Gallagher Re

1st View: Undimmed Resolve

APRIL 2023

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Introduction

The April 1 renewal season has seen a continuation of the discipline shown by reinsurers at January 1 but with a greater determination that pricing and contract improvements are applied across all territories and to all business lines. The January renewals did see some smaller territories being treated more favorably than major mature markets, but this differentiation has largely vanished by April.

Despite this more uniform and global approach, a client-led underwriting process remained evident. Clients and markets who had seen significant price increases and tightening of reinsurance conditions in recent years consequently experienced more measured increases. However in some smaller markets, where terms and conditions have remained largely unchanged for many years, the pressure from reinsurers seeking to correct soft market conditions in a single renewal has been intense.

For Japanese buyers, both client and reinsurers expectations were better aligned than at January 1, which led to a more orderly renewal process. This was aided by both the long-term nature of reinsurer relationships in the Japan market as well as the considerable improvements in primary underwriting that Japanese insurers have achieved in recent years. Unfortunately, in other smaller markets there were examples of major structural changes being enforced at the last minute and quotes being delayed to minimize negotiating time. The impact of these structural changes has been both unexpected and profound on the financials of some insurance companies and is leading to an immediate impact on their original underwriting with all the challenges that this entails, causing significant strain in some of the client and reinsurer relationships.

In line with what was witnessed at January 1, the April renewals of long tail classes have been less contentious, remaining calm and logical-- though US casualty nuclear awards are increasingly making their presence felt on many US casualty placements, and in some instances on treaties with incidental US exposures. The notable exception has been US Public D&O where pressure on ceding commissions remains following decreases of up to 2 points at January 1. Reinsurers cited continued prior year adverse development and negative rate in the underlying market as the drivers of these shifts while cedants countered that portfolio dynamics are less volatile and renewal rate change is misleading given impact of IPO/SPAC and de-SPAC business in recent years.

Capital supply remained constrained with few signs of fresh capital entering the market and existing reinsurers being impacted by mark to market investment losses. ILS issuance is picking up and remains expensive compared to previous years with pricing and capacity in line with traditional indemnity pricing.

The overall market supply demand dynamic remains delicately poised with sufficient capacity available at April 1 to meet clients' needs; however, since the largest capacity requirement at April 1 remains Japan, which represents a significantly lower than peak US cat exposure demand, the renewal cannot be regarded as a true test of market supply demand dynamics.

The reinsurance market remains stressed as reinsurers seek to achieve reasonable returns on their capital whilst nursing large mark to market investment losses. Headline capital in the global insurance industry has reduced as a result of investment losses but provided reinsurers do not have to realise these losses through the early sale of underlying assets the underlying economics remain sound providing ceding companies with secure capacity. The hopes of some buyers that new capacity might enter the market at this renewal-- and some signs of amelioration in hardening terms and conditions would emerge-- remain unfulfilled. This is pushing primary companies back to reexamine their original underwriting strategies, which in the current strained economic environment is extremely demanding to address with original policyholders.

James Kent
Global CEO, Gallagher Re
April 2023

Property: Commentary by Territory

India

- Aggressive reinsurance rate increases in a catastrophe free year unsurprisingly led to a delayed renewal
    - The national reinsurer and market leader, GIC Re, led the market in driving rate increases
    - Foreign branches of the European reinsures were more lenient, albeit selectively
    - Cross-border reinsurers primarily followed the market position
- High loss activity in the risk market ensured significant price increases for excess of loss programmes, however commissions on pro-rata treaties remained nearly flat
- Capacity was adequate, but despite the steep increases many reinsurers had limited appetite, especially at the higher end of programmes

Japan – Property Catastrophe

- Early signs of capacity shortages did not materialize, with demand and supply remaining broadly balanced
    - Little change in demand, less withdrawal of capacity than anticipated with some reinsurers seeking to benefit from positive rate movements
- Early quotations were exceptionally wide in range
    - The highest attaching layers saw the most significant quoted increases as reinsurers stressed minimum rate-on-line requirements
    - A two-speed market became apparent, with reasonable pricing for expiring capacity contrasting with opportunistic quotes for significant new capacity
- Earthquake business generally remained more sought after by reinsurers than other perils both on an excess of loss and pro rata basis
    - Earthquake-only layers tend to attach higher and have therefore been subject to tougher minimum rate-on-line requirements from reinsurers
- Many buyers managed increased pricing requirements through co-participation and small increases in attachment points
- Reinsurers widely recognized the improvement in technical pricing adequacy in the last three years, resulting in an orderly conclusion of renewals
- Catastrophe (Earthquake) Pro Rata Treaties remained in demand with reinsurers and renewed smoothly

