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

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Reinsurers brace for squeezed returns as retro costs set to bite

European property catastrophe treaty reinsurers fear a second year of squeezed returns as they face being caught between flat inwards pricing and steepening retrocession costs at the 1 January renewal.

Insurers on the continent have experienced another relatively benign year for cat events. Globally, despite creep on Typhoon Jebi losses in the first half, as well as Hurricane Dorian and typhoons Faxai and Hagibis, 2019 does not yet appear to be an above-average cat loss year.

This 2019 loss record, coupled with a long benign period for cat claims in Europe and a continued abundance of capacity, means that reinsurers have little expectation of securing anything better than a flat renewal at 1 January.

At the same time, however, those same losses – following a period of underperformance in the ILS market – look set to cause a contraction of retrocession capital that will force reinsurers' costs higher.

Early reads on the European windstorm renewal from market sources suggest it will be stable and orderly, with little change to demand, supply, pricing or terms and conditions.

Key points

- European loss experience has been benign and globally 2019 does not look to have been an above-average cat year
- Hagibis, Faxai and Dorian will put some pressure on retro capital, driving up prices
- Increasing retro costs plus anticipated flat European property cat treaty rates will squeeze reinsurers' returns
- Some cedants are starting negotiations early in a bid to lock in low prices

Loss activity

Europe was not entirely without notable losses this year, but none have been big enough have a broad-based positive impact on pricing.

Storm Eberhard, which struck Germany in March, resulted in a $1.1bn insured loss according to an Aon estimate, while hailstorms and severe weather that hit Munich and parts of Poland, Slovenia, Czech Republic and Italy in June brought $722mn in insured losses.

Sources said that where these and other incidents did become reinsurance events, they only touched the first layers of cedants' protection.

Reinsurance underwriters added that the trend seen in the US and Japan of increasingly specific pricing, with rate increases strongly tied to loss-affected regions, risks or individual clients, is increasingly evident within Europe.

Even European cedants with some losses are likely to argue that they have paid enough in premiums in loss-free years to justify a flat renewal rate this year, sources said.

Reinsurers, on the other hand, are arguing for increases after a decade-long downward trend in European property cat treaty rates which has left pricing at levels many consider unsustainable.

Underwriters have been warning for some years that pricing on European property treaty has been below technical adequacy. The run of large wind losses in Japan in 2018 and now potentially 2019 is seen as a cautionary tale about how reinsurers writing technically under-priced business in good years find this ultimately catches up with them when loss activity returns.

The case for rate increases

Reinsurance sources pointed to global cat activity and their increasing cost of capital to justify arguments for rate increases in Europe.

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A distinctive approach to capital management.
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As we see it, the future is full of opportunity.
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Reinsurance 2025: The squeezed middle

Rewind to 2014. Cat reinsurance rates were in freefall, casualty ceding commissions were soaring.

Reinsurance was becoming a single-digit return game driven by structural changes around its capital base.

The likes of Zurich, AIG and Liberty were progressively retaining more risk at the expense of reinsurers as they looked to leverage their monster balance sheets.

PartnerRe's board decided to quietly put the business up for sale after judging that it would be too expensive to build or buy an insurance business, which was mission critical for future success as a carrier.

The Bermudian reinsurer's judgement of its prospects was so bearish that it decided that a sale to Axis, which would value one of the leading reinsurance franchises in the world at less than book value, was a better outcome than an independent future.

At this point the focus of the reinsurance world was directed towards model shift, as scale was pursued through consolidation, diversification was used to secure additional financial leverage, and fee income and additional market presence was sought through the development of third-party capital platforms.

Questions were asked about whether the potential of the ILS industry and its appetite for even volatile risk at mid-single digit returns meant the days of writing cat reinsurance on your own balance sheet might be over.

But since those dark days, the industry's attention has moved on, and the real problems have emerged elsewhere.

Arguably, it is insurance pricing for large, complex, specialty risk that overshot more clearly on the downside than reinsurance.

The biggest carrier stories of the past 12 months have been the remediation of AIG's book and the tactical and strategic efforts to reconstruct Lloyd's.

Questions about industry structure and the reinsurance sector that felt urgent back in 2014 may no longer be top of mind, but I think they remain highly pertinent. And there is a question currently exercising the minds of managing agency CEOs that has interesting parallels for the reinsurance market.

With excessive expense a huge issue within Lloyd's, the Corporation has indicated as part of Blueprint One that it will look to create a greater distinction between leaders and followers.

Leadership – which is likely to be officially accredited – will require product, underwriting and servicing capabilities. But the following market will be given the freedom to operate as true capacity providers, exempted from the need to employ expensive staff to carry out work that duplicates the efforts of the leader.

If the model works as intended, flexible structures will be developed that allow capital to follow expertise, with significant cost benefits accruing to the market.

Over the next five years, the Lloyd's market looks set to bifurcate dramatically as a result.

Could the same thing happen within the reinsurance market?

Arguably, the leaders have already established themselves, with a push towards a global footprint, all-line expertise and major capacity.

And these companies are clearly highly expansive, with Swiss Re (+30 percent), Hannover (+20 percent) and Scor (+12 percent), showing they had major appetite to grow with even relatively limited upward rate momentum in Q2.

The question then becomes two-fold. First, will we see the development of a new generation of truly low-cost reinsurers that act as almost pure capacity providers?

