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(Re)insurance | Insight | Intelligence

Property cat 2023: hard just got harder

As Floridians count the terrible cost of destruction wrought by Hurricane Ian, the property cat industry is getting to grips with a major catastrophe event that threatens to create turmoil for 2023 renewals that were already expected to be extremely challenging amid a supply-demand imbalance.

Even with a clean hurricane season the consensus was that 1 January property cat renewals would see significant price increases of 20 percent or more on average just to reflect inflation – including make-up for 2022 and 2023 projections – with a more modest rate hike measured on a risk-adjusted basis.

At the recent Monte Carlo *Rendez-Vous* it became clear that the topic of price had become a sideshow in the upcoming renewal discussions, a derivative of the main event centered around capacity.

"It's the first year where they're not at all interested [in price]. They're focused on trying to assemble enough capacity, because they just don't think they have enough. They're saying, 'how can you give us more … you'll charge what you need to charge for it, we just need to be able to get it done," said a senior market source.

The reason is a major shift to disequilibrium in the relationship between supply and demand.

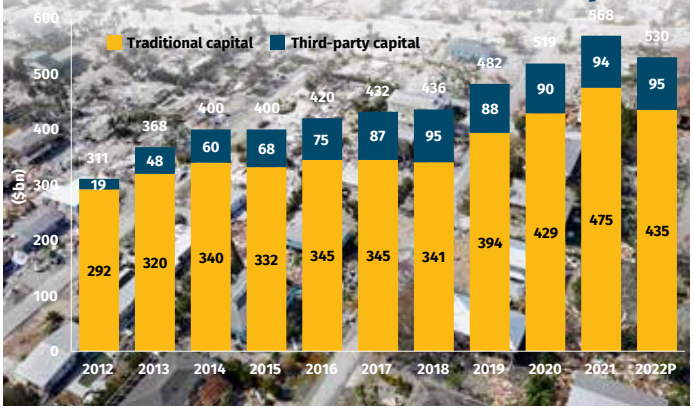
On the supply side the well-documented retrenchment from cat by several reinsurers and the collateralized market has been compounded by mark-to-market losses on bond portfolios effectively reducing industry capital.

There is also the impact of the US dollar strengthening against the euro-denominated balance sheets of three of the four Continental European giants.

These supply-side factors have coincided with an inflation-fueled demand surge that is expected to mean at least $20bn of additional limit will be required for US buyers alone at 1 January.

That represents a 10 percent increase Continued on page 14

Global reinsurance – estimated total dedicated reinsurance capital



Risk Theory launches Jupiter multiline habitational program with Clear Blue

Specialty underwriting platform Risk Theory has launched a new multiline habitational program called Jupiter Risk Services that has begun underwriting on the A- paper of Clear Blue, and supported by a panel of blue-chip reinsurers, *The Insurer* can reveal.

The move comes at a time of scarce capacity in the US hab space following the retrenchment of a number of players over the last few years, driving significant rate increases.

The ability to attract reinsurance capacity to the new program behind hybrid fronting specialist **Clear Blue**, at a time when others are pulling back is likely to be seen as a welcome addition to the space as producers seek out alternatives for the business in an increasingly tight market.

The reinsurance is understood to have been put together by HowdenRe and **Guy Carpenter**.

Jupiter is described by Dallas, Texas-based **Risk Theory** as an exclusive nationwide program providing essential property coverage designed for habitational risks.

It provides non-admitted coverage available in almost all states of the US, distributed via retail agents. Continued on page 3

NEWS horts

EMC to shutter $180mn Re biz

EMC Insurance Companies is shuttering its assumed reinsurance business at the end of the year, with the company currently considering options for the management and/or run-off of the platform's existing business.

AM Best A rated EMC Re represents about $180mn, equal to some 10 percent, of Des Moines, Iowa-based EMC's total annual premiums.

Hallmark extends 10.1 whole account casualty QS

Hallmark Specialty has extended the existing terms on its two whole account casualty quota share treaties for around two weeks beyond their 1 October inception date, ahead of the company making a larger strategic move that is expected to be announced imminently, *The Insurer* revealed.

Total subject premium for the two deals is thought to be somewhere in the region of $370mn.

Axis Re gets Gray for marine

Canopius' deputy head of reinsurance Chris Gray is set to join Axis as head of marine reinsurance, *The Insurer* revealed this week.

The hire is part of a broader drive by Axis Re to target specialty growth, with the company having announced its exit from property reinsurance in June. *The Insurer* understands Gray will be based in London for the role and will report to Andy Hottinger, president of international at Axis Re.

Ian coverage caveat

With Hurricane Ian a fast-changing live cat event as the first issue of our APCIA dailies went to press, we wanted to remind readers that interviews with industry executives and feature contributions were conducted and written before the storm emerged as a threat in the last week. Consequently, comments on market conditions come with that caveat.

For full, up-to-date coverage of the fallout from Hurricane Ian please visit theinsurer.com and look out for our breaking news alerts.

EXCLUSIVE

Continued from page 1: Risk Theory launches Jupiter multiline habitational program with Clear Blue

The program does not offer coastal Tier 1 or Tier 2 coverage.

Coverages available through the program include property for buildings and business personal, business income/rental value, ordinance or law, replacement cost for most properties, and managed repair for all covered losses.

Risks being targeted include garden-style apartments and condominiums.

There are no limitations on building ages or loss experience, but the program does require a 60 percent or greater occupancy rate, with the property managed by a professional real estate company, or with a superintendent or property manager.

Risks excluded from the program include nursing homes, manufactured housing, rehab facilities, safe houses, group homes and halfway houses, apartments with wood shake roofs, municipalities and assisted living facilities.

> "The habitational property market in the US has been in hard market territory for several years, driven by primary and secondary cat perils loss activity that has now been compounded by the impact of surging inflation"

The program has partnerships with the Apartment Association of Greater Dallas, the Texas Apartment Association and the National Apartment Association.

Hab hard market

The habitational property market in the US has been in hard market territory for several years, driven by primary and secondary cat perils loss activity that has now been compounded by the impact of surging inflation.

The segment has been described as a "problem child", suffering from longstanding issues including undervalued replacement costs and outsized losses. A recent report by wholesaler **RPS** said that better quality clients with a sizable number of carriers across their primary and excess covers, good loss track records, proper valuations and newer properties are able to keep rate increases in the 5 to 10 percent range.

But those with "horrendous" valuations and older properties in tough areas of the US will see rate increases well north of 25 percent and challenged renewals.

The most extreme examples include renewals with rate increases in excess of 100 percent.

The move to launch **Jupiter** comes after another Dallas-based MGU, Strata Underwriting Managers, told distribution partners it would non-renew accounts on its program after it was unable to secure capacity at its March renewal amid what it described as "extreme conditions" in the property cat reinsurance market.

It subsequently made attempts to relaunch a slimmed down version of the offering as a binding authority arrangement between the Amynta-owned firm and a single carrier supported by its reinsurance.

Jupiter owner **Risk Theory** is a platform for MGUs and programs founded by Bryan Wilburn and now led by Peter Smith as CEO which has built a portfolio that now represents over $1bn in premium.

It typically invests in start-ups or established MGUs with a program premium opportunity of at least $50mn focused on the SME space with a preference for the non-standard or E&S market. Classes targeted are usually niche, high hazard across commercial insurance lines spanning property casualty or employee benefits. **Risk Theory** did not immediately respond to a request for comment on this article.

The Insurer Comment

The US hab market has been a difficult place for brokers to find capacity after a wave of exits and retrenchment in recent years, in part driven by reinsurer appetite. So to get a new program up-and-running with a panel of reinsurers on board is testament to **Risk Theory** and **Jupiter** along with its reinsurance brokers and fronting partner **Clear Blue**.

THE INSURER

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Inside this edition

The search for the missing $20bn

Delegates arriving in Dallas for the start of the American Property Casualty Insurance Association (APCIA) conference today may have a feeling of déjà vu.

A decade ago the then PCI annual conference coincided with Superstorm Sandy, with lower attendance as some attendees were hit by air travel disruption, while among those who made it to Dana Point, California were a contingent who had families in harm's way up in the Northeast.

At the time of going to press on our first daily APCIA edition, Hurricane Ian was still very much a live event after its initial devastating landfall in Florida.

With a Florida presence usually seen at the association's annual meeting, we naturally send our best wishes to all those affected by Ian following its considerable impact on the many residents of the Sunshine State unfortunate enough to be in its path.

We also expect the fallout from the storm to feature heavily at APCIA this year as real-time information around industry exposures and event characteristics emerges.