Japan – Property Per Risk & Pro Rata

- The renewal saw continued reinsurer pressure on pricing and structure following recent large domestic and Japanese Interests Abroad (JIA) losses
- Buyers pursued diverse structural strategies to resolve reinsurer concerns about the long-term viability of their per risk reinsurance protections
    - These included limiting pro rata capacity (both Per Risk and Per Event), as well as implementing Reverse Franchise catastrophe limitations

    - These measures proved successful with the majority of expiring pro rata capacity ultimately renewed
    - There was limited impact on ceding commissions, which have already reduced significantly in recent years
- Per Risk placements saw tough terms and conditions imposed
    - Overseas exposures were treated significantly more harshly than domestic exposures
    - Many buyers managed increased pricing requirements through co-participation and small increases in attachment
- A significant amount of coverage issues were raised
    - Reinsurers requested a large number of coverage changes but buyers were able to push back on most of these
    - Ultimately sufficient Per Risk excess of loss capacity was secured

Latin America

- Property Catastrophe:
    - Capacity for large programs in peak zones in the Latin America and Caribbean market was tight
    - Some reinsurers struggled to allow for natural exposure growth and as a result were carefully assessing accounts and their deployable capacity
        - Some reinsurers maintained their monetary lines and took a client centric approach to offering support, while others deployed additional capacity at terms and conditions they considered appropriate
    - In some peak catastrophe proportional placements with large expiring events limits, buyers chose to slightly reduce event limits and/or reduced growth projections to ensure full placement of their proportional treaties
- Excess of loss:
    - Programs grew in size due to organic growth and to assume additional retained exposure in the case of shortfalls in proportional treaty placements
    - Consistency emerged around pricing with reinsurers initially seeking in excess of +25% risk adjusted in catastrophe exposed territories
    - Reinsurers sought non-catastrophe business with good claims experience as a means to balance their catastrophe exposures
    - In cases that buyers were able to offer balancing business, placement with smaller increases were possible
- In light of the pricing pressure for capacity, many buyers took action to limit the cost increases by revaluating growth targets, raising retentions and balancing conditions to access capacity
- The scrutiny of SRCC coverage among reinsurers was sporadic across the region but in countries with elevated levels of civil unrest, this topic remained prevalent
- Pricing trends for non-property lines reflected actual account experience, and in the absence of losses generally trended moderately upwards

US

- Overall, the market was more orderly than it was at January 1, with great clarity around available capacity, terms and conditions
- With regard to pro rata, some cedants with less profitable programs had to take greater net retentions. There was also increased focus on embedded catastrophe coverage
- First layers of risk excess and cat programs were particularly challenging to place as reinsurers looked to move up programs. Accordingly, many buyers increased net positions via co-participations, annual aggregate deductibles, or fixed retention increases
- On Catastrophe programs, focus remained on secondary perils, with some reinsurers seeking to restrict coverage to the peak perils of Earthquake and Hurricane
- Top layer pricing came under pressure as reinsurers substantially increased their minimum premium requirements in response to their own cost of capital
- Cyber, Communicable Disease, Terrorism, Strike and Riot (SRCC) became a frequent point of discussion with reinsurers seeking to restrict coverage
- Reinsurers continued to reserve nationwide, multi-peril capacity for core clients and renewal lines, so were more inclined to review new opportunities on a region or peril specific basis

