January 2023

# REINSURANCE RENEWAL INSIGHTS

January 1 renewals are proving to be one of the most challenging reinsurance markets the industry has ever experienced. Numerous headwinds have constrained available capacity levels across primary, reinsurance and retrocessional markets impacting the property catastrophe segment most heavily.

This confluence of events is also driving adjustments more broadly across the reinsurance sector. These headwinds include the impact of rising inflation, 6 years of elevated natural catastrophe activity, stressed asset valuations, impact of the strong US dollar, geopolitical uncertainty, increased interest rates and the withdrawal of catastrophe capacity by some providers. In this context, reinsurers and cedents worked diligently to establish a new market equilibrium. While timing came down to the wire, placements were largely completed at client-issued structures and pricing, with minor modifications in coverage.

A business of Marsh McLennan

## Key Findings

- For the first time since Guy Carpenter started calculating dedicated reinsurance capital in partnership with AM Best, the sector's capital contracted in 2022. This shift contributed to a tightening of reinsurance capacity and prompted reinsurance providers to re-evaluate their risk appetites.

- The imbalance of supply and demand in property catastrophe has been a key theme for the January 1 renewal season. North America was most impacted but globally, all regions experienced significant adjustments in market conditions. Some reinsurers reduced or withdrew their property capacity, whereas others used this market inflection point as an opportunity to increase their participation as pricing and attachments improved materially.

- Rating agencies' views of the sector deteriorated during 2022, driven by financial market volatility, economic and social inflation, foreign exchange rate movements, and the continued evolution of the frequency and severity of catastrophe losses. Capital providers deemed a reset in view of risk as necessary to correct market misalignment.

- Property market changes focused on the 3 distinct areas of pricing, attachment and coverage, with coverage arguably creating the most complexity. Consistency in coverage and reaching concurrent terms are priorities for cedents. Ultimately, broad coverage adjustments were largely limited to terror and strikes, riots and civil commotion (SRCC), as pricing and attachment requirements were deemed most critical.

- While changes in supply were one side of the story, primary companies responded to the measurable shift in property market conditions by adjusting their demand for reinsurance. Core purchases tend toward inelastic, but many buyers reassessed their need for additional supplemental coverage and overall demand increased negligibly. Increased retentions and opportunistic renewal layers purchased in previous market cycles dampened the expected demand surge as the cost/benefit trade-off was re-evaluated.

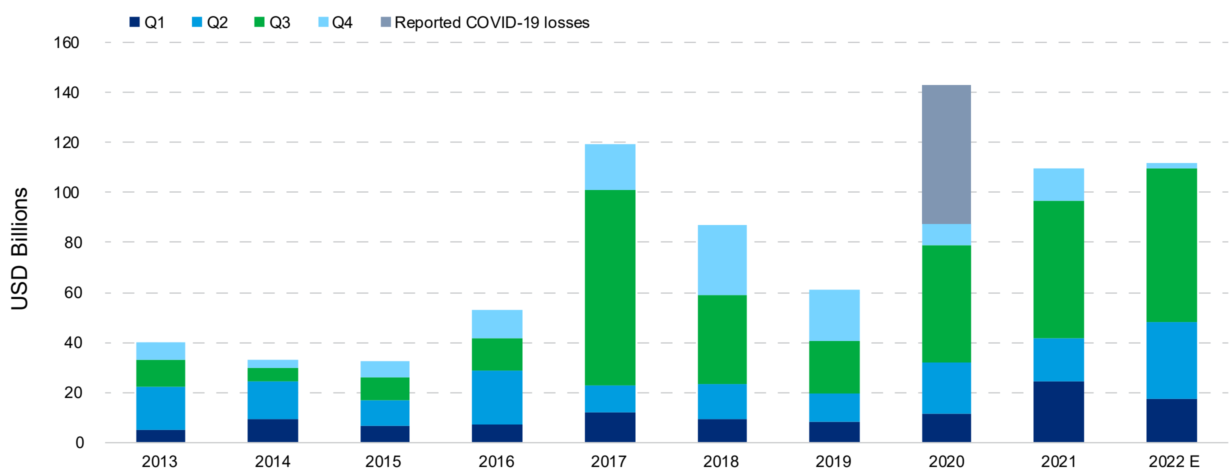
- More broadly, outside property, external headwinds, the sector's inability to earn cost of capital over recent years and social inflation considerations were catalysts for adjustments to underwriting requirements in other classes of business. These were highly varied and dependent on both internal and external influences. While casualty lines saw an increase in potential capacity, particularly from reinsurers moving away from property, there were still expectations of improved economics.

