MARKETS

It’s the Moment Insurers Have Been Waiting For: Time to Raise Your Prices

Hurricanes, earthquakes and wildfires could make 2017 the most expensive year ever for insurers

A worker cleaning up debris in a Beaumont, Texas, neighborhood flooded by Hurricane Harvey in Beaumont, Texas, on Sept. 26.
PHOTO: DAVID GOLDMAN/ASSOCIATED PRESS

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Updated Dec. 28, 2017 4:25 p.m. ET

One of the costliest years for natural disasters puts some U.S. insurers in a position to do what they haven’t done in years: raise prices.

The biggest rate increases are expected from reinsurance companies that could be asked to pay more than half of all claims attached to a string of Atlantic hurricanes, Mexico earthquakes, California wildfires and winter storms. Reinsurers, which essentially act as insurers for other insurance companies, absorb the risk of some policies sold by primary carriers and typically pay once claims reach contractual, designated levels.

Property-catastrophe reinsurance rate increases could reach 20% for some clients in hurricane-prone parts of the U.S., analysts say. The price increases are likely to mean higher insurance premiums for millions of people and businesses in Atlantic and Gulf Coast states because many primary insurers will seek to pass on the higher prices, though homeowners’ rates are regulated by states.

“They are demanding more,” Morgan Stanley analyst Kai Pan said of reinsurance companies. “The industry, collectively, is serious about needing better pricing.”

Widespread gains would reverse a trend largely in place since the mid 2000s. Property-catastrophe reinsurance prices have fallen by about half since 2012, according to a recent Morgan Stanley report.

The decadelong drop was due largely to a period of few major hurricanes. Another factor was the influx of capital into so-called catastrophe bonds and other investing vehicles that help insurance companies mitigate the risk of natural disasters. Investors that purchase the bonds are paid relatively high interest rates but can lose their principal if a hurricane or earthquake hits. Profits for reinsurers have fallen along with prices.

The last time property-catastrophe reinsurance premiums jumped considerably was in 2005, the year of Hurricane Katrina. They rose again slightly in 2011 and 2012 following earthquakes and floods in Japan, New Zealand and Thailand, as well as superstorm Sandy in the U.S. But then they dropped again. Prices in 2017 fell to their lowest point in 17 years, according to a Guy Carpenter index of global property-catastrophe reinsurance pricing.

The U.S. property-casualty industry entered hurricane season this year with its fattest-ever cushion for absorbing losses. U.S. insurers had a record $709 billion set aside last spring, and global reinsurers had $605 billion.

By fall, those cushions would be tested by a confluence of three major Atlantic hurricanes and two Mexican earthquakes that caused between $66 billion and $111 billion in insured damage, according to current estimates from catastrophe-modeling firms. Wildfires in California in October added another $9.4 billion in claims, according to the state's insurance commissioner, and Wall Street analysts say another round of fires still raging in southern California could cost an additional $5 billion or more.

The damages from 2017 may end up being the costliest ever for insurers. The global insurance and reinsurance industry's worst year previously was 2011, when companies paid out $126 billion in inflation-adjusted dollars, according to Wells Fargo.

There is some skepticism that reinsurance prices can rise enough in the coming year to offset the decline over the last decade. Any changes may also take some time to flow through the industry. In Florida, one state tested by this year's events, many insurers won't renew their reinsurance policies until June.

"A lot of these natural disasters often take many months, maybe years to manifest themselves fully in the marketplace," said Dean Klisura, a senior executive with Marsh & McLennan Cos.'s Marsh insurance brokerage.

Roughly half of Marsh's U.S. clients experienced property-insurance increases of 3% on average in the past couple months, but some with large catastrophe losses this year are in the double-digits, according to Mr. Klisura. He said the firm's brokers are exploring renewal options for clients at least a month earlier than usual in an attempt to hold down costs.

Other estimates for increases vary. Morgan Stanley projects that U.S. property-catastrophe reinsurance prices will rise 10% to 20% next year for accounts that suffered losses this year, compared with 5% to 10% for others. Wells Fargo predicts a boost of about 10% for catastrophe reinsurance prices.

A wildfire threatening a home in Ventura, Calif., on Dec. 5. **PHOTO:** JAE C. HONG/ASSOCIATED PRESS

In California, fires could lead some insurers to shrink their presence in the state, some analysts say, and that could lead to higher prices for homeowners and businesses as competition lessens.

One factor that could depress any increase in reinsurance rates is continued appetite from investors in catastrophe bonds and other investment vehicles that serve as reinsurance. These investors likely incurred losses during 2017 due to the string of disasters. If they continue to stick with reinsurance, it may be more difficult for prices to rise.

"This was a pretty substantial test," said Paul Schultz, chief executive of Aon Securities. "We're feeling pretty good about the amount of capital that's going to be available" for next year.

In a sign that these investors remain interested, financial-services firm United Services Automobile Association in November obtained $295 million of catastrophe reinsurance for its home-insurance business through bonds issued by an entity named Residential Reinsurance 2017 Ltd., according to Kroll Bond Rating Agency. The coverage is for a range of natural disasters across the U.S.

Some insurance executives say they can't wait any longer to charge clients more. Chubb Ltd. Chief Executive Evan Greenberg told analysts in October that many insurance lines—including directors-and-officers, employment practices and commercial auto—need higher prices because insurers' payouts have grown in recent years while premiums have been held back by competition. Commercial lines overall are down 1% since 2010, according to Wells Fargo.

"Pricing overall today is too cheap," Mr. Greenberg said.

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Appeared in the December 29, 2017, print edition as 'Insurers Poised to Raise Rates.'