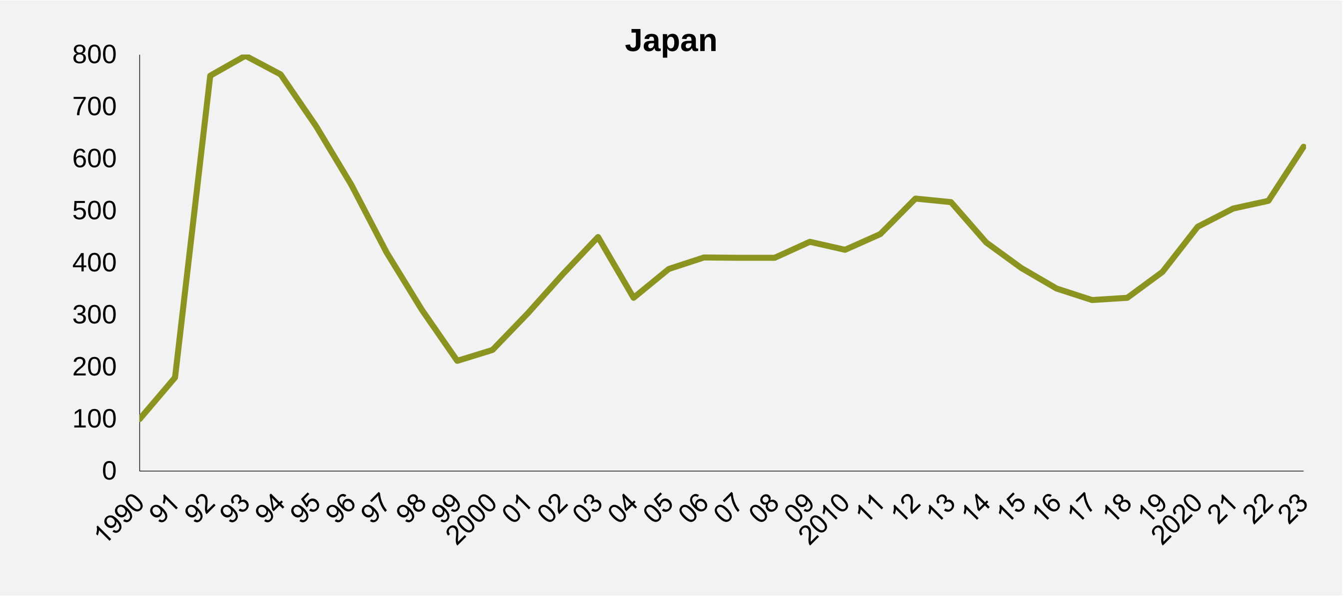
Property Rate Movements

Territory	Pro rata commission	Risk loss-free % change	Risk loss-hit % change	Catastrophe loss-free % change	Catastrophe loss-hit % change
India	0%	+10% to +75%	+15% to +160%	+25% to+90%	-
Japan	-2% to 0%	+15% to +20%	+20% to +50%	+15% to +25%	-
Latin America	-3% to 0%	+5% to +15%	+10% to +25%	+15% to +35%	+25% to +45%
US	-6% to 0%	+20% to +40%	+60% to +100%	+30% to +50%	+50% to +100%

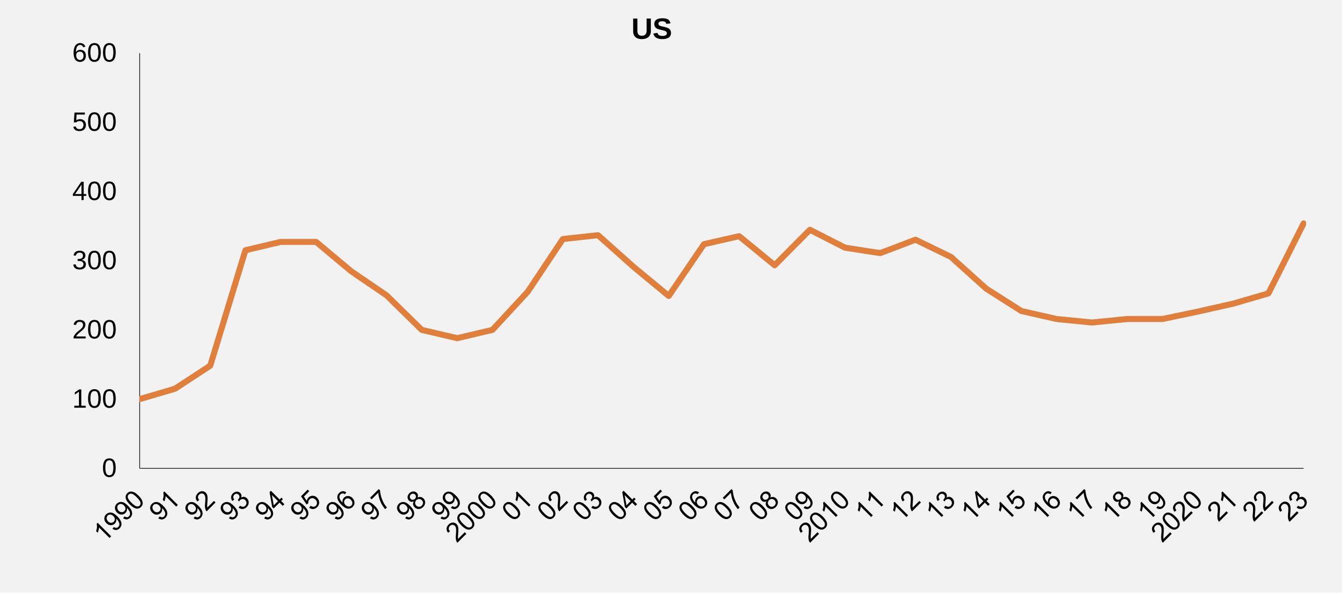
Note: Movements are risk adjusted.
Source: Gallagher Re

Property Catastrophe Pricing Trends

The charts on these pages display estimated year-over-year property catastrophe rate movement, using 100 in 1990 as a baseline.