- There was extremely limited new capital inflow through the fall as investors held back amid continued catastrophe loss, increasingly attractive risk-free rates of return, their own moderating assets under management (AUM) as asset valuations were impacted and a desire to assess the degree of market transition at January 1. However, capital finally started to move more freely into the sector in December as the degree of market correction became clearer.

## Market Drivers

- Guy Carpenter and AM Best mid-year projection of traditional dedicated reinsurance capital was USD 435 billion, an 8% decrease from year-end 2021. Since then, the sharp rise in interest rates and risk of recession has caused asset values to deteriorate further, creating additional, material downward pressure on capital levels.
- Alternative capital was forecasted to increase 1.7%. Since that mid-year projection, insurance-linked securities (ILS) AUM have held steady to down in total, with some fund managers gaining and some declining. This is total committed capital and does not reflect a decrease in currently available capital due to funding obligations. An updated dedicated reinsurance capital estimate will be released in January.
- Decreased retro capacity further constrained reinsurers' risk appetite.
- Reinsurer premium growth was seen across most lines of business due to a combination of escalating rates and increased exposures driven significantly by inflation adjustments.
- The projected annual large loss total rose to **USD 112 billion, driven by Hurricane Ian**. PCS' current loss estimates for Hurricane Ian are well above Irma and Ida, making Ian the second-costliest hurricane on record. Overall, Hurricane Ian loss estimates range greatly. Current model vendor estimates include variation in what is included relative to wind, surge and flood. The impact of storm surge, flood and litigation will play a significant role in both the insured and economic losses.
- European floods and hail events, Australian floods and US severe storms also drove 2022 loss experience.
- Current loss estimates do not include the most recent December events, which will further increase the 2022 total.

**Figure 1:** Significant Insured Losses 2013-2022*
Significant large loss activity generated another year in excess of USD 100 billion in 2022.




*Significant Insured Losses (Est. losses > USD 100M). All reported COVID-19 losses allocated to 2020 for purposes of this chart.

Source: PCS, ICA, AIR, Guy Carpenter

## Additional Property, ILS and Cyber Renewal Observations

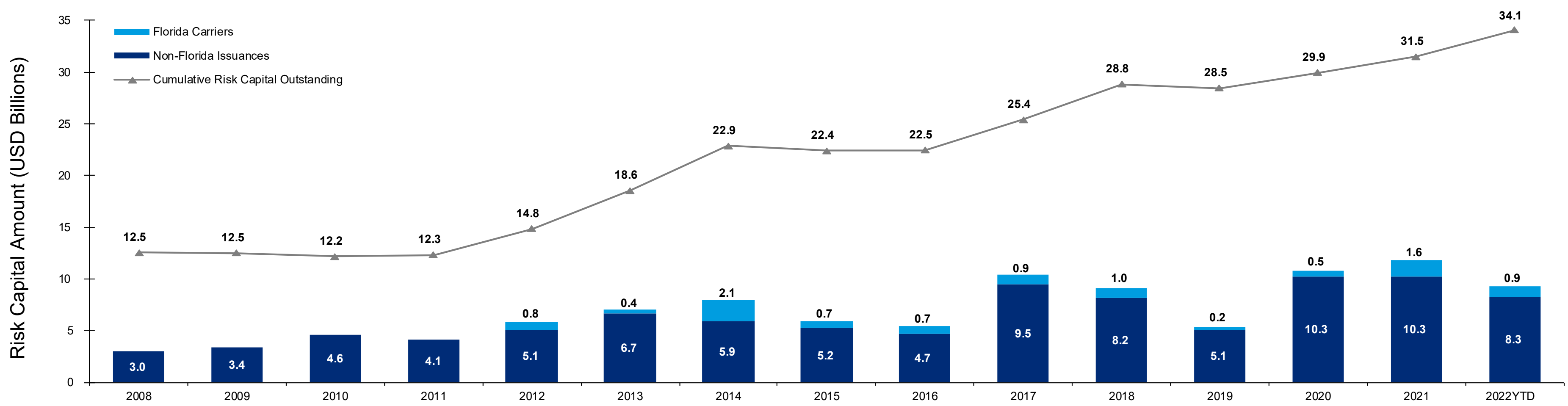
The January 1, 2023 renewals experienced challenging conditions across virtually all classes and geographies, as an unprecedented confluence of events produced internal and external pressures on the reinsurance sector. Guy Carpenter will provide additional, in-depth insights in the coming weeks as the final renewal outcomes are evaluated. Property, ILS and cyber were among the most challenged segments. Below are additional observations focused on these drivers of renewal complexity.

