ANNUAL EDITION 2020

**WILDFIRES:** A burning issue for reinsurers

**FLORIDA:** Climate change ground zero

**RENEWALS:** Challenges as we approach 1 January

**SPECIAL REPORT:** Riding the cycle

globalreinsurance.com

# GR GLOBAL [RE]INSURANCE

# ENTER THE CLASS OF 2020

## Who will make it out of the gates?


A company of Chedid Capital
chedidre.com

Chedid Re

# CONTENTS







GR
GLOBAL [RE]INSURANCE

LOCAL INSIGHT AND GLOBAL STRATEGY FOR THE INTERNATIONAL (RE) INSURANCE COMMUNITY

**EDITORIAL & COMMERCIAL**

Editor
**Helen Yates**
E: helen.yates@nqsm.com

Publishing Director
**Adam Jordan**
E: adam.jordan@nqsm.com

Reporter
**Daniel Dunkley**
E: daniel.dunkley@nqsm.com

**EVENTS, MARKETING & PRODUCTION**

Head of events
**Debbie Kidman**
E: debbie.kidman@nqsm.com

Graphic design
**Angela Lyons**

**MANAGEMENT**

Managing director
**Tim Potter**


NEWSQUEST
Specialist Media





# A new normal?

The 2020 renewal season has been a sombre affair on many fronts, not least because it has for the most part involved virtual negotiations in this new normal where underwriters, brokers and cedants thrash out pricing and terms over Zoom, Teams and Google Meet. In an industry that prides itself on relationships, it has also lacked the usual combination of business socialising at annual meetings in Monte Carlo and Baden Baden.

There was no jostling for position at the Cafe de Paris or at the Monte Carlo Fairmont this September. No overindulgence in champagne, rich canapés or a flutter in the casino. There was no brisk chill of a Baden Baden coffee meeting.

At a time when the market is hardening and uncertainty over the COVID impact remains, the inability to agree terms and conditions eyeball to eyeball has proved a challenge for many market participants.

Where relationships already exist, the shift to renewal meetings via video conferencing was not a huge stretch, according to the participants at our virtual roundtable discussion in October (page 22). It is more that new relationships are difficult to build and nurture in a half hour on Zoom, they said. And younger executives (who have never experienced a hard market during their career) are unable to learn the tricks of the trade first hand.

It has not been easy, but the industry has risen to the challenge of the new normal. Back at the 1 January 2020 renewals, if it had been suggested then that within three months most industry participants would be working from home, it would have seemed crazy. The idea that Lloyd's would stand empty for over five months, with brokers and underwriters connecting and collaborating via a virtual underwriting room, as the market traded efficiently via digital platforms would have been the stuff of April Fool's.

And yet it happened. Different personalities responded differently - some better than others - and it is clear that remote working is not for everyone. But it seems unlikely - even after the threat of COVID-19 has completely passed - that the industry will ever go back to the way it was.

Firms that once feared the very idea of flexible working are now considering downsizing their office space, strengthening security around their remote network connections and slashing their business travel budgets. They are prioritising electronic placement and other automation initiatives.

**HELEN YATES**
Consulting editor

"The COVID-19 pandemic has reinforced the importance of modernising the market and has helped soften some of the cultural resistance to change," notes AM Best in its appraisal of Lloyd's.

There are softer issues brought into focus by lockdown that will resonate long after the pandemic crisis. Yes relationships will continue to be integral to the reinsurance business, but will they be as influential? As the next generation of digital natives rises up through the ranks, they will write their own rules on how the business can and should be transacted.

For an industry that has survived a long and deep soft market, with the constant pressure to cut costs and improve efficiency, current trends can be leveraged and business models re-evaluated. A transition which could prove helpful as reinsurers and brokers strive to meet ESG goals and an expanding raft of climate reporting requirements.

So where do conferences and meetings such as the Rendez-Vous de Septembre fit into this vision of the future? At gatherings over the past 20 years, including 2005 - shortly after Katrina had struck - and in 2008, at the height of the financial crisis, the wealth on display in Monte Carlo appeared decadent and at odds with the crises of the time. Brokers and reinsurers duly re-evaluated their hospitality budgets and cancelled some of the more extravagant parties.

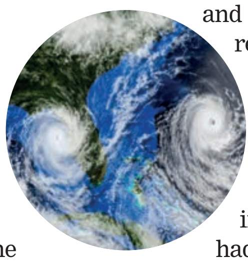
But the meeting continued and then, spurred on by the zeal of the burgeoning ILS markets, a new cohort began to flock to the South of France each renewal season. Until this year.

Nostalgia and the desire to meet face-to-face with partners will inevitably drive people back again in September 2021, on what will be the 20th anniversary of 9/11. But times are changing. There is no going back and the more sober industry of today is unlikely to lose its head. ■

*Helen Yates, consulting editor, Global Reinsurance*

# WTW: Appeal of ILS persists despite challenges

Over 80% of investors expected to maintain or increase their ILS allocation in the next 12 months, according to research from Willis Towers Watson.



The broker says the findings suggest the broad appeal of the sector persists, in spite of the challenges over the past three years, including the issues surrounding trapped collateral and the high-profile collapse of Markel CatCo.

Eighty-six percent of ILS funds expect market growth of five percent or more cumulatively during the next five years, and more than half of reinsurance and insurance companies surveyed world-wide now use ILS capacity, according to the survey of ILS market participants.

William Dubinsky, managing director Willis Re Securities, said: "The survey suggests that the ILS market may have adapted more swiftly and effectively than generally reported to the challenges posed by Hurricane Irma and subsequent events over recent years, but the story is not over."

About a third of end investors indicated that they had postponed new ILS allocations as a result of COVID-19. "Notwithstanding guarded optimism, COVID-19 and continued uncertainty around other property-related losses have created additional challenges for end investors, ILS funds, and cedants alike," added Dubinsky.

Almost across the board, ILS funds and end investors expect further growth driven by factors such as the impact of climate change and the positive ESG characteristics of ILS. Four out of five fund managers expect climate change to create significant threats and opportunities for ILS over the next five years.

End-investor respondents identified non-catastrophe weather insurance (64%) and life, accident & health risks (46%) as suitable for ILS mandates, but less than a quarter found appeal in ILS for other perils, with only 5% interested in securitised cyber risk. ■

# Miller finds new backer

Private equity firm Cinven and GIC, Singapore's sovereign wealth fund, have agreed to buy specialist re/insurance broker Miller from Willis Towers Watson.

The transaction secures Miller's future as an independent broker as the mega-merger between WTW and Aon gets underway. The deal between two of the world's top three biggest brokers was announced on 9 March, at the start of the COVID-crisis.

In February, WTW announced in a filing that it was considering 'strategic alternatives' for Miller, in which it holds an 85% stake. The hunt for a suitable buying was delayed by the pandemic, but the broker was able to demonstrate its resilience through the crisis.

"Miller is a highly attractive, resilient specialist insurance business with strong long-term growth opportunities across all of its segments and a history of consistent growth through various economic cycles," said Luigi Sbrozzi, partner of Cinven. "We see opportunities both organically, by recruiting new specialist brokers, and through incremental M&A over time."

"Miller also offers a scalable platform, particularly internationally, with associated benefits for clients as the business develops and expands over the long-term. We believe that independent ownership is the right model to really accelerate the company's growth." ■

# Convex secures another $1 billion of capital

Stephen Catlin's Convex Group has secured commitments for an additional $1 billion of equity capital.

Convex launched in April 2019 with $1.7 billion of initial committed capital, bringing the total committed capital raised by Convex to over $2.7 billion in just over 18 months.

The initial capital was raised from the Convex management team, Onex Partners V, Onex Corporation's large-cap private equity fund, and a consortium of co-investors. This additional capital has been raised by the same investor group as well as additional new Onex co-investors.

Catlin commented: "Onex and our existing investor base has provided us with tremendous support in building the business and we welcome our new investor partners. [This] additional capital will enable us to take full advantage of the hardening market." ■

# Sigma: Global insurance markets will rebound

The pandemic will impact each economy depending on its capacity to absorb shocks and its government policy

World gross domestic product (GDP) is expected to contract by 4.1% this year in what is so far the deepest recession of our lifetimes. According to the latest sigma study the recovery will be slow and uneven in 2021. Global GDP is forecast to grow by 4.7% in 2021 in real terms, below the market expectation of 5.2% growth.

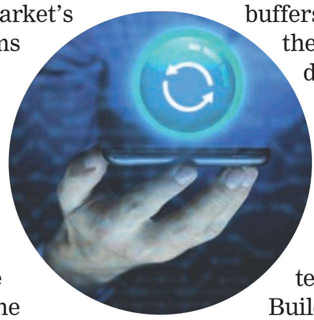
In this context, the sigma study finds that, amid the economic shock inflicted by COVID-19, global insurance markets have been less severely impacted than expected in the Swiss Re Institute June 2020 forecast.

Total premium volumes in 2020 are estimated to decline by 1.4% in real terms, less than the earlier anticipated 2.8% drop. Premium growth is forecast to recover swiftly to 3.4% and 3.3% in 2021 and 2022 respectively, supported by continued rate hardening. Volumes are expected to already be back above pre-pandemic levels by the end of next year.

Advanced market non-life premiums are forecast to grow by close to 3% in both 2021 and 2022, led by advanced Asia and the US, where a hard market in commercial insurance will boost premiums.

China will remain the fastest growing market with premiums up an estimated 10% annually over the next two years, largely thanks to a strong health business. The other emerging markets will see aggregate premium growth of nearly 4% annually.

Pricing in non-life insurance strengthened again in 2020, noted sigma, supporting the market's overall resilience in terms of growth and profitability.



"Market conditions from both the demand and supply sides point to continued pricing strength," said Andreas Berger, CEO of Swiss Re Corporate Solutions. "The low interest rate environment and the ongoing social inflation in the US will be key drivers of market hardening."

The upswing has broadened across commercial lines of business and in almost all regions. Casualty business, which had remained soft until 2018, also started to improve this year, notably in the US and Europe. Rate hardening will likely continue through 2021, anticipate sigma.

**A COVID reset**

Looking at countries' economic resilience levels, the pandemic will impact each economy depending on its capacity to absorb shocks and its government policy. Preliminary data suggest fiscal responses will be the key differentiator. Among the large advanced economies, the fiscal buffers of the UK, Japan and the US are expected to be depleted most.

"For sustainable economic recovery, we need a policy reset. Public policy should focus on areas such as infrastructure, technology and climate. Building new sustainable infrastructure will have a significant impact on GDP growth," said Jerome Jean Haegeli, Swiss Re Group Chief Economist.

"In addition to smarter spending, policymakers should make more use of public-private partnerships and establish the operational and regulatory frameworks to enable greater participation of private-sector finance, including insurers' assets, in the real economy," he added. ■

# Ignore ESG at your peril

## Failure to engage on ESG factors poses a reputational risk to re/insurers - AM Best

Larger insurance and reinsurance companies with an international focus are typically more engaged and more active in the environmental, social and governance (ESG) arena than their smaller peers, according to research from AM Best.

Respondents also acknowledged that failure to act on stakeholder pressure around ESG issues could lead to long-term reputational challenges for their organisation and the wider industry. Larger respondents were more likely to make the link between failure to act and the detrimental impact on reputation.

Survey respondents recognise the re/insurance industry has a pivotal role to play in steering the wider ESG agenda. Insurers identified corporate governance, product liability (including cyber security) and climate risk as the most relevant ESG issues.

Dealing with climate risk is increasingly important on the underwriting side, whether it comes from insuring properties that are exposed to the consequences of climate risk or making decisions about whether to provide cover to high polluting industries.

# TACTICS FOR A DISCIPLINE-LED HARD MARKET

As reinsurance companies, brokers and cedants prepare for the 1 January 2021 renewals, with negotiations largely taking place virtually, we ask industry experts for their thoughts on what some of the key challenges are likely to be

Reinsurance buyers preparing for renewal face a different kind of hard market. Previous upcycles were driven by capacity shortfalls caused by market contraction. Dramatic price increases were rolled out quickly and indiscriminately, accompanied by take-it-or-leave it changes to terms and conditions. This time it's different.

For 2020 it's not the capital that's in short supply, but carriers' willingness to deploy it. Buyers must contend with a discipline-led hard market where pricing reflects each carrier's appetite, based on their unique risk and portfolio analysis (the likely impact of which is a shallower but more sustained tightening). In this new environment, solid relationships between cedants, brokers and their markets are more important than ever. Mutual understanding will be invaluable in overcoming the challenges of new-found underwriting discipline.

Contagious disease exclusions are high on every negotiating agenda. Parties must take great care to ensure reinsurers agree to meet the shared obligations of their insurance-company clients, since any differences in conditions may later prove extremely difficult to manage. Varying needs and obligations by class complicate the challenge. COVID-19's impact on marine reinsurances has been minimal, for example (a handful of early cruise cases notwithstanding).

Cedants and their brokers must ensure that markets understand the specifics of the relevant class. Preferably exclusionary language for specific classes will be applied consistently across the market, because patchy implementation will unintentionally disadvantage some insurers.

