Gallagher Re

APRIL 2024

1st View: Heading Out of the Woods

Heading Out of the Woods

The FY2023 reporting season concluded in Q1 and saw many companies reporting some of the best reinsurance underwriting conditions in over 20 years. The radical redistribution of risk between primary and secondary markets in property catastrophe and specialty segments during 2023 stimulated a greatly improved equity story for reinsurers. Recent results have vindicated that optimism, with reinsurer valuations much improved after several years.

This report covers the 1st of April renewal period, the traditional Japanese renewal date, but also some significant US and worldwide placements as well as Indian and other Asian markets. It is therefore a useful regional bellwether as well as a triangulation point for the broader reinsurance market.

Competition slowly heating up

In the property catastrophe space, the 1st of April saw a continuation of reinsurance markets moving to "risk on" in the search for growth seen at the 1st of January. This resulted in increased available capacity at the top end of programs and incremental improvement in risk adjusted pricing at firm order terms.

In the property arena, the quoting process was disciplined and predictably most reinsurers were reluctant to open the bidding with discounts, although many led with a desire to take increased shares. Spreads in clearing prices remained narrow by historical standards indicating that reinsurers' desire for growth, while significant, was not at any price, terms, or conditions.

In the US market, client demand for additional limit was satiated. Year on year pricing comparisons are not possible as new layers have no comparable, however, capacity was readily available for the top end of programs at pricing that was in line with the underlying placements - bringing an end to any requirement for inverted pricing.

In specialty classes the quoting process was made more complex with structural changes, including some increased retentions. However, in the final analysis, specialty reinsurance and retro pricing moderated just slightly more than the catastrophe market albeit perhaps from a higher jumping off point.

For some clients, coverage was a greater priority than price. There remains more work to be done on unifying event definition language into a uniform version, giving buyers clarity in how their program will respond, but the picture is an improving one.

Client differentiation and mixed fortunes for reinsurers

The quotation process for the large Japanese catastrophe excess of loss programs saw an unusual degree of consistency as reinsurers quoted flat to very modest risk adjusted rate increases with few outliers on the upside or downside. The generally perceived adequacy of Japanese cat rates, which has been achieved over the last five years, allied with a largely flat capacity demand, allowed buyers to achieve firm order terms with flat to modest risk-adjusted rate reductions. This was helped in some cases by adjustments in modeled views of risk. Whilst the perceived pricing adequacy of catastrophe exposure outside Japan remains more subjective, buyers in other territories saw similar quoting patterns and were able to achieve similar firm order terms.

The desire by some reinsurers to try to grow their revenues while maintaining pricing adequacy, opened the door for more multiclass placement strategies to assist the completion of some other more demanding lines of business. Property per risk treaties both on an excess of loss and pro rata basis and casualty treaties were beneficiaries of this approach, helped in several cases by improvements in original pricing and the positive

impact of changes made to treaty terms and conditions over the last couple of years, resulting in improved performance.

Those reinsurers that were able to respond across the entirety of the cedants' placements, especially where their capacity was disproportionately helpful in the per risk arena, achieved superior signings. Once again and especially for the larger clients with diverse reinsurance needs, those reinsurers able to adopt an enterprise position fared better than those for whatever reason that are unable or unwilling to. Some reinsurers might be disappointed having failed to meet their revenue growth goals.

US casualty: the challenge is not going away

The US casualty and financial lines markets remain more stressed. Significant prior-year adverse development reported for FY23 in casualty, plus continued reductions in insurance pricing, notably for public D&O, led to more challenging negotiations and increased client differentiation. This resulted in reinsurers offering both increased and decreased shares in ostensibly the same classes dependent on the client.

Those clients able to articulate how they are managing the challenges of prior-year reserve-deterioration, loss inflation, the impact of COVID-19 on recent performance, a forward-looking impact of social inflation and new forms of litigation on their underwriting plans fared better than others who have faced pressure on ceding commissions and excess of loss pricing.