Pre-Ian, the expectation was that, in line with the Monte Carlo *Rendez-Vous* three weeks ago, property cat reinsurance would be the dominant theme amid a fast-hardening market driven by a clear mismatch between demand and supply.

And it was telling that there were Florida carriers spotted in the principality no doubt soaking up a unified message from reinsurers and brokers that capacity may only become more scarce heading into 2023, even before Ian crashed onto the scene.

As we report in our lead article, recent reinsurer retrenchment from cat, the hit to balance sheets from investment write-downs and the forex impact on European players has coincided with an inflation-driven surge in demand from insurers.

At least $20bn of new property cat capacity is probably needed in the US, based on the rule of thumb assumptions that US insurers buy ~$200bn of cat/all risks limit and inflation is nudging double digits. There is little expectation that supply from incumbents will fully meet it or that meaningful new capital will enter the fray. Hurricane Ian, if anything, just made life a lot more difficult for ILS funds as they approach the Q4 investor funding season confronted by yet more trapped capital. The 2022 Côte d'Azur experience for Floridian visitors may have been rather chastening, after already experiencing a painful renewal at mid-year.

> "Hurricane Ian, if anything, just made life a lot more difficult for ILS funds... confronted by yet more trapped capital"

David Bull, North American editor

Loss-struck Florida carriers may fear that they are further down the food chain than large nationals, globals and other US carriers already seeking out additional limit at 1.1, and the tangible shift in market sentiment witnessed in Monte Carlo will have given them little comfort. And it is at this juncture that this publication senses a déjà vu moment of its own.

The RIMS awakening

It was three and a half years ago at RIMS in Boston that there was arguably a similar shift in market sentiment in the commercial insurance industry.

For years of the long soft market, brokers and underwriters turned up to discuss renewals and pricing dynamics where the only real question was how much of a reduction would be applied to an account.

Then, suddenly, everything changed. The drastic actions of AIG and Lloyd's Decile 10 initiative drove the market to follow with widespread slashing of limits and hiking of rates across multiple lines of business.

Almost overnight, the mood of the market went from brokers talking the market down, to brokers publicly prepping their clients for the inevitability of having to pay significantly more for less cover.

That created its own challenges. A generation of inexperienced brokers had to sell the idea of increases to clients, while their underwriting counterparts for the first time had to be confident in pushing for more.

That dynamic seems to have finally made its way to the reinsurance market – at least in property cat.

And the challenges will be there for both sides of the negotiation. Long-defeated underwriters will need to demonstrate real underwriting skills, getting to grips with shifting exposures driven by inflation and following through on strategies to prudently deploy capacity.

Brokers will need to be at their most creative, piecing together patchworks of capacity, potentially at non-concurrent terms, and finding ways to bridge the $20bn gap. The events of the last few days – including potential issues around underinsurance – demonstrate the importance of the reinsurance industry and the role it plays. In these challenging times the market must deliver the solutions to continue proving its worth.

Casualty will benefit from more expert treatment

The last two years tested nerves in the casualty market, but the worst fears failed to materialise. TigerRisk's Joshua Everdell examines how experience and judgment can help reduce the stress

A definitive view on what Covid-19 really meant for casualty lines is not quite possible yet, with claims far from over and legal disputes still under way in some cases. As the pandemic finally begins to pass into history one thing is clear, however – the casualty market once again proved to be notable for its unpredictability.

The casualty market was already hardening in 2019 as primary insurers began to re-evaluate risks and rate adequacy. As the global pandemic accelerated the hardening the outcome for capital exposed to property and casualty looked potentially severe. But the response of authorities to the pandemic saved lives, both by directly curtailing the spread of Covid-19, but also indirectly as the slowdown or closure of large parts of the economy also dramatically reduced the incidence of casualty losses.

The data now emerging for casualty in 2020 shows a dramatic drop in frequency and claims, while at the same time rates were hardening. The picture is never quite as simple as one might expect during the event.

> "On balance, we think rates will stay stable in the near term, and in particular, the reduced use of limits seems to be largely intact"

Casualty is in a stable condition

Today, casualty rates are markedly higher than pre-2019 – a correction that was under way and largely inevitable with or without a pandemic – but they remain decent. On balance, we think rates will stay stable in the near term, and in particular, the reduced use of limits seems to be largely intact. There are still significant severity loss trends with which carriers have to contend, but pricing and limits use has mitigated their effects.

Reinsurance capital is stable in casualty at the moment and that is based on the expected returns. Indeed, there are signs that alternative capital has increasing interest in the casualty market. How this develops, their precise appetite for risk and their expectation for return will be significant factors in how the casualty market develops over the coming months and years.

Joshua Everdell is global head of casualty and head of global accounts at TigerRisk

The unexpectedly low levels of casualty frequency and losses during the pandemic coinciding with rising rates and the potential interest from new capital sources demonstrate that operating in casualty markets requires a depth of knowledge and experience.

A combination of analytics and judgement

Analytics are a vital tool in today's complex insurance markets and the combination of TigerRisk and Howden creates a business with sophisticated analytical skills. It also creates a business with human experience, which in casualty is an essential ingredient. Quantitative analysis is essential, but in the moment, particularly in unexpected conditions such as we have all experienced over the last two and a half years, qualitative judgment is also key.

Casualty insurers are looking for expert advice on their original insurance business, both data analysis and experience to help them get their book in as good a shape as it can be. Further, they are looking for creativity and thoughtfulness in how they structure their reinsurance. Part of those solutions will be taking a broader look at their lines of business. Many clients in casualty are also in property and can benefit from examining how they can align and balance those lines of business and their access to capital. Investment banking capability, such as that provided by TigerRisk Capital Markets and Advisory, will be a valuable service to those clients.

Casualty may not be facing quite the same degree of stress that other lines are currently undergoing. However, clients need more than advisers that look at insurance lines entirely in isolation. Our industry needs and deserves something rather more sophisticated.

Andrade: Everest Re cat deployment focuses on key trading partners

Despite increasingly attractive opportunities in the fast-hardening property cat reinsurance market, Everest Re will not reverse its recent de-risking strategy and will instead emphasize supporting global trading relationships with key cedants at 1 January, according to group president and CEO Juan Andrade.

The Bermudian has dramatically transformed its risk profile over the last five years in a bid to improve risk-adjusted returns by reducing exposure to natural catastrophe events.

The strategy has seen its 1-in-100 probable maximum loss (PML) as a percentage of group equity, excluding unrealized gains or losses, drop from 15.6 percent at the start of 2017 to just 5.2 percent at 1 July this year for peak zone Southeast US wind.

Asked about Everest Re's desire to grow in a hardening cat market at 1 January, Andrade said the carrier will operate within the boundaries of its redefined risk appetite designed to cap the earnings and capital it is prepared to expose.

"The market is going to be very tight at 1.1, but that doesn't mean that we abandon our strategy of reducing volatility. I'm building the company for the long term and that sustainability of earnings is critical to me.

"What we clearly understand and what we told our investors is that we're going to mitigate the peaks and the valleys, so in a quiet cat year maybe you make a little bit less money, but in a bad year, you will have a lot fewer losses," he explained in an interview with this publication.

But with PMLs now comfortably within the boundaries set (see graphic), the executive said there is an opportunity to deploy additional capital to cat, as he noted that at the mid-year renewal Everest Re had been opportunistic on certain deals.

"We're not out of the cat game, and that's something that people sometimes misunderstand about what we're trying to do.

> "The market is going to be very tight at 1.1, but that doesn't mean that we abandon our strategy of reducing volatility. I'm building the company for the long term and that sustainability of earnings is critical to me
>
> **Everest Re CEO Juan Andrade on the reinsurer's cat appetite after recent significant de-risking**

"Our objective was pretty clear: define an underwriting appetite range for cat, stick to it, reduce the volatility that brings to our earnings to be more sustainable, and then diversify the company with other lines of business in reinsurance and also with the growth in insurance," he commented.

As long as Everest Re trades within the range it has set, it can deploy capital.

And Andrade said that maintaining a strong presence in property cat is important for the carrier as it looks to diversify and grow other lines of business.

"Obviously property cat gets you other things, like the casualty trade. So it's important to maintain the presence in that space, and we're still very much a cat writer," he continued.

Global trading relationships

Amid a tightening cat market, reinsurance brokers are likely to look to leverage broad strategic relationships with reinsurers to secure capacity for their clients.

Andrade highlighted the emphasis the carrier has on global trading relationships with key partners that span the gamut of product lines.

He said it is crucial for Everest Re to be there when its customers need it, but also because these kinds of relationships help diversify its portfolio. That means that if a treaty line's profitability is suffering, other products in the partnership portfolio can help offset the issue.

