriorate.

Exhibit 3
Other Liability Claims Made – Estimated Combined Ratio by Accident Year
($ billions)

	Other Liability - C/M				Other Liability - Occ				Commercial Auto				
	LR	UW Exp Ratio	CR	Implied Margin	LR	UW Exp Ratio	CR	Implied Margin	LR	UW Exp Ratio	CR	Implied Margin	Inv Yield
2014	65.0	29.0	94.0	9.6	69.6	30.8	100.4	3.2	81.5	27.4	108.9	-5.3	3.6
2015	66.5	29.9	96.4	6.7	73.8	29.9	103.7	-0.6	83.9	29.6	113.5	-10.4	3.1
2016	76.0	30.5	106.5	-3.5	76.1	32.3	108.4	-5.4	86.8	29.4	116.2	-13.2	3.0
2017	73.8	29.8	103.6	-0.6	78.2	30.8	109.0	-6.0	87.1	28.6	115.7	-12.7	3.0
2018	80.3	29.2	109.5	-6.2	77.4	30.4	107.8	-4.5	86.6	28.1	114.7	-11.4	3.3
2019	74.7	29.1	103.8	-0.7	77.2	30.0	107.2	-4.1	87.7	27.4	115.1	-12.0	3.1
2020	67.1	27.9	95.0	7.8	70.6	27.9	98.5	4.3	71.1	27.8	98.9	3.9	2.8
2021	60.9	25.8	86.7	15.9	67.1	27.0	94.1	8.5	75.9	26.1	102.0	0.6	2.6
2022	61.8	27.1	88.9	14.3	66.3	27.1	93.4	9.8	77.8	24.6	102.4	0.8	3.2
2023	63.2	28.5	91.7	11.5	69.6	26.3	95.9	7.3	79.8	25.8	105.6	-2.4	3.2

Source: BESTLINK

Barring any broad tort reform, social inflation trends will likely continue to worsen. However, reforms are unlikely if reinsurers are willing to write the business. The January 2025 renewals demonstrated that reinsurers are inquiring more about insurers' casualty operations, but those insurers have still been able to find ample capacity for their programs. If insurers are able to purchase reinsurance for their casualty books, they will continue to write high limits. If insurers offer high limits, social inflation will continue to vex the industry until some reform takes place.

Reinsurers are incentivized to write more casualty business to grow their business, lower their costs of capital, and leverage their returns. Executives will find it difficult to justify scaling back their casualty books and giving up all those benefits, especially as rates continue to climb. At some point, it will become a necessity, though, when the volatility in reserves becomes so uncertain that capital needed to absorb that volatility is no longer economically feasible. If this were to occur, the market could experience the availability crisis that sparks change.

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