Bigger balance sheets, improved performance so what now?

In previous reports we suggested that the main driver in the change in market dynamics on the 1st of January 2023 was driven by reinsurers' reluctance to deploy limit rather than any shortage of deployable capital.

However, the market now has more capacity at its disposal. Industry capital has increased by roughly 12%, driven by a mix of much improved underlying combined ratios, a light natural catastrophe load (despite insured natural catastrophes across the industry being heavy), and better investment income.

Increased capacity, coupled with increased appetite, should lead to an easing of terms and conditions for clients despite the continued challenges facing the insurance market on natural catastrophe exposure.

Alternative capital riding the same wave

Our estimate of year-end non-life alternative capital has similarly increased by double digits, driven by the same fundamentals of favorable cat experience and elevated investment income. Despite there being no signs of a significant influx of new capital yet, other than into some of the best performing ILS funds, it is hard to see anything other than a slight further improvement in pricing from the cedant's perspective.

Now what?

Overall, at the 1st of April property and specialty buyers able to access increased capacity were able to firm order and clear programs at improved terms and secure support in critical non-cat areas. It remains to be seen if the reinsurers who are falling behind their growth targets will maintain the same pricing discipline at the mid-year renewals which represent the last chance to achieve their 2024 revenue goals.

At the time of publication, the full impact of the tragedy in Baltimore is yet to unfold in terms of its' impact on the marine market. But at first glance, it appears to be a potentially significant event that will be closely monitored over the coming weeks.

Tom Wakefield
CEO, Gallagher Re

Gallagher Re

Property: Commentary by Territory

India

- There were no major risk losses in the market; rate increases aligned with inflation and increased Gross Net Premium Income (GNPI).
- Attachment points did not change, but limit increases were seen in a few programs.
- The Indian market was hit by at least five major catastrophe events and most companies' programs were impacted, which was reflected in pricing.
- Some of the lower layers were placed privately or through structured solutions.
- Reinsurers maintained a disciplined renewal by and large, which saw flat commissions and Loss Participation Corridors (LPCs) on pro rata treaties
- Event limit increases were seen in a few select programs

Japan – Property Catastrophe

- Demand for capacity from buyers was marginally down year-on-year; some increases in retentions were offset by a small amount of additional capacity purchased.
- There was a significant uptick in supply of capacity from reinsurers; this was across all parts of programs, but strongest for higher layers.
- Significant changes in underlying portfolios were seen, driven by:
    - Divergent Views of Risk
    - The impact of Reverse Franchises introduced in previous years
    - Vendor models offering different views of organic portfolio growth
    - Portfolio and underwriting changes
- Early reinsurer hopes for risk adjusted flat or even modest risk adjusted increases were eroded during an extended quoting process.
    - Reinsurers offered a narrower range of views than seen at last renewal.
    - Buyers were emboldened to set more aggressive pricing targets based on early messaging from reinsurers.
- Buyers had confidence to issue firm order terms at flat to risk adjusted reductions.
    - Once firm order terms were issued, following reinsurance capacity was buoyant.
    - Buyers pushed for reinsurers to show flexibility on other covers and lines of business, favoring larger multi-line reinsurers.
- Some reinsurers were disappointed with signings, with reinsurer appetite outstripping demand.

Japan – Property Per Risk & Pro Rata

- Reinsurers positioning ahead of renewal was firm but softened as renewal approached, driven by:
    - Reinsurers' desire to secure cat excess of loss signings
    - Good performance of domestic property portfolios more clearly apparent than at last renewal
    - Strong messaging on underwriting improvements, particularly for overseas portfolios
- The significant pressure on coverage terms seen at last renewal was absent this year.
- There was a significant uptick in reinsurers' interest in writing pro rata business.
- Additional capacity from existing reinsurers was visible.