**"After moments of doubt, the pandemic proved the resilience of the collateralised reinsurance model, which has bounced back and is now growing"**

**KEN MACDONALD,** EXECUTIVE CHAIRMAN, MILLER

Verticalisation presents another class-variable challenge. Completion pricing may be higher than the leader's price, which allows small-line followers to wield significant influence over aggregate rates on line. That in turn affects brokers' confidence in their ability to complete placements; they require supportive followers before sureness can be raised.

Those in classes where reinsurance capacity is tight will resist verticalisation, since it is bound to bid up the price and exacerbate hardening by exaggerating its effects. In contrast, for classes that enjoy a surfeit of capacity, brokers can manage verticalisation to reduce total prices by engendering competition for quality risks.

### Back on fac

Conditions in property facultative encourage the latter. Rates continue to increase, but here brokers face an exception to the rule. Hardening is not discipline-led across the board. Many London markets, for example, will seek the same 20% increase for an excellent risk as for a poorly-managed, loss-prone one.

This non-technical approach has caused a pricing disconnect between insurers and reinsurers (as little as 5% in Germany, but as much as 45% in Latin America). The result is a highly verticalised market which lacks consensus pricing. Each carrier's price for its line is known only by clients and their brokers, creating a complex jigsaw. To achieve even that, it is critical to help underwriters discern differences between risks, and to look further afield for competitive outcomes.

Major insurers' general reaction to poor results in 2019 and 2020 has complicated facultative renewals. Most have reduced their lines, often by half, to mitigate risk through reduced exposure. But since loss frequency is unaffected, the unintended consequence is volatility in net retentions. That has driven demand for facultative cover, a trend which has gathered pace for several years. Together these factors make risk syndication a serious challenge. It is far from uncommon to approach 100 carriers to achieve an optimal outcome.

The discipline-led hard-market challenges facing speciality catastrophe excess of loss and ILW buyers are well known. Costs are up. Capacity is constrained despite pricing in many classes (in part because much collateral posted by alternative suppliers remains trapped). Uncertainty over COVID-19 losses lingers and will remain well past 1.1, as questions such as the applicable meaning of 'physical damage' are considered by the courts.

## UNL retro contracts

Meanwhile, the collective appetite to underwrite Ultimate Net Loss retro has contracted. That has driven accelerating interest in collateralised layers and Industry Loss Warranties, on both sides of the deal.

Coverable perils are expanding, recently to include wildfire, and interest in live cat has extended, for example with Japan's first transactions. After moments of doubt, the pandemic proved the resilience of the collateralised reinsurance model, which has bounced back and is now growing. The widening spectrum is fuelling interest in parametric-style transactions both from dedicated risk carriers and from corporates.

The renewal challenges of the discipline-driven hard market require solid relationships with a wide variety of markets, new and traditional, in locations around the world. To support our relationship with Bermuda carriers, for example, Miller is re-activating its office on the island.

Coping demands careful attention to detail, and the support of the most sophisticated analytics, all of which must be brought to bear to show underwriters the true nature of each risk presented. It requires tenacity, and a mutual understanding. The environment is challenging, and last year's approach won't do. Fresh thinking is the order of the day in the new, discipline-driven hard market. ■

# VIRTUAL REALITY

The reinsurance market's transition to a virtual workforce was as swift as it was unexpected. The COVID-19 pandemic dramatically upended the working world, creating unanticipated business challenges, which have forced many senior leaders to rethink their key decision-making processes and how they communicate with staff. Meanwhile, other external pressures - such as the uncertainty around natural catastrophes and man-made events, a historic low investment environment, social inflation and the ongoing lack of clarity about how the pandemic will play out – will have meaningful bearing on potential losses for the industry. Taken as a whole, they amount to a once-in-a-generation scenario that will undoubtedly change the market.

Looking ahead to the 1 January 2021 renewals, the lack of face-to-face interaction will be a challenge for an industry that is built on trust, relationships and collaboration. It's likely that market participants will prefer to do business with people they have worked with before, and who they know and trust. The new working environment has also forced us to reassess the way that we write risk. Prior to COVID-19, our underwriters had relied on personal interaction with clients and potential clients, which allowed them to build up a chemistry and to taka a nuanced view of the risk. We are no longer afforded that luxury, which means that we are having to rethink the way we do our due diligence before deciding on whether to underwrite a risk.

This means that experience will be crucial in the coming months. Brokers and underwriters who have worked in a hard market before will have the upper hand, and brokers have an opportunity now, more than ever, to be considered as trusted advisors to clients as they build consensus in a changing market. That said, the recent merger and acquisition activity in the broker community has resulted in large numbers of brokers currently on gardening leave who will be sitting out this critical renewals season.

I feel for the younger members of the workforce, as they cannot watch and learn on the job in the same way they can in an office. In normal times, younger brokers and underwriters could learn from senior colleagues who have been through the highs and lows of soft and hard markets. I'm sure however, younger colleagues who have grown up immersed in the online environment, will find their own ways to succeed.

It has also been a challenge when it comes to hiring staff. Companies are having to go through the hiring process by video conference. We have 40 employee and have hired six since the pandemic started, which means that 15 percent of our staff have never visited the office, and never met a colleague before starting their job ■

**"Brokers and underwriters who have worked in a hard market before will have the upper hand"**

**DAN MALLOY**, CHIEF EXECUTIVE OFFICER OF THIRD POINT RE

# BROKING INTO THE POST-PANDEMIC HARD MARKET

As we enter the continuing hard market of 2021, experienced but younger reinsurance brokers face a fundamental challenge. For the first time in their careers, underwriters' resolve to achieve higher rates across a wide variety of lines is immutable. In some cases the capacity brokers seek to acquire for their clients may not be readily available. That alone would be challenge enough, but this time the difficulties of broking into a hard market are multiplied by the multifaceted impacts of the global pandemic.

Primary insurance and retrocession entered a hardening phase in 2019, but the reinsurance market followed in only a few areas, and hardly at all in Europe. That looks set to change as the impact of increased retro pricing in particular could pressure reinsurers into focusing on securing sufficient rate in order to pay for their own assumed protection.

Expectations of buyers will have to be managed carefully. The onset of reinsurance market hardening will not just mean rising prices, but also the demand for greater clarity over coverage itself, which in practice amounts to narrowing. Tightening terms will be especially pronounced in reinsurance and retro lines with any form of COVID-19 exposure. In property, for example, the definition of named perils looks certain to be updated with particular scrutiny over the 'including but not limited to' definition.

Capacity for aggregate retro will be challenging. Appetite to underwrite this product has clearly reduced as carriers shift towards occurrence-based forms. Lingering uncertainty over COVID-19 losses (for example, whether they constitute one or multiple events) means cedants may be reluctant to release collateral. Questions around COVID coverage are unlikely to be resolved quickly, since the validity and scale of the loss still remain uncertain on the insurance side. Ultimately some claims will feed into the retro market, where currently clients are obliged to take a worst-case scenario view.

**"Reinsurers want to support clients where they can, but only where it is reasonable to do so"**

**DAVID SOWREY,** PARTNER, BEACH & ASSOCIATES

COVID presents the ILS markets in particular with challenges around the releasing of collateral, but ultimately most carriers will look to adapt by creating release structures that work both for them and the client. Nonetheless, the hard retro market remains, and with it the challenge to brokers of delivering valid capacity.

On the direct side, the hard market will lead to tough trading conditions around delegated business as it competes against the open market. This potential restriction in delegated capacity could promote a flight to quality in supporting MGAs, with the more established, bigger and more profitable coverholders looking to muscle their way to the front of the queue. Consequently others may suffer as a result and brokers will need to be creative in their quest to generate binder capacity.

Meanwhile much of COVID-19's impact has still to be quantified. Losses have filtered through from the insurance side, but uncertainty over reinsurance coverage in areas like catastrophe and non-physical-damage BI remains.

The pandemic has accelerated reinsurance market hardening, and probably made it more sustainable. Reinsurers want to support clients where they can, but only where it is reasonable to do so. Coverage will be worked out and clarified for 1.1 and wordings rewritten to ensure clarity on pandemic losses. COVID-19 continues to create a huge amount of work, including contract reviews and coverage interpretations, which the marketplace has handled pretty well, especially given pandemic-driven changes to the working environment. But the work will take time to complete, particularly as longer-tail claims and potential class actions continue to materialise.

Before COVID-19, pandemic cover had been regarded as a luxury but is now seen as a necessity. The result of this looks likely to be the emergence of a new, standalone pandemic market, much like 2002 birth of the terror market, but the answer to this much broader risk won't lie entirely within the insurance market given its vast scale. Given that, public-private initiatives are probably the only viable way that coverage can be offered to everyone who needs it.

That's a challenge for the future. As renewals gather pace for 1 January 2021, the weeks and months immediately ahead will see brokers continue to muster their resources to negotiate recoveries, remove coverage uncertainties, and find much-needed sources of capacity for those primary carriers with solid hard-market growth plans – all while many individuals exercise their untested hard-market broking skills for the very first time. ■

# TUG-OF-WAR

Positive and negative factors offset each other to create a stable outlook for the global reinsurance segment, explains Carlos Wong-Fupuy.

Given the uncertainty that has defined 2020, it may seem counterintuitive that AM Best maintains a Stable outlook for the global reinsurance segment as we head into 2021.

This year has been as a tug-of-war, with both positive and negative factors competing in the reinsurance segment. Ultimately, however, those opposing factors have created an equilibrium of sorts.

So far, reinsurers largely seem to be weathering the strains of 2020. Even the pandemic-related challenges appear manageable; AM Best's COVID-19 Stress Test identified only a limited impact on balance sheet strength for most global reinsurers.

Robust risk-adjusted capitalisation has positioned most non-life reinsurers to absorb both underwriting losses and investment volatility resulting from COVID-19. On the life side, strongly capitalised companies with advanced modelling capabilities have shown the ability to withstand a 1-in-200-year mortality event.

That said, there have been negative factors pulling on the reinsurance segment. Topping the list is uncertainty around claims reserve development associated with previous years' property catastrophe events, social inflation, and, more recently, business interruption and casualty lines related to COVID-19. Combined with an overcapitalised sector, these factors have translated into companies struggling to meet their cost of capital.

## Rates start to harden

On the positive side, however, the market is hardening. That trend has been evident in both 1 January and midyear reinsurance renewals.

The third-party capital that for years placed downward pressure on pricing is, to a degree, retrenching. Affected by loss creep and trapped capital, and concerned by discrepancies between actual and modelled claims experience, third-party capital providers have begun to reassess their role in the industry and are becoming much more selective. As a result, the rapid growth of third-party capital that we saw in previous years has flattened or even slightly declined. This retrenchment is helping harden the market.

**CARLOS WONG-FUPUY**, SENIOR DIRECTOR, GLOBAL REINSURANCE RATINGS, AM BEST.

In contrast to 2001 and 2005, when a void in capital resulted in widespread market hardening, the current firming is driven by underwriting discipline rather than capital depletion. The collapse of interest rates in particular and investment returns in general has exacerbated the pressure on underwriting discipline and, by extension, risk-adjusted premium rates. As it has become more difficult to generate adequate returns on the investment side, reinsurers have focused on improving technical profits.

Average return on equity measures have declined consistently since 2014 and were at breakeven levels in the last three years. The situation is even more pressing when we note that 3% to 4% of that performance is attributable to favourable loss reserve development. With reserve releases diminishing steadily, reinsurers must take corrective action to avoid a drag on earnings.

The hardening conditions create a window of opportunity in that regard. Property catastrophe, specialty lines, and some US casualty lines already have shown much-needed improvement in pricing and coverage terms.

## Winners and losers

Not all reinsurers are created equal, though. For some underperforming ones, the rate increases so far, even if significant, may not be sufficient to restore desired profitability. Capital position, business mix, and recent underwriting performance in particular lines of business are key factors in the relative success of reinsurers.

Companies' individual abilities to take advantage of the hardening market conditions are likely to be influenced by a flight to quality. After three years of significant industry losses, those companies with a solid financial strength, robust reputation, and market position, as well as stable, consistent, and transparent results, should be best positioned to optimize their underwriting risk portfolio and continue to attract and deploy capital.

There is some discussion regarding a "Class of 2020" start-ups emerging. Armed with capital and clean balance sheets, several new reinsurers are looking to take advantage of rising rates. It is estimated these companies will bring \$5 billion to \$10 billion in new capital to the global reinsurance industry, which we estimate at around \$470 billion. AM Best believes that market recognition may prove to be a challenge and a key differentiator between winners and losers in this new class.

As we head into 2021, there is some risk that the positive market momentum turns out to be short-lived, excess capacity starts expanding again, and we return to where we started. An already overcapitalised sector and limited investment opportunities somewhat mitigate that risk.

As we reported in our annual commentary on the global reinsurance market in September, AM Best believes that the current market hardening must continue for at least the next year or two to have meaningful impact on the segment. The pricing momentum must be sufficient to offset the losses from previous years, including the uncertain impact from COVID-19 (likely to have a long tail due to legal disputes) and the continued surge from social inflation. ■

# ENTER THE CLASS OF 2020?

For the first time since 2005, a new class of start-up reinsurers are forming in Bermuda. But do they have what it takes?