"That's our strategy in casualty as well, where instead of being a broad market casualty player, we picked our spots with companies we understand and underwriting strategies we understand that were being executed, where we were aligned and there was mutual interest.

"I give [reinsurance CEO] Jim Williamson and his team credit for doing that, because, yes, we've reduced our cat writings, but for those that needed the cat capacity within our trading group it's been there," Andrade explained.

The approach represents a more "thoughtful" way of

writing property cat risks than the company had done in the past, he suggested, with capacity still preserved for Everest Re's "best customers".

Macro headwinds drive discipline

One of the drivers of the hardening property cat reinsurance market is significantly increased demand for limit from insurers to reflect the impact of surging inflation on their underlying portfolios.

That has led to suggestions that there could be additional demand of up to $20bn at the upcoming renewals from large nationwide and global carriers.

Andrade pointed to rising loss costs in the homeowners sector, which are up in the 16-20 percent range. "That puts pressure on loss costs of cedant companies, which in turn means they need to buy more reinsurance to be able to maintain net lines. So we're not in a benign risk environment, we're actually in a heightened risk environment," he observed.

That dynamic should help ensure that pricing momentum continues and that competitors maintain discipline.

"We have not seen a lot of undisciplined behavior at this point and I think it's because people are watching this environment and they're getting hit on both sides of the balance sheet. What it does do is really continues to be a tailwind on pricing and terms.

"Clearly you've got a supply and demand imbalance in property cat, but even for other lines of business, inflation concerns are real, so people are being prudent," he continued.

Casualty opportunities

While discussions at the Monte Carlo *Rendez-Vous* last month were dominated by cat, there was also debate about the trajectory of casualty pricing dynamics, especially in relation to cede commissions on quota shares.

Everest Re has been among several reinsurers looking to grow in casualty, both in North America and Europe.

Andrade said part of the strategy was to diversify the group's reinsurance book by targeting regional companies in Continental Europe.

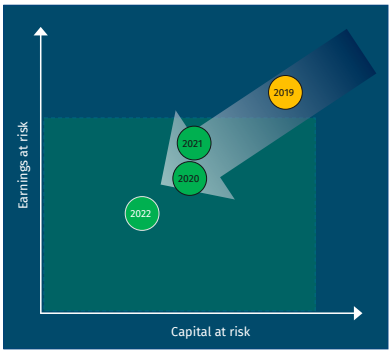
And he said the economics of quota shares have been attractive, with rates remaining strong and the benefit of exposure growth because of inflation, against a backdrop of significant demand for product from insurers looking to manage earnings volatility.

"The other thing is that we saw a stabilizing of cede commissions, at least in the second quarter, and I think that relates directly to the risk environment.

"We'll see where that goes eventually, but I think that probably is a good thing, and if that happens, the trades are still profitable, otherwise we wouldn't do them. We watch them, because the moment there's an inflection, that's when you've got to make sure you don't get behind the eight ball," the executive said.

Everest Re has transformed its risk profile

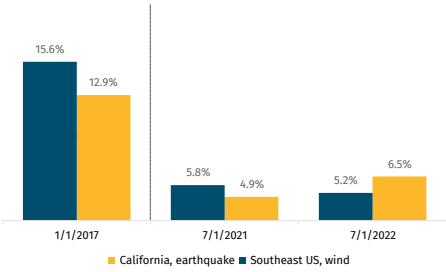
Superior risk / return economics within our defined risk appetite



- The above chart for illustrative purposes
- 2022 amounts at risk based projected PML at year end 2022

Source: Everest

After tax net 1:100 PML as a % of group equity excluding URGL [1]



Year over year gross PMLs down 10% across the curve

Notes:
1/Calculated as the 1:100 net economic loss as of January 1, divided by Everest's shareholders' equity (SHE) excluding unrealized gains/(losses) (URGL) of the preceding December 31, and preceding June 30 for 7/1/21 and 7/1/22 PMLs.

Retro capacity to remain tight at 1.1

The capacity shortage in retro is expected to continue at 1 January with no significant change amid muted interest from investors, Andrade predicted.

The Everest Re CEO noted that retro can be lucrative if priced correctly, but also volatile because of the level of aggregate exposure a writer of the business can pick up.

The executive said the frequency and severity of losses this year from secondary perils like French hailstorms, Australian flooding, Brazilian droughts and the Canadian derecho had given people pause. "While we are still a retro player, we are less of a retro player than we were in the past because of that … but there will be an opportunistic place, because depending on how hard the pricing gets, and how hard the terms are, there's a price for every risk," Andrade suggested.

Everest Re has the Mt Logan Re sidecar as part of its third-party capital stable and the executive said there are sophisticated investors that are still very interested in deploying capital into the space.

He said the vehicle is an attractive proposition for investors because of its modeling capabilities and that it operates as a quota share structure so that Everest Re has skin in the game on business ceded.

Opportunities amid uncertainty

Guy Carpenter's Gina Carlson and Richard Hewitt highlight why the industry is in a strong position to face current headwinds as 1 January approaches

The reinsurance industry is built on a commercial relationship between risk and capital. In the current, palpably dynamic environment, the industry appears to have reached an inflection point.

A reassessment of not only the relationship but also of the opportunities risk and capital afford is under way. Countervailing forces are influencing the industry. Drivers of uncertainty, including macroeconomic and other relevant trends, have led to severely stressed market conditions. On the other hand, drivers of confidence – including resilient industry capital, disciplined underwriting and a firming commercial lines rate cycle – are injecting positivity into the sector.

As 1 January approaches, Guy Carpenter is confident that the industry is in a strong position to face the headwinds and once again successfully evolve and adapt to meet the changing nature of risk.

> As 1 January approaches, Guy Carpenter is confident that the industry is in a strong position to face the headwinds and once again successfully evolve and adapt to meet the changing nature of risk

This past year, inflation has rightly been an area of significant focus and uncertainty for the industry, as evidenced by rising levels of consumer price indices across most regions. However, the industry's long history of data utilization alongside advancements in technology and modeling methods puts insurers in a strong position to forecast, monitor and measure risk in a changing environment. Insurers are successfully addressing inflation's impact by adjusting exposures and updating procurement practices, increasing insurance rates and monitoring loss cost trends more frequently.

Globally, central banks have rapidly raised interest rates among other policy steps in an effort to bring inflation back within targeted levels. Yet, while this response has contributed to financial market volatility and a repricing of their assets, (re)insurers' ratings and solvency positions have proven to be robust and they are well placed to reap the benefit of higher reinvestment yields in future years' earnings. Higher interest rates are also slowing economic growth prospects for 2022 and 2023. Fortunately, the sector is considered "late-cycle", meaning its growth prospects are less influenced by short-term economic cycles. In fact, economic volatility can be expected to reduce risk appetite among insureds and spur the demand for modified and innovative product offerings.

These macroeconomic forces are coupled with all the other significant, relevant issues faced by the industry, inter alia, rising catastrophe losses, climate change, cyber threats, the Russia-Ukraine conflict and for some participants, the adequacy of returns. Forged together, these have caused a re-evaluation of risk appetites by some market participants, which has been accompanied by a fall in dedicated reinsurance industry capital, particularly for retrocessional capacity. Guy Carpenter and AM Best estimate that year-end 2022 total dedicated reinsurance capital will be 7 percent lower, with traditional capital down 8 percent and alternative capital up 1 percent. However, these mixed results create the foundation for a positive cyclical market turn.

Gina Carlson, senior vice president business intelligence, Guy Carpenter Richard Hewitt, head of business intelligence, EMEA, Guy Carpenter

Now is the time to invest in the sector. By understanding how macroeconomic conditions, geographic footprints and lines of business come together in specific portfolios and impact risk tolerances, Guy Carpenter can deliver bespoke solutions for today as well as address emerging challenges of tomorrow. Collectively, the reinsurance sector, through detailed and thoughtful analysis and execution, can once more prove resilient and prosper in this ever-changing risk landscape.


EXPERIENCE
TransRe™
We value risk.

(Continued from p1) Property cat 2023: hard just got harder

on a US property cat treaty market currently estimated in the region of $200bn of limit, with the majority of the extra limit required by an estimated 8-10 nationwide and global players.

As one investor source told this publication: "Take demand up by 20 and supply down by 20 and I think prices are going up."

Allstate and **State Farm** are understood to have communicated the need to buy around $1bn more apiece, with **Liberty Mutual** expected to seek several hundreds of millions of dollars of incremental cover, while **AIG** is among others likely to add to the demand side of the equation.

Sources have suggested the total is likely to be as high as $30bn when taking in increased demand globally.