Philippines

- Competition has reemerged in the market, with an increasing number of reinsurers eager to provide quotes to secure preferred following shares.
- A number of buyers have taken proactive measures to mitigate underperformance in their property portfolios, resulting in a year-on-year reduction in aggregates. Consequently, slip premiums were down compared to expiry.
- Full subscription placements returned with both shortfalls and the demand for private pricing rarely seen or required.
- Levels of over placement higher than at last renewal, although they have not yet returned to levels seen prior to the 2023 market change.

Latin America & Caribbean

- Following balance sheet strengthening during 2023 and increased availability of retrocession capacity at 1st January 2024, more property catastrophe capacity was available to clients renewing in 2024. Additional capacity was predominantly provided by existing reinsurers, with an absence of new markets.
- Outside peak catastrophe zones, reinsurers have been able to offer support beyond that required by underlying portfolio organic growth. In peak catastrophe zones reinsurers have been able to support reasonable organic growth in underlying portfolios.
- In peak catastrophe zones however, proportional catastrophe capacity remained tight. In these markets reinsurers prefer to deploy their capacity on non-proportional cat excess of loss programs.
- Whilst some reinsurers were still quoting double digit increases for excess of loss programs, most supported final terms at risk adjusted 0% to +5%: this was most notably for those programs not affected by Hurricane Otis in Mexico in late 2023.
- Most proportional treaties renewed with no significant changes in quantitative conditions, but some reinsurers pushed for SRCC sublimits.
- The trend of reinsurers looking to diversify their property catastrophe exposure by offering shares in other non-correlated lines of business continued.

- Extratropical cyclones have been hitting the south of Brazil with a higher frequency over the last four years, impacting cat excess of loss programs. Although not a severe cat exposure territory, reinsurers have been expressing the need for rate adjustments particularly on property cat programs with exposure in the south of Brazil.

United States

- There are limited renewals of meaningful size at April 1, but the placements that were in the market suggest a continuation (and in some cases acceleration) of the themes witnessed at 1.1.24.
- The market remained functional and operated in an efficient and timely manner as respects quoting, firm order terms and authorizations.
- Capacity has continued to flow into the property catastrophe market, where capacity is sufficient to meet expiring and new capacity needs.
- Cat pricing discipline continued at the bottom end of programs, where risk adjusted decreases were difficult to achieve. We saw risk adjusted rate reductions at the top end of programs, particularly on capacity that was purchased new in the height of the hard market. We are seeing the end of "inverted pricing" where new top layers placed in the past couple years required pricing in excess of underlying layers.
- The risk market remained firmer than the cat market, as there has been no material capital inflows to this segment, and the market continues to question the macro issues of valuation adequacy, the changing inflation environment, and individual risk exposure to severe weather events (severe convective storms (SCS) in particular).
- That said, across both risk and cat markets we are seeing material softening in minimum rates on line, as reinsurers abandon the requirement for top layer pricing to exceed the risk-free rate of return in US Treasuries.

Table 1: Property Rate Movement

Territory	Pro rata commission	Risk loss-free % change	Risk loss-hit % change	Catastrophe loss-free % change	Catastrophe loss-hit % change
India	0%	-13% to +9%	n/a	-12% to -10%	+3% to +10%
Japan – Property Catastrophe	0%	-	-	-5% to +1%	n/a
Japan – Property Per Risk & Pro Rata	0%	-2.5% to +5%	n/a	-	-
Philippines	n/a	0% to +5%	n/a	-2% to +5%	n/a
Latin America	-1% to 0%	0% to +5%	+5% to +30%	0% to +5%	+5% to +15%
United States	-2% to +2%	-5% to +5%	+5% to +25%	-15% to +5%	0% to +20%