Source: Gallagher Re



Source: Gallagher Re

Casualty: Commentary by Territory

Japan – Cyber

- Underlying portfolios continued to perform well
- Primary rates are stable and coverage remained relatively restrictive by global standards
- Portfolios continued to grow steadily
- Reinsurance purchases remained an attractive diversifier for reinsurers, ensuring strong demand
- Reinsurance terms and conditions remained largely unchanged

Japan – General Third-Party Liability

- Many reinsurers sought to diversify further into non-cat lines, but capacity was cautiously deployed
- While some reinsurers with larger existing lines looked to manage down their exposure, others with smaller shares wanted to grow, benefiting from improving rates and diversification
- Concerns and discussions driven by US exposures and some recent loss developments
- 'Social Inflation' in the form of catastrophic single-plaintiff bodily injury claims were the key concerns for larger portfolios
- Pricing varied significantly depending on the mix of underlying exposures, but broadly between +10% and +20% risk adjusted

Japan – Personal Accident

- A number of larger personal accident programs were affected by significant COVID-19 losses in 2022, resulting in significant disruption to a market that has long been very stable
- A stalemate between buyers and reinsurers over the availability of ongoing Contagious Disease (CD) coverage was slow to be resolved
    - A significant portion of capacity providers would only contemplate excluding CD coverage
    - A smaller number of reinsurers have agreed to provide coverage, albeit on a more restrictive basis
- Some programs were renewed at more competitive pricing, excluding CD coverage
- Some buyers restructured their programs to maximize the available CD coverage
    - Where available, CD coverage was sub-limited and subject to significant restrictions in terms and conditions
- Regardless of loss history, terms and conditions, all programs saw significant price increases

US – General Third-Party Liability

- Overall dynamics remain stable - structures and cession levels were relatively consistent amongst continued strong appetite by reinsurers for US Casualty

- Reinsurance costs (Rate, Ceding Commission) remained sensitive to individual cedent portfolio dynamics which include prior year development, loss trends, rate change, and portfolio shape/mix
- Reinsurers continued to exert some pressure on ceding commissions and excess of loss pricing, however buyers who laid out robust and transparent underwriting strategies were able to maintain relatively stable pricing and coverage terms

Casualty Rate Movements

Territory	Pro rata commission	Excess of Loss – no loss emergence % change	Excess of Loss – with loss emergence % change
Japan – Cyber	-	-	-
Japan – General Third-Party Liability	-	+10% to +20%	+20% to +30%
Japan – Professional Lines	-	+10% to +20%	0%
Japan – Personal Accident	-	+25% to +75%	+50% to +100%
US – General Third-Party Liability	-2% to 0%	0% to +5%	+5 to +15%

Note: Movements are risk adjusted.
Source: Gallagher Re

Specialty: Commentary by Line of Business

Japan – Bond & Credit

- No significant changes in structure or coverage required by ceding companies
- Domestic business seen as attractive by reinsurers and demand for business remained high
- Reinsurance appetite for international exposures and niche lines was more muted
- Detailed discussions around potential exposures to sanctioned territories were ultimately resolved
- Placements completed smoothly