### Property

- The global property catastrophe market was already hardening materially prior to Hurricane Ian, which further tightened the market ahead of January 1 renewals.
  - Economic inflation added 10%-15% to underlying valuations within existing property programs in all major zones worldwide.
  - Demand shifted as market terms adjusted and cedents re-assessed their reinsurance buying strategies. There was clear focus on reinsurance structures—particularly portions of programs with higher expected losses—and, significantly, the tradeoff between reinsurance costs, available capacity and retaining risk.
- Some capacity providers announced exits or material reductions to property catastrophe writings. Reinsurers meaningfully adjusted their view of risk, whether looking to grow or shrink in the sector.
  - Risk-adjusted pricing increased on average 40% to 60% in North America and 25% to 35% in Europe/UK, the 2 largest property markets at January 1. This level of adjustment is after increases to account for inflation and exposure growth. Note that outside of these averages there was a very wide range of outcomes dependent on individual client characteristics. Cedent risk profile and loss activity drove increases in excess of 100% in cases.
  - Attachment points were scrutinized, as increased values and lengthy periods without upward adjustments put significant pressure on bottoms of programs after several years of loss activity. In North America, attachments increased by 30% to 40% percent on average.
  - A material focus on tightening terms and conditions emerged as the quoting process got underway. While pressure on pricing and attachments were well communicated during the fall, modifications to terms were raised later and without 1 dominant focus. This fracturing of market standards to define coverage created arguably the most difficult aspect of the renewal process.
- Authorizations and signings were very delayed as reinsurers and cedents struggled to find market equilibrium around pricing and other material terms. With roughly 1 week to go in December, authorizations at cedent's ordered terms significantly picked up pace. Ultimately, out of the number of coverage issues raised, treatment of terrorism and SRCC became the most common areas of discussion, with more restrictive definitions of each required in certain cases.
- Hurricane Ian exacerbated reinsurers' view of the sector and further decreased available capacity due to timing of the event, uncertainly in loss magnitude (amid concerns of Irma-type development) and trapped capital. This was in addition to an observed increase in frequency and severity of global catastrophe loss.
- While prevalent in many risk re-assessment discussions, Guy Carpenter analysis of the annual impact of climate on global average annual losses is on the order of 1%, not the 5%-10% or greater per year, as some sources note. Increasing population and concentration of housing and business units in suburban areas was a much larger driver of increasing losses.

# Catastrophe Bonds

**Figure 2:** 144A Catastrophe Bond Risk Capital Issued and Outstanding—2008 to 2022YTD




Source: GC Securities

- In 2022, 42 different bonds were brought to the 144A market totaling more than USD 9 billion in limit placed, taking the total outstanding notional amount to an all-time high of more than USD 34 billion.
- A strong sign of the interest in utilizing the 144A market, there were more deals offered in 2022 but diminished capacity available on average per deal, constrained the issuance total.
- Approximately 73% of the limit placed utilized an indemnity trigger, with the balance coming from industry loss index structures.
- In view of constrained investor capacity, a significant majority of the bonds priced at or above the higher end of the price guidance.
- Investors pushed back on complex books, secondary perils, aggregate structures, call provisions and extension spreads. There was keen focus on inflation and portfolio growth projections.
- The sidecar market remained challenged, with several ILS managers withdrawing capacity from the collateralized reinsurance/retrocession space in view of previous trapping and lack of fresh capital inflows. While ILS capacity has provided an attractive market alternative in past firming cycles, it was not immune to the overall reset in acceptable pricing and structure requirements.