Note: Movements are risk-adjusted.
Source: Gallagher Re

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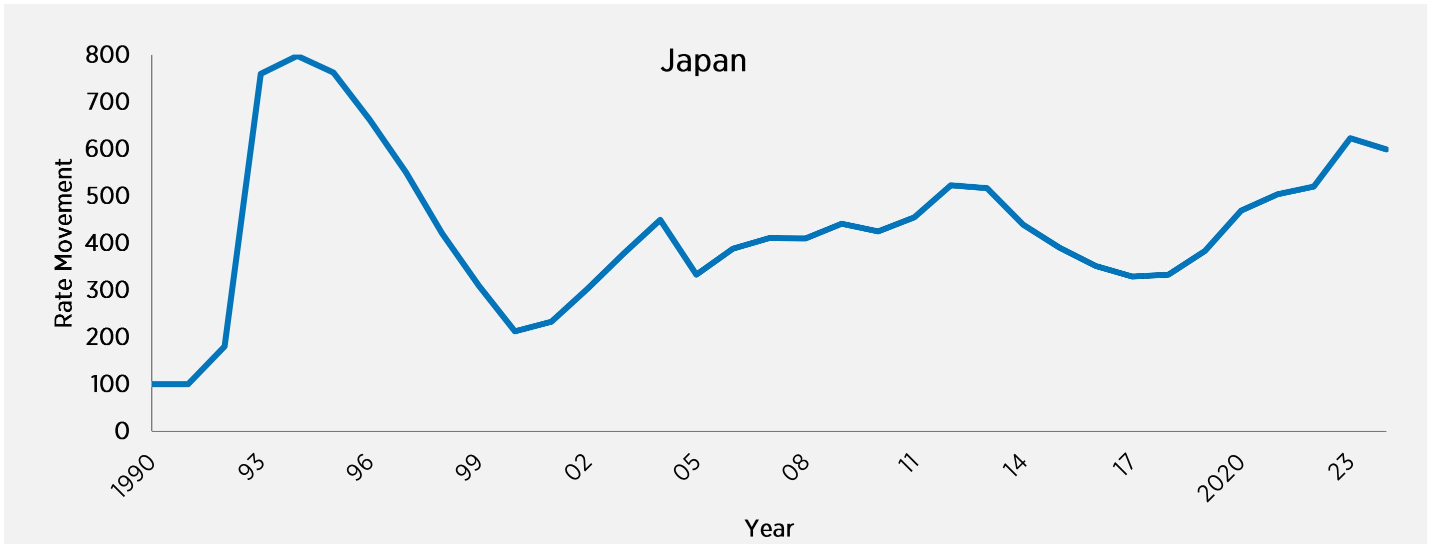
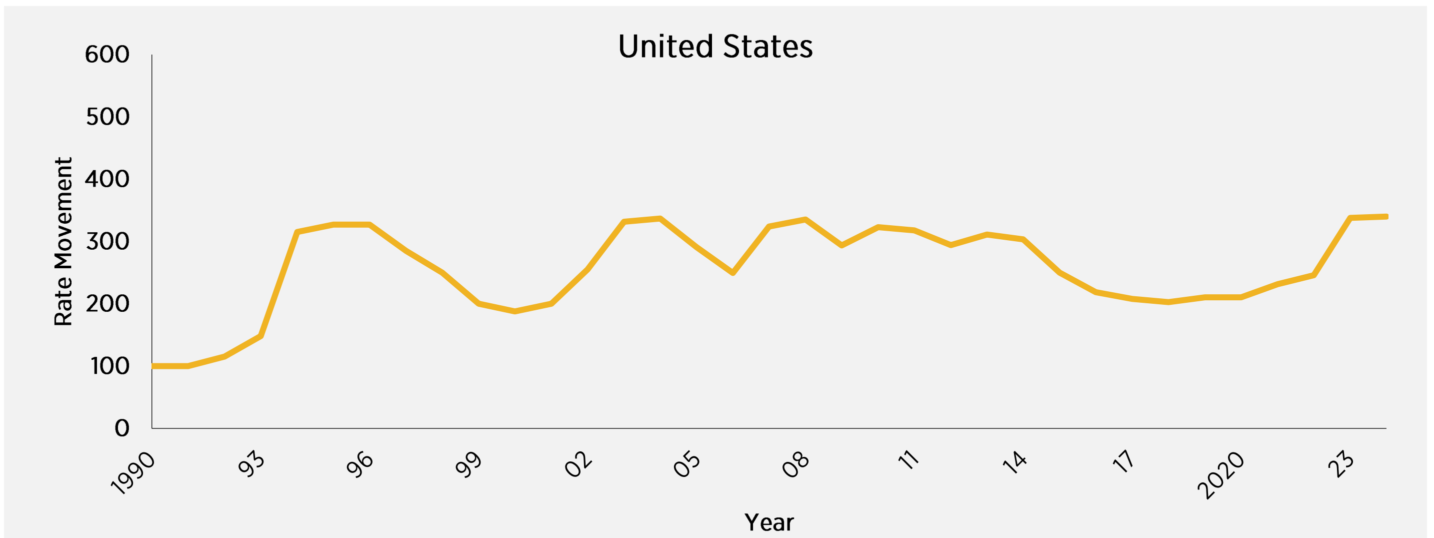
Table 2: Property Catastrophe Pricing Trends