"So the question is, where does that supply come from? There'll be plenty of people who do a little bit more but is anyone looking to do more than their share more?" asked a senior cat reinsurance executive.

Retro market sources have suggested that at this stage there is little discussion from buyers about business plans to meaningfully increase cat writing. And, as we will report in our APCIA daily issue on Tuesday, there is no sign of any easing in the retro market to accommodate any seeking that support.

Talking Points

- **Hurricane Ian could send property cat to true hard market territory**
- **There was already a significant supply-demand imbalance ahead of 1.1**
- **Estimated increased demand of at least $20bn cat limit in US alone**
- **Reinsurance supply shrunk from retrenchment and capital hits**
- **No sign of meaningful capital creation; retro crunch continues**
- **Increased appetite from few not expected to meet demand**
- **Price increases of 20% were expected just to keep up with inflation**

Cautious cat deployment

In today's APCIA daily, we also tackle the supply side by looking in detail at reinsurer appetite for cat business in the lead-up to 1.1.

Although several companies have indicated a desire to cautiously increase their participation at 1.1 and into other 2023 renewals, the majority have emphasized they will be highly cautious and selective about their deployment.

For many reinsurers, just keeping up with rising exposures driven by inflation to maintain probable maximum loss and annual expected loss curves is as far as their appetites will stretch, amid ongoing concern about climate change, recent poor results in cat and the frequency and severity of secondary perils.

In an interview with *The Insurer* to be published in our APCIA daily on Tuesday, Marcus Winter, president and CEO for US reinsurance at **Munich Re**, said inflation has led to a "completely revised landscape" for property cat.

But he added: "It's not just inflation but the bad experience of the last few years and recalibration of the risk appetite of many reinsurers including ourselves that has fundamentally shifted capacity away from certain buckets in the market."

Speaking before Hurricane Ian came on the scene, he said that as one of the few reinsurers not reliant on retro markets or alternative capital to support its underwriting, **Munich Re** will not reduce its capacity next year, but will be very selective in its deployment.

And fellow European giant **Swiss Re** appears to have some appetite to grow its cat book at 1.1, with CUO Thierry Léger telling this publication – also before the hurricane season rapidly escalated – that the market will go "from hard to even harder" amid a phase of "heightened volatility and uncertainty".

The prospect of accelerated hardening in the aftermath of Hurricane Ian may lead some of those reinsurers already looking to lean in to increase their appetite. But they may also be content to reap the benefits of higher prices for the same level of exposure without taking on more risk.

And if anything – depending on how the next few weeks pan out – Hurricane Ian may drive further retrenchment as it compounds issues of trapped capital in the ILS collateralized reinsurance and retro market, and if it further spooks investors with characteristics that fall outside of event expectations.

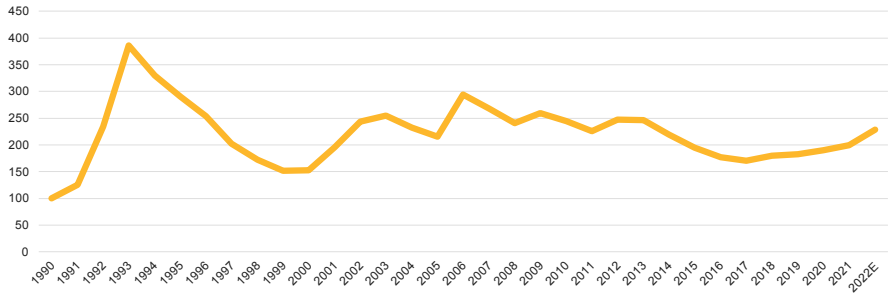
Marcus Winter, president and CEO for US reinsurance at Munich Re

True hard market

With no prospect of meaningful new capital entering the fray (see box-out), the effect could be to tip a property cat reinsurance sector already teetering on the edge into true hard market territory. At Monte Carlo last month, the broad consensus of reinsurers, brokers and buyers

Global rate on line index

1990-July 1, 2022



When factoring in mid-year movement, the Global ROL is estimated to have increased 15%.

Source: Guy Carpenter

was that a continuation of a quiet hurricane season would have provided a backdrop of much-needed calm for challenging renewal negotiations.

"It's the odd year where nobody is rooting for an event. We don't need it for the market to move. We have this discrepancy [between demand and supply] and an event would be chaos," a senior reinsurance executive commented at Les *Rendez-Vous*.

Meanwhile, an ILS fund manager warned that a major hurricane or other loss in the fall could lead the market to "seize up". In the collateralized space that would lead to another crisis around trapped capital and create even more challenges for ILS managers already struggling to grow assets under management despite an increasingly attractive pricing environment.

Buying decisions

Now the reality of a major Florida hurricane signals a move further into hard market territory with surging demand chasing severely constrained capacity driving significant rate increases for all – especially in peak zones – but the experience will not be the same for buyers across the board.

There will be difficult choices to be made by most, however, and moving beyond 1 January towards mid-year renewals capacity is likely to become increasingly scarce, once again challenging the survival of some of the smaller regional homeowners players.

That will especially be the case in Florida, where the fast-moving claims situation on the ground in the coming weeks and inevitable impact of litigation and fraud to follow may threaten the existence of some of the more vulnerable domestic carriers before they make it to the next renewal.

For other insurers, purchasing decisions will be dictated by factors such as their reliance on reinsurance and where they need to buy to in order to satisfy rating agency requirements, including **AM Best** BCAR scores.

That means that some cedants facing a limited capacity supply and soaring prices – particularly for low-down layers – may need to raise retentions and deploy budget from those layers to buy more limit at the top.

"Now the reality of a major Florida hurricane signals a move further into hard market territory with surging demand chasing severely constrained capacity driving significant rate increases for all – especially in peak zones"

Others may look more for earnings protection lower down if they can find it.

There is also likely to be a flight to quality as reinsurers look to deploy capacity to what they view as better quality cedants with good underwriting and solid portfolios.

And reinsurers will keenly assess how cedants are pricing in inflation on the underlying business, and their approach to the issue of insurance to value.

One strategy advocated by some brokers pre-Ian was for cedants to come to the market early with submissions to lock in capacity where they could.

That approach may be increasingly challenging as the industry digests the fallout from a Florida hurricane, however, and the expectation is likely to shift to a late renewal as reinsurers wait for loss development and retro availability to set out their appetite at 1.1.

New capital prospects dim

In hardening or hard markets past – especially in the aftermath of a major cat event – capital creation has been rapid, spawning a string of Bermuda start-up classes and the creation of the collateralized reinsurance market.

This year, however, there appears little to no prospect that there will be a level of capital formation sufficient to meaningfully impact the supply-demand imbalance that will drive the 1.1 renewal.

Investor fatigue in the cat space after several consecutive years of losses and growing skepticism of the insurance industry's grasp of growing exposures and climate change risk has collided with the macroeconomic headwinds of inflation and severe volatility in financial markets.

That means existing ILS funds, for example, were already struggling to gain any traction with investors to increase their assets under management at 1.1 – and that was before Hurricane Ian tore into Florida.

The prospect of a much-needed clean year being badly damaged by a highly destructive Category 4 Florida landfalling hurricane will inevitably waken the specter of trapped capital.

And the likelihood of the more traditional influx of capital from private equity-backed start-ups also looks to be fairly remote. Even on the cusp of a hard market, reinsurers are trading at historically low valuations in the public markets, at a significant discount to book.

Where historically a private equity firm might invest in a start-up at book value and look to sell or IPO at 1.4x or 1.5x, it seems unlikely that equity markets that seem to be cat risk-averse will provide an environment for an attractive exit any time soon when established players are trading at 0.75x.

That leaves the prospect of markets of last resort such as **Berkshire Hathaway** deploying more at 1.1 as it did at mid-year 2022. Sources have suggested that hard market conditions at 1.1 may begin to draw outside investment later in 2023, but questioned whether a full clean year would be needed first to overcome investor fears around cat risk.

Aon's Marcell: Ability to create capacity will be key for brokers in 1.1 cat crunch

Brokers that can harness data and analytics alongside a scaled presence in the global catastrophe market will be in a strong position to navigate challenging conditions in property cat and create much-needed capacity for clients, according to Andy Marcell, CEO of Aon's Reinsurance Solutions.

Speaking to *The Insurer*, Marcell highlighted inflation, concerns over the impact of climate change on peak and secondary perils, a lack of confidence in models, stress on capital from investment volatility and the impact of the strong dollar as among the factors driving a demand-supply imbalance in property cat, particularly in the US, Europe and Australia.

"There's uncertainty and when there's uncertainty people want to charge more for that uncertainty," he commented.

