Insight and Intelligence on the US and International (Re)insurance Markets

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Standalone terrorism market attracts greater interest as Tripra renewal looms

With the Terrorism Risk Insurance Program Reauthorization Act (Tripra) set to expire at the end of December 2020, conversations are already underway on a potential replacement, as the Reinsurance Association of America calls for a clean renewal, while insurers have begun adopting contingency plans for any possible disruption.

Though expiration remains a year away, insurers and reinsurers must begin preparing for renewals that incept after 1 January 2020, since those policies will be in effect after Tripra expires.

With rates and forms needing to be filed in advance of inception, international standards body ISO has dusted off policy language drafted in the run-up to the 2015 expiration.

According to the Insurance Information Institute, among the steps insurers are taking to prepare for the potential non-renewal of Tripra are the addition of contingent endorsements nullifying coverage in the absence of the act, contingent reinsurance arrangements, or provisions allowing insurers to cancel or non-renew policies should the program be terminated.

Insurers hedge with standalone covers

Preparations and contingency plans appear to be moving ahead more so in the primary space than the reinsurance market. Insurance buyers are lining up greater levels of standalone coverage as a hedge against a lapse in Tripra – often still referred to in the market as Tria.

"The standalone market has matured tremendously since 9/11," according to Aaron Davis, managing director of business development and national sales leader at Aon Risk Services.

"There was, in theory, only \$450mn to \$500mn in per risk/per client limit available and it was incredibly expensive. Now there is technically over \$3.5bn of outstanding terrorism capacity for property risks and it's a very competitive and profitable market," Davis explained.

That said, in the run-up to Tripra's renewal, capacity in the standalone market remains sought after and there is some time pressure to secure coverage before carriers fully deploy their aggregates.

Davis added: "The smart buyers are in early and they know they'll have competition for that capacity, and that competition will likely come with some very steep increases in pricing for standalone terrorism. We're not operating in a vacuum."

In the reinsurance market, it is business as usual.

"Given the fact that the program has been in place for almost two decades, [buying patterns are] relatively unchanged," said Aon Reinsurance Solutions' Ed Ryan.

"Insurers have grown accustomed to the situation as it exists and are comfortable with their net retention of the exposure under a combination of their traditional reinsurance and Tripra. There has not been a significant shift in buying practices in quite a few years now."

Among the (re)insurance community there is general support to renew the program under the expiring terms. While Congress has a history of reauthorizing the program late – in 2015 it lapsed for two weeks – hearings are already underway.

Earlier in October, the House Financial Services Committee held a hearing on the Tripra renewal, where Marsh's president and CEO John Doyle testified.

"There is a strong possibility that if the federal backstop ceases to exist, we could see a domino effect of increased pricing across multiple insurance lines, not just terrorism, with a likely result of major marketplace disruption. This trend will intensify beginning in January 2020," Doyle said.

Absent a clean renewal, among the Tripra variables that could change are the aggregate industry retention, individual insurer deductibles, insurer co-participations, the minimum loss threshold for a certified event, and the maximum limit available under the program.

Despite the potential for change, Ryan told

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AIG's reinsurance rethink

From around 2012 to 2015, the prevailing orthodoxy at the big global cedants was that they had been buying too much reinsurance.

Reinsurance purchasing, which had hitherto been piecemeal and local, was subsequently centralized through the use of intra-group reinsurance arrangements. With highly diversified risk pooled at group level, and backed by massive balance sheets, cedants judged that they could take bigger net bets, handing off only cat tail risk to reinsurers.

Liberty Mutual's annual cessions dropped by billions of dollars, Zurich too scaled its purchases back massively. And AIG's management team pushed the approach hard.

Taken alongside the increasing maturity of the ILS market and the structural reduction of cat reinsurance returns, the development prompted serious questions about the attractiveness and sustainability of the reinsurance market.

Could industry consolidation and pension fund money tip the reinsurance sector into long-term decline?

Berkshire Hathaway's decision to press into specialty insurance in a major way in 2013 – and its decision to back away from a takeover of either Swiss Re or Munich Re – were taken as signals of the malaise gripping the sector, along with a wave of Bermudians selling out over the following 18 months.

The picture in 2019 looks very different.

Zurich and AIG effectively tested to destruction the net underwriting model, with investors clearly signaling a preference for stable earnings over maximizing cross-cycle dollar earnings.

And the ostensibly unstoppable march of ILS has at least been checked by loss activity, which has tested collateralized structures and demonstrated their limitations versus rated balance sheets.

AIG stands as a case study in the change in reinsurance buying philosophy, with group CEO Brian Duperreault and general insurance CEO Peter Zaffino embracing the value proposition of the reinsurance market.

Despite its monster balance sheet, AIG's new leadership has set about a process of de-risking its P&C portfolio and dampening volatility by hedging exposures. This has gone hand in glove with a radical remediation of its inwards portfolio, which has seen maximum line sizes cut, a move towards higher layers, a rebalancing away from the largest clients and a determined drive on pricing.

The new ethos was applied first to AIG's property portfolio, with the catastrophe reinsurance program restructured at the start of 2018. This was followed by the purchase of two major new casualty treaties in the fourth quarter of last year.

AIG called a request for proposal in the summer, with the big three brokers asked to pitch reinsurance solutions for its $4bn financial and professional lines portfolio, the jewel in the crown of its P&C business.

Since then, there has been almost radio silence from AIG, with the company playing its cards very close to its chest.

We still expect the insurer, via some combination of the big three brokers, to bring a number of new covers to the market in the fourth quarter. The question – besides the exact broker line-up – is whether or not excess-of-loss towers will be supplemented by a quota share.

The balancing act for AIG is to find structures that allow it to secure the reduction in volatility it wants without ceding away too much profit from what has been its best-performing book of business.

Whether or not AIG provides additional clarity in its meetings at APCIA, or that is held back until later in the year, we expect this significant additional new demand to make AIG's reinsurance buying one of the most talked about topics at the conference for the second year in a row.

Regardless of the details, which will come in time, the approach looks consistent with what we have seen elsewhere from AIG, and will come as a further endorsement of reinsurance as a tool for managing volatility, protecting capital and providing a second set of eyes on underwriting.

What a change a few years makes.

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The Insurance Insider: "I think there is a good chance there will not be significant, if any, changes to the act as it is currently constituted and it's just about the timing."

The broker described the early move from the House to put together a resolution as "a pleasant surprise", although he forecast the Senate would act more slowly.

Reinsurance opinion divided

While market commentary would suggest broad support for the renewal of Tripra, not all in the private sector are aligned. Some take a more critical view, believing the act crowds out private market capacity.

As one source put it: "Some folks like free reinsurance from the federal government, where other parties that provide reinsurance for a premium don't like the federal government providing it.

"Having said that, its existence does provide a functioning market that might not otherwise exist and therefore does provide some opportunities for the reinsurance market to assume risk and make a return on that assumption."