Such companies would need to find ways to satisfy regulators and ratings agencies that they had sufficient oversight in place (perhaps harder to achieve outside the Lloyd's ecosystem), while convincing investors they could make a return and create franchise value.

None of that is a mean feat, but it could perhaps be done with enough ingenuity.

And second, if they could establish themselves – or if some existing reinsurers evolved in this direction – would the middle tier of reinsurers be able to successfully compete against the full-service leaders and the ultra-low-cost followers?

One suspects that in such a scenario, the middleweights would find the squeeze far from comfortable.

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Scor's Channel Syndicate seeks RITC transaction

Scor-owned Lloyd's business Channel Syndicate 2015 has approached the legacy market as it looks to secure a reinsurance-to-close (RITC) transaction, *The Insurance Insider* understands.

It is understood that Channel is using a broker to advise on the deal, which would address the liabilities for the 2017 and prior years of account.

The RITC market at Lloyd's is highly concentrated and there are only a handful of players which would be in a position to take on the transaction. They include Enstar's RITC syndicate Shelbourne, which dominates the market and is believed to have more than £3bn ($3.3bn) of reserves.

Arch-backed legacy carrier Premia has provided new competition in the RITC space and will be keen to strike its first third-party deal, having recently acquired the Standard Syndicate and Charles Taylor's managing agency to provide it with a Lloyd's platform.

RiverStone and Randall & Quilter are also active, while Berkshire Hathaway has been largely dormant for years.

Stuart McMurdo, CEO of Scor's specialty insurance operations for Europe, Middle East and Africa, confirmed the RITC process to this publication in a statement and said: "Our strategy centres around delivering enhanced, consistent and sustainable profit in specialty insurance lines.

"We confirm that we are investigating a reinsurance to close for our 2017 and prior years of account. This will enable us to redeploy capital into our focus classes, namely cyber, political and credit risk, environmental impairment liability, fine art and specialist areas within property."

Channel Syndicate 2015 has struggled with profitability since its inception in 2011, as it attempted to build critical mass in a poor pricing environment. It has recently undertaken a number of remedial measures to address underperformance, including exiting general and professional liability, accident and health, hull and cargo insurance last year.

Allianz to add £500mn UK pillar as it digests acquisitions

Allianz will purchase a new UK-specific protection to sit underneath its SuperCat and MegaCat treaties at 1 January as it begins the process of integrating its two new UK acquisitions, *The Insurance Insider* understands.

Sources told this publication that Allianz has indicated to reinsurers that it will buy a roughly £500mn ($628mn) cover for its existing UK exposures and the Legal & General portfolio.

It has decided to postpone a bigger restructure, initially rumoured at Monte Carlo, which would have seen a single reinsurance purchase to cover all UK exposures, including the recently acquired LV portfolio.

Sources said that Allianz will instead continue with the existing LV cat treaty at its scheduled 1 December renewal date, which is understood to have around £300mn of vertical limit.

Reinsurers assume that the exposures from the LV portfolio will be rolled into the UK-specific protections over the next 12-15 months.

Sources said that Allianz had already submitted data to its panel of reinsurers, as it looks to follow the kind of early timetable it has typically used.

Allianz is one of the biggest buyers of cat reinsurance in the market and buys around EUR2bn ($2.2bn) of limit across the SuperCat and MegaCat treaties, with an additional global umbrella layer. Guy Carpenter and Willis Re broker Allianz's cat covers.

The company has maintained a stable reinsurance panel over the years, and – like many Europe-focused portfolios – has been highly profitable for reinsurers.

The US-specific tower has historically renewed at 1 May, but is set to move to 1 January.

Allianz purchases its cat covers for all group companies via a central vehicle – Allianz Re – which is run by Amer Ahmed.

At the end of May, Allianz announced the twin UK acquisitions.

It agreed to buy out the 51 percent of LV's GI business that it did not already own for £578mn.

It also said it had struck a deal to acquire Legal & General's GI business for £242mn.

The combined deals will make Allianz the second-biggest GI insurer, with pro forma GWP of £4.0bn and a market share of 9 percent.

Following the close of the deals, Allianz will have 12 million customers in the UK.

Allianz declined to comment.

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Reinsurers with global exposure will have been hit by Hurricane Dorian, which RMS estimated would cause insured losses of $4bn-$8bn; Typhoon Faxai, believed to be a $5bn-$7bn event; and Typhoon Hagibis, which the most bearish reinsurers fear could result in losses on a similar scale to last year's $15bn Typhoon Jebi.

Jebi is also responsible for billions of dollars of losses that have come through this year, as claims poured in during the first half.

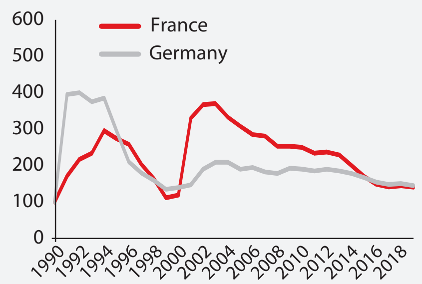
A European underwriting source said these losses all pointed towards a disappointing set of Q3 results for reinsurers, which they could use to strengthen their hand with European cedants during pricing negotiations.

These incidents do not make 2019 a worse-than-average cat year, even with the caveat that the Japanese winter storm and North American wildfire seasons are still to come. Year to date, catastrophe activity is still likely below average after a first half in which losses were only $15bn versus a 10-year average of $31bn.

Reinsurers can argue, however, that their cost of capital is rising owing to soaring retro rates, squeezing returns further if they cannot achieve rate rises.