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Casualty: Commentary by Territory

Japan - Cyber

- Strong underlying performance of domestic portfolios continued.
  - A reduction of quota share cessions was broadly discussed by buyers as a mid-term strategy.
- Reinsurers continued to see Japan as a strong diversifier, due to:
  - Steady growth
  - Stable primary rates
  - Coverage more restrictive than global standards
- Implementation of war exclusions under domestic policies was the main talking point.
  - Most domestic insurers are committed to implementing new war exclusions under their original policies in the year ahead.
- Reinsurance terms remained largely unchanged, despite increased discussion about occurrence coverage.
  - Ceding commissions remained largely flat, but some result-based commissions were newly introduced.
  - Aggregate limit and retentions were typically increased, reflecting underlying portfolio growth.

Japan – General Third Party Liability

- Discussions about underwriting and line size management of US exposures dominated the renewal.
  - Some reinsurers pulled back capacity, due to changes in risk appetite or concerns over US exposures.
  - Other reinsurers were more positive on portfolio re-underwriting and cautiously deployed more capacity.
- Lines were typically heavily leveraged against other lines of business.
- Pricing varied significantly based on mix of underlying exposures, progress in re-underwriting and the size of capacity sought.

Japan – Personal Accident

- Buyers took divergent views of Contagious Disease
  - Some dropped coverage to reduce premium spend
  - Others were able to complete placements that could only be partially placed at last renewal
- Several program were significantly restructured, and overall purchased market capacity fell
- Available capacity for Contagious Disease saw redistribution as a result of restructuring
  - Some additional capacity became available at the right price
- Supply of capacity was abundant, with existing and new players seeking to deploy at least their expiring capacity, and sometimes more

United States – General Third Party Liability

- Prior year development and future loss trends continued to complicate the view of go-forward profitability of the underlying market and as a result reinsurers continued to put pressure on treaty pricing
- Overall reinsurance capacity remained adequate and stable, although individual reinsurer capacity and appetite continues to evolve. Some reinsurers looked to selectively grow in segments (e.g. Excess E&S Casualty) while others looked to moderately reduce their positions
- Individual placement outcomes were highly dependent on cedents' transparency on strategy and disclosure of data, in around key battlegrounds such as view of rate adequacy, loss trends, claims trends, etc. Those that provided greater transparency and insight were able to achieve stable pricing and placement outcomes

Table 3: Casualty Rate Movements

Territory	Pro rata commission	Excess of Loss – no loss emergence % change	Excess of Loss – with loss emergence % change
Japan – Cyber	0%	0%	n/a
Japan – General Third Party Liability	n/a	+10% to +30%	+20% to +30%
Japan – Personal Accident	n/a	-10% to 0%	n/a
United States – General Third Party Liability	-1.5% to 0%	-5% to +5%	0% to +10%

Note: Movements are risk-adjusted.
Source: Gallagher Re

Specialty: Commentary by Line of Business

Aerospace

- Some degree of easing in the push for further rate increases was experienced; this was certainly the case in the primary to middle areas of excess of loss programs, where much of the heavy lifting has already been done.
- There was continued momentum for further rate increases in the catastrophe area as reinsurers pushed for further rate increases of +10% to +15%, dependent upon the degree of potential clash exposure within programs.
- A slightly greater degree of differentiation was evident in reinsurers' approach to pricing especially at the top end of programs.