As reinsurance prices rise, capital is re-entering the industry as investors seize the opportunity a hardening market presents. And for the first time since 2005, some of it is backing new companies - a Class of 2020. So does this mean a return to a more traditional reinsurance cycle? And what does it tell us about the potential longevity of the upward momentum in rates?

There has been a great deal of hype surrounding the potential emergence of a 'Class of 2020' reinsurance start-ups. Among the potential new kids on the block is Vantage, which is understood to be headed by industry veterans Dinos Iordanou and Greg Hendrick as chair and CEO respectively. Chris McKeown, the former CEO of New Ocean Capital will lead risk, reinsurance and innovation, while Nick Pritchard, previously of Neon, will head up property catastrophe reinsurance.

Also at the starting line is an as-yet unnamed Chaucer-backed Class 4 Bermuda reinsurer; an eponymous Rosh Capital Management-backed reinsurer; a strategic partnership between American Equity, Värde Partners and Agam Capital Management, and SiriusPoint, the product of a merger between Sirius Group and Third Point Re. Third Point is also backing a new Bermuda-based excess casualty and professional liability MGA, Arcadian Risk Capital, led by John Boylan, which opened for business in October 2020.

"SiriusPoint will be part of the Class of 2020 and we will be a significant player with a capital structure, platforms, underwriting talent, and most importantly, the clients already in place," says Dan Malloy, chief executive officer of Third Point Re. "Potential new class of 2020 insurers are still in the process of starting up from scratch, but SiriusPoint will already be many steps ahead."

Some existing entities are having a makeover before being re-launched. Lloyd's syndicate Ark, for instance, is in the process of recapitalising and re-activating its existing Class 3 reinsurer in Bermuda, with the intent of upgrading it to a Class 4 entity.

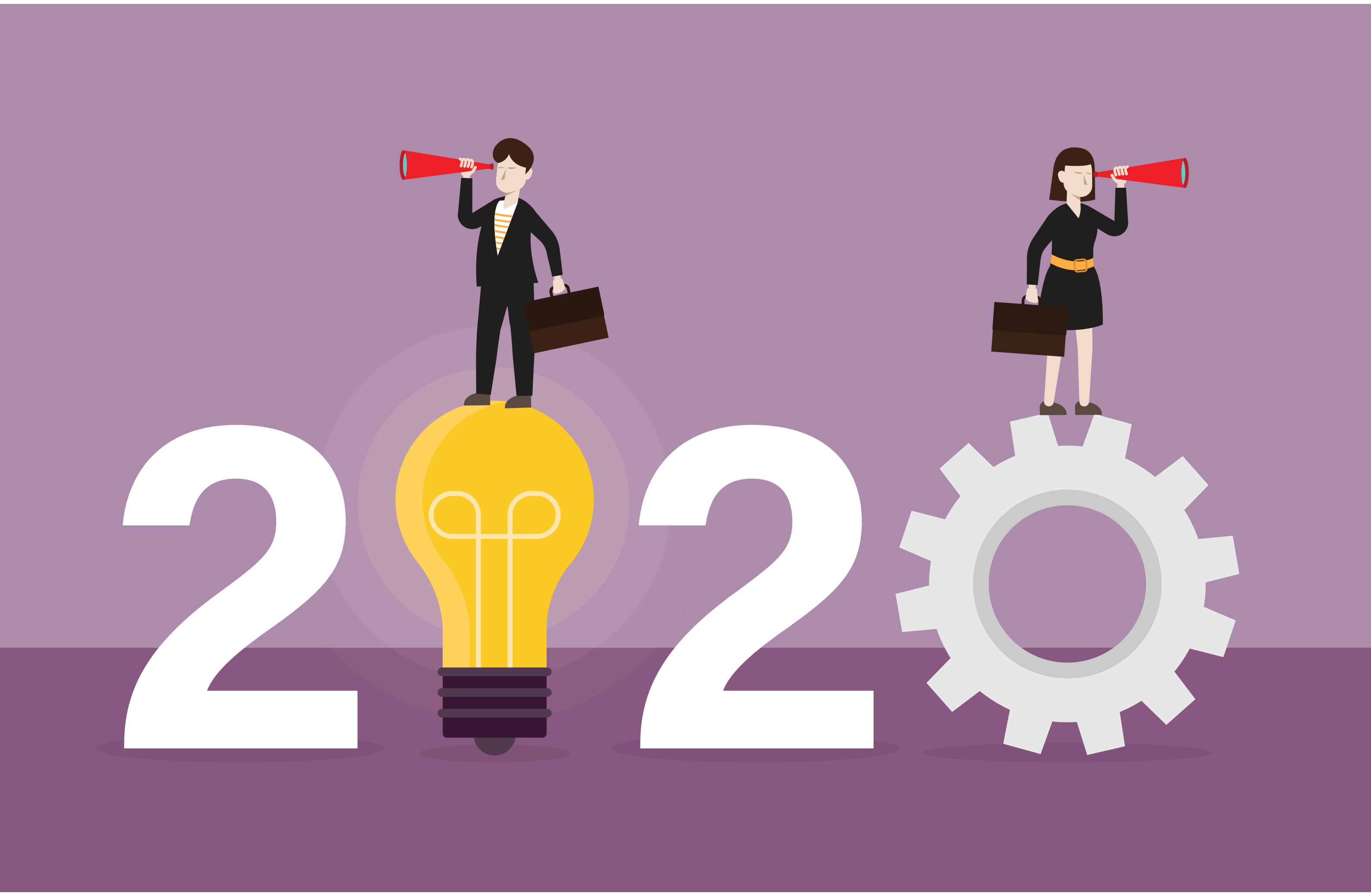
However, it remains to be seen which of these business models and management teams get the private equity backing they need to make it out of the gates. The stakes are high and the process of launching a Bermuda reinsurance company with seed capital of over $1 billion, a couple of trusted industry veterans at the helm and an AM Best A-rating is not quite as straightforward as it was back in 2001 or 2005.

**"It remains to be seen which of these business models and management teams get the private equity backing they need to make it out of the gates"**

Launched too early to be counted as one of the Class of 2020, Stephen Catlin and Paul Brand's reinsurer Convex saw the opportunity well over a year ago, backed by $1.8 billion in capital. But others have dropped out of the race, including - it is understood - David Eklund, former RenRe and Aeolus Re chair, who has been mulling a new retro-focused start-up ILS fund since 2019.

"Bermuda is the place most people go to for reinsurance-related start-ups but it's not easy," says Jason Howard, chief executive of Beach. "There is plenty of capacity still there and existing players in that market will have the first call on new capital and new reinsurance arrangements."

"People who are committed to the insurance market as investors will see this as a good opportunity and they will take the volatility that comes with it. And then you will have others that are a bit more reticent to enter the fray, and may see opportunities to invest in other asset classes that may have been worse affected by COVID."



## Not a slam dunk

"There are five or six potential start-ups in the market at the moment," says Howard. "But it's not as if investors will be handing out cheques to all and sundry. Investors need to be convinced that the opportunity makes sense, and will be looking to back the business plans that maximise potential returns whilst mitigating the pitfalls involved in starting new businesses."

"Just because the reinsurance market is hardening, it doesn't necessarily mean start-ups are going to attract backing," he continues.

Howard notes that existing reinsurance entities, including RenaissanceRe and more recently Everest Re had succeeded in raising $1 billion in capital respectively. "Existing companies with great track records are going to be able to raise money, especially if they can show that it's for offensive reasons and not defensive reasons, such as shoring up their balance sheets or putting more money into reserves."

"I would imagine investors will be looking at putting money into existing companies in the sector before they look at start-ups, as start-ups naturally have added layers of uncertainty and complexity."

Reinsurers have raised approximately $28 billion in debt and equity so far this year, according to Guy Carpenter, with estimates that between $4 billion and $7.5 billion of further capital is waiting to be deployed into new companies (newcos) or onto existing balance sheets. Currently, specialty and E&S business have most momentum behind them, according to Scott Mangan, associate director of Global Reinsurance at AM Best.

Speaking during a panel discussion hosted by AM Best in early September, Silke Sehm, Hannover Re executive board member noted that: "We definitely see capital flowing into the reinsurance space. A number of insurers and reinsurers have done capital raises." She added: "New money has been coming in to start new reinsurance companies. The number being mentioned is about four billion US dollars in comparison to the Bermudian class of 2005, which was around five billion US dollars... and the class of 2001, which was around eight billion US dollars."

The rate hardening that has attracted such investment became inevitable even before the COVID-crisis. A prolonged soft market and low interest rate environment had resulted in a challenging operating environment over several years. As profitability deteriorated, loss reserves dried up and the claims situation worsened in both property and casualty lines of business, markets such as Lloyd's tackled underperformance and there was a contraction of capacity.

"On the primary side rates have been going up for a while now, and reinsurance rates have now begun to

**"Not all market commentators are convinced the 2020 newcos will get past the starting line, particularly as the stakes have risen so considerably"**

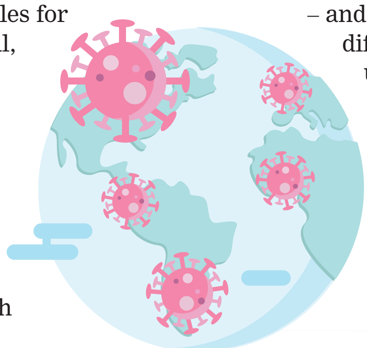
follow suit," says Beach's Howard. "We did not struggle in completing any renewals on 1st April, 1st June and 1st July. There were discussions around some of the conditions such as COVID exclusions, which you would have expected, but there was no shortage of capacity if the right price point was found. For me, a true hard market is if placements really struggle to get done."

The fact there is still plenty of capital available in the industry is one reason why rates are going up slowly. Howard predicts additional increases of single digits to low double digits, depending on class of business, at the 1st January renewals. He does expect the hardening trend to continue through 2021 and potentially into 2022 however.

"It isn't losses that drive markets, it's capital," he adds. "The reinsurance capital base is much bigger than it was during previous market changing events such at 9/11, and bringing capital into the market is less problematic. There are more routes and vehicles for bringing in new capital, provided the investors are convinced that pricing adequacy has returned to the business in question."

"It is a fact that capital has been taken out the market through losses, with more expected to leave as COVID losses are paid out, and whilst it's not been fully replaced, there's still plenty of capital there to support the underlying risk exposures."

Reinsurance rate hardening market has become more pronounced over the course of 2020, with losses related to the COVID-19 pandemic further exacerbating the upward momentum in pricing.



Uncertainty surrounding ultimate COVID losses persists, as business interruption test cases rumble on through the courts in various jurisdiction.

In May, Lloyd's estimated the ultimate cost to the industry could be over $100 billion, putting it on a par with some of the biggest major claims years for the industry, including 2005 (Hurricanes Katrina, Rita and Wilma) and 2017 (Hurricanes Harvey, Irma and Maria).

"Estimates for nat cats this year are coming in at $45-50 billion, but that would not be a market changer on its own," says Third Point Re's Malloy. "However, if you add in the potential $50-100 billion losses from COVID to the equation, that changes the dynamic significantly - especially if you also factor in low interest rates, casualty development and ongoing social inflation concerns. They are all big straws we are loading onto a camel's back."

"There is a definite distinction between uncertainty and risk – and it is incredibly difficult to price uncertainty. What is the right load for climate change or government shutdown? From a rating perspective, in a world where uncertainty is greater than it was a year ago, there are efforts being made across the spectrum to try to create more certainty by focusing on terms and conditions, and then a 're-rating' of the risk as it is currently understood."

**$100 BN**

COVID-related claims could exceed this, according to estimates from Lloyd's.

Within retro there has been a significant correction, with prices continuing to harden over the course of 2020, as collateralised capacity has dried up following the collapse of Markel CatCo and drop in investor confidence following the surprise aspect of recent catastrophe losses, including loss creep and trapped collateral.

As funds face another year of trapped funds due to the COVID-crisis and claims uncertainty, aggregate coverages have all but disappeared and the collateralised portion of the retro market has shrunk from around 60% to 50%.

### Return to a traditional cycle?

The flutter of newco activity is a challenge to the belief that reinsurance capital had become more 'fungible' in recent years. As the ILS market grew, it became clear that institutional investors were opting for non-traditional solutions, waiting at the sidelines to move in quickly post event - hoping to capitalise on a short-lived market dislocation - opting for collateralised solutions, such as sidecars, cat bonds and ILS funds.

This capital replenishment process had become altogether more preferable to the lengthy set up and due diligence required by a new company, which also required significant (and growing) seed capital, a well-respected management team and a minimum A- rating.

But the ease with which capital could enter and exit fundamentally altered the cycle, taking out the peaks and troughs and disappointing some investors with the lack of a

# $4BN TO $7.5BN

Capital estimated to be waiting in the wings to fund newcos and recapitalise existing players

# $1.8BN

Seed funding needed to launch Stephen Catlin's Convex in 2019

post-event 'dividend'. Even after major event years such as 2017, with a trio of hurricanes resulting in combined insured losses of $92 billion, plentiful capacity and the influx of further funds meant favourable rating environment conditions were short-lived.