The ILS market is in a fragile state, with investors wary of putting money in after two years of weak performance, mistrust of models and concerns over climate change.

Property cat pricing trends



Source: Willis Re

At the same time, there are fears that if Hagibis is a significant event in the $10bn-$15bn range, this will spark a lock-up of capital as buyers freeze collateral while they wait for a clear picture of the typhoon damage to emerge. These factors point to significant increases in retro rates of between 10 percent and 25 percent.

The case for stasis

The main barrier – alongside benign loss experience – to increasing property cat treaty rates in Europe remains an abundance of capacity. Reinsurers with exposure to North American hurricane and wildfire risk have long used the highly capital-efficient European property market as a diversification play.

This, sources said, means some carriers are happy to continue to grow or maintain strong presences in the European market, despite soft pricing, and cedants are able to take advantage of that. The cornerstone capacity in the market provided by large continental players Swiss Re, Munich Re and Hannover Re also adds to the downward pressure on rates.

It is yet to be seen how much influence a contraction in retro capacity and the continuing abundance of capacity will wield over pricing negotiations at 1 January. But in private reinsurers are not hopeful that they will gain ground.

An indication of where power lies between reinsurers and cedants is an emerging pattern of earlier-than-usual manoeuvres from primary carriers.

Sources said some cedants had started negotiations and sent submissions earlier in the quarter than would be expected. This may reflect either a hope to get ahead of any further loss activity in the year, or an attempt to secure flat terms before a potential retro lock-up begins to make its effects felt on first-tier reinsurance pricing.

One source reported that a Swiss cedant had achieved a risk-adjusted reduction on their renewed contract by agreeing a deal at this early stage.

Cyber XoL demand grows as aggregation concerns mount

Cyber insurers are showing increasing demand for aggregate excess of loss (XoL) reinsurance protection as board-level concerns around aggregation risk heighten.

Participants in the standalone cyber reinsurance market told *The Insurance Insider* that while quota share structures are still bought most, the past year has seen rising demand for a solution which can help protect net retentions.

"Applying reinsurance structures to insurers' market shares, you would find that 80 percent of the market is protected by some sort of proportional arrangement," said Anthony Cordonnier, head of cyber product management at Swiss Re.

"About half of that number is protected by a mixture of proportional and non-proportional covers, generally a combination of quota share and aggregate stop loss."

However, demand is now slowly increasing for aggregate XoL protection. Additionally, it was also suggested by sources that insurers with subsidiaries in more than one geography are seeking to secure cyber reinsurance protection at group level, and are often now looking for solutions which can address both affirmative and non-affirmative – or silent – cyber exposures.

Despite more frequent and high-profile losses in recent months, including the Capital One data breach, cyber insurance books generally run profitably and cedants are keen to retain more of that profitable premium, although to date cessions have not come down significantly.

Sources said that a 50 percent cession rate on a standalone cyber quota share was not unusual but this varied by cedant.

"Cedants are still keeping their quota shares in place but they want more of that sideways protection," said one source. "Over time I would expect cessions to decrease."

Attachment points for aggregate stop-loss covers typically hover around the 100 percent loss ratio mark, but those reinsurers which rely more heavily on retro cover can offer attachment points as low as 80 percent or 90 percent, sources said.

Reinsurance reliance

The cyber insurance market continues to expand and demand for reinsurance is increasing, and sources described cyber reinsurance market conditions as stable.

The primary market's reliance on cyber reinsurance is fairly substantial, with Swiss Re estimating that cyber reinsurers take approximately 40 percent of all insured cyber risk globally, equivalent to around $2bn of premium.

Taking the Capital One loss as an example, if the full $400mn tower (pictured) was exhausted, the reinsurance market would absorb a loss of around $160mn. However, many in the primary market believe the loss will only reach around halfway up the tower.

Sources speaking to this publication also agreed that the 40 percent reinsurance dependency figure felt about right.

"We believe that capacity is not constrained at the moment, there seems to be enough reinsurance capacity in general in the market and we believe reinsurance capacity will likely grow with the primary market," said Maya Bundt, head of cyber and digital solutions for Swiss Re. "I don't see that there will be a shortage of reinsurance capacity apart for some very large, difficult risks."

However, if cyber insurers start to look for substantially more protection some underwriters believe conditions should start to harden.

"There is ample capacity but there is not a huge volume on the sidelines waiting to come in and flood the market," one underwriter said.

Writers of cyber reinsurance include Munich Re, Swiss Re and Hannover Re, as well as carriers such as RenaissanceRe, TransRe and PartnerRe. MS Amlin-backed MGA Envelop also serves the market, as does Radius, which operates on Fidelis' MGA platform Pinewalk.

Cross collaboration

Bundt said risk capacity was not the only thing the reinsurance market delivers to the primary market.

"There is also a strong knowledge exchange," she said. "There is still so much to research and understand in the cyber world that it makes for strong collaboration between primary insurers, reinsurers and brokers."

Just as it concerns the primary market, risk aggregation is also a major challenge for cyber reinsurers, particularly around silent cyber exposures.

A number of moves have been made to try to tackle this silent challenge. AIG and Allianz have rolled out group-wide initiatives to clarify wordings for cyber exposures on all P&C polices, while Lloyd's has mandated managing agents to do the same.

Swiss Re and broker Capsicum Re have collaborated to launch a cyber reinsurance solution that provides cover for both affirmative and silent cyber risks.