Japan – Bond & Credit

- Reinsurers remained keen to grow in domestic business and tried to accommodate clients' requests.
- There were no significant structural changes, but some expansions in coverage and modest increases in limit were observed.
- Client differentiation was at the forefront of renewal negotiations, based on historical performance, current results, and demands.
- Reinsurer capacity for international exposures and medium-to-long-term business remained available, but was more selectively deployed to core multiline clients.
- The placement process was relatively slow compared to previous years but was ultimately smooth as markets remained cooperative.

Marine

- The market flat lined with at this renewal, with some ability to secure risk adjusted reductions.
- Capacity was plentiful with the exception of retro which is still dominated by a limited number of players
- Reinsurers remained keen to grow and/or protect their existing portfolio, given the historical profitability of marine and energy reinsurance.
- Pro rata commissions were very much dependent on the trend in original market, which varied dramatically across class

Table 4: Specialty Rate Movements

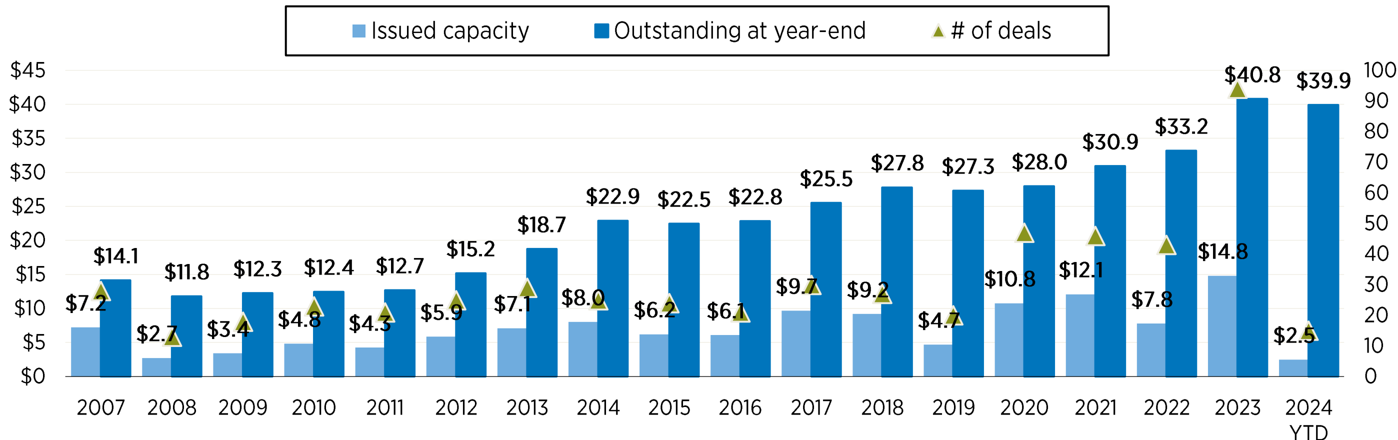
Line of Business	Pro rata commission	Risk loss-free % change	Risk loss-hit % change	Catastrophe loss-free % change	Catastrophe loss-hit % change
Aerospace	0%	0%	n/a	+10% to +15%	n/a
Japan – Bond & Credit	0%	n/a	n/a	n/a	n/a

Notes: Movements are risk-adjusted.
Source: Gallagher Re

Insurance Linked Securities (ILS)