The loss creep associated with events such as Maria and Typhoon Jebi and issues surrounding trapped funds have also diminished some of the earlier fervour surrounding ILS investments. The surprise element of the losses and the impact of claims from secondary perils, such as wildfires, that were not as well modelled or understood further dented investor confidence.

So does the potential new cohort of start-ups represent a return to a more traditional time. "Nature abhors a vacuum," notes Malloy. "For capital to flow into areas that are perceived as opportunities is both natural and positive."

"The breadth of market change means there is an opportunity for capital to be put to work in many different forms, including the scale-up of existing entities in the catastrophe or E&S space, or investing in new companies in the much anticipated 'Class of 2020'. Given the restrictions on travel and the challenges of face-to-face meetings, reloading of capital in the industry seems to be focusing on is backing known commodities and the teams the leaders have developed."

Not since Hurricanes Katrina, Rita and Wilma in 2005 has private equity been willing to back traditional start-up business models in quite this way. And yet not all market commentators are convinced the 2020 newcos will get past the starting line, particularly as the stakes have risen so considerably over the past 15 years.

"The nature of the opportunity is much less clear than after a more traditional event, such as a $100 billion hurricane or after 9/11," says Malloy. "After all, the impact of COVID on direct losses is still uncertain and ongoing. Lack of clarity to the quantum of the loss and resulting market reaction creates a challenge for new companies coming to market."

"To become a member of the Class of 2020, you need people, capital, platforms and rating agency support. These logistics are much more complicated in a COVID environment. If you do manage to complete those steps, you then have to go and get the actual business."

He notes that investors are being cautious and realistic about who they back. "The last four years has shown that investors can lose money in ways that were not immediately apparent to them five years ago on the back of a great run in property catastrophe. As a result, there will be more stringent requirements in place from investors while the opportunity for reacting to a post COVID market is still unclear. As a result, it is more than likely that investors will only part money with people they made money within the past, or with people who are seen as leaders in the business." ■

# WILDFIRES: A BURNING ISSUE FOR RE/INSURERS

Wildfires in California and Australia have underlined the growing threat of climate change. How are reinsurers reacting to the fires? And how is the market evolving to mitigate the risk?

In mid-October, severe and deadly wildfires continued to rage across northern California. By 16 October, the Glass Fire in Napa County and Sonoma County has burned an estimated 67,500 acres and destroyed 1,555 structures. The devastating blazes, active for several weeks, have ravaged the northern part of the state, sweeping through towns, communities and homes and along the US western coast. Already, six of the top 20 largest California wildfires, have occurred during 2020.

The charred, blackened landscape of the wealthy American state underlines the harsh reality of increased climate risks facing nations across the globe in 2020. The California fires have officially affected more than one million acres, elevating the event from a "megafire" to "gigafire". According to Aon's Impact Forecasting, seasonal direct economic costs from the fires across California, Colorado and Oregon are estimated to exceed $13 billion, while insurers face payouts beyond $8 billion, with both estimates subject to change.

California's huge wildfires, which follow on from similar devastation in 2017 and 2018, come after Australia's "Black Summer" in late 2019 and early 2020. Months of fires ripped through cities across Australia's east coast, affecting 18.6 million hectares of land, and killing more than 450 people.

According to independent catastrophe firm PERILS, the insurance industry suffered peak losses of A$1.8 billion per week from the Black Summer, with most of the losses in New South Wales. The fires caused significant damage and disruption to Australia's largest city, Sydney, with further indirect costs to businesses and livelihoods across the nation.

Insurance companies have been hit hard by this year's wildfires, while rating agencies expect reinsurance costs to increase as the scale of the damage becomes clear. AM Best says market share

in California is held by larger insurers able to shoulder the financial costs of the devastation, and believes robust reinsurance programmes are in place for insurance companies in the region.

The credit agency expects the damaging wildfire season to hit surplus lines insurers, and believes reinsurers will demand rate increases to cope with increased global risks, leading to higher insurance costs for primary carriers. Despite significant improvements in wildfire modelling and mitigation strategies over the past decade, AM Best believes rate increases will need to be enforced.

History tells us price increases are sure to follow the devastating US fires. Wildfires in 2018 caused significant rate hardening, and a retreat from wildfire zones and high-risk regions.

Insurance premiums are also expected to rise in Australia. Australian insurers paid over A$5.3 billion in catastrophe related claims over the summer months, according to the Insurance Council of Australia, with A$2.43 billion related to bushfire events.

### The climate change link

Amid the devastation, why are wildfires growing in severity and frequency? According to Alex Pui, head of nat cat for the APAC region at Swiss Re Corporate Solutions, there's no doubt man-made climate change is behind the increasingly severe weather events. "There is a growing body of scientific evidence that climate change is increasing the severity of wildfire events around the world, leading to larger economic losses."

He adds: "Australia, which experiences one of the largest natural climate variability in the world - primarily through the El Nino Southern Oscillation phenomenon – is particularly exposed, where a warming planet has meant an increased frequency of extreme El Niños leading to more severe and prolonged drought conditions, and increased background evaporation rates due to a warming trend leading to an overall net drying effect over time."

Pui says the result is catastrophic for the region. "The end result we see is wildfire seasons getting longer, and inter-event time between significant events reducing – from one in seven years in previous decades to one in three years today in South East Australia."

The erosion of natural forests, and encroachment of humans into wilderness areas, are significant factors, he adds. "The severity of these events is exacerbated by the increased degradation of our natural forests, for example the draining of peatlands in Indonesia, and human populations extending closer to the wilderness – magnifying the economic loss potential."

It is clear the increasing frequency and severity of fires across the globe will impact reinsurance and insurance markets in the years to come. Pui acknowledges concerns that "wildfires are quickly becoming uninsurable".

"We've already observed how these losses suffered by the insurance market - particularly in the 2018 Californian Camp Fires – have resulted in decreased capacity (particularly on the liability side) in that region," he says. "Australia suffers from similar challenges, and with an increasing move towards risk based pricing, affordability is also a major challenge."

## Changing land use patterns

Aon's head of APAC analytics Peter Cheeseman says wildfires have increased in severity due to heightened exposure, and agrees that encroachment onto the urban wildland interface (WUI) is a key factor. More people are living in "wildfire prone" areas, he says, with population and building growth in wild areas, particularly notable in California.

Cheeseman says both Australia and California have experienced increased temperatures and rainfall deficiencies in recent years. "If we look at temperatures over the past decade, Australia has seen seven years out of the last decade with temperatures well above average. In California, we've seen eight out of the past ten with increased temperatures."

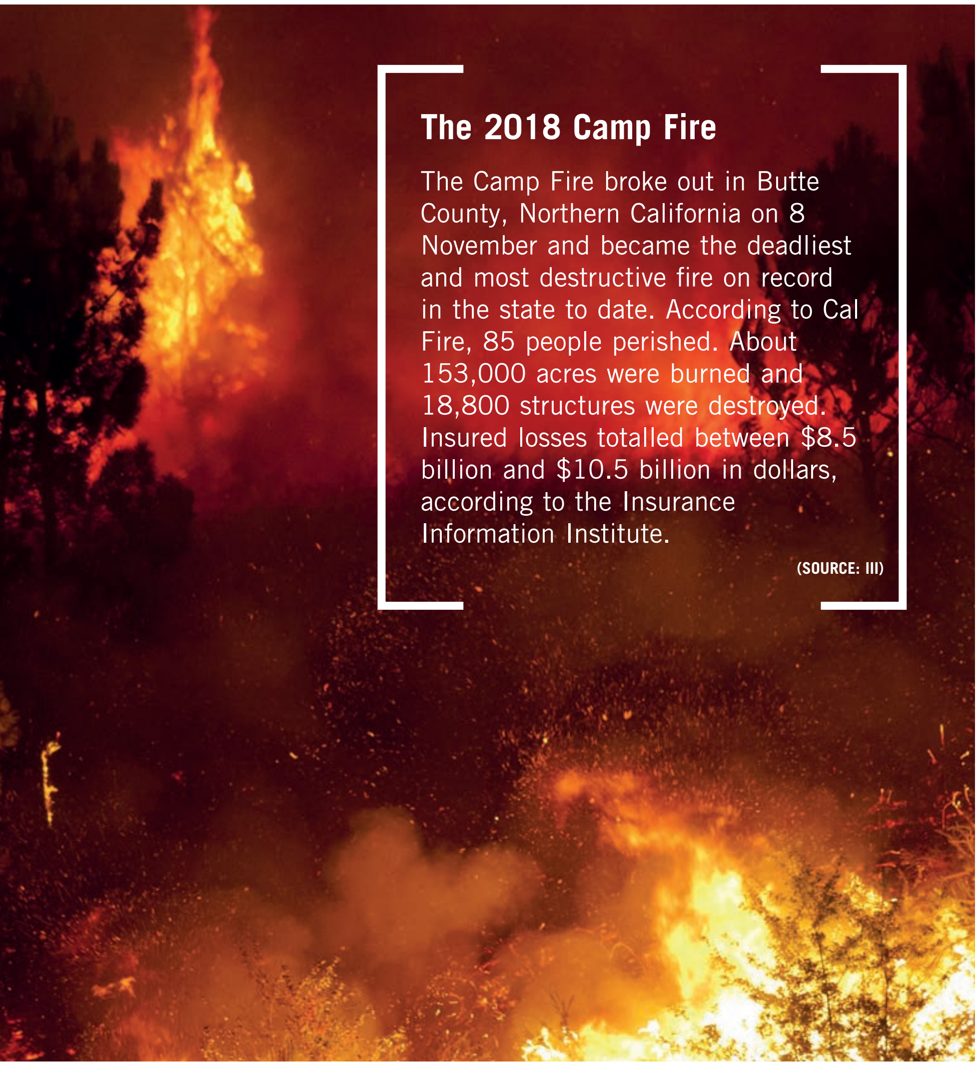
**"Seasonal direct economic costs from the fires across California, Colorado and Oregon are estimated to exceed $13 billion, with insurance losses beyond $8 billion."**

Modelling and analytics around the wildfire threat have improved in recent years, with claims data from major wildfire events offering new insights into the hazard. Insurers "should already understand the implications of this recent fire activity on their portfolios and have some knowledge of what causes these conditions to occur and how exposed they are," thinks Cheeseman. "Looking ahead over the short-term, over the next ten years, property damage from wildfires is likely to continue to be driven by natural variability in the climate system".

"Insurers may look to better understand the impacts of these climate drivers on their portfolio. The now active La Niña phase of ENSO in Australia is a good example. Looking longer-term, anthropogenic warming is projected to become a key promoter of severe fire weather conditions and subsequent insurance losses," he adds.

Despite improvements in modelling and exposure management, many re/insurers have reduced their exposure to secondary perils, such as wildfires, in recent years. And in the collateralised cat bond space, there has been a refocus on peak perils.

The often localised impact of such events is a challenge, while at the same time the attritional impact of secondary losses can make a big difference to annual loss ratios. According to Swiss Re Institute,



### The 2018 Camp Fire

The Camp Fire broke out in Butte County, Northern California on 8 November and became the deadliest and most destructive fire on record in the state to date. According to Cal Fire, 85 people perished. About 153,000 acres were burned and 18,800 structures were destroyed. Insured losses totalled between $8.5 billion and $10.5 billion in dollars, according to the Insurance Information Institute.

(SOURCE: III)

so-called secondary perils are fast becoming the primary driver of annual natural catastrophe losses.

**A role for parametrics?**

So which new products could help ensure the insurance ecosystem for wildfire risks remains intact? Swiss Re's Pui believes parametric solutions will help companies and homeowners in wildfire risk zones. "Parametric insurance solutions can provide some relief, particularly for non-damage BI type covers, such as business interruption in distant sites from smoke haze, or expenses relief, to cover for example, fire fighting resources."

"With technology and data availability improving, there could be upside potential for parametric solutions that for example, premise the payout based on the extent of burn scars."

"What is key to note, however, is that insurance solutions will be priced to reflect the high risk in these regions. To maintain long-term sustainability of the industry, first and foremost, focus should be directed at reducing fuel loads and improving mitigation measures," adds Pui.

Mark Bove, natural catastrophe solutions manager at Munich Reinsurance America, agrees there is a growing need and role for innovative risk transfer solutions, potential involving public private partnerships.

"Parametric products will definitely be a part of the risk transfer ecosystem in wildfire country over the coming years and decades," he says. "Community-based risk transfer partnerships at the municipal or county level, whether indemnity-based or parametric, will also likely be an important part of addressing wildfire risk as well."

As individuals, businesses, and governments grapple with growing wildfire risk, indices and data which enable the structuring of new risk transfer products are becoming more important. Aon's Cheeseman is seeing specific interest from government insurers looking to de-risk their portfolios using wildfire parametric solutions.

"Parametric products can be purchased on any weather variable linked to the likelihood of fires occurring," he says. "Currently, this variable is most commonly the Forest Fire Danger Index (FFDI) which is a combination of weather variables conducive to triggering and sustaining fires, hot, dry and windy weather. Alternatively, cover can be placed using area burnt as a trigger."

Risk transfer is just one part of the solution. Risk mitigation strategies are also an essential part of reducing the impact of wildfire risk and ensuring insurance solutions remain affordable.