"We believe the main risks which would aggregate are first-party risks, like business interruption and data restoration, and that is definitely something that we are monitoring and managing very carefully," said Bundt. "It is worth noting that not everything in cyber aggregates in the same way."

Capital One 2019/2020 cyber placement

$55mn xs $345mn – Shared layers

$45mn xs $300mn – Marsh Echo Facility

$50mn xs $250mn – Marsh Echo Facility

$50mn xs $200mn – Aspen Bermuda $5mn, Beazley $10mn, Validus $10mn, Ironshore $10mn, RLI $15mn

$50mn xs $150mn – WR Berkley $5mn, Sompo Bermuda $5mn, Axa XL Bermuda $10mn, Markel US $10mn, AIG Bermuda $10mn, AWAC Bermuda $10mn

$10mn xs $140mn – Tokio Marine HCC

$35mn xs $105mn – Ironshore $5mn, WR Berkley $5mn, Allianz $10mn, Axa XL US $15mn

$15mn xs $90mn – CNA

$15mn xs $75mn – Nationwide

$15mn xs $60mn – Berkshire Hathaway

$15mn xs $45mn – Sompo

$15mn xs $30mn – Chubb

$15mn xs $15mn – Axis

Primary $15mn – AIG

Source: *The Insurance Insider*

Late Brexit agreement could pave way for reinsurance equivalence

The UK (re)insurance industry is waiting to see whether it has sidestepped a potentially damaging loss of equivalence with the EU after Prime Minister Boris Johnson and EU negotiator Michel Barnier's eleventh-hour Brexit deal on Thursday.

At the time of writing, it was far from clear that the agreement would gain parliamentary approval on both sides of the future border.

However, if the pact and accompanying political declaration pass muster and mirror work done under former UK PM Theresa May, a built-in assessment of whether UK rules are equivalent to the EU's for reinsurance purposes would follow.

Article 172 of Solvency II provides for the provision of third-country reinsurance within the bloc by equivalent jurisdictions. As the UK has been one of the most enthusiastic adopters of Solvency II some observers had originally assumed the country would gain equivalence on exiting the EU almost as a matter of course.

However, it emerged in September last year that Polish and German regulators were already taking a hard line on domestic cedants transacting with Lloyd's, sending the Corporation scrambling to provide the full gamut of reinsurance from its Brussels platform and raising alarm bells for the wider (re)insurance industry.

It's now clear that in the event of a hard Brexit with no transition period or baked-in equivalence assessment, UK-based carriers with no alternative reinsurance platforms in equivalent jurisdictions will be unable to operate on a level playing field with their EU counterparts.

Speaking before the Johnson-Barnier deal, Shearman & Sterling partner Thomas Donegan assigned a "close to 100 percent" probability of the UK gaining equivalence if a deal replicated the structure of May's deal, with a transition period. With a hard Brexit, though, it would – at least initially – "look like a zero".

The main problem in that case would be "for UK insurers with EU customers, and without an international reinsurance network, who wish to insure EU customers after Brexit from a new EU entity and reinsure back to the UK", he added. "In those cases, it will be very difficult to do new business."

"The work-around is to reinsure into an equivalent jurisdiction such as Bermuda. That may involve not just the sunk business cost of a new EU subsidiary but another cost of establishing in an 'equivalent' third jurisdiction too," Donegan said.

Many UK carriers' Brexit EU hubs have been designed on the basis that the bulk of business will get reinsured back to Britain, though the European Insurance and Occupational Pensions Authority has recommended a maximum cession limit of 90 percent.

But even in a hard Brexit scenario, a number of companies have work-arounds via platforms based in equivalent jurisdictions.

RSM UK's financial services co-head Peter Allen said: "Carriers can put business through third parties, or run it through places with an equivalence status. Most specialist insurers have access to Swiss, Bermuda, Japanese paper – all the big ones have choice of paper and even smaller ones have something," he noted.

Switzerland and Bermuda have full equivalence, while Japan has temporary equivalence. A clutch of other countries have provisional equivalence, including the US, whose covered agreement with the EU of March 2018 includes mutual recognition of regulatory frameworks and will ultimately remove cross-border local presence and collateral requirements for reinsurers.

The UK and the US signed their own pact mirroring that arrangement last December, putting Britain on par with the EU27 in terms of the (re)insurance rules governing transactions with the US.

In January the UK government forged a similar bi-lateral pact for (re)insurance with Switzerland.

EU reinsurers transacting in the UK are well-catered for through the temporary permissions regime, which runs until 2022 provided carriers have applied for the leeway.

For their counterparts based in the UK – and for the wider (re)insurance industry – equivalence only goes so far, since it doesn't provide for direct insurance or intermediation. What's more, the EU is able to rescind the equivalence designation at short order.

For that reason, groups such as the London Market Group (LMG) and CityUK have called for "enhanced equivalence" after Brexit.

Layered on top of the current uncertainty is the extent to which a future UK government will seek to make the most of Brexit freedoms by loosening rules and moving the domestic regulatory framework further away from Solvency II.

The LMG, for one, is keen to keep divergence to a minimum. However, the notion of the UK faithfully tracking amendments to Solvency II – which is currently under review – looks politically tricky.

One top executive at a major (re)insurance group warned of the threat the country may lose equivalence down the line.

"Carriers without any reinsurance operation in any other equivalent jurisdiction might struggle," he said.