The source went on to say that in some ways, the existence of Tripra has limited the development of a private sector solution.

"There is a significant amount of terrorism reinsurance capacity afforded under traditional [property reinsurance treaties] right now. There is not, however, a huge standalone terrorism reinsurance market and that is because there is a reliance on the federal backstop."

The expiration of Tripra is on AM Best's radar, with the rating agency monitoring the capital position of companies believed to be too reliant on the federal backstop. Ahead of the last Tripra renewal, AM Best flagged roughly 30 companies it considered to be overly dependent on Tripra as a source of reinsurance. These carriers are thought to be smaller casualty and workers' compensation insurers, many of which have now largely addressed the concerns raised through facultative reinsurance and similar solutions.

Under the Tripra program, carriers are required to make terrorism insurance available and explicitly state the additional premium charged for such coverage.

As the program is currently structured, Tripra recoveries kick in above a $200mn industry loss.

Lumen Re

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Catastrophe claims hit (re)insurers' Q3 results

Early disclosures from various P&C (re)insurers have highlighted how catastrophe losses have hit third-quarter results, with some industry loss estimates from carriers tracking slightly higher than those issued by the major risk modelers.

Although the third-quarter 2019 reporting season is yet to get truly underway, several major P&C players have already pre-disclosed loss estimates for catastrophe claims during the three-month stretch.

Hurricane Dorian and Typhoon Faxai are the two events behind the bulk of the losses, according to the companies that have so far revealed third-quarter catastrophe loss estimates.

Dorian was the first significant storm of the 2019 North Atlantic hurricane season. It wreaked havoc across the Caribbean, including the Bahamas and Abaco Islands, before making landfall on 6 September over Cape Hatteras, North Carolina as a Category 1 hurricane.

Faxai was one of the strongest typhoons on record in the region, making landfall on 9 September in Japan as a Category 2 hurricane.

In early September, AIR Worldwide predicted that insured losses in the Caribbean resulting from Dorian would range from $1.5bn to $3bn.

For Faxai, AIR said insured losses would total between $5bn and $9bn.

RMS pegged insured losses in the Caribbean from Dorian at $3.5bn to $6.5bn. As RMS explained at the time, the vast majority of (re)insurers' exposure to Dorian will come from the Bahamas, in particular the islands of Grand Bahama and Abaco.

The risk modeler believes insured losses for Faxai will range from $5bn to $9bn.

Karen Clark & Company's (KCC's) own Caribbean insured loss estimate for Dorian came in at $3.6bn.

Including the US, the US Virgin Islands and Puerto Rico, KCC's estimate for Dorian increases to $5.2bn.

During the Monte Carlo *Rendez-Vous de Septembre*, an industry consensus developed around an insured loss range of $3bn to $5bn for Dorian.

However, various (re)insurers that have now reported loss estimates for Hurricane Dorian and Typhoon Faxai are based on industry loss predictions that are in fact higher than those put forward by AIR, RMS and KCC.

Axis has revealed it is expecting to take a $150mn to $175mn hit to its third-quarter results from natural catastrophes.

As the (re)insurer explained, the range is before tax and net of estimated reinsurance recoveries.

"RMS pegged insured losses in the Caribbean from Dorian at $3.5bn to $6.5bn. As RMS explained at the time, the vast majority of (re)insurers' exposure to Dorian will come from the Bahamas, in particular the islands of Grand Bahama and Abaco"

Axis' third-quarter 2019 catastrophe loss estimate includes claims that have arisen from Dorian, Japanese typhoons and other weather-related events that arose during the period.

These figures, Axis explained, are based on (re)insurance industry losses of approximately $6bn from Dorian and $8bn for the typhoons that hit Japan.

Everest Re's third-quarter catastrophe exposure is estimated to be in the region of $280mn, before tax. The majority of that will come from Dorian and Faxai, the company disclosed.

At $160mn, Dorian is expected to have the larger impact to Everest Re's results, with Faxai accounting for some $120mn. Both estimates are net of reinsurance, retrocession and reinstatement premiums.

Everest Re's loss estimates are based on industry insured loss estimates of $8.5bn for Dorian and $9bn for Faxai.

RenaissanceRe predicts its third-quarter results will include natural catastrophe losses of $155mn, mainly from Dorian and Faxai, with the former representing $55mn and the latter $100mn.

The estimates are before tax and net of reinsurance recoveries.

Arch has also disclosed a catastrophe loss number for the third quarter. The Bermudian (re)insurer revealed it is facing between $65mn and $75mn of catastrophe losses during the three months to 30 September.

As Arch explained, the final loss figure may differ from that $65mn to $75mn range, which is before tax, net of reinsurance recoveries and reinstatement premiums.

Away from the major Bermudian players, Floridian carrier FedNat incurred $11mn of gross catastrophe losses during the third quarter of 2019.

Most of that catastrophe exposure comes from Dorian, while Hurricane Barry and Tropical Storm Imelda also resulted in losses for the business.

United Insurance Holdings has disclosed Q3 natural catastrophe losses of roughly $46mn, before tax.

The figure stems from retained catastrophe losses from Dorian, Barry and Imelda, and increased retention from non-tropical events related to the company's aggregate reinsurance program.

Dorian and Faxai cat losses

Firm	Date	Low	High	Notes
Arch	07-Oct	$65mn	$75mn	Primarily from Hurricane Dorian and Typhoon Faxai, and pre-tax, net of reinsurance recoveries and reinstatement premiums
Axis	10-Oct	$150mn	$175mn	From Dorian, Japanese typhoons and other weather events, net of estimated recoveries from reinsurance and retrocessional covers, and including the impact of estimated reinstatement premiums
Everest Re	15-Oct		$280mn	From Hurricane Dorian and Typhoon Faxai, and pre-tax, net of reinsurance recoveries and reinstatement premiums
RenRe	15-Oct		$155mn	From Hurricane Dorian and Typhoon Faxai, pre-tax and net of reinsurance recoveries

Source: *Inside P&C*


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Reinsurance and retro pricing differential 'has to give', Bredahl says

The significant pricing differential currently at play within the reinsurance and retrocession markets "doesn't make a lot of sense" and "something has to give".

That is the view of TigerRisk's newly arrived president Rob Bredahl, who told *The Insurance Insider* "there seems to be a disparity between price movement in the reinsurance market versus the retro market".

"We've been scratching our heads, and think that the difference between two such closely aligned markets doesn't make a lot of sense. Something has to give," Bredahl said.

The availability of retro coverage has become increasingly tight, with trapped capital and the withdrawal of capacity combining to push up pricing in the sector. At the same time, the market has been hit with losses. As Bredahl noted, "most retro programs were impacted somehow over the last three years" with hurricanes Harvey, Irma and Maria in 2017, Hurricane Michael and Typhoon Jebi in 2018, as well as successive years of wildlife losses in California, among other events.