Cheeseman warns parametric insurance and other new technologies will not address the underlying problem of humans living in high risk, vulnerable wildfire regions. "Parametric insurance products, and insurance in general, doesn't solve the issue of living at risk within the wildland-urban interface," he says. "These products may however offer some comfort to the insurance buyer so that if they do lose it all in a fire, there is at least some support to help them get back on their feet and recover from such a devastating event." ■

## BIG NUMBERS

**90%**

percentage of wildfires in the US caused by people

**4.5 MILLION**

number of US homes identified as being at high or extreme risk of wildfire

**45,939**

number of US wildfires between 1 January and 16 October 2020

**8.3 MILLION ACRES**

extent of wildfire damage during the 2020 period to date

(Source: Insurance Information Institute)

# SHAKEN TO ITS CORE

Following the Christchurch and Kaikoura earthquakes, New Zealand's risk and insurance sector has seen seismic shifts in both risk assessment standards and the cost of underwriting. Exactly how deep was the impact?

In February 2011, New Zealand was struck by its most devastating earthquake for a generation. A magnitude 6.3 tremor hit the nation's third-biggest city, Christchurch, killing 185 people and injuring thousands. The event caused massive damage to the city's central business district, destroying historic landmarks and commercial buildings. Nearly a decade later, the city is still trying to recover.

Before this, Christchurch was not even viewed as one of the nation's seismic hotspots. Sitting on major fault lines, the north and south islands have both been hit by catastrophes, before and since. In 2016, Kaikoura, 180 kilometres away, was rocked by a magnitude 7.2 quake, killing two people and affecting thousands.

Christchurch became the biggest insured event in New Zealand's history, according to the Insurance Council of New Zealand. While the earthquake was reasonably low in magnitude, it caused huge damage to the city centre, with the insured cost estimated at more than $31bn, and private insurers paying out $21bn.

New Zealand's protection gap entity, the Earthquake Commission (EQC), paid out $10bn following the Christchurch quakes. The EQC is funded through a levy on home insurance, collected by insurers and passed on to the public body. The EQC pays out the first $150,000 of damage to residential properties caused by natural disasters, with insurers assuming the remainder.

Lloyd's of London says reinsurance market support is vital for the future of New Zealand's insurance market. Reinsurance costs have soared since the two major quakes, with a shift towards risk-based pricing. Over the past decade, insurers and brokers have learned many lessons, while premiums have risen across the country. In high-risk urban centres, like the capital, Wellington, commercial buildings struggle to obtain coverage.

## Lay of the land

Risk professionals say the earthquakes have prompted an overhaul of risk management procedures. Chris Beh, practice leader for New Zealand at Marsh, notes that the tremors of the past decade have resulted in new building codes and technical standards for structural assessments.

"From an engineering and technical perspective, a lot of changes came out of the 2011 earthquake. And out of that grew a chartered field of engineers to do seismic assessments."

The Christchurch event was notable for a high degree of ground liquefaction, where soil turns to liquid. Beh says it helped insurers to learn more about the process and related risks. "Prior to Christchurch, it wasn't well understood. We also learned a lot about liquefaction causing lateral spreading, where the soil moves horizontally, causing issues for underground pipework."

New Zealand has also since moved to classify earthquake-prone buildings, and put plans in place to mitigate potential damage, Beh says. "Over time, there have been changes across the different regional authorities in terms of the time required to upgrade buildings if they are earthquake-prone. How we look at things is more conservative since Christchurch."

**83%**

of property claims from Kaikoura earthquake had been fully settled within a year.

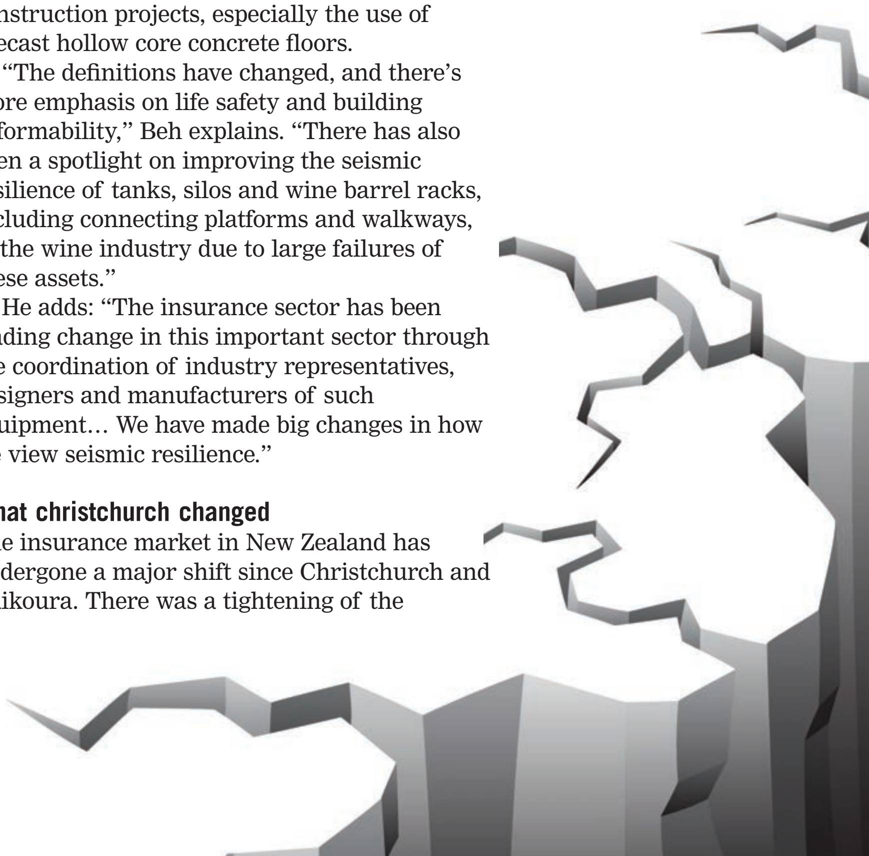
The Kaikoura event prompted a review of the building materials used in construction projects, especially the use of precast hollow core concrete floors.

"The definitions have changed, and there's more emphasis on life safety and building deformability," Beh explains. "There has also been a spotlight on improving the seismic resilience of tanks, silos and wine barrel racks, including connecting platforms and walkways, in the wine industry due to large failures of these assets."

He adds: "The insurance sector has been leading change in this important sector through the coordination of industry representatives, designers and manufacturers of such equipment… We have made big changes in how we view seismic resilience."

## What christchurch changed

The insurance market in New Zealand has undergone a major shift since Christchurch and Kaikoura. There was a tightening of the



reinsurance market, leading to increased reinsurance costs and higher premiums for households and commercial buildings.

Insurers have also moved from total replacement home insurance to ‘sum insured’, helping reinsurers gain a clearer understanding of their maximum liability for residential homes.

The terrible impact of the tremors has changed insurers’ approach, particularly around seismic risk in city centres. Swiss Re says the consequences seen in Christchurch are “probably the norm as opposed to the exception” for a city centre earthquake.

The insurer wrote a whitepaper on lessons learned from Christchurch, saying: “It is true that the probability of a Christchurch-type event in any specific city is very low. Nevertheless, there is a substantial probability that one or other city somewhere in the world will be affected in the coming years and will show similar claims-inflating effects.”

**“There have been changes in the time required to upgrade buildings if they are earthquake-prone. How we look at things is more conservative after Christchurch.”**

Practice leader for New Zealand, Marsh
**Chris Beh**

**$31bn**

total insured cost of the Christchurch earthquake in 2011.

Tim Grafton, chief executive of the Insurance Council of New Zealand, says the insurance market has evolved since Christchurch: “That earthquake series and the 2016 Kaikoura have better informed understanding of risk, and this has been reflected in revised models produced by RMS and AIR. There is also work underway by GNS to upgrade the Natural Hazard Seismic Model for New Zealand, noting a substantial revision has not been made since well before the Canterbury earthquakes. The better understanding of risk has informed insurance underwriting.”

According to Grafton, the major quakes of the past decade have resulted in “upwards adjustments to how that risk is priced in higher risk areas, regardless of whether the property is residential or commercial”. Risk appetite “will vary on location around the country”, he adds.

Wellington is viewed as the country’s biggest earthquake risk. Grafton says Wellington, largely built on reclaimed land and subject to liquefaction, has a high level of commercial property, “with varying degrees of seismic resilience”.

He notes even Kaikoura caused $1bn in damage, including building destruction. “Consequently, commercial property has seen sharper increases in risk premium. Residential apartment dwellings, of which there are quite a few in the CBD, purchase commercial property insurance as opposed to standalone home insurance. When you buy home insurance, you buy an all-perils cover. However, if you are a commercial property, you must buy separate earthquake cover, which often carries a 5% excess and a higher charge, because it is a more complex risk than a house.”

Grafton adds: “Also, while standalone residential house owners can select their sums insured, residential property owners in apartment dwellings are required by law to fully insure for fire and separately for earthquake. Consequently, these owners face the sharper premium increases and have limited ability under the law to share risk to mitigate that cost.”

The insurance sector was criticised over its handling of the Christchurch event. But in Kaikoura, the EQC and private insurers worked in a partnership model, with insurers acting as agents of EQC, investigating and paying out on claims for customers directly. Insurers then sought reimbursements from the EQC.

Grafton hopes Kaikoura will be a new model for disaster recovery. One year on from the event, 83% of all property claims relating to the Kaikoura earthquake had been fully settled. In contrast, three years after the Christchurch earthquakes, only 34% of property claims to private insurers had been fully settled.

“It is acknowledged that this is the way forward,” Grafton says. “Learnings from Kaikoura will lead to more efficient responses in future.” ■

# EARTHQUAKE CENTRE OF THE WORLD

Including the two giant earthquakes, north of Sumatra in 2004 and east of Japan in 2011, East Asia has demonstrated its status as the most concentrated region of earthquake activity on the planet, explain **Robert Muir-Wood** and **Chesley Williams.**

Damaging earthquakes are rarer than climate perils such as floods and typhoons, yet have the capacity to be more destructive, with the impacts extending over a wider region. Even evaluating the hazard can be challenging when the past few centuries of history may not contain examples of the largest events in a given region.

We think of the 2011 Great Tohoku earthquake and how the unprecedented tsunami overwhelmed coastal cities, along with the back-up generators for nuclear power plants. We think of the 1976 Tangshan earthquake, located not far from Beijing, which destroyed a city of a million, yet had no antecedent for more than two thousand years.

Asia is crisscrossed with earthquake-generating plate boundaries. The Pacific "ring of fire" runs from Kamchatka and the Kurils and past the east coast of Honshu Japan, where it splits. One boundary heads south into the subduction zone running down the east coast of the Philippines, along the Tonga Arc to New Zealand. The other boundary runs past southern Japan and Taiwan, down the west coast of Luzon in the Philippines to link with the Java and Sumatra subduction zone in Indonesia, which runs north along the coast of Myanmar before turning to rim the southern Himalayan front.

Since the year 2000, many of these plate boundary regions have been active, generating earthquakes, such as in Sulawesi, Hokkaido, New Zealand, and Nepal. Including the two giant earthquakes, north of Sumatra in 2004 and east of Japan in 2011, East Asia has demonstrated its status as the most concentrated region of earthquake activity on the planet.

The insights gained from each new disaster will help us improve our ability to forecast the consequences of future events.

### Secondary perils: liquefaction, landslides and tsunami

Large earthquakes possess an armoury of weapons. First there is the shaking itself – the "quake" of the earthquake, vibrations generated by friction as the two sides of a fault move past each other. The larger the breaking fault the greater the offset, and the bigger the magnitude of the accompanying earthquake.

Shaking can cause the particles of an unconsolidated saturated sediment to pack together more tightly. The particles could be the grains of sands deposited in a river delta. As the water-filled space between the particles reduces, the pressure rises, forcing the grains apart. Instead of the surface load being carried grain to grain, the material now behaves as a liquid – the process is called liquefaction.

> "The Pacific 'ring of fire' runs from Kamchatka and the Kurils and past the east coast of Honshu Japan, where it splits"

Liquefaction means that a surface load, like a building, will sink into the ground. If the subsurface deposits are irregular, the building may tilt as it sinks. Even on a slight slope, the shallow soil or any building will slip downhill, moving on the frictionless liquefied layer. Liquefaction brings a completely different set of damage mechanisms to shaking. A building can be completely undamaged by shaking but still a total loss to an insurer because the floors are left tilted.

Where liquefaction is most intense, pressurised water pours out at the surface, carrying thousands of tons of silt and sand, flooding roads and buildings. This was the scene in eastern Christchurch, New Zealand after the shallow, moderate magnitude earthquake on 11 February 11, 2011, in which 'ultra-liquefaction', was assessed as causing almost as much damage as shaking.

Liquefaction is commonly a trigger for near-lateral landsliding. In villages inland of the city of Palu, the earthquake that struck Sulawesi on 28 September 2018 showed the most extraordinary liquefaction-induced landsliding, on the shallowest gradients (recorded on amazing cellphone videos). These slides caused so much destruction to some villages, where buildings were left ploughed into the ground.