Investor concerns around the level of volatility in cat had also driven a more cautious approach from publicly traded (re)insurers, he added.

"So they're saying 'unless the rates are substantially higher, I might as well reduce my commitment to that product line or withdraw, and focus on areas that increase shareholder value', which is generally insurance over reinsurance," the executive observed.

In an environment of reinsurer retrenchment, Marcell said it is incumbent on brokers to find ways of accessing enough capacity to meet the growing requirements of cedants and convince those capacity providers they can make money out of property cat.

"For Aon, it's using our data and analytics, the scale of our position in the global catastrophe market, our understanding of the risk, our understanding of the return, and how to package portions of that business to be able to create capacity for our clients," he suggested.

"We have to articulate to investors why they should be in this business and that they can make satisfactory or superior returns in the property cat market, and that some of the reasons they are afraid are magnified and misunderstood," Marcell claimed.

He also asserted that although property cat capacity is global, the dynamics across different territories and perils are markedly different.

"Even in the US cat is not equal. Hurricane risk in the Gulf or Florida is much more of an issue than in New York or Massachusetts, or New Madrid quake, or Cali quake or wildfires.

"The advantage to the reinsurer is actually knowing what the aggregate is to be able to quantify and manage your portfolio of risk. And if you can write a global portfolio, you can still make terrific returns in property cat," said Marcell.

> "There's uncertainty and when there's uncertainty people want to charge more for that uncertainty
>
> **CEO of Aon's Reinsurance Solutions Andy Marcell on the key driver of current conditions in property cat**

The executive highlighted efforts made by Aon to create facilities to bring capacity to clients in both its treaty and facultative businesses.

As previously reported, Aon's Reinsurance Solutions launched a global property cat facility called Marilla just under two years ago.

Initially supported by Swiss Re and PartnerRe, its aim was to bring capacity across the broker's portfolio of excess of loss property cat placements.

Marcell also said Aon has some bespoke treaty facilities in Europe.

In the facultative arena the firm recently expanded its Marlin Latin American facility, and is expanding its European facility called Landmark, as well as those in Asia.

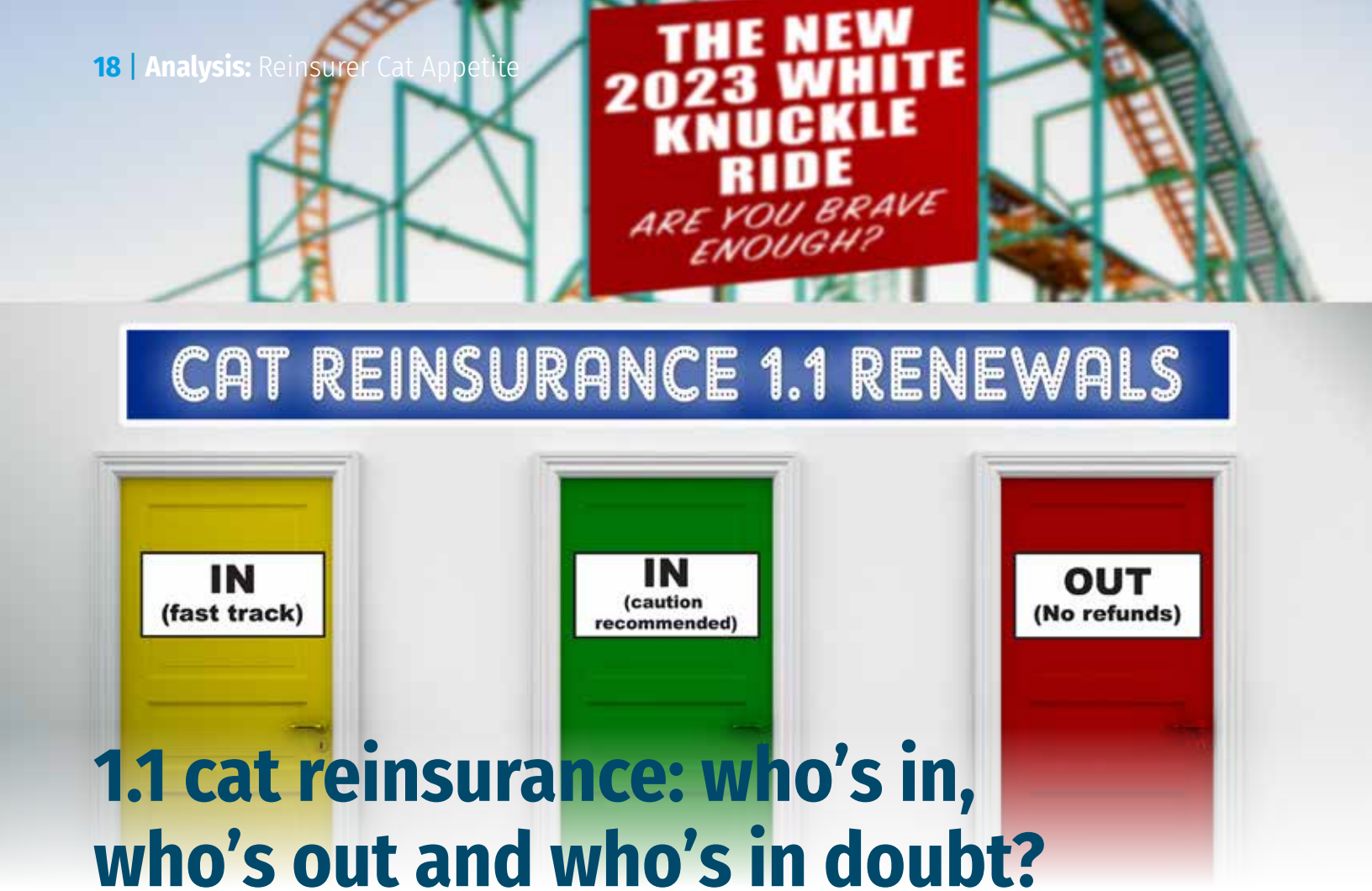
"That's the direction we need to go, particularly now. We talk to reinsurers about what gets them to put up more aggregate, what return they need by peril or region, and then we can try to figure out a basket of risk to get them to commit some serious capacity," he explained.

But the executive claimed that not all reinsurance intermediaries have the capabilities to come up with capacity solutions to address the current cat crunch.

"There are very, very few that have the scale and breadth of business to understand the dynamics, to quantify the returns and be able to package risk with investors and risk takers to help clients.

"We have to do it, and it's not that other newer or smaller firms wouldn't do this, they can't!

"They don't have the data, or the portfolio to analyse and package and present. So it's on us to meet the challenge," he claimed.



1.1 cat reinsurance: who's in, who's out and who's in doubt?

Public statements compiled by this publication from 19 reinsurers throw a spotlight on the contrasting strategies around property cat appetite, ahead of what is expected to be one of the most challenging January renewals in years.

Inflation and climate change are acting as the main influencing factors of the January renewal season, with market observers striving to predict the impact these will have on the capacity that will be made available by traditional reinsurance capital at 1 January.

Surging inflation this year has fueled demand for higher limits as the expected losses on perils continue to rise.

Last month, we noted that if the US property cat/all risks reinsurance market is ~$200bn in limit then a 10 percent increase to accommodate inflation would mean cedants requiring an additional $20bn in 2023 just to – in effect – stand still.

A number of nationwide carriers have already privately indicated a desire to expand their limit bought, including Allstate, Liberty Mutual and State Farm. We expect this list to increase in size this month perhaps also with the addition of some large European cedants.

Meanwhile, there is a growing perception among reinsurers that climate change – through its impact on loss frequency and severity for primary and secondary perils (see graphic opposite) – has not been adequately priced in so far or properly modeled.

But even before these factors came onto the scene, many reinsurers had begun shifting their appetite away from property lines, placing additional pressure on the capacity for quota share support for cedants in 2022.

The market already experienced that capacity shortage at the mid-year renewals as placements struggled amid rate increases and a squeeze in cat appetites.

But while there is a broad perception of a forthcoming 2023 supply deficit – particularly for QS property reinsurance, cat agg and lower layer XoL – individual reinsurers are in fact taking notably different approaches to their cat/all risks exposure strategies in the run-up to the 1.1 renewals.

Indeed, commentary from the latest earnings calls and public statements at the Monte Carlo *Rendez-Vous* show that while some reinsurers have drawn a line in the sand by reducing their exposure on a permanent basis (at least for now), others are intending to profit opportunistically from the better rate environment and terms and conditions that are expected.

And some are even eyeing the opportunity for an outright expansion in the segment amid the emerging hard market conditions that the demand-supply imbalance is creating.