There is an expectation in the market that retro pricing could be up by 25 percent at the upcoming renewal. But when it comes to expectations with regard to reinsurance, the anticipated price increases are far lower. Non-loss-affected accounts may renew flat, and loss-impacted programs could renew up 5 percent.

"My view on reinsurance pricing is it's going to increase a bit more through 2020 than what I think the consensus is, especially as the impact of Hagibis is fully considered," said Bredahl.

A segment that is seeing considerable pricing disruption is excess and surplus (E&S) lines. Bredahl described the E&S property catastrophe-exposed sector as "one of the tightest markets around".

"Several MGAs and others are looking for property E&S capacity, and it is difficult to find. There is plenty of reinsurance capacity for the exposure up to the 1-in-250-year return period, but it is difficult to find a home for the tail risk – the exposure beyond that 1-in-250-year return and total TIVs," said Bredahl.

That property cat-exposed E&S space is seeing pricing increase by as much as 5 percent each month, Bredahl noted.

"Although it is hard to separate out expected attritional losses, I think a unit of cat risk might be most attractively priced in the E&S market right now," he added.

"My view on reinsurance pricing is it's going to increase a bit more through 2020 than what I think the consensus is, especially as the impact of Hagibis is fully considered"

"The market is talking about [renewals being] flat to up 5 percent for loss-affected business, and while I don't think it'll be up 20 percent, I think it'll be a little tougher than that, especially given Typhoon Hagibis and current wildfire activity.

"This is the sort of market where reinsurance brokers will be tested and where we will see a separation in performance between the truly good and the not so good."

While hurricanes, typhoons and wildfires have been fueling pricing on the property reinsurance market, there is increasing pressure on the casualty side of the industry too.

Bredahl describes the casualty market as "fragile".

"We haven't seen a huge across-the-board price movement yet, but there's lots of worry out there. Lots of talk about social inflation, the opioid crisis and revisionism," said Bredahl.

"We're seeing rate movement on the primary side across most casualty lines. Medmal, other lines of professional liability, workers' compensation pricing has bottomed out and we're thinking it's going to bounce up," he added.

Two of the casualty lines garnering much of the industry's attention at present are commercial auto and medical malpractice, or medmal.

"Commercial auto, and specifically trucks, has seen significant rate increases for multiple years now. Everybody has wondered for years whether it's enough, and I see and hear about a number of reinsurers jumping back into trucking.

Medmal is another line that has been underperforming and where there have been big price increases. But again, is it enough?"

There are, however, rate increases and adjustments in both the primary and reinsurance casualty markets, and Bredahl speculated whether these might just be covering loss cost trends.

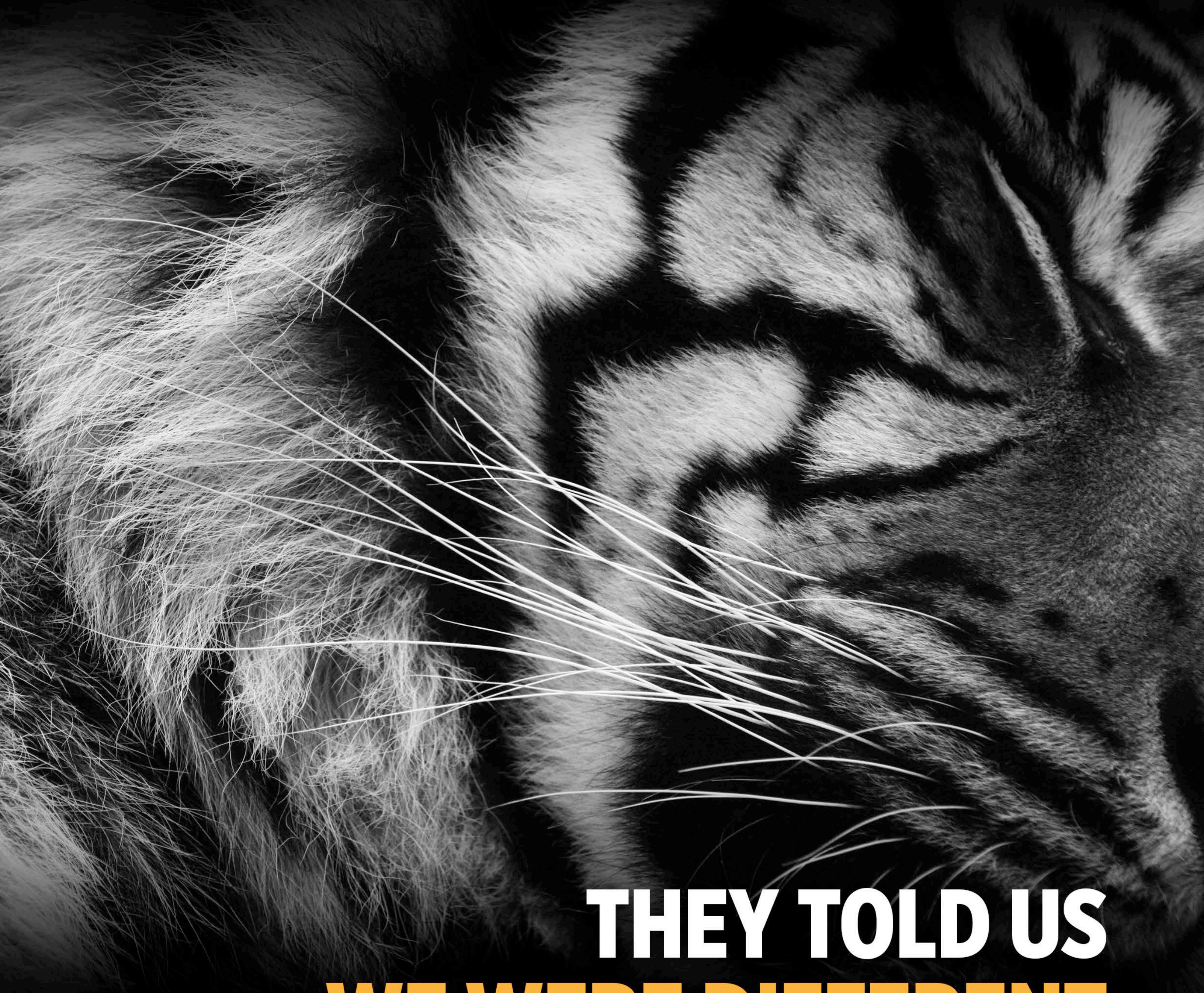
The recent spike in the frequency and severity of casualty losses impacting the primary insurance market has led to increased interest in the purchase of reinsurance to help manage exposure.

"There's no doubt there's increased appetite right now for casualty reinsurance," said Bredahl.

Bredahl said this interest has manifested itself in various ways, and one of those has been increased appetite for reserve covers – products that protect casualty reserves from previous years.

"We're also seeing incremental casualty buys," Bredahl stated.

"There is a noticeable increase in interest in aggregate stop loss covers and other forms of volatility covers versus pure quota shares. Across the casualty segment, there are more companies exploring possibly increasing their purchases, although we'll see whether they actually buy."



