globalreinsurance.com

GR GLOBAL [RE]INSURANCE

RIDING THE CYCLE: SPECIAL REPORT

IN ASSOCIATION WITH

Dubai International Financial Centre

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:

IN ASSOCIATION WITH

“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).

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

"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."

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."

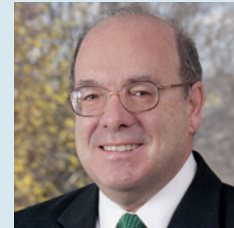
SCOR's Blanc thought there would ultimately be a 'flight to quality' in how reinsurance buyers selected their panel of reinsurers. "Cedants are protecting their earnings against volatility but their capital base as well. We anticipate increased demand for both capital-driven top layers as well as earning 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



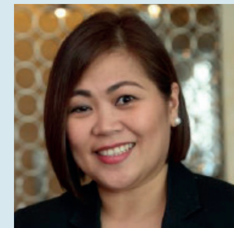
Stephen Marcellino
Attorney at Law, Wilson Elser

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.

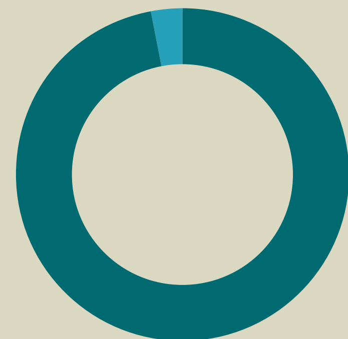
Classes of business being most impacted are D&O and financial lines, aviation and aerospace, retrocession and casualty/liability. Respondents pointed to a growing frequency and severity of natural catastrophe losses, with the additional uncertainty of COVID-related claims as driving the pricing correction 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.

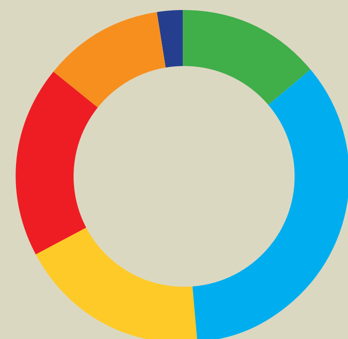
"Also , along with generally stronger demand for high-quality reinsurance protection, primary insurers are increasingly seeking tailor-made solutions offering solvency relief. This is where first and foremost reinsurers with a particularly large risk-carrying capacity and above-average ratings have a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

SURVEY RESULTS

Do you anticipate upward pricing momentum will continue into 2021?

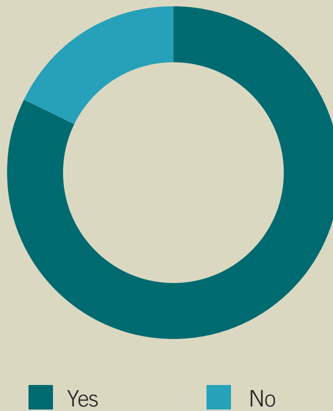


If yes, what range do you anticipate price movements to be in globally?

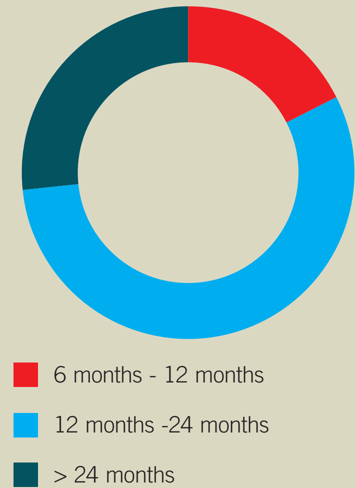


SURVEY RESULTS

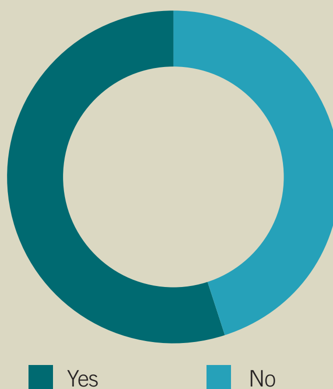
Before rates began to rise, many commentators declared the reinsurance cycle was 'dead'. Does the current hard market show the cycle is alive and well?



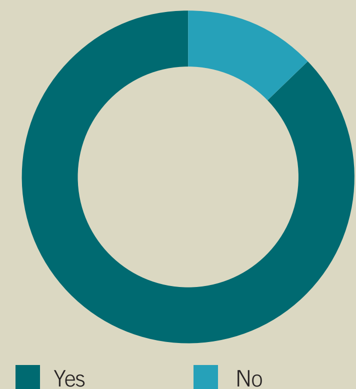
How long do you anticipate the current hard market to last?



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. ■

Ready for everything your business needs?

MAKE IT HAPPEN.

DIFC gives you everything your business needs, from resources to network and more.
Let's make it happen.

<Learn more> difc.ae/areas-business