Strategic retreats

Among those that have made a strategic decision to reduce exposures are mid-size reinsurers Axis and Axa XL.

The former announced in June that its reinsurance unit Axis Re was exiting the property treaty segment entirely as part of a shift to specialty underwriting.

This came after the company looked into selling the business but found limited interest in the unit.

At the time of the announcement, the move meant Axis was giving up a $706mn-premium portfolio, which the company had scaled down since peaking at just over $1bn in 2019.

Axis' cat retrenchment followed that of Axa XL, which was among the first to undertake a strategic move to cut PMLs.

As revealed by this publication in November last year, Axa XL stopped writing property catastrophe reinsurance out of London as the business looked to undertake a "material reduction" in its cat exposures across its portfolio.

In May this year, Axa's CFO Alban de Mailly Nesle said the group remained focused on "disciplined execution".

"We have been repositioning our reinsurance portfolio with nat cat exposure already trimmed by 40 percent across first quarter's renewals," he said.

US reinsurer Markel was also among the early movers in withdrawing from the segment.

In October 2020 it announced it was closing its Markel Global Reinsurance property catastrophe unit, with its ILS fund manager Nephila becoming the single point of entry for the business.

In June this year, Lloyd's player Tokio Marine Kiln (TMK) unveiled the details of a proposed restructure which is expected to see an accelerated reduction of its property reinsurance book at 1 January 2023.

The plan will see TMK's quota share reinsurance Syndicate 557 cease underwriting and instead merge into the group's flagship Syndicate 510.

At a group level, Tokio Marine also took a strategic decision to cut back its reinsurance exposures when it sold its Bermuda reinsurer Tokio Millennium Re to RenaissanceRe for $1.5bn in 2018.

Global reinsurer Scor has also retreated, reducing its 1-in-250-year PML by 21 percent during the June and July property casualty renewals, significantly ahead of its original 11 percent projection for 2022 at the start of the year.

"Since then we have reshaped our cat risk profile, reducing both earnings at risk and capital at risk," said Scor CEO Laurent Rousseau on an earnings call.

Big 4

Scor's defensive stance stands in contrast with that of its European global reinsurance peers.

Indeed, German reinsurers Munich Re and Hannover Re are perceived to be approaching 1 January with a more forthcoming attitude and no outright intention to reduce exposures, though still maintaining a prudent position on pricing.

Commenting on the P&C reinsurance market in general, Hannover Re's CEO Jean-Jacques Henchoz said: "Inflation will clearly be one of the key topics, both in renewal negotiations ahead of 2023, but also in discussions with our investors. In our pricing, we adjust the inflation expectation regularly and have done so last year and this year, in particular."

Meanwhile Munich Re's reinsurance CEO Torsten Jeworrek said the group had "no ambition to shrink our cat capacity" and wanted to remain a "very reliable partner to our clients."

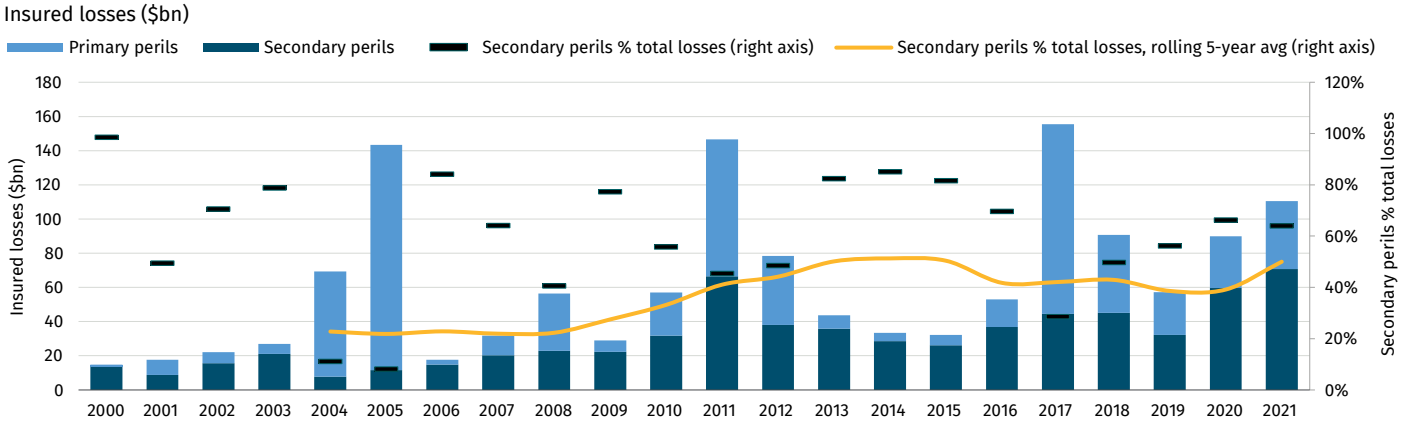
Jeworrek said the firm will maintain its appetite for natural catastrophe as long as pricing is "prudent and conservative".

With more than 60 percent of Munich Re's treaty reinsurance premiums up for renewal in January, he said the company was taking steps to ensure factors such as inflation and exchange rate impacts were built into pricing at 1.1.

At the more dynamic side of the spectrum, Swiss Re appeared willing to lean in at the upcoming January renewal.

On an earnings call, group CUO Thierry Léger said: "We do indeed see cat as an attractive area to grow further."

Secondary perils accounted for 63% of total insured catastrophe losses in 2019-2021



Source: Swiss Re Sigma, presented by Moody's Investors Service

Reinsurers 2022/23 cat appetites...