Landsliding proved to be the principal cause of the thousands of fatalities. Once again, this highlighted the importance of mapping liquefaction-prone soils in earthquake risk assessment, in

A helicopter team surveys the tsunami and earthquake damage over Japan after Tohoku in 2011

particular when urbanisation has extended into flood plains.

A large earthquake in mountainous areas will trigger widespread landsliding, as affected Nepal on the 25th April 2015. Where the soils covering the landscape are the products of past volcanic ash eruptions, they can be particularly prone to slipping, in particular when rain-saturated. Landsliding was a major source of disruption in the Mw6.6 Hokkaido earthquake of September 6th 2018, blocking many principal highways. Massive landsliding was also widespread after the cluster of shallow earthquakes around Kumamoto in Kyushu from 14-20 April 2016.

Where the earthquake alters the configuration of the seafloor, whether from the rebound that accompanies the fault displacement or from underwater landslides, a tsunami can be generated. We saw this in the city of Palu during the Sulawesi earthquake. As the main fault rupture involved horizontal movement the earthquake would not typically be 'tsunamigenic'. Yet either as a result of vertical seafloor displacement at an offset in the line of the fault and/or a submarine slide, a destructive tsunami was generated. These waves became amplified as they moved along the funnel-shaped coastline leading to Palu.

Local tsunami of this kind are more of a challenge to model than the far more destructive mega-tsunami accompanying the largest subduction zone earthquakes. In the 2011 March 11th Mw9 Tohoku earthquake in Japan, an estimated 30% of the damage and almost all of the near 16,000 casualties were driven by the tsunami.

**"On the plate boundary 'front line' we have cities like Tokyo, Manila, Karachi and Wellington, but Delhi, Jakarta, Beijing and Seoul are also at risk"**

### Role of building codes

Other factors learned from these earthquakes concern the importance of granular data on the affected building stock. Even where building codes and building code compliance is strong, as in Japan and New Zealand, buildings constructed prior to the modern codes have proved most susceptible to collapse and casualties. In Kumamoto Japan, the fact that there had not been a significant earthquake for many decades meant that the building stock was on average older and more vulnerable.

All of these earthquakes presented insights that have been included in earthquake models. In the 2018 Hokkaido earthquake, there were systemic consequences when three million customers lost power after damage and fires at the main coal-burning power station on the island. For the majority, power was not restored for two days, leading to disruption in the agriculture, food retailing, and health sectors.

Another feature of earthquakes is that one fault rupture influences the stresses and potential for fault rupture on other faults in the vicinity. For example, the Nepal earthquake ruptured the deeper part of the India-Eurasia plate boundary that dips down to the north under the country, and there may now be the potential for the shallower part of the fault to rupture through to the surface, bringing stronger ground motions.

The 2016 Kaikoura earthquake, located midway between Christchurch and Wellington, ruptured a whole interlinked set of faults. As has been recognised in earthquake hazard definition for California, the length of a single fault does not constrain the size of an earthquake when there is the potential for a cascade of ruptures passing from fault to fault to fault.

A number of cities in Asia lie in the path of potential earthquakes. On the plate boundary 'front line' we have cities like Tokyo and Manila, Karachi and Wellington. Yet there are also many other cities which are less at risk, but could still be hit by infrequent damaging earthquakes, cities such as Delhi, Jakarta, Beijing and Seoul. Because of the lower risk, there has not been the focus on improving earthquake building codes and construction standards in these areas.

RMS is committed to helping (re)insurers in Asia manage their seismic risk with comprehensive solutions that reflect the latest understanding of earthquake science and building performance. ■

*Robert Muir-Wood is Chief Research Officer, RMS, and Chesley Williams is Senior Director, Product Management, RMS.*

# SPECIAL REPORT:

# RIDING THE CYCLE

This special report, in partnership with the Dubai International Financial Centre, includes the highlights a roundtable debate hosted virtually by Global Reinsurance in October 2020 and the results of research conducted during September 2020.

At a time when industry participants would normally be gathering to kick-start renewal discussions in Monte Carlo and Baden Baden, the coronavirus pandemic has brought unprecedented change and is accelerating automation, in terms of how the business is transacted, as well as some of the underlying pricing trends.

**Roundtable highlights: Unpicking the hardening market**

The reinsurance cycle is undoubtedly hardening, but it is not yet a truly hard market, felt participants at the Global Reinsurance DIFC Virtual Roundtable discussion in October 2020. While the overall direction of rates is encouraging, they felt, there is still some pricing correction to come, particularly on the treaty side of the business.

The price increases come after a long soft market, with challenges on both sides of the balance sheet resulting in a situation that was simply unsustainable, according to Michel Blanc, CEO, Reinsurance, SCOR Global P&C. "When it comes to assessing the reinsurance market cycle it's clearly a question of profitability," he said. "It is important to consider the risk has been mispriced in many lines of business and the market has been giving away far too much for far too little in recent years. So clearly we need a stronger correction."

"The reinsurance industry needs to establish baselines in pricing where costs of risk, capital, expense and margins are all well covered, over the long term to make the business sustainable and profitable."

Continuing upward pricing is necessary in order to compensate reinsurers for the lack of investment returns over the past years, insisted Blanc. "The lower interest rate is the most important driver today, as about two thirds of the return generated by P&C Reinsurers are from investment income. With yields this low, cost of capital has to be covered from underwriting.

"It shows clearly that we have to improve the technical part of the results, and that's the reason why market hardening should continue - not only in 2020 but beyond - until interest rates increase again. We see this market hardening across all lines of business and geographies."

While it is clear that reinsurance industry results are coming under pressure, it is still an earnings issue rather than a capital issue, thought participants. According to Willis Re, total capital dedicated to the global reinsurance industry was $587 billion as of 30 June 2020, reflecting a three percent decline since the end of 2019. However, total industry capital remains 12% higher than at the end of 2018, noted the global reinsurance broker.

HOSTED AND ORGANISED BY:

GR GLOBAL [RE]INSURANCE

IN ASSOCIATION WITH

Dubai International Financial Centre


"At the early stages of the COVID-19 pandemic, Fitch performed a stress test to see if reinsurers would run into a capital problem or earnings problem," said Robert Mazzuoli, CFA, Director, EMEA Insurance, Fitch Ratings. Capital is not the issue. Capacity remains and that probably explains why we do not see a hard market yet in some sub segments."

"The sector still looks healthy, which from a credit rating agency point of view looks good," he added. "But for the cycle, it means a hardening market might be short lived, because it is mostly driven by a lack of profitability and not lack of capital."

"Going forward, the main focus is whether and when the sector can generate returns that go beyond the cost of capital, without just good luck. In our expectation, it will not happen yet next year. So 2021 will be another year of deficiencies, which will also be a function of the pandemic and capital flows etc. So there are lots of moving parts but the main point of weakness for the sector is this need to generate to decent return on capital."

### Taking a stand on treaties

Reinsurance companies need to maintain discipline, particularly on the treaty side of the business, thought Salvatore Orlando, Head of Western and Southern Europe & Africa, Partner Re. "After three to four years of, at best, average results, reinsurance companies are under pressure to demonstrate this industry segment is able to perform and to continue to attract interested capital," he said. "To do that we need to change our strategy."

"After 12 to 14 years of decreases in rates, now it is looking likely that the cycle is going up. The question is for how long? It is always about supply and demand and there will be less supply because reinsurers have to be more selective. There will be more losses to come because of climate change, COVID-19 and other claims."

"We are in a hardening market and the journey is going to be long. We as reinsurers have started to change the market on the facultative side, where rates are going up in an important way. But we are still seeing a soft market on the treaty side, and so we have a responsibility to change things there. Because without changing the treaty market we will not have a hard market as such."

Roundtable attendees acknowledged capital was seeking to re-enter the industry in order to benefit from the uptick in rates. While there are some signs of a burgeoning Class of 2020, participants thought investors would be most likely to back existing rated players who have a tried and tested track record.

They did not anticipate the same influx of capital from institutional investors and private equity backers that may have been seen in the past following a market correction, such as a major catastrophe loss. They pointed to issues such as trapped collateral within the ILS sector, as well as the ongoing challenging operating environment.

"We have to live with competition and new capital will flow into our segment, which is a good thing," said Orlando. "We have investors looking into our segment and our job is to make sure our industry is attractive enough for investors."

"Investors are becoming more and more sophisticated and they understand exactly what kind of return you can get out of certain segments," he added. "Over the last 20 years the information level on the reinsurance side was good, but always driven by uncertainties. Today, with more sophisticated data, we need to demonstrate we will be able to get the right return for the capital - which is going to be more and more difficult."

**"The price increases come after a long soft market, with challenges on both sides of the balance sheet"**

Despite broader hardening trends within the global reinsurance market, elsewhere the vestiges of a soft market still persist. This is especially true in regional markets such as the Middle East, according to Andrew Woodward, Regional Manager for the Middle East and Turkey, Lloyd's.

"Anything that is a capacity risk, where you have to get London or European markets involved, the rates are going up by double and sometimes even triple digits," he said. "What is really sad - if you go and talk to the cedants - is that the rates are still going through the floor for anything that can be tucked away in the treaty. Unless someone takes a stand on treaties I don't see a change, especially in markets like the Middle East, which are so reinsurance-driven."

Woodward said reinsurers would need to do much more than just ride the hardening stage of the cycle and hope it lasted as long as possible. "As long as I've been in the Middle East people have talked about change and M&A and consolidation, but if you look at it the way treaties are bought, it hasn't changed that much in 20 or 30 years."

"In a hardening market its easier

for reinsurers to make money and everybody is talking about the way the market is changing," he added. "But if people are just relying on a positive rating environment, I don't think that's going to be good enough. It's got to be about how you are transforming your business into a different way of working, whether you are a cedant, broker or reinsurer."

He thought the coming 1/1 treaty renewal would be critical for the future momentum of the local market. "We've seen capacity coming out of Dubai and these things tend to be a bit of herd mentality. Too many underwriters don't think you can make money in the Middle East - which is wrong - but as a region we don't help ourselves when we have to acknowledge that local underwriters are still driving rates down."

Elie Abi Rached, CEO, Chedid Re, KSA, said the treaty reinsurance rating environment had become unsustainable. "The reinsurance market has been paying losses of hundreds of billions since 2017 with little [improvement in pricing]. On the facultative side we have seen a fairly quick response. The market has now to benefit from the 1 January 2021 renewals to introduce tighter terms on treaties in order to push towards a hardening market."

He thought that while 2020 would see the arrival of some new start-up reinsurers, most smart investors would be buying into well-established companies. "It's not going to be similar to 2001 or previous years where you had a lot of start-ups. A few start ups will be present but the main focus will be on existing market players, those which are sound and capable enough to survive the crisis we are in now and eventually overcome it."

## Adjusting to the 'new normal'

The coronavirus pandemic has had a dramatic impact on the industry, forcing participants in a relationship-based industry to transact the business remotely and virtually. The upcoming renewals will be a test of some of the new ways of working. There will be positives, such as a broad adoption of placement technology - thought participants - as well as opportunities to learn and improve.

**"The upcoming renewals will be a test of some of the new ways of working"**

"If you got a bunch of people together back in January and said, 'there's a pandemic coming and 90% of you are going to be working from home: Would you expect the service of claims, renewals, endorsements, policy issuances etc to be pretty as it was before all this happened?' I think everyone would have fallen over laughing," said Woodward. "But the reality is the industry has actually done quite well."

"I just find it absolutely tragic that it's taken a pandemic to drag our industry kicking and screaming into the 21st century," he added. "It's not like video conferencing has been invented in the last six months, it's just that we've all started using it to accommodate a new way of working because there was no other choice."

Participants felt it was important, going forward, to find the right balance between conducting business remotely and meeting face to face. Relationships cannot be built over Zoom, Teams or Google Meet, they felt.

"You can keep the lights on with these calls - but you don't build relationships," said Woodward. "If you look at what Lloyd's is doing with the virtual underwriting room, there is absolutely no appetite whatsoever for doing away with human contact. When it actually comes to doing the deal you want to be looking the guy in the eye, and I don't think that will change."

"The people I know and who I've known for over 20 years I can negotiate with via virtual media," added Partner Re's Orlando. "For the business you want to acquire - the new business, you need the personal relationship, and that is something we should not forget. For the younger people that's important because otherwise you lose that touch."

It is not just placing the business that becomes more difficult in a virtual environment. The claims settlement side of the business is also more difficult, explained Stephen Marcellino, Attorney at Law, Wilson Elser Moskowitz Edelman & Dicker LLP.

"I've seen a lot of people trying to do this virtually and it is a lot harder when there is not a pre-existing relationship and those years of experience. Dealing with claims in this COVID environment is a more challenging process, particularly if there's going to be an aspect of coverage that's unclear."

Henri Labat, Senior Executive Officer and Board Member of IGI Dubai, said his company was prepared for the switch to a digital environment, but felt that some of its brokers were less prepared initially. "After a few weeks everyone had switched to the new normality of virtual meetings and it was back to business as usual and I didn't face any issues in transacting via digital meetings. When you only have established contacts, and you know the people you are already dealing with, it's easier."

## More pain to come?

The continuing uncertainty posed by COVID-related claims and how this will impact reinsurance books of business is helping to maintain the upward pressure on rates, thought participants.