InsurTech could be set for 'wave of IPOs', foresees Munich Re's Rear

InsurTech could be set for a "wave of IPOs" as the largest technology businesses gain scale, Andrew Rear, the chief executive of Munich Re Digital Partners, has predicted.

Speaking to *The Insurance Insider*, Rear said that a series of public offerings by some of the most successful InsurTechs may "not be far away".

His comments came shortly before Munich Re raised the curtain on its latest $250mn investment, in small business underwriter Next Insurance.

Rear, who joined Munich Re in 2010 as head of life insurance for the UK, Ireland, Australia and South Africa, defended the model of InsurTech businesses remaining as MGAs for as long as possible.

Bought By Many and Next Insurance, two of the companies in Munich Re Digital Partners' portfolio, have followed that model.

The executive, who became CEO of Munich Re Digital Partners in May 2016, explained that operating an MGA gives a start-up a choice of exit routes – selling the business to a broker, a carrier or going public.

A number of the largest and best-known InsurTech businesses including Lemonade, Root, Metromile and, most recently, Kin Insurance, have gone full-stack, meaning they have set up balance sheet insurers.

"Post-IPO really big exits will be to a carrier," Rear said.

Undertaking a public offering before being acquired is a well-worn path for InsurTech businesses. Long before the phrase InsurTech was even invented, listed online broker Esurance was acquired by Allstate in 2011 for $1bn.

RMS, which could be described as the grandfather of the 21st century InsurTech industry, was acquired by the Daily Mail & General Trust for $210mn in 1998.

Existing stock exchange-listed insurance tech companies include Guidewire and Sapiens, which trade on the NYSE and Nasdaq respectively.

"If you IPO, having a balance sheet can be helpful," said Rear, although he noted that it can be easier to attract a tech company valuation if you are a capital-light MGA.

Next Insurance is one company that has taken the hybrid approach. Next operates as an MGA, writing on Munich Re paper. Earlier this month, the German reinsurer invested $250mn in the Palo Alto, California-based small business insurer in return for around a 27.5 percent stake. Although Next owns its own Delaware-based insurance carrier, it places around 90 percent of its business as an MGA.

Munich Re's justification for the Next investment, at a valuation in excess of $1bn, is that the business offers what the German reinsurer's chairman, Joachim Wenning, described as "outstanding growth opportunities" in the $139bn US small and medium-sized commercial insurance market.

The funding for the deal came from the Munich Re group itself, adding an instant $250mn injection to the InsurTech's balance sheet.

One of the secrets of Next's ability to attract venture funding – it has raised $381mn to date – is the way the InsurTech uses AI.

This publication understands that Next uses AI analytics in its marketing and lead generation, as well as its underwriting engine.

AI attracts funding

On the underwriting side, Next is able to automatically search for court filings relating to individuals. In doing so, it can determine whether potential insureds have ever been sued.

Using external data is a key part of many InsurTechs' underwriting process, and other Munich Re-affiliated companies, such as Hippo Insurance, have been working with the reinsurer on how it can embrace it as well.

Next competes directly with well-funded initiatives by incumbents in the small and medium-sized business insurance sector including AIG, Two Sigma, Hamilton-backed MGA Attune, and Berkshire Hathaway's Three.

But, unlike Attune and Three, Next's main distribution channel is direct to consumer rather than through agents. Next has long viewed itself as force for evolution rather than total disruption however, and the company has now opened up its platform to brokers looking for a simple way to place small business risks.

Underwriting companies are only one piece of the InsurTech jigsaw. Many tech companies are building businesses that look to sell software and services to insurers. Rear is bearish about the outlook for start-ups that bill themselves on their ability to deploy technology to help insurers.

He said it was tough for start-ups without their own proprietary data to make headway with carriers.

"Doing AI without data is really difficult," he said.

He offered one cautionary tale about an unnamed AI business that did a proof of concept with Munich Re Digital Partners. He said he got "very excited" by the firm and gave them a book of premiums and claims data to work through. Munich Re's own data science team were ultimately unimpressed by the InsurTech's output.

Rear explains that the experience taught him that he needed to learn more about AI to better select companies that could be truly additive to the Bavarian reinsurer's bottom line.

Rear said that machine learning has now become a commodity. You can buy both the computing power required to use AI in problem-solving and the AI capability itself from the likes of Google, Amazon and Microsoft.

"Those skills are a commodity," he stated.

Rear said that many so-called AI start-ups are simply consultancy outfits and should be valued as advisory firms rather than at the often staggering multiples tech start-ups have merited.

Rear also sees huge potential for tech-driven efficiencies in the back office. It will be hard for start-ups to immediately dislodge incumbent tech providers such as Guidewire though, owing to a reticence in the boardroom to entrust a major project such as the implementation of a major policy administration system to a relatively new player.

Andrew Rear
CEO, Munich Re Digital Partners

RMS Models and Analytics can Identify Your Business Risk.

There's a growing need to quantify the impact that climate change will have on your business – today and over time. With regulators starting to scrutinize how climate change will affect your book of business, investors and stakeholders will also soon be asking questions. RMS can help you assess your business's climate change risk. Using advanced modeling and analytics, we can answer your questions on how climate change may be affecting your business today. And help inform your strategy by quantifying the risks and uncertainties of climate change in the future.

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Maintaining momentum

Odyssey Group president and CEO Brian Young explains why discipline will be a key feature of the 1 January renewals for primary carriers, reinsurers and ILS players alike

What are your takeaways thus far in 2019?

I did not expect insurance markets to firm as much they have, especially in North America, and the pace of improvement is accelerating, which is great to see. I was in Germany in July and even industrial fire business there, which has long suffered from intense competition, is showing meaningful signs of improvement. A common refrain we hear, "pushing the market", is the contraction in capacity from many carriers.

On the flipside, the reinsurance market response continues to be disappointing. In most parts of the world, reinsurance rates are flat to down, and commission levels remain stubbornly high. Reinsurance rates have not moved nearly enough to address the loss activity of 2017 and 2018, or the significant rate erosion during the last decade or a casualty claim pipeline that is bursting at the seams. Getting a 25 percent increase on one third of a loss-affected cat placement up for renewal provides little solace, especially when the rate has more than halved over the last decade and reinsurers' retro costs have spiked. And with commission levels generally running in the mid-30s for all but the most distressed business, reinsurers will continue to struggle to generate adequate margins on proportional business.

One positive on the reinsurance side is the increased demand from buyers to purchase more cover. We started to see it in the second half of 2018 and it has continued in 2019. The increased opportunity is a pleasing development at a time when original prices are moving in a positive direction.

What are your expectations for the 1 January renewal, in the absence of any material loss events between now and year-end?

Insurance markets should continue to firm in 2020. I do not anticipate that the renewed pricing and capacity discipline that we are seeing from insurers will change anytime soon.