Lloyd's and reinsurance

Lloyd's is among the many entities lobbying hard for enhanced equivalence, given that local rules in Germany, Poland and the Netherlands may prevent reinsurance being written directly into the UK in the case of a hard Brexit.

The Corporation equipped its Brussels platform to write facultative reinsurance and non-proportional excess-of-loss reinsurance across the entire European Economic Area as of 1 January this year and the Brussels business has deployed work-arounds to enable it to write proportional reinsurance business.

Chief among the requirements for quota-share underwriting is the creation by managing agents of an "in country" service company. However, it is understood that the appetite for proportional treaty business through the platform is mixed.

In the first half of this year, Lloyd's Brussels wrote about EUR1.07bn ($1.19bn) of gross premiums.

GC's Reina on the growing role of reinsurance

The CEO of Continental Europe and Mena gives his view on 1.1 dynamics, the evolving broker space and how client demands are changing

Whisper it, but when Massimo Reina was first contemplating his career path, reinsurance wasn't his first choice.

In fact, he really wanted to go into the banking sector.

"It was a very attractive marketplace at that time," he says. "But I am of course delighted with the choice I eventually made!"

Reina entered the (re)insurance market more than 30 years ago, and has never looked back. He has spent the last 11 years at Guy Carpenter, where he is now CEO of Continental Europe and Mena, a role he took on in 2014.

When *The Insurance Insider* interviews the executive, he explains how much the industry has changed since his early days of placing risks in the Lloyd's market.

"The reinsurance sector has always been an incredibly dynamic and stimulating environment to work in," he says.

"In recent years, the status of reinsurance has risen considerably in the eyes of the C-suite. Its value to the buyer is now viewed in a much broader context than simply a risk transfer mechanism.

"Rather, it is seen as a strategic tool that enables carriers to better protect their balance sheet against the financial fallout of large-scale events, reduce potential P&L volatility and provide an effective means of managing capital in line with risk appetite."

No two buyers are ever the same, but to a large extent, client demands haven't changed, he explains.

For the most part, clients are keen to maintain a diversified panel of core reinsurers that are financially robust, can demonstrate a thorough understanding of their business, and can offer consistency of supply over time – although cost efficiency, demand for broader coverage and access to alternative capital can influence the panel composition.

Broker evolution

But the role of brokers has had to evolve just as the risks their clients face have done.

"We are seeing a more sophisticated and considered approach to the broker relationship from buyers," he says.

"Our role is now much more far-reaching, encompassing not only the ability to provide the most effective risk-transfer product at the best price through the most efficient market channel, but also acting as strategic advisers to our clients in all matters relating to risk and capital."

Growing demands and expectations from clients mean that the barriers to entry in the reinsurance broking space can be quite high, Reina explained.

While the reinsurance broking sector has undergone a period of consolidation – most notably with Marsh & McLennan's acquisition of JLT Group – a handful of start-ups have emerged.

"Expanding demand from clients means that significant investment is required into technology, analytics and, of course, human capital," Reina says. "There is also the challenge of achieving the necessary proximity to clients and having that working knowledge of local market dynamics. Building an effective distribution network and establishing that on-the-ground presence in your key markets is a significant undertaking."

When Reina isn't working you can generally find him at the top of a mountain or on a boat in the middle of the ocean.

He loves to be active and escape to the great outdoors, though, "unfortunately, of course, you never get as much time to enjoy these opportunities as you would like!"

Of course, he tries to spend as much time as he can back in Italy, where he likes to take his children on holiday.

"They were all born in Milan, but they have spent most of their lives in the UK," he explains. "I want to make sure they maintain their Italian identity, so regular trips are a must."

1 January dynamics

The conversation turns to the Baden-Baden reinsurance conference and the upcoming 1 January European

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"In recent years, the status of reinsurance has risen considerably in the eyes of the C-suite. Its value to the buyer is now viewed in a much broader context than simply a risk transfer mechanism"

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property catastrophe renewals.

Reina says that from a global perspective, there is no doubt that carriers reaped the benefits of robust reinsurance protection during the devastating losses seen in 2017 and 2018, helping to limit earnings volatility despite considerable financial impact.

"The knock-on effect of this has been an uptick in the amount of premium being ceded to the market, as companies are seeking to further capitalise on the stabilising quality that reinsurance can provide during times of volatility," he continues.

The executive believes there are multiple factors combining at present to put pressure on rates, and the market will have to see how that pressure plays out during the 1 January renewals.

At the same time, the market is also experiencing a number of structural changes which may have a knock-on effect on buying dynamics.

"One of the common threads during my discussions with reinsurers at Monte Carlo was a desire to grow their European book of business. So, when you combine all of these components, I think it will make for a very interesting renewals period."

Property catastrophe business can often steal the limelight in the reinsurance world but Reina warns that at the moment, the casualty sector is a greater cause for concern among reinsurers than the property sector.

An increasingly litigious environment in North America is driving up loss costs for the casualty market, but even in Europe there are profitability pressures on casualty insurers.

"In Europe, the prolonged soft market has reduced rates to a level which may not be sustainable," Reina says.

"However, Europe is a very diverse region, with each country having its own specific characteristics, legal systems and market dynamics. This diversity means there are still profitable opportunities for reinsurers in specific areas of the casualty market."

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Closing the gap

Close to Reina's heart is the role the reinsurance sector can play in society and building more resilient economies, and he explains there is always more than can be done in this regard.

Despite being a largely developed, Western economy Europe still has a large protection gap, particularly around flood and earthquake risk.