Marine – Global

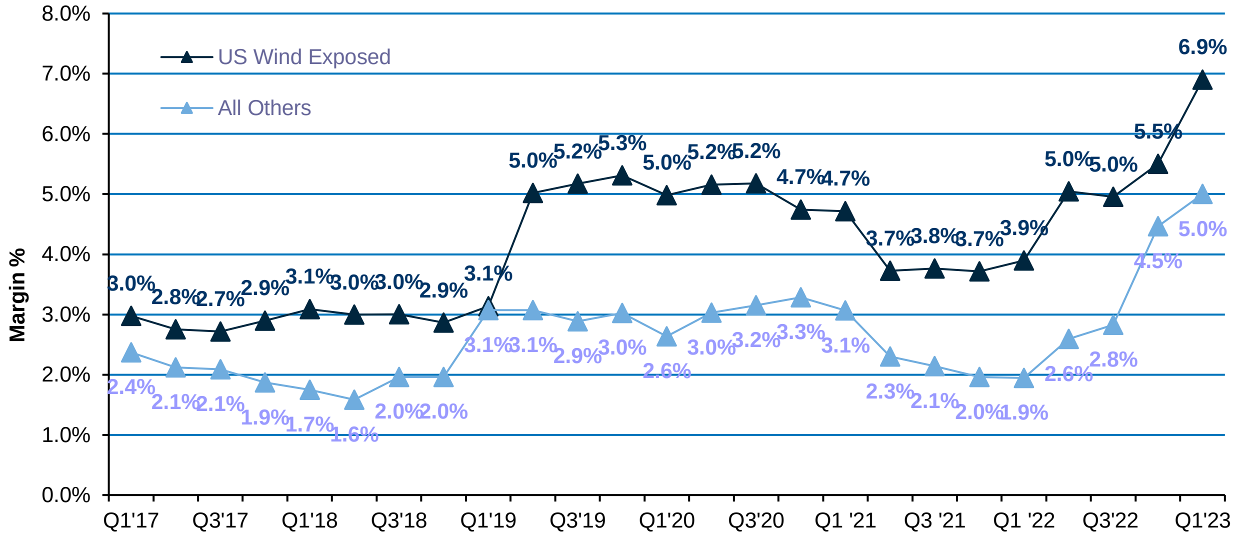
- Core Marine & Energy capacity remained plentiful though limited retro supply has been an issue for those reliant upon it
- Capacity was more constrained for War, Terror and Political Violence (WTPV) and catastrophe-focused business
- Focus of the reinsurance market on suitability of structures in respect of retention against peak exposures and line size, as well as individual class pricing adequacy when multiple lines of business are covered within a single layer
- Reinsurers required geographical restrictions for Sabotage & Terrorism (S&T), Strikes, Riot, & Civil Commotion (SRCC), and War on Land (WOL) coverage with varied times and distances
- Aviation & Aviation War coverage was widely unavailable in composite structures and a challenge to buy cost-effectively on a stand-alone basis as a consequence of the potentially significant claims in respect of leased aircraft in Russia
- Continued debate and inconsistency in respect of on-going Marine War coverage for trade with Russia and Ukraine
- Where Downstream Energy was covered recent loss activity has raised concerns over pricing adequacy despite recent rate rises. Breadth of coverage being addressed with additional exclusions
- The pricing negotiations themselves focused on the topics of inflation – both economic and social – Nat Cat, and reinsurers increasing cost of capital
- There was pressure from reinsurers to increase retentions, which was often resisted despite the increase in costs as buyers' attitude to net risk appetite remains cautious

ILS Update

- The primary market began the year relatively quietly over the first couple months with activity becoming extremely active starting in late February
- At the time of writing 13 transactions have closed or are in the process of being marketed seeking capacity of USD 2.8bn or more
- The pricing dynamic has also changed versus Q4 2022 with more transactions upsizing and execution spreads sometimes under guidance, reflecting that some ILS funds have increased their Assets Under Management (AUM)
- Prices are still at a historical high. However, thus far, the higher spread levels have not decreased the demand for new sponsors to come to the market. If ILS Fund AUM can continue to keep pace with demand, we could see a potentially record year for new issuances
- As investors raised capital and did not have many primary transactions to invest in over the first couple months of the year, prices started to increase (spreads levels decreasing) in the secondary markets at the start the year