"Yes the market is hardening," noted Labat. "It's not hard yet because there is still a lot of uncertainty because of COVID - it will take time but we think it will fuel the hardening market from both a time and intensity perspective. That's why we feel, at least during 2021, the same overall trends will continue."

"Rates are going up and capacity in some classes and geographies are being reduced," he continued. "It's a trend that started before COVID and it will continue into 2021."

Other sizable losses in 2020, including those relating to the port explosion in Beirut and natural catastrophes, such as Hurricanes Sally, Laura and Zeta and wildfires in California, will also help focus reinsurance underwriters as they approach the critical renewal period of 1 January. While there had been a brief respite in claims through the lockdown period in some classes of business, this is a temporary lull, thought Marcellino.

"Issues around social inflation in the US market in particular will continue to remain," he said. "We are going to see an uptick in professional liability and employment claims, particularly as employees return to work. And there may be a further D&O market assault due to various decisions directors and officers have made in the context of responding to the COVID-crisis."

The attritional and growing impact of secondary perils - such as wildfires and tornadoes - on the bottom line is another challenge the industry faces, with Blanc pointing to climate change as one of the drivers. "The catastrophes we have seen over Q3 should sustain the momentum on rates regarding the renewal. What we observe on the secondary perils is they contributed around 50% of claims over the past few years."

"At SCOR, our opinion is that some of these are driven by climate change," he added. "And we need to try to get adequate terms for this renewal, not only on catastrophe business but a lot has to be done on the long tail side in the US."

"Even though we read about the double digit rate movement on the primary side, it doesn't really compensate for the loss trends that we see from the past underwriting years. We will probably need a bit more in order to achieve a price underwriting ratio that is better than 2020."

The temporary lull in claims on the liability side of the business during 2020 will not be sustained, thought Orlando. And therefore, primary insurers will find 2021 a more challenging year overall. "I am convinced 2020 will be one of the best performing years from a profitability point of view for the majority of the primary companies with motor being out of order for three to four months (and most P&C companies have about 60-70% of their portfolio related to motor, so that's going to be an Eldorado).

"2020 is going to be an excellent year for primary carriers - particularly for the companies who can transfer the COVID losses to the reinsurer," he added. "For those who have to pay on their own, that's going to be tough. 2021, 2022 and 2023 is going to be totally different ballgame. Primary insurers need to start to prepare carefully to ensure they can maintain a certain profitability going forward."

**"The attritional and growing impact of secondary perils - such as wildfires and tornadoes - on the bottom line is another challenge the industry faces"**

## Managing a more volatile world

Where reinsurers are concerned, the conversation needs to move beyond a discussion over pricing to encompass the extent of coverage, risk and limits. This is because of how the world is changing and the economic realities introduced by the COVID-crisis.

"The economic environment will hardly allow us to have the same cycle as we had in the past where we were able to increase the rates by 100% because the economy worked," said Orlando. "If mass retail and hospitality business is disappearing, reinsurers are going to be more and more exposed to very volatile accounts."

"Those accounts have to understand. We cannot simply accept $1m of premium for $1 billion of exposure - it's not going to work going forward. It is the responsibility of the primary insurer, working with the reinsurer, to say that the limits have to come down. I'm convinced this is going to be one of the main discussion points over the next couple of years."

SCOR's Blanc thought there would ultimately be a 'flight to quality' in how reinsurance buyers selected their panel of reinsurers. "Cedants are protecting their earnings against volatility but their capital base as well. We anticipate increased demand for both capital-driven top layers as well as earning driven cover and we also see a lot of capital relief deals on our radar. Cedants are favouring reinsurers with solid ratings and robust balance sheets as preferred partners." ■

# ROUNDTABLE PARTICIPANTS

Global Reinsurance wishes to thank the Dubai International Financial Centre Authority, without whose welcome support such roundtable discussion events and reports would not be possible. We also wish to show our gratitude to all the 2020 Global Reinsurance Roundtable participants for their precious time and unique insights. A full list of the roundtable participants is included below.

**Salvatore Orlando**
Head of Western and Southern Europe & Africa, Partner Re

**Michel Blanc**
CEO, Reinsurance, SCOR Global P&C

**Stephen Marcellino**
Attorney at Law, Wilson Elser

**Robert Mazzuoli**
CFA, Director, EMEA Insurance, Fitch Ratings

**Henri Labat**
Senior Executive Officer and Board Member of IGI Dubai

**Andrew Woodward**
Regional Manager for the Middle East and Turkey, Lloyd's

**Elie Abi Rached**
CEO, Chedid Re, KSA

**Gracita Aoa-de Gracia**
Senior Manager, Insurance & Reinsurance, Dubai International Financial Centre Authority

**Khadija Ali**
Chief Representative, Business Development Segments, Dubai International Financial Centre Authority

**Helen Yates**
Chair and Consulting Editor Global Reinsurance



# DIFC expects upward pricing momentum and positive disruption

**By Arif Amiri, Chief Executive Officer of DIFC Authority**

The global reinsurance industry is transforming. Driven by the global pandemic and the need to service the sector's rapidly changing requirements, the reinsurance industry has embraced technology and accelerated the digital agenda. This in turn, has led to improved efficiencies in client services, underwriting, and claims management, enabling the sector to reinvent and seize new opportunities.

The 2020 Global Reinsurance Virtual RVS Monte Carlo Survey conducted in partnership with Dubai International Financial Centre (DIFC), found that 82% of respondents reported confidence in the sector. The overwhelming majority of those surveyed expect pricing momentum to be sustained into 2021, whilst 43% predict that rate rises would be in the range of 5% to 10%.

Indeed, this sentiment is reflected in DIFC, the leading international financial hub in the Middle East, Africa and South Asia (MEASA) region. DIFC is home to more than 100 registered insurance, reinsurance, captive firms and insurance-related entities, including three of the top five global insurance companies. The DIFC reinsurance market is poised to service the region's need for capacity and world-class technical underwriting expertise.

In June 2020, the Centre confirmed that Gross Written Premiums (GWP) for Q1 2020 reached $472 million, on par with the same period during Q1 2019, reflecting continued industry stability and resilience. Based on Q1 2020 performance, we expect to see Gross Written Premiums continue to increase in DIFC. The sector grew by 17.4% in 2019, representing the highest volume of premiums ever written in the market, further reinforcing the Centre's position as the leading reinsurance hub in the region.

As a result, the insurance community will need to continue to review their response to the pandemic. We have already seen innovative products and services launch and new business models emerge.

Positive disruption is central to growth. DIFC is the most stable and comprehensive, yet innovative ecosystems in the Middle East, Africa and South Asia region.  InsurTech will lead the rapid transformation of the (re) insurance sector. DIFC currently features 10 pioneering InsurTech institutions that are working with established insurance companies to change the industry landscape.

As we navigate forward, we expect to see InsurTech become an even more important component driving large-scale changes in the sector. At DIFC, we are focused on shaping the future of finance through innovation, technology, and collaboration. This will be achieved by supporting digital adoption, and DIFC will continue to enhance our legislative and regulatory frameworks in order to retain its reputation as the region's most enabling environment which will secure industry growth. ■

Dubai International Financial Centre

# The Global Reinsurance Virtual RVS Monte Carlo 2020 Survey

Will reinsurance pricing momentum continue into 2021 and how will capital re-enter the industry? These were questions we put to a selection of senior reinsurance executives in our annual renewals survey

During September 2020, when the industry would normally be gathering for the Rendez-Vous de Septembre in Monte Carlo, Global Reinsurance conducted a survey of senior reinsurance executives.

As they began renewal discussions, the majority taking place virtually for the first time due to the ongoing COVID-crisis, we asked for their thoughts on where we are at in the reinsurance cycle. After a prolonged soft market, reinsurance prices are continuing to harden into 2020 against the backdrop of a global pandemic.

And according to 82% of respondents to the 2020 Global Reinsurance Virtual RVS Monte Carlo Survey, the reinsurance cycle is alive and well. Just because the cycle is getting longer - with a prolonged soft market ahead of the current correction - "does not mean it was dead", said one. Others thought hard markets may not be as pronounced or lengthy than they had been in the past.

Sustained loss experience and unsustainable pricing are the two biggest drivers of the reinsurance market pricing correction, according to respondents. However, these drivers cannot be taken in isolation. The current hardening market is also the result of market performance reviews, a contraction in reinsurance capacity, deteriorating loss reserves and rising retro pricing.

"Rates will harden in commercial lines, which will support profitability in non life. Rising risk awareness due to COVID-19 will support premium growth across many lines," thought a Middle East-based reinsurance manager.

The hardening market is a challenge for many practitioners, not least because it is the first truly hard market many have experienced in nearly two decades. "Insurance and reinsurance market is at crossroads which has not been witnessed by any professional with less than 25 years of industry experience," added another respondent. "Hence, 75% of the market is learning how to reorganise themselves in this rapidly-changing reality."

"It's a time all risk carriers have been talking about but unfortunately, very few have planned and educated their underwriters and modelling teams to ride this wave. The confusion is likely to continue for another 12-18 months before new capital returns to insurance industry."

## Sustained rate improvements

The overwhelming majority of survey respondents expect pricing momentum to be sustained into 2021 and beyond, with 43% predicting that rate rises would be in the range of 5% to 10% (23% thought rates would increase by 10%-20%). Over half of respondents (56%) expect the hard market to last for 12-24 months, while just over a quarter (27%) thought it could persist for over two years.

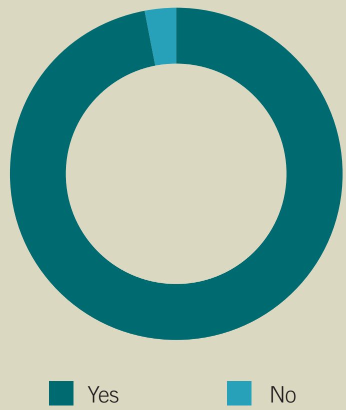
Classes of business being most impacted are D&O and financial lines, aviation and aerospace, retrocession and casualty/liability. Respondents pointed to a growing frequency and severity of natural catastrophe losses, with the additional uncertainty of COVID-related claims as driving the pricing correction across most classes. Within D&O it is due to increasing litigiousness, while from a retro perspective, trapped collateral is a significant source of uncertainty and frustration among investors.

"The key drivers here are the strains incurred by primary insurers and reinsurers in connection with the COVID-19 pandemic, a further drop in interest rate levels and the large losses recorded over the past three years," said an Asia-based reinsurance executive.

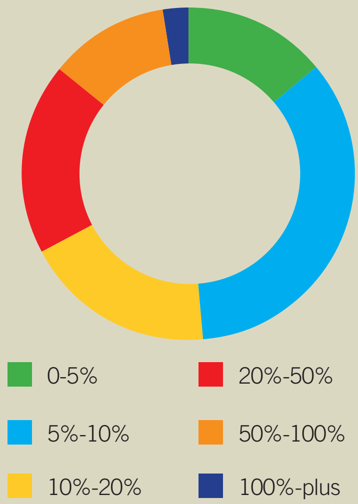
"Also , along with generally stronger demand for high-quality reinsurance protection, primary insurers are increasingly seeking tailor-made solutions offering solvency relief. This is where first and foremost reinsurers with a particularly large risk-carrying capacity and above-average ratings have a pivotal role to play."

### SURVEY RESULTS

**Do you anticipate upward pricing momentum will continue into 2021?**



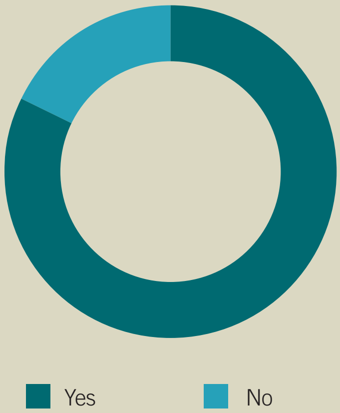

**If yes, what range do you anticipate price movements to be in globally?**



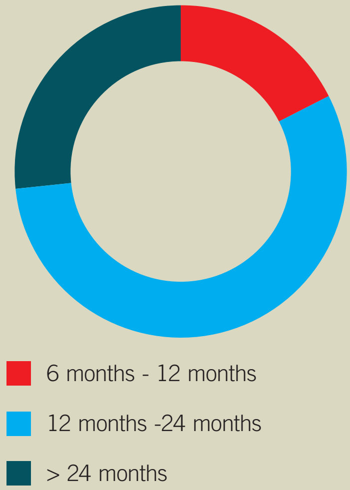

When uncertainty is constant
you can be prepared
As a proven leader in catastrophe risk management, we help customers outperform
Uncertainty and risk portfolio management are now inseparable. You need the highest level of confidence in your models and analytics to improve your business decisions and outcomes. It's now absolutely vital to invest in a partner with the vision, ability, and commitment to prepare you for the unexpected.
See how RMS helps customers outperform.
Visit: www.rms.com/risk-analytics
© 2020 Risk Management Solutions, Inc. All rights reserved.
RMS

**SURVEY RESULTS**

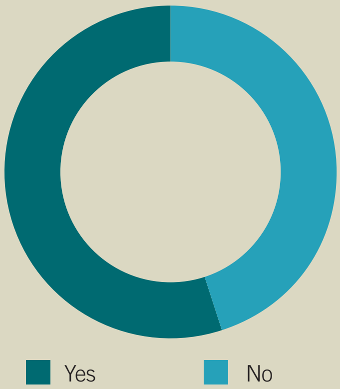
**Before rates began to rise, many commentators declared the reinsurance cycle was 'dead'. Does the current hard market show the cycle is alive and well?**



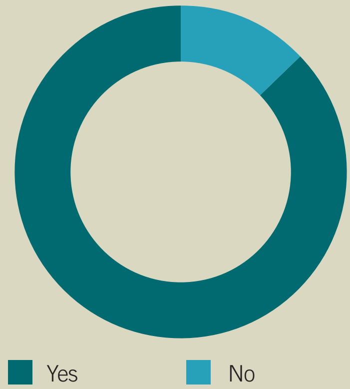

**How long do you anticipate the current hard market to last?**




**Are you concerned about ongoing consolidation within the broker space?**




**Have the COVID-crisis and global lockdowns accelerated the pace of change within the industry**




Cedants are adapting to reinsurance rate hardening in a number of ways. This includes taking out more standalone coverage, increasing commercial insurance rates and retaining more of the risk on their own balance sheets. Others revealed they are reducing their participation in unsustainable lines of business and geographies, while making the most of existing relationships to secure coverage at reasonable terms.