According to Swiss Re Sigma figures, in 2018 Europe as a continent suffered $20.7bn in economic losses, of which just $7.7bn were insured.

"We are making some progress towards closing the gap, but there is still a significant amount of work to be done," says Reina.

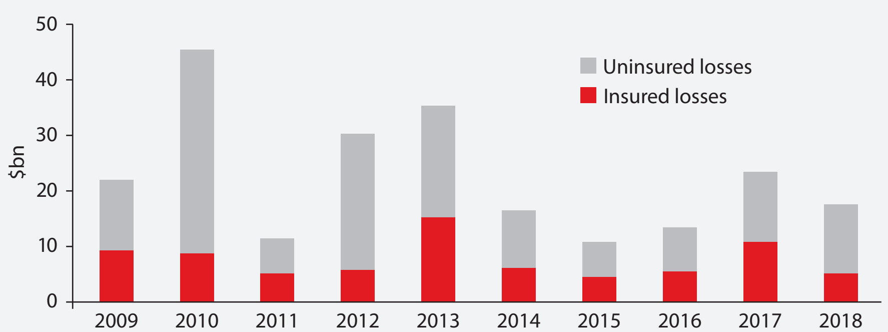
"This is a long-term project and one of the key challenges to overcome is to find better ways of aligning the interests of the public and private sectors. However, we are increasingly seeing the emergence of successful public-private initiatives."

Guy Carpenter has worked closely in the UK market on two major initiatives, Pool Re and Flood Re, which are respectively providing critical cover for terrorism and flood-related risks as public-private partnerships.

Other similar initiatives include the Insurance Pool against Natural Disasters of Romania and the Turkish Catastrophe Insurance Pool.

"More needs to be done to encourage the development of such schemes and Guy Carpenter is committed to supporting greater interaction between the public and private sectors," Reina says.

Europe: natural catastrophe protection gap 2009–2018



Source: Swiss Re Institute

Quick-fire Q&A

What's been your biggest achievement personally, or your proudest moment?
There have been a number of stand-out moments during my career, but it is on the personal front that I have experienced some of my proudest moments. Almost all of these have involved my family and in particular key events and stages in the lives of my children.

What is your favourite city and why?
I love many cities around the world for different reasons, but if you ask me where I would live, outside of London and Milan, I would say Madrid. I love the people, the food and the climate there – once you have these three elements then in my view you have the perfect location.

Which lesson has been the hardest to learn?
The hardest lesson that I have had to learn, and one which everyone must learn, is that there is always another lesson to learn.

Where would you like to see the reinsurance industry by the time you retire?
I would like to see a greater recognition of the critical role that insurance and reinsurance plays in an increasingly complex and exposed world. The industry fulfils a central function at the societal level, not only through enabling recovery in the aftermath of a major event, but also through providing the security to keep moving forward.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Net Worth (with Fair Value Change Account)
$ 7,888 Million
Total Assets
$ 16,929 Million as on 31.03.2018
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Cat bond market to rebound in 2020

The cat bond market is expected to rebound in 2020 following a notably quiet 2019, market participants told sister publication *Trading Risk*.

The bulk of the deals set to mature in the first half of next year are US transactions, though there are a handful of European deals too.

Among these is the $305mn Benu Capital 2015-1 transaction from Axa Global Life which covers French as well as US and Japanese mortality. There is also the $190mn Queen Street XII Re transaction from Munich Re, which covers hurricane and Europe windstorm.

At the time of writing, the EUR100mn ($110.2mn) Hexagon II transaction from Covea Group was the only transaction with a European focus to be issued in the second half of the year.

Cat bond issuance dropped by 57 percent in the first half of 2019 to $3.5bn, as rising rates and tight capacity led to less activity in the Q2 run-up to hurricane season.

Despite the low issuance the market is expected to pick up in 2020, due to the sheer volume of cat bonds expected to mature in 2019 and 2020. Up to $3.1bn of cat bonds are expected to mature in the second half of this year.

Brokers say upcoming renewals could help pick up the pace.

Cory Anger, GC Securities head of ILS origination, said the large volumes of cat bonds due to mature in early 2020 could be a major catalyst in shifting the ILS rate equilibrium.

Meanwhile, Willis Re's head of ILS Bill Dubinsky told *Trading Risk* that the low issuance was due to price fluctuation in the early part of the year.

"For 2020 we think it will go back to relatively more cat bond issuance but that will take a while to happen – it took a while to move the other way."

Diversity

Analysis by *Trading Risk* shows that 22 percent, or $7.1bn, of current cat bond coverage is due to mature in the first half of 2020. However, a quarter of the 28 bonds tracked have been impacted as a partial or full loss, with loss-free renewal volumes dropping back to $6.1bn.

There is a notable weighting towards the first six months for next year's renewals, with three-quarters of the year's maturities falling due before June. Total maturities for full-year 2020 only rise to $9.1bn.

The maturing bonds represent a diverse set of perils in the half year, such as coverage for US health and against extreme mortality events in the US, France and Japan, plus a Latin American quake bond.

As would be expected, US wind risks represent a high proportion, at 18 of the 28 maturing bonds, including multi-peril deals, with a particular focus on Florida.

However, three bonds supply reinsurance for risks in Japan – two of which address typhoons. As Typhoon Jebi creep continues and with concerns still live about Typhoon Faxai, and calculations beginning on the impact of Typhoon Hagibis, particular attention will be paid to renewals in this space.