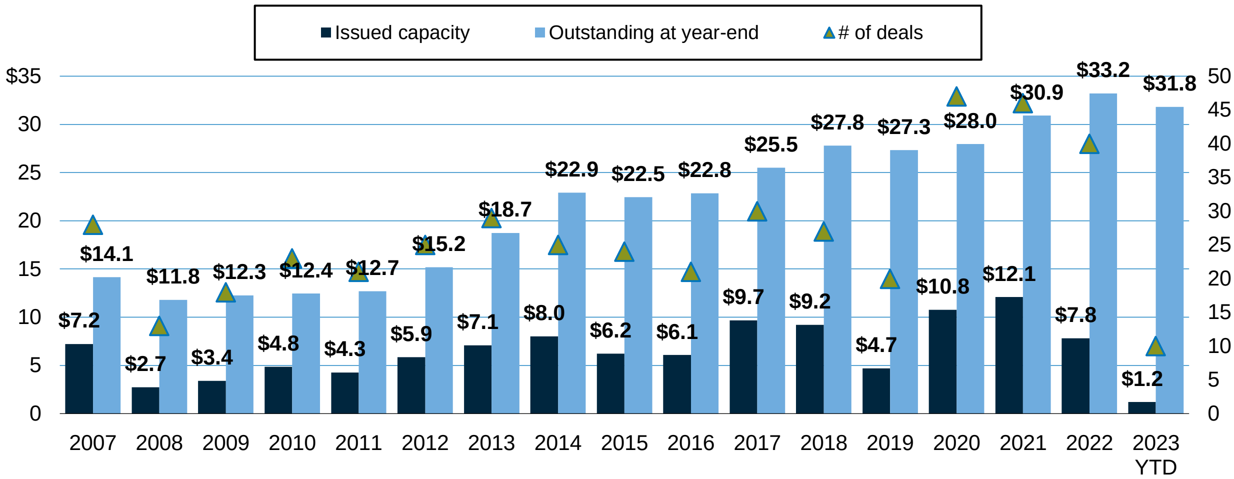
The charts below show the changes in quarterly weighted average margin (risk spread - expected loss) for different types of cat bonds, along with the capacity development of the cat bond market, and a comparison of the total return on cat bonds as against two other comparable investment classes.

Quarterly Weighted Average Margins for New Issue Cat Bonds on an LTM Basis



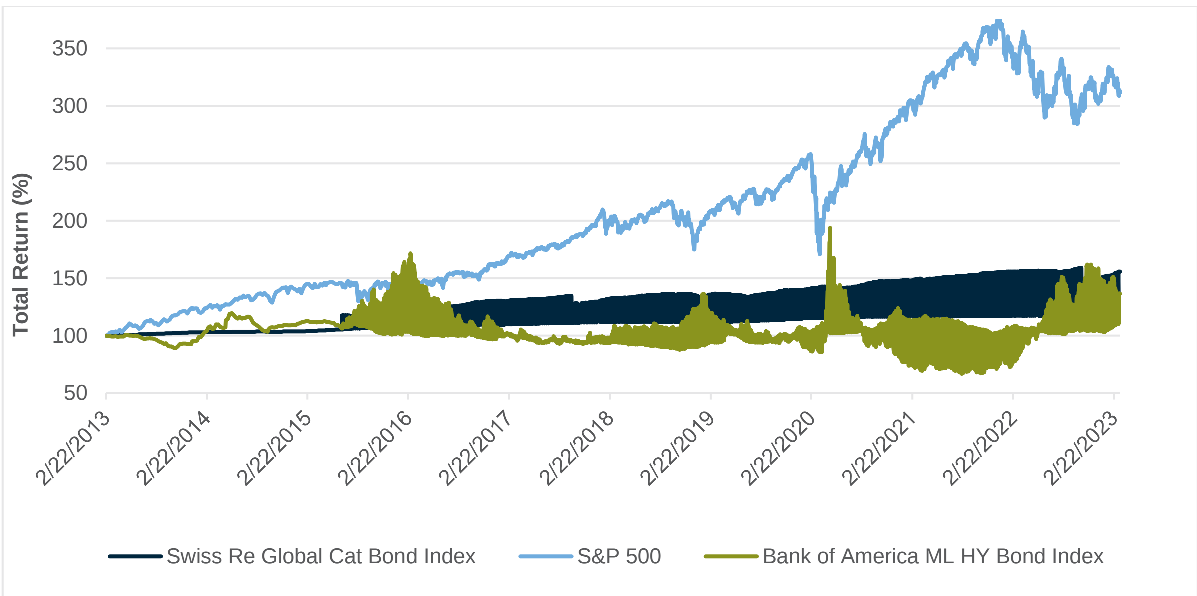
Source: Gallagher Securities Transaction Database as of 16 March 2023. Aggregate data exclude private ILS deals. LTM = Last 12 months. Aggregate data are for primary issuance only and do not reflect secondary trading.

Non-life Catastrophe Bond Capacity Issued and Outstanding by Year[2]



Source: Gallagher Securities Transaction Database as of 16 March 2023. Aggregate data exclude private ILS deals.
2-All issuance amounts reported in or converted to USD on date of issuance.

Historic Relative Returns



Source: BofA Merrill Lynch US High Yield Bond Index, Standard and Poor's 500 Index, and Swiss Re Global Cat Bond Total Return Index

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