## Broker consolidation

With the mega tie-up between Willis and Aon underway, we asked about the ever-evolving role of the broker and whether further consolidation would help or hinder renewals and the placement process. Some thought it would offer tier 2 brokers an opportunity to differentiate their offering, while others questioned whether there was a risk of too much power and influence in the hands of just a few very large intermediaries.

"Mergers in business are part of a cycle," said one respondent. "Megamergers however, signal beginning of a monopolistic trend. However, the Willis and Aon merger is likely to be challenged by the current (and most likely persisting) economic atmosphere that will challenge the new business opportunity as well as retention of existing ones. Boutique broking outfits will benefit from the confusion that any large merger brings to the business."

## Embracing automation

Among the near-term challenges for reinsurers are the impact of claims - including those relating to the COVID-crisis - a tightening of terms and conditions, rising retro pricing, the ongoing low interest rate environment and pressure to innovate and remain relevant.

While it is undoubtedly a challenge operating environment, there are some silver linings. The global pandemic has accelerated the pace of change within the global reinsurance industry, according to 87% of respondents. They said that digitisation initiatives and remote working are being widely adopted as market participants have adapted to lockdown restrictions.

"COVID-19 has certainly increased pace of change when it comes to remote working etc," commented one respondent. "I think this will have a long lasting effect on whether companies provide central London office space for their entire workforce going forwards."

Another added: "The way business is communicated and transacted has changed significantly, but there may be some negative side effects, especially when it comes to risk transparency."

Some respondents mooted this could lead to a more permanent shift due to the opportunities to further trim operational costs. Meanwhile, three quarters of respondents thought new business models and new products and services would emerge as the industry innovates and seizes new opportunities. Parametric covers, pandemic solutions and further advancements in technology are all anticipated. ■


Rubbish and debris in the aftermath of Hurricane Irma

# CLIMATE CHANGE GROUND ZERO?

The true, devastating economic risk created by increased flooding in Florida is still under-estimated, exposing a global need for systemic shifts in the way we protect assets vulnerable to climate risk, explain **Paula Pagniez** and **Prasad Gunturi**.

The full economic impact of climate risk includes many hidden costs. And certain areas will experience these both sooner and more severely. One such place is Florida – the canary in the climate risk coal mine, due to its particular geography.

The geography of the Sunshine State – an expansive coast line, low elevation and porous limestone foundation – makes it vulnerable to flooding and makes adaptation challenging. With storm surge from hurricanes of increasing intensity and frequency projected to become more severe and tidal flooding more frequent, physical damages to Florida real estate will accelerate with the changing climate. Rising sea levels could also push saltwater into the fresh water supply and damage water management systems.

### Flooding batters revenues

The knock-on effects could be even greater. Florida's real estate losses during storm surge from a 100-year hurricane event would be $35bn today, forecast to grow to $50bn by 2050, assuming no change in building stock. Devaluation of exposed homes could be $10–30bn in 2030, and $30–80bn by 2050. This could be even greater if climate hazards affect public infrastructure assets like water, sewage and transportation systems.

**$50bn**

Florida's projected real estate losses for a 100-year hurricane by 2050.

Property values and the taxes associated with buying and selling real estate make up a sizable chunk of state and local budgets. So, the very governments tasked with protecting residents from extreme weather events will have less revenue to do so because of – that's right – extreme weather.

The price or availability of insurance and mortgage financing in high-risk areas could also be negatively affected. While mortgages can be 30 years long, insurance is repriced every year. This duration mismatch means current risk signals from insurance premiums might not build in the expected risk over an asset's lifetime. This may lead to poorly informed decisions.

The insurance market will have to adapt to the risk-adjusted cost of insuring properties that now face a much higher likelihood of floods and hurricanes by pricing higher premiums for this coverage.

Even homeowners not financially distressed may choose to strategically default if their homes fall in value with little prospect of recovery. Shortly after Hurricane Harvey hit Houston in 2017, the mortgage delinquency rate almost doubled, from about 7–14%. As mortgage lenders start to recognise these risks, they could change lending rates for risky properties or even stop providing 30-year mortgages. This would further damage homebuyers and the state's economy.

## Greater resilience globally

Research by US-based Climate Central provides a more global perspective of the impact from flooding, revealing the greatest effects will be felt in Asia, due to the number of people living in the continent's low-lying coastal areas. Mainland China, Bangladesh, India, Vietnam, Indonesia and Thailand together account for roughly 75% of the 300 million people who will be living precariously in areas projected to be affected by coastal flooding at least once a year by 2050.

In response to the scale of the myriad economic challenges presented by climate risk, it is estimated that $90 trillion needs to be invested worldwide in sustainable infrastructure by 2030, which will only be possible with a systemic shift in the way projects are financed to build resilience to climate change.

The need for societal resilience to shocks has already been made clear by the COVID-19 crisis. Investment decisions made now will either lock in a global network of climate-resilient infrastructure or a collection of exposed assets that will make social and economic activity vulnerable to climate risk.

**Investment decisions made now will either lock in a global network of climate-resilient infrastructure or a collection of exposed assets that will make social and economic activity vulnerable to climate risk.**

There are three critical barriers we must overcome in shifting toward a more climate-resilient economy.

- **Incentive structures are limited by short-termism.** There is a crucial need to support longer-term incentive structures that promote resilience, such as regulation and cost of capital, in their growing efforts to foster and reward an appropriate integration of physical climate risks in investment decision-making.
- **Climate risk data and analytics is needed in mainstream finance.** Better data supported by sophisticated analytical tools is needed to properly assess and price climate risk, and to translate exposure into cash flow modelling.
- **Expertise must be shared across industries and the public sector.** A collaborative approach focused on building consensus in areas such as analytical methods and financial materiality is pivotal.

**300m**

people worldwide may be seriously affected by coastal flooding by 2050.

Properly pricing climate risk in financial decision-making will entail aligning investment flows towards infrastructure capable of withstanding a changing climate. Equally important will be to put in place a methodology to quantify the economic and financial risks and benefits, providing a substantial incentive for financial markets to embed resilience upfront.

With this in mind, the Coalition for Climate Resilient Investment (CCRI) launched last year with 35 institutions, including the WEF and the UK government, and $5 trillion in assets under management, and has since grown to include 53 members and $10 trillion in assets. CCRI members have been collaborating to address the accurate pricing of physical climate risks in investment decision-making to support more resilient economies and communities worldwide.

This is a good start. Alongside the physical impacts, climate change will continue to reshape every aspect of the global economy. With the stakes so high, the need to manage climate risk and support a more sustainable economy – from Miami to Kolkata – has become a strategic and financial imperative. ■

*Paula Pagniez is director, Climate and Resilience Hub at Willis Towers Watson and Prasad Gunturi is executive vice-president, Catastrophe Analytics at Willis Re.*

# GETTING BACK TO BASICS

Despite the current economic turmoil, Chedid Re's Elie Abi Rached, thinks opportunities remain bright in the Middle East and beyond.

There are growing signs that treaty reinsurance pricing is set to harden at the 1 January 2021 renewals. This is true even in the Gulf Cooperation Council (GCC) GCC region, where pricing has been soft for over a decade, due to overcapacity and intense competition.

According to Elie Abi Rached, chief executive officer of Chedid Re KSA, the combination of this year's COVID-related losses along with the departure of some reinsurers from the region, is setting the scene for a more sustainable market.

The reinsurance cycle is back, he thinks. "This year we're seeing proper indications towards a hardening market. As always, a hardening market starts on the facultative side, and in particular the lines that are most affected by the COVID-crisis - event cancellation, D&O and most casualty lines. But then it continues into other lines and usually moves towards the treaty side of the business."

"For the 1 January renewals we see most players focusing on generating proper returns to cover minimum return on capital for the core operation, be it insurance or reinsurance."

The uncertainty that remains surrounding the ultimate impact of the pandemic on reinsurance claims is an issue that will remain for some time, and it will make it difficult to gauge reinsurance performance for 2020. Across the market, reinsurers have made provisions for COVID-related claims that equates to a loss ratio of around 10%, explains Abi Rached.

**"Government fiscal stimulus programmes began during the pandemic with authorities stepping in to cover COVID claims. Without it, the impact on the sector would have been really tough"**

"This does get them above the 100% combined ratio - so in theory reinsurers will enter the red zone - yet a lot of these claims have yet to be finalised and we're still not sure how the court rulings in various countries will go."

For a long time, the oversupply of reinsurance capacity within the GCC region has been a factor in maintaining pressure on rates. But this is beginning to show signs of easing. The decision of some reinsurers to close their operations in the region, prompted by the Lloyd's market's performance review of 2018 and 2019, has altered the dynamics.

"This poses a bit more of a challenge when it comes to coping with the changes happening in the market, but on the whole we still see plenty of opportunity." says Abi Rached.

### Opportunities for growth

The fundamentals within the region remain overwhelmingly positive, he feels. With the potential to increase insurance penetration remaining one of the most attractive characteristics of the local insurance markets. "The penetration ratios of insurance are way on the low side compared to other developed markets so the potential remains there and we're confident the trends in our region will be positive moving forward," says Abi Rached.

The underlying primary insurance market is starting to show signs of greater maturity when it comes to risk management and risk retention, encouraged by new legislation in different parts of the region. More stringent solvency regulation is encouraging a shift towards stronger,

better capitalised insurers, which are willing to take more skin in the game.

"As far as the retention levels of insurance companies this was highlighted by a few regulators in the GCC and there is definitely action being considered from the regulator to push towards increasing retention levels," says Abi Rached. "Other opportunities for growth will come from new and compulsory lines of insurance, with the introduction of Inherent Defects Insurance in KSA, for instance, and some of the GCC markets introducing compulsory medical cover. All of this will help to grow GWP."

Strong support from local governments and regulators has been an important theme through the crisis, he adds, with many now pledging a series of stimulus programmes to kick-start economies once the threat of the pandemic has passed. Saudi Council of Cooperative Health Insurance introduced a raft of support measures to help the health sector and insurers through the crisis. Meanwhile, the country's Vision 2030 is intended to boost economic growth while also reducing dependence on oil.

"Government fiscal stimulus programmes began during the pandemic with authorities stepping in to cover COVID claims," says Abi Rached. "This helped the insurance sector because without it, the impact on the sector would have been really tough. Governments also stepped in to help SMEs by giving them some flexibility regarding payments of wages, which was backed up by the government."

Investments in construction and megaprojects will also help to boost the economy and benefit re/insurers. A number of major projects are close to being finalised with the momentum expected to gather pace in 2021. Among some of the more exciting projects in the pipeline are those involving renewable energy, including the UAE's Al Dhafra solar PV plant, set to be the largest solar power plant in the world, and KSA's 400MW Dumat Al Jandal wind array."

**"This year we're seeing proper indications towards a hardening market, which always starts on the facultative side before moving towards treaty business"**

On a Group level, Chedid Capital's 80% acquisition of Ascoma (Ascoma Afrique Assureurs Conseils) an insurance broking network present in 21 countries, is part of the organisation's expansion plan to new territories. This will definitely allow Chedid Re to reinforce its presence in Africa," says Abi Rached. "Besides its geographic expansion, Chedid Capital is investing in the digital sector and in new technology infrastructures to absorb the global and regional shocks that challenged our group and the world, especially with the COVID-19 crisis." ■


THE JOURNAL
The Journal is StrategicRISK's series of interactive online books for professionals in the corporate risk management and insurance sector. The Journal is published in partnership with Swiss Re Corporate Solutions. Each edition features case studies, academic articles, research, interactive infographics and video interviews, helping you get to grips with the biggest risks facing organisations in a volatile world.
strategicrisk-asiapacific.com/sections/the-journal
PRODUCT RECALL | BUSINESS INTERRUPTION | CONSTRUCTION RISK