Reinsurers will benefit from rising insurance pricing on proportional contracts, and commission levels should continue to trend down, especially where experience warrants a reduction.

Excess of loss pricing will be subject to increasing discipline, but whether this translates to higher prices will depend on individual account circumstances. Clean business should expect a flat risk-adjusted renewal, and any account with losses during the last few years should anticipate paying more again in 2020.

> "The reinsurance market response continues to be disappointing. In most parts of the world, reinsurance rates are flat to down, and commission levels remain stubbornly high"

We have seen an increase in the demand for aggregate covers the last few years. These structures have increasingly become more complex in scope. In my view, these will get harder to place as reinsurers and the ILS market push terms, exercise more discipline and show greater appetite for simpler risk- or event-based structures.

How much of a factor will ILS play in the 2020 renewal cycle?

Retro capacity has become more precious and certainly more expensive the last two years. While a low interest rate environment will continue to draw capacity to the sector, the days of cheap retro are over, at least for the next few renewal cycles. This should introduce more pricing discipline into cat business and will force some reinsurers to adjust their risk appetites.

Odyssey Group has had an exceptional run in recent years and even managed to generate underwriting profits in 2017 and 2018 when few peers did. What are the key factors driving your success?

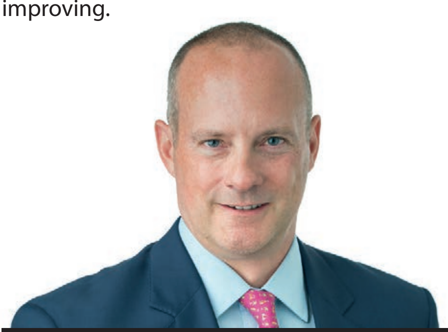
It helps to be a little lucky, and we have had our fair share of good fortune in recent years. As a group, we pride ourselves on the stability of our workforce and the consistency of our underwriting and claims handling. Discipline is embedded in our culture across our three platforms – OdysseyRe, Hudson and Newline – and embraced by a leadership team that has remained largely intact for two decades. Not having to answer to new masters every few years has allowed us to maintain our discipline and manage the business for the long term.

The focus on diversifying risk has been a key factor in our growth in recent years, but it has also played an instrumental role in helping us to generate underwriting profits the last two years in spite of the abnormally high level of cat activity. Our underwriting success in 2017 was driven by a 91.9 percent combined ratio in our Hudson and Newline insurance operations. In 2018, it was our reinsurance operation that delivered exceptional results, producing a market-beating combined ratio of 89.9 percent. Our results the last two years are a convincing display of the value of Odyssey Group's portfolio diversification.

Odyssey Group has grown significantly in the last few years. What have been the main drivers?

As I said earlier, diversification has played a huge role in our growth the last few years. Across our three platforms and 36 profit centers, our top line has expanded 40 percent from \$2.4bn in 2016 to \$3.3bn in 2018. Through the first six months of 2019, our top line is up an additional 10 percent and our new business pipeline remains solid.

The primary areas of growth have been in specialty lines, most notably in crop, motor, health, credit, affinity and cyber. We have also been growing selectively in property and casualty where results have been solid and/or where pricing and terms have been improving.



Brian D Young
President and CEO, Odyssey Group

PRICING, CAPITAL LEVELS AND 2020 RENEWALS

Presuming we're over the worst of this year's North Atlantic hurricane season, what do you think pricing will look like for US property catastrophe business in 2020?

Justin O'Keefe, RenaissanceRe: The result of these recent losses is that our risk profile has increased, which requires us to use more capital per unit of risk we assume. This has resulted in the need for increased premium per unit of exposure in order to keep margins the same year over year. Combined with our belief that margins have been inadequate in recent years, this has created a compounding impact that requires increased premium to maintain returns that are suitable for investors over the long term. We have seen material changes in rate within specific loss-impacted regions and perils such as California wildfire. However, it has yet to be seen how the reinsurance market will respond in 2020 on a broader portfolio basis.

The interesting dynamic in the current reinsurance market is that changes seem to be coming both from the top down and bottom up. Property insurance pricing – specifically cat-exposed US rates – are increasing and we are seeing material increases in retrocessional property prices. This will ultimately have an impact on reinsurance pricing but the big question going into 1 January is what the extent of that change may be. Across a variety of insurance and reinsurance lines, we're seeing better terms and conditions. There are a few markets which are hard, however it's certainly not a hard marketplace.

John Trace, Guy Carpenter: Without commenting on the specifics of forward-looking market pricing, mid-year renewals in 2019 have confirmed that underwriting is alive and well, as adjustments were made to various segments of the market. These adjustments were not one-size-fits-all, as it is clear that the industry's ability and willingness to focus on individual client needs, custom solutions and differentiated renewal strategies have never been stronger.

Renewals experienced a wide range of differentiated outcomes depending on characteristics such as drivers of loss activity, company performance and geographic considerations. Looking at an area that was impacted by recent loss activity and loss creep as a specific example, Florida risk-adjusted pricing outcomes in 2019 produced one of the broadest ranges of price change that Guy Carpenter has tracked for a single region. We expect to continue to see highly bespoke renewal results based on the merits of each programme.

While there was a wide range of outcomes on individual accounts in 2019, the US property catastrophe rate-on-line index for January through July renewals overall was up approximately 3 percent year on year. Wind and wildfire exposed programmes played a prominent role in driving the index up as they experienced upward rate pressure. Much of mid-year renewal activity elsewhere was generally flat.

Jason Busti, Axis Re: The global reinsurance industry continues to produce returns that are unsustainable – not just in catastrophe lines and not just in the US. Profitability across the industry needs to improve and, as an industry, we need to take action.

Losses arising from heightened storm activity in the Atlantic and elsewhere over the past several years have reinforced inadequate pricing relative to the risks that the sector bears. At the same time, certain industry conditions underline the fact that pricing must rise.

For example, many third-party capital providers continue to have capital trapped following the catastrophes of 2017 and 2018, which has caused a supply squeeze in some areas, particularly for US property cat retro.

Another factor is that very few reinsurers can expect to rely on prior-year reserve releases, as some have in the past, to offset rate inadequacy. In 2020, prices should continue to increase.

How has the ILS market's attitude to US property catastrophe business changed in the last 12 months?

James Doona, Munich Re America: The 2017-18 loss events and the subsequent loss creep have resulted in investor concerns regarding trapped collateral. As a result, some market participants were forced to reshuffle their ILS investments to generate liquidity, especially for redemptions.

At the same time, some investors have expressed reluctance to support renewing deals at expiring levels, putting upward pressure on spreads, and falling prices have been giving rise to opportunistic purchases in the secondary markets. Given uncertainty in the markets, issuance activity in 2019 has been limited so far, but conditions may change as the hurricane season has remained relatively benign. Despite the disruption, we expect continued moderate growth and persistence in long-term investor appetite. Emerging loss scenarios, such as wildfire and flood, are interesting areas of expansion for the ILS market, although vendor model development has lagged the desire for innovative covers.

