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Market Segment Outlook: Germany Non-Life

The stable outlook reflects German non-life insurers' very strong balance sheets and good underwriting discipline.

A.M. Best has a stable outlook on the German non-life insurance sector. Germany's robust economy continues to drive growth in the non-life insurance market. Technical profitability is solid and is expected to remain so, underpinned by good underwriting discipline and sustainable rate adjustments. For the most part, non-life insurers benefit from very strong balance sheets, which positions them well to withstand evolving market conditions. Persistently low interest rates and the threat of market disruption are offsetting factors.

The German economy grew by 2.2% (measured by growth in gross domestic product) in 2017, enjoying its fastest rate of expansion since 2011. This was driven by rising exports, strong growth in the building sector, higher investment by companies, as well as record high employment rates and rising wages. It is expected that these fundamentals, which supported non-life premium growth of 2.9% in 2017, will persist through 2018 and form the foundation for further premium growth. However, A.M. Best notes that economic headwinds, the global rise of populism and trade protectionist policies could adversely impact Germany's export dependent economy. Any related economic slowdown would likely subdue demand for insurance cover.

Also contributing to the growth of the non-life market in 2017 was an increase in premium rates. Higher rates were recorded for both motor and property business, which are the largest classes, accounting for close to 70% of total non-life premiums.

In A.M. Best's view, Germany's non-life insurance market has solid earnings potential over the short to medium term, underpinned by robust underwriting profitability. In 2017, the sector reported a combined ratio of 95%. The market has exhibited effective cycle management and good underwriting discipline over the past 15 years, and has reported accident-year combined ratios below 100% since 2014 for both motor and property insurance. An offsetting factor has been depressed investment income as a result of low interest rates.

The largest segment, the motor market, is increasingly competitive as the dominant players vie for new policies with a mix of price reductions and product initiatives. However, in contrast to previous cycles, insurers appear to be differentiating themselves predominantly by service rather than by price.

The property segment has benefited from sub-100% accident-year combined ratios since 2014, primarily supported by strong premium rate increases for homeowners' comprehensive insurance on the back of rehabilitation efforts. However, the commercial property class remains negatively impacted by strong price competition and adverse claims experience, and has recorded combined ratios above 100% in most years since 2010.

Germany is exposed to natural catastrophe losses, largely from windstorm, flood and hail events, and insurers tend to retain a high proportion of retail risks. Consequently, A.M. Best expects the overall results of the sector to be somewhat volatile over the long term. Since 2014, benign catastrophe experience has helped overall performance, with annual insured property losses from natural catastrophe events around the EUR 2 billion mark. In contrast,

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Best's Market Segment Outlooks

Our market segment outlooks examine the impact of current trends on companies operating in particular segments of the insurance industry over the next 12 months. Typical factors we would consider include current and forecast economic conditions; the regulatory environment and potential changes; emerging product developments; and competitive issues that could impact the success of these companies. Best's ratings take into account the manner in which companies manage these factors and trends.

A Best's Market Segment Outlook, like a Best's Credit Rating Outlook for a company, can be positive, negative, or stable.

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- A negative market segment outlook indicates that A.M. Best expects market trends to have a negative influence on companies operating in the market over the next 12 months. However, a negative outlook for a particular market segment does not mean that outlook for all the companies operating in that market segment will be negative.
- A stable market segment outlook indicates that A.M. Best expects market trends to have a neutral influence on companies operating in that market segment over the next 12 months.

We update our market segment outlooks annually, but may revisit them at any time during the year if regulatory, financial, or market conditions warrant.

hail and windstorm events in 2013 resulted in combined insured losses of greater than EUR 6.5 billion. Although the frequency of natural catastrophe losses increased in 2017, single major natural catastrophe events abated. Windstorms that affected western and central Europe during January 2018 are expected to have caused a significant industry loss in Germany with independent estimates of approximately EUR 1 billion in insured losses.

Progressive advancements in digitalisation and data analytics increasingly shape the German non-life insurance market, as more participants focus on digital transformation and innovation. Traditionally, German non-life insurers have been known for their caution rather than for spearheading innovation. However, partially as a result of changing customer behaviour and technological advancements, the largest German carriers are deploying extensive resources in the development of their digital capabilities and have started to digitise parts of their value chain.

A.M. Best believes that companies that are successful in their digital evolution will likely benefit from higher growth, lower expenses, better policyholder retention, and ultimately long-term success, compared with their less progressive peers. Advancements include the development of new insurance products such as cyber insurance, enhanced underwriting analytics, and superior claims management and mitigation.

Digital transformation in the German market is largely focused on internal process simplification and improving policyholder satisfaction, with an emphasis on optimising operations and enhancing customer experience. This is simultaneously seen as an opportunity and challenge by a market that has traditionally been dominated by a strong tied agent distribution model, as a key challenge will be embedding technological advancements into the agent's interaction with customers.

As market players target leanness and complexity reduction, there are long term questions over whether smaller companies will be able to keep pace with the investments made by market leaders, and whether larger companies can be responsive and adapt quickly to developments. Failure to embrace developing market dynamics is considered a significant risk for all insurers over the long term.

The low interest rate environment continues to put negative pressure on companies' earnings, and yields are likely to remain depressed in the near term. In spite of this, investment income is expected to continue to make a stable, albeit relatively modest, contribution to earnings, as companies tend to favour a conservative investment strategy.

The invested assets of insurers are largely held in bonds and debentures, which accounted for approximately 75% of the sector's total investments in 2016, and provided insurers with adequate liquidity. Although assets are predominantly of high credit quality, some insurers have been increasing the credit risk in their investment portfolios, or increasing their exposure to real assets, in order to enhance yield. While there are indications that interest rates may rise over the medium term, a change in the European Central Bank's monetary policy in the form of rising interest rates is unlikely to occur in the near term.

Over the past decade, German non-life insurers have largely adapted to the challenges of declining current yields by becoming increasingly focused on prudent underwriting practices. In the short term, A.M. Best expects the market to continue to focus on underwriting operations in its quest to strengthen profitability. Nevertheless, a sharp adjustment in global monetary policies could trigger sudden volatility in capital markets, which could negatively impact short-term investment results.

Despite weak investment income and an increasingly competitive environment, the capital adequacy of German non-life insurers remains at a very strong level. As at year-end 2016, the market's aggregate Solvency Capital Ratio under the Solvency II regulatory regime was recorded at 286%, although there was significant variance in the ratios of individual insurers. Very strong regulatory solvency levels are supported by relatively low underwriting leverage and conservative investment strategies. With an overall profitable market in 2017, capital adequacy is likely to have remained at a very strong level.

In A.M. Best's opinion, the German non-life insurance market is well-positioned to withstand challenges that may arise from increasing competition and higher natural catastrophe losses. Surplus capital provides a buffer to adverse performance, and better enterprise risk management, due in part to the implementation of Solvency II, has led to an improvement in the control and oversight of key risks.

The impact that emerging technologies have on the non-life sector will accelerate with time and how companies adapt to this will be an important driver of future performance. Although there is a shift towards the adoption of new technology and innovation in areas such as data-analytics, digitalisation and insurance as a utility, it is expected that substantial operational and underwriting efficiencies, as well as a greater focus on claims costs, will only crystallize over the medium term. It is expected that German insurance carriers will gradually adjust their business models and strategies in order to take advantage of evolutions in technology and data.

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