But with no new Japanese deals brought to the cat bond market in 2019, the regional diversity will likely be greeted by investors.

Eyes will be fixed on the largest maturities. This group is led by the California Earthquake Authority which has $925mn across two classes of its Ursa Re 2017-1 bond rolling off risk.

Second up is Galilei Re 2016, ceded by XL Insurance, where the firm's subsequent takeover by Axa and departure of the former XL retro buying team for Convex raise questions over how the (re)insurer will approach the ILS market in future.

Pricing and low issuance

The stream of issuance has been notably quiet, with sources blaming the lack of deals on pricing disparities between the cat bond market and the traditional market, as well as a reaction to capacity shortages.

Several cat bonds have struggled to reach their target capacity this year, while pricing has been pushed to the higher end of forecasts.

Overall, cat bond volumes for the second quarter fell 60 percent to $1.8bn due to both the low number of issuances and fewer deals being upsized.

Pricing in the second quarter of 2019 was significantly harder than in 2018, with spreads increasing by an average of 0.1 percent from median targets, compared with falling by an average of 7.3 percent last year.

The overall level, however, reflected a mixed bag of results, with some Florida deals pricing at the top of or above targets and the retro deals concluded toward the end of the quarter coming in more competitively.

In contrast, Floridian cedants were forced to pay above their initial pricing ranges.

Floridian insurer Safepoint, which claimed on its Manatee Re 2016-1 cat bond following Hurricane Irma, ended up paying rates in line with those it paid in 2016.

Non-US cat bonds maturing in H1 2020

Year	Transaction (full name by tranche)	Sponsor / ceding insurer	Final size ($mn)	Peril and territory	Scheduled maturity/ redemption date	Final spread (bps)
2016	Vitality Re VII 2016 A;B	Aetna Life Insurance Company	200	US health	07 Jan 20	215; 265
2015	Benu Capital 2015-1 A;B	Axa Global Life	305	US/France/Japan extreme mortality	08 Jan 20	255; 335
2014	Nakama Re 2014-2 2	Zenkyoren	200	Japan earthquake	16 Jan 20	287.5
2018	IBRD Capital At Risk 118 A;B	Fonden	260	Mexico earthquake	14 Feb 20	250; 825
2016	Akibare Re 2016-1	Mitsui Sumitomo Insurance	200	Japan typhoon	07 Apr 20	250
2016	Aozora Re 2016-1	Sompo Japan Nipponkoa	220	Japan typhoon	07 Apr 20	220
2016	Queen Street XII Re	Munich Re	190	US hurricane and Europe windstorm	08 Apr 20	525

Source: *Trading Risk*

Building bridges

Axa XL's Bertrand Romagne discusses changing cedant demands, this year's unique reinsurance pricing challenge and bridging the protection gap

Picture this: the scene is Venice. Or, more specifically, one of the 400 bridges that connect the beautiful city, defining its uniqueness. Bertrand Romagne is a civil engineer working on one of the most famous bridges, the Ponte di Rialto, having fallen in love with the city at the age of 18 while studying.

In a parallel universe, maybe. If he wasn't in reinsurance this might have been the career path Romagne would have chosen. But today, Romagne is chief executive for Europe and CUO for P&C at Axa XL Reinsurance, and while it's not the role he dreamt about as a teenager, there's no place he'd rather be.

This year marks his 27th year in the industry and "what a time it has been", he says. Like everyone else, he "tripped" into the sector but has no regrets. "It's funny looking back on what you think you would do as a career and where you are now. A civil engineer in Venice." Perhaps a retirement plan? "Oh, there's a lot that needs to be done before I retire," he says.

Speaking to *The Insurance Insider* ahead of this year's Baden-Baden reinsurance conference, it is clear his belief in the industry's potential to make a difference is driving his commitment to the market.

Indeed, in his 27 years, he's seen the industry go through many different cycles, and witnessed a variety of trends which have contributed to carving out where it finds itself today. "But something is different now," he says. "We're seeing things in this market that we've never seen before, so it is a very interesting time to be in reinsurance."

Talking specifically about Europe, Romagne flags the recent cat losses in the north and south of Germany and also in Italy. "While these are not too big, they're not inconsequential," he says, bringing to light the systemic impact of these losses. "It's not a secret," he says, "We all know there is much less margin in this business than there used to be and by having smaller, but regular losses, those losses are affecting [the industry's] earnings. So, that's something that we will have to address when we think about pricing," he continues.

Romagne is hesitant to make assumptions about where pricing will be at the 1 January renewals. "Most of the predictions we as an industry make after Monte Carlo happen to be incorrect. We all spend some time talking about it and collecting our thoughts on how the market might move but these views usually contrast with what really happens," he says.

Optimism versus reality? "Yes," he chuckles, "There's perhaps a bit too much optimism."

But he says the industry is at the bottom and there is no bandwidth to go down any further. "I don't think anyone has written business in the past few years where they've been 100 percent happy about it. We've seen years of rates decreasing so no one is going to be happy about that," he continues.

"We're clearly not where we want to be right now, but I do expect there to be some recovery. Is it going to be a massive increase? I don't know – the year isn't over yet and the hurricane season in the US is far from being over and we could have any sort of loss before the end of the year. We live in a dangerous world where things happen. We can't forget that."