O'Keefe: Capacity is down, capital is lost or locked up, and expected returns are below required. Capital in the ILS market is down for only the second time in 17 years. ILS capacity tends to want to find those managers with proven track records and there is a clear flight to quality. ILS capital is still there to support risk, however it's definitely requiring a higher expected rate of return and seems to be sitting on the sidelines waiting for proof that those returns will exist – and are very willing to walk away if they do not.

Trace: The magnitude of loss development from wind events in Asia and the US, more recent catastrophe losses, ongoing concern regarding potential climate change effect on future losses and a greater awareness of the impact of the "unknown", have contributed to a slowing of the influx of alternative capital into the reinsurance space. In the first half of 2018, $10.5bn of new ILS reinsurance capital entered the market; in the first half of 2019, this number fell to $4.8bn.

However, it is important to note that overall capital levels remain fairly stable. While alternative capital was down slightly through mid-year 2019, traditional capital actually increased by 1.5 percent for an overall increase in total dedicated reinsurance capital of roughly 0.5 percent as calculated jointly by Guy Carpenter and AM Best. As underwriters and investors reshaped their underwriting assumptions, pricing and capacity allocation was impacted for certain perils and geographies. We saw evidence of this as capacity for mid-year 2019 risks tightened significantly, a notable reversal from mid-year 2018 renewals, where excess unsigned capacity hit record highs.

In particular, US excess property catastrophe capacity fell to 13 percent from 28 percent a year ago, with hurricane and wildfire risks seeing the most impact from reinsurers' willingness to pull back capacity.

Busti: Given the retro supply shortage, pricing has improved, and investor appetite for well-modelled cat risk does not seem to be contracting. That said, some investors are enduring trapped capital, which means their principal will be inaccessible until losses arising from severe storms in prior years are settled. That has led to a somewhat more conservative approach on the part of some investors. But the trapped capital problem is sometimes floated as an excuse for ILS reluctance. In simple terms, current market returns are inadequate to encourage many potential and even past ILS investors to put their cash on the table, because prices remain too low.

The primary casualty market's performance has continued to deteriorate in 2019. How will this impact the 1 January reinsurance renewals?

Trace: Reinsurers will price each specific renewal based on their own merits and the results of those individual treaties. We do not expect to see a retraction in capacity for primary casualty either, but in fact expect to see reinsurers begin to look to expand as primary market rates continue to increase.

Busti: Despite improvements in primary casualty, the entire market should be pushing for significant rate increases. Primary markets will continue to drive rates and terms, and reinsurers need to do their part. The current environment is not sustainable, but it is at least moving in the right direction – more quickly for some lines than others. Rates in some casualty lines may seem to be rising ahead of loss trends, but that doesn't mean we are close to achieving adequate price levels. Nor does it mean that the prices charged will prove adequate down the line, when claims are ultimately settled. Casualty is difficult, since you can never really know what's coming, and the pacing of loss trends is always subject to a great deal of uncertainty, given the complex and long-tail nature of the risks. So casualty reinsurance specifically has a long way to go.

Exacerbating that uncertainty is the sustained backdrop of extremely low interest rates and the continuous rise in settlement levels (including the occasional unexpected "nuclear verdict").

Gerry Skalka, Munich Re America: While poor industry-wide commercial auto results have persisted for several years, adverse developments in other commercial liability segments were less evident or acknowledged broadly prior to this year. With 2019 quarterly earnings reports, as well as other public statements, the (re)insurance markets on a much broader and consistent basis have acknowledged the uncertainty and increasing loss trend emerging from prior accident years.

The effects of these trends in the insurance space are already evident in the market. Company decisions to withdraw or reduce capacity in certain segments (e.g. E&S risks), a more consistent movement upward of rates being charged across lines of business and risk classes, and a re-underwriting within certain companies resulting in a clearer distinction between standard and non-standard risks are a few of examples of change in 2019. We expect this trend to continue in 2020.

From a reinsurance perspective, while the market has remained competitive overall, a similar transition has been occurring in 2019. The general trend of increasing ceding commissions on proportional business abated last year. Progressing through 2019, reductions in ceding commissions, where warranted, are being quoted and accepted by the markets. Similarly, reduced share authorisations and higher rates on excess-of-loss covers, in recognition of volatility stemming from uncertainty in loss trends, are further evidence that reinsurers are beginning to restore profitability to more adequate levels.

Risk awareness of responsible reinsurers, further influenced by the impact of "social inflation" trends that have resulted in higher loss severity and added uncertainty in commercial liability, will increasingly drive discipline in reinsurer decisions. Other factors that will contribute to a disciplined and firming reinsurance market are the impact that a low interest rate environment has on expected returns, lower expected profitability of workers compensation from multiple years of loss cost decreases, and the adequacy of current reserve levels across all casualty lines.

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Private brokers: What lurks beneath the tip of the iceberg?

Insurance brokerage is a booming industry. Aided by strong economic fundamentals and industry-specific trends, the sector has enjoyed a decade of tailwinds at its back.

Our predominant view into the broking sector is through large public broker reports, but this space is only the tip of the iceberg. The majority of the industry's revenue is still generated by the smaller agents and brokers.

Far less attention is paid to where the non-public brokers stand relative to their larger public peers. This report is intended to partially fill the gap by delving into operating results of the next 12 largest brokers by revenue, where financial data is available (courtesy of Moody's credit reports), and which we collectively refer to as "non-public" or "private" brokers.

The takeaways are that the second tier of brokers below the big five public firms are:

- Growing more aggressively, largely through acquiring smaller brokers and agents and allowing them operate fairly autonomously.
- Supporting tight M&A pipelines through debt-financing that leads to substantially higher financial leverage relative to public peers.
- Showing organic growth figures that are generally analogous to those reported by the public brokers.
- Are roughly as efficient as the public peers on Ebitda profitability basis, but fall short on net earnings basis.

However, two key questions remain for us.

First, the extent to which Ebitda margins are currently being supported by a lack of integration work, which may be contributing to deferred maintenance costs for potential future owners.

Second, the level of leverage and lack of bottom line profitability raises questions about the sustainability of the model should operating conditions become less benign.

It may not be the hardest of markets, but the insurance brokerage business is undeniably enjoying excellent operating conditions.The peer group has been firing on all cylinders the last several years on nearly every meaningful financial metric – profits, margins, growth, valuation, etc.

While the current economic expansion has provided a strong foundation that has allowed the brokerage business to thrive, strong macroeconomic conditions – such as multi-decade low unemployment and rising consumer disposable income – are only a small part of the story.

The longest global economic expansion in history has been in part fueled by easy money globally, which has led to a spike in all kinds of asset prices to historical highs. More expensive land, real estate, equipment, workforce and technology in turn contribute to exposure growth and a greater incentive for individuals and businesses to re-evaluate insurance needs.