Company	Notes
Reducing/withdrawing	
AXA XL	Early signaller with its strategic move to cut PML, Axa XL cut reinsurance revenues by 21% in H1 to €2.2bn. In May Alban de Mailly Nesle, chief financial officer of Axa, said the group remained focused on "disciplined execution". "We have been repositioning our reinsurance portfolio with nat cat exposure already trimmed by 40% across first quarter's renewals," he said
AXIS	The company announced in June that it would be fully exiting property reinsurance, with this publication reporting at the time that Axis would be giving up a $706mn-premium portfolio (which had been scaled down by 31% since peaking at just over $1bn in 2019)
MARKEL	At 1.1 last year, Markel announced its reinsurance property business would be moved from its reinsurance underwriting operations to instead be managed by the Nephila ILS operations
SCOR	The reinsurer said actions taken at the 1 June and 1 July renewals had contributed to a 21% reduction in its 1-in-250-year PML for the 2022 underwriting year, significantly ahead of its original 11% target. "Since then we have reshaped our cat risk profile, reducing both earnings at risk and capital at risk," said Scor CEO Laurent Rousseau on an earnings call
TOKIO MARINE KIUK	In June, TMK unveiled the details of a proposed restructure which is expected to see an accelerated reduction of its property reinsurance book at 1 January 2023. The Lloyd's player will see its quota share reinsurance Syndicate 557 cease underwriting and instead merge into the group's flagship Syndicate 510. At a group level, Tokio Marine also took a strategic decision to cut back its reinsurance exposures when it sold its Bermuda reinsurer Tokio Millennium Re to RenaissanceRe for $1.5bn in 2018
Standing still/Limited appetite to increase	
EVEREST	Discussing property cat, president and CEO of Everest Re Juan Andrade said "Everest's position as a preferred market has allowed us to reposition our participation in key programs, further away from frequency losses and achieve better expected profit or reduced cat exposure"
hannover re	Hannover Re has maintained a cautious view on nat cat-related business in the Americas and has not increased risk appetite for US wind and earthquake-exposed business. Commenting on the P&C reinsurance market in general, CEO Jean-Jacques Henchoz said: "Inflation will clearly be one of the key topics, both in renewal negotiations ahead of 2023, but also in discussions with our investors. In our pricing, we adjust the inflation expectation regularly and have done so last year and this year, in particular"
Munich RE	Munich Re's reinsurance CEO Torsten Jeworrek has said the firm will maintain its appetite for natural catastrophe as long as pricing is "prudent and conservative". Jeworrek said the group had "no ambition to shrink our cat capacity" and wanted to remain a "very reliable partner to our clients". But with more than 60% of Munich Re's treaty reinsurance premiums up for renewal in January, he said the company was taking steps to ensure factors such as inflation and exchange rate impacts were built into pricing at 1.1
RenaissanceRe	At the mid-year renewals RenRe held its PMLs flat as it benefited from increased rate. Southeast wind still remains the peak risk in its portfolio as the reinsurer has moved away from Florida domestic carriers to more regional and nationwide programs. RenRe's president and CEO Kevin O'Donnell said: "I think with increased demand at 1.1, we're going to see further rate pressure come into the market and reinsurance-led pricing, which we haven't seen for a long time"
TransRe	In January, TransRe said it had executed on a plan to reduce its property writings by more than 25%. However, speaking to this publication at Monte Carlo, CEO Ken Brandt said TransRe's de-risking from cat business is now complete but the plan was never to exit cat business entirely. "We've pulled back some capacity over the last year, mainly in the lower layers, aggregate programs, where a lot of the secondary peril losses were coming from. We're pretty satisfied with where our portfolio is now, and we still have a lot of limit committed to the cat market," Brandt said
Cautious increase/leaning in	
ageas	Ageas Re, the newly launched third-party reinsurance operation of Belgian insurance group Ageas, has long-term ambitions to write gross premiums of €1bn ($1.02bn) although it expects to have a "modest" and "limited" impact at the upcoming 1 January renewals
Arch	Arch Capital CEO Marc Grandisson said the June and July renewals "showed a property cat market in transition". "While I hesitate to make predictions, we are cautiously optimistic that this momentum will continue into 1.1.23," he said. "The general psychology of the market appears to have shifted to requiring substantial rate increases to accept cat exposure." He reported that the Bermudian selectively expanded its writings in the Sunshine State as it eyed property cat rates up by more than 30% and grew its 1-in-250-year event PML
Ariel Re	Ariel Re is in active discussions with potential capital providers in a bid to increase Funds at Lloyd's to support growth opportunities in 2023, including in cat reinsurance at the upcoming 1 January renewal. Ariel Re was one of only a handful of reinsurers that looked to increase their presence at the mid-year US wind renewal
Aspen	Andrew Rippert, CUO at Aspen Reinsurance, told *The Insurer TV* that the group will target property lines – especially property cat – for margin growth. Rippert said that Aspen will look to strengthen its position in property at 1 January by capitalising on the "best opportunities", after de-risking its book in 2019-21 following the improved market conditions
convex	Convex CEO Paul Brand said the group would likely see a modest shift in the balance of its portfolio towards reinsurance this year, reflecting premium growth on the back of price increases. "Lots of people are running backwards from reinsurance at the moment, particularly for short-tail lines, which are having a pronounced impact on pricing," he said. "While we are not growing our overall aggregate, we are growing premiums in that space"
HISCOX	Property catastrophe continues to represent one of the "best areas for growth" for Hiscox Re & ILS with rising rates and a capacity crunch leading to increased demand for limit, according to group CEO Aki Hussain
PartnerRe	PartnerRe will present a business plan to its board that will budget for a modest increase in cat capacity, which the reinsurer will deploy strategically along with its cyber capacity first to cedants where it can access other business it finds attractive, CEO Jacques Bonneau told this publication. The reinsurer is also looking to harness more capacity through its $1.1bn third-party capital platform
Swiss Re	At the July renewals, the reinsurer said nat cat growth was in line with January/April renewals, with the company shifting capacity to higher-attaching layers with attractive economics. "We do indeed see cat as an attractive area to grow further," Swiss Re group chief underwriting officer Thierry Léger said on an earnings call. "We think the market has arrived to a hard market positioning, and we feel that continued hardening will happen in the next 18 months or so. So we are very optimistic with regard to the market out there"
VALIDUS RE	Validus Re CEO Chris Schaper said the reinsurer is actively quoting across the board as others retrench, as he described an "underwriter's market" that the carrier is addressing from a position of strength after reshaping its book over a two-year period in which it has doubled in size to $3.1bn

Source: *The Insurer* based on earnings statements or public comments at Monte Carlo *Rendez-Vous*

The reinsurer said nat cat growth at 1 July was in line with January/April renewals, with the company shifting capacity to higher-attaching layers with attractive economics.

"We think the market has arrived to a hard market positioning, and we feel that continued hardening will happen in the next 18 months or so. So we are very optimistic with regard to the market out there."

Standing still in cat exposures

Everest Re, RenaissanceRe and TransRe appear to be sitting in the middle of the road in terms of property cat appetite for 2022/23, with all three having pared back their exposures in recent quarters but now looking to maintain current levels.

Juan Andrade, president and CEO of Everest Re, said that overall reinsurance market conditions had steadily improved over the course of 2022 and the company was now "seeing improved economics".

"Everest's position as a preferred market has allowed us to reposition our participation in key programs further away from frequency losses, and achieve better expected profit or reduced cat exposure," he added.

Meanwhile, fellow Bermudian RenaissanceRe held its PMLs flat as it benefited from increased rates at the mid-year renewals.

President and CEO Kevin O'Donnell said: "I think with increased demand at 1.1, we're going to see further rate pressure come into the market and reinsurance-led pricing, which we haven't seen for a long time."

And speaking at the Monte Carlo *Rendez-Vous* last month, TransRe's CEO Ken Brandt said the company's de-risking from cat business was now complete but the plan was never to exit the segment entirely.

In addition, Andrew Rippert, CUO at Aspen Reinsurance, recently told *The Insurer* TV that the group will target property lines – inclusive of property cat – but for margin growth only.

Rippert said that Aspen will look to strengthen its position in property at 1 January by capitalizing on the "best opportunities", after de-risking its book in 2019-21.

The group anticipates margin growth given the improved pricing opportunity, but confirmed it will not be growing its net cat exposures.

Seizing the opportunity

Aside from Swiss Re, there were other reinsurers that appeared willing to take advantage of the current hardening market.

Indeed, some observers suggest reinsurance pricing could rise as much as 20 percent on average at 1 January to account for inflationary pressures both this year and in 2023, as well as the uncertainty around secondary perils which has not been priced in. Against this backdrop, established reinsurers like Arch, PartnerRe and Hiscox have communicated their intention to grow their exposures if the right conditions are present. Arch Capital CEO Marc Grandisson said the June and July renewals "showed a property cat market in transition".

"While I hesitate to make predictions, we are cautiously optimistic that this momentum will continue into 1.1.23," he said. "The general psychology of the market appears to have shifted to requiring substantial rate increases to accept cat exposure."

Grandisson reported that the Bermudian selectively expanded its writings in Florida.

The executive said that rate pressure was also evident also beyond Florida. "However, we will need a few more quarters to confirm we are facing a hard property cat marketplace," he said.

Meanwhile, PartnerRe's CEO Jacques Bonneau said last month he was planning to present a business plan to its board that will budget for a modest increase in cat capacity, which the reinsurer will deploy strategically along with its cyber capacity first to cedants where it can access other business it finds attractive.

And similarly, Hiscox's group CEO Aki Hussain said property catastrophe continued to represent one of the "best areas for growth" for Hiscox Re & ILS, with rising rates and a capacity crunch leading to increased demand for limit. Others looking to increase their exposures include Convex, Validus Re and Ariel Re.

Convex CEO Paul Brand said the group would likely see a modest shift in the balance of its portfolio towards reinsurance this year, reflecting premium growth on the back of price increases.

"While we are not growing our overall aggregate, we are growing premiums in that space", he said.

Validus Re CEO Chris Schaper said the reinsurer is actively quoting across the board as others retrench, as he described an "underwriter's market" that the carrier is addressing from a position of strength after reshaping its book over a two-year period in which it has doubled in size to $3.1bn.

Meanwhile, Lloyd's reinsurer Ariel Re is in active discussions with potential capital providers in a bid to increase Funds at Lloyd's to support growth opportunities in 2023, including in cat reinsurance at the upcoming 1 January renewal.

Ariel Re was one of only a handful of reinsurers that looked to increase their presence at the mid-year US wind renewal.

Despite the new hardening conditions, there has been little in terms of new entrants to the markets, with a class of 2023 unlikely to emerge for the time being.

The only exception perhaps was Belgian insurance group Ageas, which announced the creation of Ageas Re.

The newly launched third-party reinsurance operation has long-term ambitions to write gross premiums of €1bn ($1.02bn) although it expects to have a "modest" and "limited" impact at the upcoming 1 January renewals.

Property cat treaty crunch turbocharges fac market

The boom in the property facultative market that began as insurers de-risked by cutting limits and appetite is now accelerating amid the retrenchment of reinsurers from cat, which is driving cedants to fill gaps and offload exposure lower down in their net retentions.

The dynamic is pushing fac – at least for property – into true hard market territory, with some sources suggesting the supply-demand imbalance is such that current conditions are even harder than in the aftermath of 9/11.

And the growth in the market over the last few years means that overall premium volumes are now approaching their previous peak.

Estimates for the overall size of the facultative market are hard to pin down, given the inconsistent classification by different market participants and where the business sits in their operations.