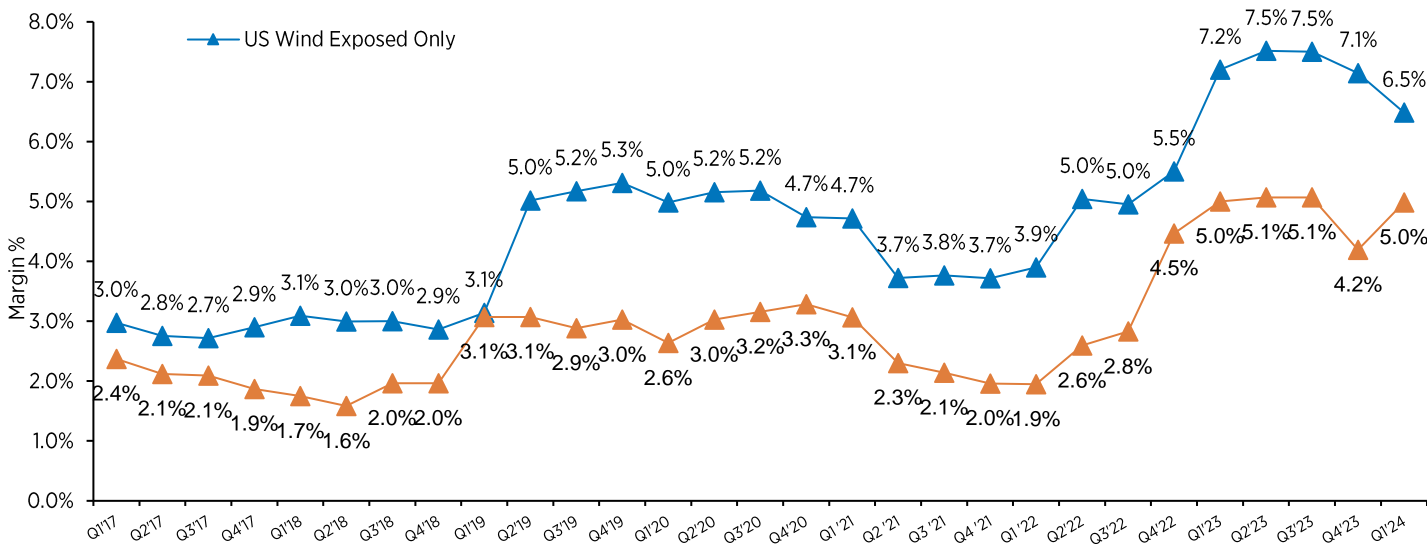
- Q1 saw a continuation of record setting cat bond activity across a range of perils, structures, and cedant types potentially setting up 2024 for a second consecutive record issuance year
- Cat bond risk spreads for most perils have declined 30% plus year-on-year but remain stable vs. Q4 2023 with growing capacity in dynamic balance with growing demand
- Cat bonds continue to grow relative share of ILS assets under management ("AUM")
- ILS investor returns for cat bonds, sidecars, and other products continue to benefit from benign loss activity and enhanced collateral yields vs. prior periods driving increased ILS AUM for both existing and new investors
- Q1 2024 also saw continued innovation most notably in cyber and also the first use of SOFR puttable IBRD Sustainable Notes as collateral

Table 5: Non-life Catastrophe Bond Capacity Issued and Outstanding by Year



Source: Settled cat bonds in the Gallagher Securities, Inc. Transaction Database as of March 20, 2024. Aggregate data exclude private ILS deals. All issuance amounts.

Table 6: Quarterly Weighted Average Margins for New Issue Cat Bonds on an LTM Basis



Source: Settled cat bonds in the Gallagher Securities Transaction Database as of March 20, 2024. Aggregate data exclude private ILS deals. LTM = Last 12 months. Aggregate are for primary issuances only and do not reflect secondary trading.

Table 7: Historical Index Return Comparison

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

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