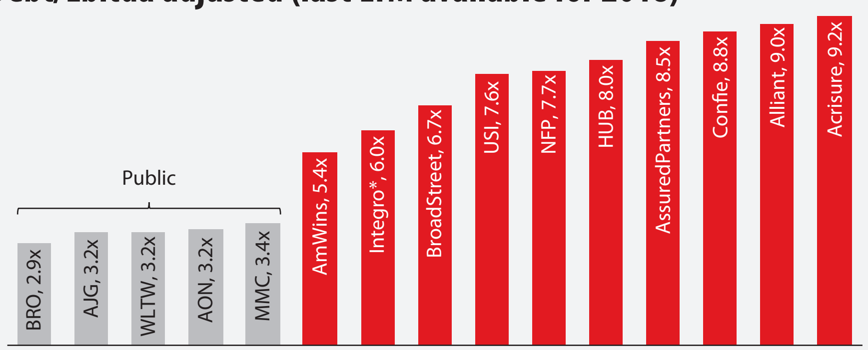
A popular thesis in the insurance industry is that brokers will become disintermediated due to the rise of technology and more efficient forms of risk transfer. Instead, what has been observed is that corporates' increasingly entangled risk profiles have reinforced brokers' position in the supply chain as insurance and professional advice are now increasingly difficult to detach.

Large broker CEOs of past and present would agree, believing the threat of disintermediation to be at its lowest in quite some time.

At the same time, the multi-decade consolidation trend of the industry shows little signs of slowing. For years, broker concentration has meant more power lying in fewer sets of hands, which has led to greater pricing pressure and eroded margins for carriers. Add to that a more recent tailwind – the acceleration in insurance pricing – and we get a highly favorable environment.

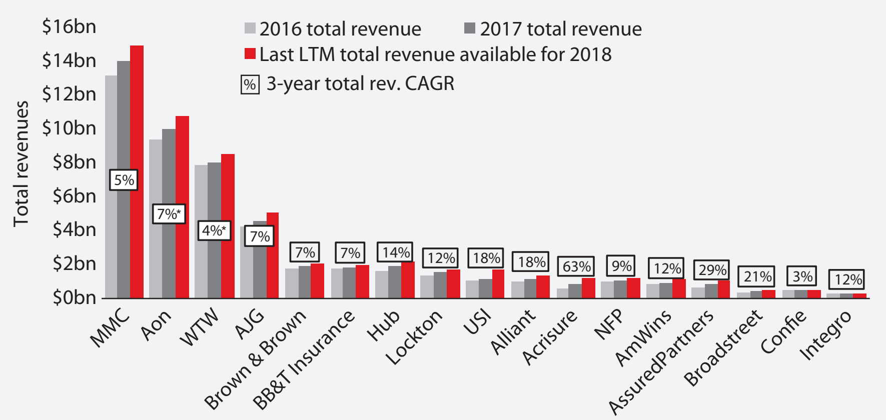
This is an executive summary of a longer form article published on 30 September. For more details see www.insidepandc.com

Debt/Ebitda adjusted (last LTM available for 2018)



*Pro forma following US business divestiture and related debt reduction per Moody's. LTM = last 12 months
Source: Company reports, Moody's Investors Service, *Inside P&C*

Total revenue and 3-year CAGR for largest insurance brokers



*2-year total revenue CAGR is shown to eliminate large divestiture effect (Aon) and capture only growth since merger (WTW)
Source: Company reports, S&P Global, Moody's Investors Service, *Inside P&C*

Aviation reinsurers quote double-digit rate rises as losses crystallize

Reinsurers are pushing for rate hikes in the aviation market as the final cost of 2019 claims, including the global grounding of Boeing's 737 Max aircraft, becomes increasingly clear.

The reinsurance market has quoted increases of between 10 percent and 20 percent at third-quarter renewals as aviation claims crystallize, according to Capsicum Re.

Writing in AJ Gallagher (AJG)'s third-quarter Plane Talking report, Capsicum Re partner Jenan Nakeeb said increased clarity over loss costs had led reinsurers to expect meaningful rate rises.

"Sentiment in the reinsurance market supports the upwards pricing momentum, so it is likely that 1 October programs will be quoted with increases in the range of 10 percent to 20 percent," she said.

Reinsurers are quoting the most significant rate hikes for at least five years following public loss disclosures by a number of carriers.

In July, PartnerRe said it had taken a charge of $39mn stemming from the crash of Ethiopian Airlines flight 302 and the subsequent grounding of Boeing's 737 Max aircraft.

This came after an Allianz Global Corporate & Specialty executive revealed in May that the carrier expected to absorb a maximum of EUR150mn ($165.4mn) loss from the crash.

Munich Re said its losses from the 737 Max loss would likely fall between EUR100mn and EUR120mn, while Swiss Re pegged its exposure at $90mn for the Ethiopian Airlines crash and subsequent grounding.

In its Plane Talking report, AJG said 2019 was "firmly on track" to become one of the costliest loss years in aviation history, with three months left to go until the end of the year and incurred but not reported claims yet to filter through. In 2018, the aviation market took a combined $1.6bn in claims.

Commenting on aerospace losses in particular, which include the worldwide grounding of the Boeing 737 Max fleet and the subsequent liability payments, AJG said it was "highly likely to assume that whatever the final quantum of losses it will be sufficient to wipe out substantial portions of the annual aerospace premium, across a number of years, potentially impacting some reinsurance programs".

Nakeeb added that the final rates for programs placed were as yet uncertain because brokers would defend their clients' renewals with vigor.

The broker added that capacity in the aviation reinsurance market remains relatively stable, despite new entrants, and that Capsicum does not anticipate a flood of new capital into the market in the fourth quarter of the year.

"We also expect a meaningful increase in minimum rate on line to be pushed by markets at the top end of reinsurance programs driven by the cost of capital," the broker said in its report.

"This [Boeing] loss has reinforced the value of reinsurance for the direct insurers after several years of low loss activity and sliding prices," Nakeeb added.

Space reinsurance rates under pressure as withdrawal rumors swirl

Space insurers are expecting to pay more for reinsurance as carriers withdraw from the class and rates in the primary market surge by double digits, *The Insurance Insider* understands.

Market sources canvassed said a correction currently occurring in the primary market – which has seen composite rates rise by as much as 40 percent or 50 percent on risks quoted in recent weeks – would likely filter through to reinsurance contracts.

The vast majority of space reinsurance is purchased on a quota share basis and most renewal negotiations occur either across the fourth quarter or at year-end.

A number of reinsurers are understood to be reviewing their appetite for the class, prompting fears that cedants will be unable to obtain sufficient cover.

One underwriting source said further withdrawals from both the primary and secondary markets were highly likely in the coming weeks, leading to expectations that risk-adjusted rates on reinsurance treaties would rise by at least single digits.

"The losses in recent months are unprecedented and if further markets pull back this will certainly push up reinsurance rates by at least single digits.

"The contraction in appetite we are seeing will definitely affect reinsurers as well," the source added.