## Cyber

Key cyber reinsurance themes at January 1:

- Reinsurers looked to manage aggregate cyber capacity on proportional and non-proportional placements. This put loss ratio caps and shares under pressure for quota share business, while reinsurers evaluated dollar limits on non-proportional business.
- Suitability of war exclusions have been re-evaluated, especially in light of the Lloyd's Market Association (LMA) Cyber Bulletin and the Russia-Ukraine conflict.
- There was a divergent view of trend across the industry, as (re)insurers evaluated decelerating rate with uncertainty regarding inflation and the overall risk landscape.
- Reinsurance buying strategies shifted: Clients revisited their buying approach, given the stabilized threat landscape and implementation of underwriting strategies.
  - Quota share remained prevalent, and net risk appetite increased.
  - Buyers explored event excess of loss covers, in lieu of aggregate stop loss, to help drive reinsurance cost savings.
  - Definition of a cyber "event" remained a challenge. Guy Carpenter has drafted our own branded definition and socialized it with markets.
- Stabilized pricing at January 1:
  - After flat ceding commissions in 2022, 2023 trends toward flat to slight increases, dependent on the ceding company's ability to show frequency/severity drops in its loss data.
  - Aggregate stop loss pricing and attachments are flat, after significant increases in the past 24 months.
- Reinsurance capacity:
  - New quota share reinsurance capacity slowly entered the market, while aggregate stop loss capacity remained stable.
  - Guy Carpenter continues to seek new or expanded sources of capital to support the growth of the market.
  - Third-party capital is gaining traction, as alternative providers are open to cyber opportunities.

## Looking ahead:

As we reflect on the recent reinsurance renewal and look toward the year ahead, it is important to remember that we have been at these crossroads before. In prior reinsurance cycles, significant natural catastrophe losses brought rate corrections, which in turn created the incentive for new reinsurers to form.

New capital that entered the market equaled approximately USD 4 billion in 1993 following Hurricane Andrew, USD 8 billion in 2001 following the attacks of September 11, 2001, and USD 8 billion in 2005 following Hurricanes Katrina, Rita and Wilma. In addition, existing companies were able to reload with over USD 12.5 billion raised in 2005.[1]

In more recent years, capital has moved to sidecars, catastrophe bonds and collateralized reinsurance capacity supplied through ILS fund managers.

As we look ahead to 2023/2024, we view the structural shift in market pricing—and consequently an attractive return prospect—as creating the necessary conditions to attract material new capital to the sector.

1. Not adjusted for inflation.

## How Guy Carpenter Helps Clients

Diversification and multi-faceted reinsurance solutions have never been more critical for our clients to achieve their capital, growth and volatility objectives. Data-driven insights, product innovation, enhanced market intelligence and broad renewal strategies are the cornerstone of our approach to navigating the current difficult circumstances. In these volatile times, Guy Carpenter is committed to bringing the full breadth of our market-leading presence and expertise, along with leveraging the complement of Marsh McLennan resources to navigate market conditions and generate solutions in cooperation with all of our partners. A healthy, dynamic and responsive reinsurance market is crucial to the global economy and our collective success.

### About Guy Carpenter

Guy Carpenter & Company, LLC is a leading global risk and reinsurance specialist with 3,400 professionals in over 60 offices around the world. Guy Carpenter delivers a powerful combination of broking expertise, trusted strategic advisory services and industry-leading analytics to help clients adapt to emerging opportunities and achieve profitable growth. Guy Carpenter is a business of Marsh McLennan (NYSE: MMC), the world's leading professional services firm in the areas of risk, strategy and people. The Company's 86,000 colleagues advise clients in 130 countries. With annual revenue of over $20 billion, Marsh McLennan helps clients navigate an increasingly dynamic and complex environment through four market-leading businesses including Marsh, Mercer and Oliver Wyman. For more information, visit www.guycarp.com and follow us on LinkedIn and Twitter @GuyCarpenter.