But in the US it has been suggested that this year top line at fac reinsurers could hit $1.5bn in property and $1.5bn in casualty.

Property fac had already been in a state of resurgence for the last few years with a flood of submissions that really picked up in 2019 amid fast-hardening conditions in the commercial property market.

Large commercial property insurers such as **AIG** and **FM Global** – which had previously put down huge lines and offered 100 percent capacity on some accounts – were dramatically cutting back limits as they reined in their appetite.

Hard property fac market drivers

- Kick-started by the retrenchment of large property capacity providers like AIG and FM three years ago
- Splitting 100% placements between multiple markets, many requiring fac to support their lines
- US property insurers continue to seek to mitigate volatility after adverse loss experience
- Insurers using fac to maintain participation on important relationship accounts
- Demand now accelerating as cat reinsurers retrench and seek to move further away from lower layers hit by frequency of severity, including from secondary perils
- That has led cedants to buy lower down to offload exposure in net treaty retentions
- Inflation is another factor driving demand as insurers look to manage TIVs and close the gap on insurance to value
- Supply of fac capacity is not keeping pace with surging demand (at least at a price fac writers are prepared to accept)
- Barriers to entry are higher in fac than treaty, which has restricted the volume of new capacity entering

That created two dynamics that drove demand for fac at a time when there was also tighter supply with the pullback of the direct and facultative market in London.

Retail and wholesale placements had to be filled by

more markets and many of those carriers joining the placements required fac capacity to support the lines they were putting down.

Meanwhile those underwriters that had cut back were using fac as a tool to maintain relevance in the market and relationships with key clients – a trend that continues in the current trading environment.

As **Swiss Re Americas** head of P&C facultative Ute Michaelsen told this publication: "Many carriers, especially the larger names, don't want to completely relinquish control over an account. So one way to do that and to stay in the driver's seat regarding pricing and terms is to buy fac.

"You also have smaller participants now playing on these accounts, and they typically have smaller balance sheets, so they need fac," she continued.

Aon president Eric Andersen made a similar point when he highlighted the strong contribution from fac placements to the broking giant's Reinsurance Solutions organic revenue growth of 9 percent in the second quarter.

"Facultative has been a great business for us over many years. And if you put it in the context of the overall market, where many of the insurers continue to remediate their portfolios, they often do that through the use of facultative placements in order to maintain their direct client relationship," he said.

For many of the historically large players in commercial property insurance, much of the remediation has been done.

But there is no sign of a return to large limits deployment and, if anything, carriers are more cautious than ever of heightened frequency and severity around cat losses from primary and secondary perils in the current environment.

Meanwhile, inflation is an increasingly hot topic for property insurers as they face rapidly rising total insured values (TIVs) and the need to close the insurance to value gaps that have opened up at a time when rising materials and labor costs are also driving claims costs higher post-event.

These factors are driving an across-the-board focus on managing down cat exposures and tight control of cat aggregates as carriers look to manage earnings volatility and protect balance sheets.

> "The fac market will be driven by what happens in the treaty renewals, so expect a lot more demand"
> **Howden RE chairman Elliot Richardson**

The downward shift

Cedants are now facing what some sources are describing as a perfect storm.

After a harder 1 January cat renewal in Europe than seen for several years, the mid-year US wind-focused renewal has been described as the toughest in memory in the Southeast, where in some cases excess-of-loss (XoL) reinsurance capacity couldn't be secured at any price.

Observers currently expect the market for property XoL to continue hardening up to 1 January even in the absence of a major cat event. If the hurricane season proves to be active, or other significant losses hit the reinsurance market, it could enter true hard market territory.

Meanwhile, quota share capacity is also increasingly tough to come by.

So insurers looking to manage down volatility and exposures – without further retrenching from the property line – are left looking to other alternatives.

And the property fac market is in pole position.

Santi Hernandez, CEO at **Arch Re Facultative**, told this publication: "We're the natural place where people go to solve their problems and it's our job to prudently solve them."

Howden RE chairman Elliot Richardson, who is still a prominent day-to-day practitioner in the space, added: "The fac market will be driven by what happens in the treaty renewals, so expect a lot more demand."

For Hernandez, current demand-side dynamics in the property cat market represent a fundamental shift.

"If you went back 10 years the traditional fac placement was just high excess and it was capacity driven. Now clients buy much lower down in the program to protect their nets," he observed.

Where a decade ago it was about a property fac

Fac to basics

Fac	v	Treaty
Protects individual risks		Protects large block of business
Offer and acceptance basis		Reinsurer does not have right of rejection on per risk basis
Reinsurer retains right to accept or reject each risk		Supported by a contract
Supported by certificate		Pre-agreed conditions
Certificate attaches to conditions of underlying policy		Cession is obligatory
Cession is optional		Acceptance is automatic

Other types of facultative reinsurance include facultative obligatory treaty, which is a treaty under which the primary insurer has the option to cede or not cede individual risks, but the reinsurer must accept any risks that are ceded
Source: NAIC, *The Insurer*

reinsurer's ability to trade with $100mn in limit high up, now clients are looking for $4mn xs $1mn or $5mn xs $5mn facultative covers.

That demand for low-down cover has been heightened by the trend for reinsurers to seek to move away from lower layers on XoL cat structures.

"As programs are getting pushed up that net is potentially increasing as there's less appetite [from treaty reinsurers] to play lower down, so we'll continue to see our participation within the first 10 percent of the TIV.

"That's just the evolution of fac. We are always filling in for either a change in perception of risk or actual reactions to losses," said the Arch Re Fac executive.

The demand for fac is not just to address growing net retentions in relation to XoL treaties.

Ascot Re US president Rory Cline – another veteran of the fac market – noted the trend for cedants to cut back cessions on quota shares.

"If you bought a 70 percent quota share, now maybe you're buying 35 percent, and that's now coming back into the fac market," he observed.

"The use of facultative protection allows an insurer to be more strategic in its reinsurance purchasing to take out some of the volatility and severity of certain accounts. That's what is starting to happen right now, especially in property," Cline continued.

More generally he agreed that cedants are taking bigger retentions because they are struggling to afford the necessary increases they are seeing on their property treaties.

> There is a finite amount of capacity and I think the overriding goal for all of us is to get adequate returns for our capital
>
> **Ute Michaelsen, Swiss Re Americas head of P&C facultative**

> Cat is hard to buy. People want more and more cat in the fac market, but the price needed for this capacity is up substantially
>
> **Ascot Re US president Rory Cline**

Supply shortage

But he cautioned: "Cat is hard to buy. People want more and more cat in the fac market, but the price needed for this capacity is up substantially."

Hernandez also pointed to the limited appetite for cat among reinsurers, whether treaty or fac.

"It's a challenge to manage it and make sure that you're making the most of the opportunities while taking care of your aggregation," he said.

Michaelsen agreed. "There is a finite amount of capacity and I think the overriding goal for all of us is to get adequate returns for our capital. If you are in a hard market you are really looking to optimise your portfolio and your risk selection to get the most return on your capital. In that sense, fac can be more selective than treaty," she said.

Richardson highlighted the demand-supply equilibrium in the property fac market.

"If the treaty market continues to refuse to take the cat you've got to find a home for it. Right now, on large US property insurance accounts you could literally place 10 times the amount of fac you place and still not find a home for it all. There just is not enough capacity," he said. For Richardson current conditions are harder than after 9/11, when fac was at the fringes of the reinsurance world with relatively few buyers. "Now you have most of the panel buying and even with large increases in deductibles and prices they still want to purchase fac because they don't feel happy with their net and treaty lines," he stated.

That sustained level of heightened demand coupled with finite supply suggests the fac boom has plenty of road to run.

The fac barrier

With current conditions in the property fac market arguably as attractive as they have been in at least two decades, it might have been expected that an influx of capital would enter to capitalise on the resurgent segment.

Although there has been some increased participation and new entrants, that influx has largely not materialised and demand continues to strongly outpace supply.

Sources have said that one factor explaining the imbalance is the greater barriers of entry to fac compared to treaty.

Recent start-ups – such as **Vantage** and **Conduit Re** – have looked to grow meaningfully in treaty from the outset in part because the business can operate on a relatively low headcount without heavy infrastructure.

Fac does require a major investment in people and infrastructure to be able to handle the high volume of submissions and level of individual risk and account underwriting necessary to successfully write the business.

And like almost every area of the commercial (re)insurance industry, the fac market is facing a talent shortage.

"We are a subset of that whole war for talent in the industry," suggested Cline.

"But I still think fac is a great space, and it's a hell of a learning experience. Fac is going back to being the eyes and ears of any global insurance company," he said.

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