In August this publication revealed that Swiss Re Corporate Solutions had exited its global space insurance book as part of a move to reduce gross premiums written by about $900mn, or 20 percent.

The move to exit the class of business follows pricing uncertainty caused by a slew of claims including the $400mn+ loss of the Falcon Eye-1 Vega spacecraft, which is understood to have hit key space markets including Allianz Global Corporate & Specialty (AGCS).

Sources told this publication the total loss of the launch vehicle and its payload would likely cost about $413mn-$415mn. The launch policy for operator Arianespace is understood to have been placed by Aon, with Atrium Syndicate 609 believed to be on the slip.

Last month AGCS confirmed to *The Insurance Insider* it would continue to underwrite space risks, despite market rumors the carrier had significantly curtailed its appetite for the class of business.

In August the space market was also left reeling by the loss of Chinasat-18, which is understood to have cost insurers at least $250mn.

The cost of the two claims combined outweighs the market's total premium pot, which sources pegged at about $45mn for 2019.

Market sources speaking to this publication also complained about opportunistic carriers entering the class temporarily in a bid to take advantage of surging rates.

"The brokers don't really care where the capacity comes from, which is one of the reasons you are seeing long-term players like Swiss Re withdraw."

"These recent rate rises are likely to filter through to the reinsurance market," a source said.

M&A maps new direction for ILS industry

Further M&A deals among reinsurers and ILS managers look likely in the coming years, after multiple prior transactions have brought the segments closer together.

As retro markets tighten it remains to be seen whether this will accelerate the trend, as reinsurers look for ways to try to manage down net retentions and keep their cost of capital low.

But any would-be buyers won't have a clear field. For institutional investment shops, the ILS industry is one where they can still earn relatively high fees due to the opacity and niche characteristics of the asset class, and if Pimco is able to pull off its move into the asset class this may push other big-name managers to look at their own offerings.

The ownership shift

Five years ago the ILS industry still largely comprised independent firms, with reinsurers having a trailing foothold in the third-party capital business.

But since then, reinsurer-owned platforms have propelled themselves to take a leading share of ILS assets under management, according to analysis from sister publication *Trading Risk*.

Organic growth helped at platforms such as RenaissanceRe, AlphaCat, Mt Logan and Hiscox Re & ILS, but M&A was a huge driver through landmark acquisitions such as Markel's Nephila takeover in 2018.

However, in 2019 ILS M&A has continued to show a mix of competing influences. While Scor's bolt-on acquisition of Coriolis fits the narrative for reinsurer domination, two other deals were done in the asset management sector.

Schroders bought up the shares in Zurich-based Secquaero that it did not already own, and White Mountains took a minority stake in Elementum (Although many in the industry saw this as a reinsurance trade deal, White Mountains has previously disposed of its (re)insurance subsidiaries, and is no longer a risk carrier.)

For ILS managers, the attraction of a reinsurer sale is that it is more likely to help the platform resolve issues around access to rated paper and diversifying into non-catastrophe business, if this is an area of strategic focus for them.

For reinsurers such as Scor, acquisitions may be a way to quickly gain critical mass in dealing with third-party capital – an impetus that will likely only gain strength over the coming year as retro capacity dries up.

However, two of the largest investment management-owned ILS firms – LGT and Credit Suisse – are starting to set up their own rated balance sheets, offering a third-way operating model to would-be ILS sellers.

Competing attractions

There is no single winning formula. Both major ownership models – institutional asset manager and (re)insurer parent – have their pros and cons. In general, the asset manager model is seen as offering a head start with distribution and investor relations capabilities, whereas (re)insurer owners are perceived to have an edge in access to underwriting risk and leverage from their rated balance sheets.

However, the reinsurer ILS model still has its share of challenges, even with the key attractions of leverage and underwriting resources on offer.

And crucially for investors, the range of affiliated ILS platforms makes it harder to evaluate them as a single bloc.

One group in the reinsurer-affiliated market comprises satellite platforms that were formerly independent managers, such as Nephila or Leadenhall, which operate beyond their parents' control. Similarly, some in-house platforms – such as Scor Investment Partners – have maintained a distance from the parent reinsurer.

Then there are the firms that have grown up integrated within a reinsurer, such as AlphaCat or Hiscox Re & ILS. These source risk in tandem with the parent, though overseen by separate portfolio management teams.

Finally, there are small teams within a reinsurer that oversee third-party capital almost as part of their retrocession activities. Here, ILS initiatives are more likely to focus on sidecar vehicles that offer a pre-agreed slice of their portfolios to investors.

Investors will be looking for aligned interests from any ILS asset manager, but this is particularly the case for the reinsurer platforms, where the parent is directly sharing certain risks with ILS investors.

If most risk going to third-party investors from reinsurers is via quota share, so long as the parent retains a sufficient share of the risk, it may seem a straightforward way of achieving alignment of interests.

But prod a bit further and it's not necessarily such a simple answer. In most cases, investors would not be getting a net share of the risks assumed by reinsurers after they buy retrocession protection which, in many cases, is critical to their final portfolios.

Moreover, if a reinsurer-manager is overseeing only quota share portfolios, will they be able to offer fiduciary oversight when their ILS team is not underwriting the original business?

In the early days of reinsurer ILS platforms, the market discussion centred on matters that are perhaps more ephemeral – the cultural barriers to getting reinsurance underwriters on board with sharing risk with ILS affiliates.

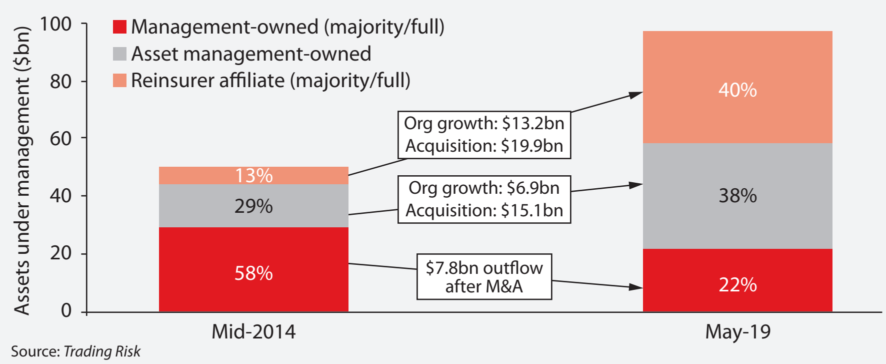
Despite initial worries about alignment, it seems reinsurer-managers have largely come through unscathed in the past couple of active catastrophe years.

However, in some cases the reinsurer reserving model may be challenging to adapt for ILS frameworks, according to LGT ILS Partners executive Christian Bruns.

Reinsurers are used to setting conservative reserves, with the expectation of releasing some of the excess over time – precisely what ILS investors want to avoid, he noted.

"They want clinical precision."

Reinsurers catch up to lead ILS AuM



Source: *Trading Risk*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