> "We're seeing things in this market that we've never seen before, so it is a very interesting time to be in reinsurance"

Pricing influence

There's no doubt about it, the market needs to see better pricing trends. "We've been under a lot of pressure for many years now, but the thing people need to remember is that it's easier for markets to have increased terms when they've just had losses," Romagne says, citing the Japanese renewals as an example of this.

"It's a bit difficult to explain to a client that the price needs to go up if they haven't had any losses for a long time. But that's the (re)insurance business. Clearly in markets where we've experienced losses this year, like Germany and Italy, prices will go up. Others, we'll see. We're still a reactive market more than anything else."

At the time of going to press, third-quarter disclosures were on the horizon and Romagne says these will dictate some of the rate activity at renewal. "I'm not sure it's going to be a good year for reinsurance in general, but we have to see how it goes," he says.

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Further compounding the current state of affairs for the reinsurance market is activity elsewhere in the industry. "The price increases we're seeing in insurance and also in the retrocession market are setting a new precedent," says Romagne, while acknowledging the necessity of these rate rises, especially in the insurance arena.

"The price of retrocession is going up, which is interesting because in the past when the market was getting harder, it was usually the retrocession market that would raise rates, then reinsurance, then insurance; whereas now, you're seeing insurance and retro having rate increases and reinsurance is not really moving fast enough and we've not seen that before. Honestly, it's a bit of a mystery," he says.

However, while pricing remains the cause of some frustration for reinsurers, appetite for reinsurance among Axa XL clients is showing no signs of dissipating. Driven in part by solvency requirements and more recently an increase in demand to protect earnings, buyers continue to turn to the reinsurance market for solutions.

"What we've seen in the past year is an increase in demand regarding earnings protection," he explains. "For many years, clients were more focused on protecting their solvency ratio, now they're also realising the need to protect their earnings so they're buying more of that sort of cover – so quota share, aggregate cover, things like that and that's a trend we're seeing more of."

According to Romagne, there is a direct correlation between an increase in quota share arrangements and earnings protection. With cedants feeling less concerned about becoming insolvent, having spent the last five to six years prioritising reinsurance spend in this area, they are now turning their attention to results and earnings.

"The issue has become more to do with making sure companies can protect their results, so their shareholders and stakeholders are confident in their business," he says. "A lot of them have started to buy certain covers, especially in Europe, to protect their results, but the other solution for that, of course, is quota share because it does two things at the same time. It does the protection for solvency and it does the protection for earnings.

"It's a different way of buying, but because the market is fairly good for them, they feel they can generate enough commission to make this quota share acceptable."

Bigger and better

At Axa XL, there is a lot to be energised about. Not only did the 2018 acquisition of XL Group stamp XL Catlin's legacy reinsurance business with an AA rating, it also gave the existing team access to skills, insights and new coverage opportunities it hadn't previously been able to grasp.

Examples which are complementary to the reinsurance operation which Romagne is "very excited" about include the insights derived from Axa's liability management and climate teams to help develop new reinsurance business opportunities.

> "We talk a lot about the protection gap, but there are still plenty of people in this world who have no coverage, no protection. I hope reinsurance will continue to provide a service which will make the world better"

"There are more," he says. "But these are the ones that come to mind in the first instance. Being with Axa brings such a power and more skills into the group to help us to develop our reinsurance business and I'm very excited about that."

It would also seem that previous speculation about whether Axa XL's reinsurance business would continue to write as much cat risk as the business had done previously, given a difference in appetite, was unwarranted. As an underwriter, Romagne says it hasn't changed at all.

"We write the same thing. The group manages the overall exposure and there are many ways of doing that. We are investing a lot in third-party capital to help with this as part of the solution. As an underwriter, it hasn't really changed anything. We still have the same level of capacity and we can do as we were doing before," he affirms.

In terms of specific growth areas, Romagne says that in addition to improving the property side of the book, he expects there to be more focus on longer tail and casualty business as it's an area they want to continue to develop, as they leverage the capabilities Axa brings to the scope. And while it might not be a big topic in 2020 for the industry, climate change is on his mind. "This is an issue because it will probably bring some disturbance and we'll have to face it."

Bridging the protection gap

When he's not building bridges in the reinsurance industry, Romagne spends as much time with his family as possible. "I am travelling almost half of my time, so this is very important to me," he says. "Also, it's important to be around friends outside of the industry. Reinsurance is a small world and the people you know do the same job, they travel the same way as you are, so sometimes we can forget the real world is very different."

Furthermore, Romagne has no intention of winding down. "There's too much I want to do in this industry, but when I think about what the future holds, I hope we will continue to provide a bit more support," he says.

"We talk a lot about the protection gap, but there are still plenty of people in this world who have no coverage, no protection. I hope reinsurance will continue to provide a service which will make the world better."

He adds: "I'm not ready to retire, but I hope in the next 10-15 years we can say the gap has reduced significantly. We're still too far away from providing protection to the level the world needs. It's not just a job, we are all part of this world and it's good to provide something that will make a difference."

The bridges of Venice will have to wait.

Bertrand Romagne CV

2018 – present: Chief executive, Europe & chief underwriting officer, P&C, Axa XL Reinsurance

2015-2018: Underwriting director, XL Catlin Re EMEA

2010-2015: Head of international property treaty, XL Re International

2004-2010: Head of property treaty, Le Mans Re/XL Re Europe

2002-2004: Deputy head of property treaty, Le Mans Re

1999-2002: Head of worldwide facultative, Le Mans Re

1995-1999: Head of facultative, MMA Re

1992-1995: Facultative underwriter for Mutuelles du Mans

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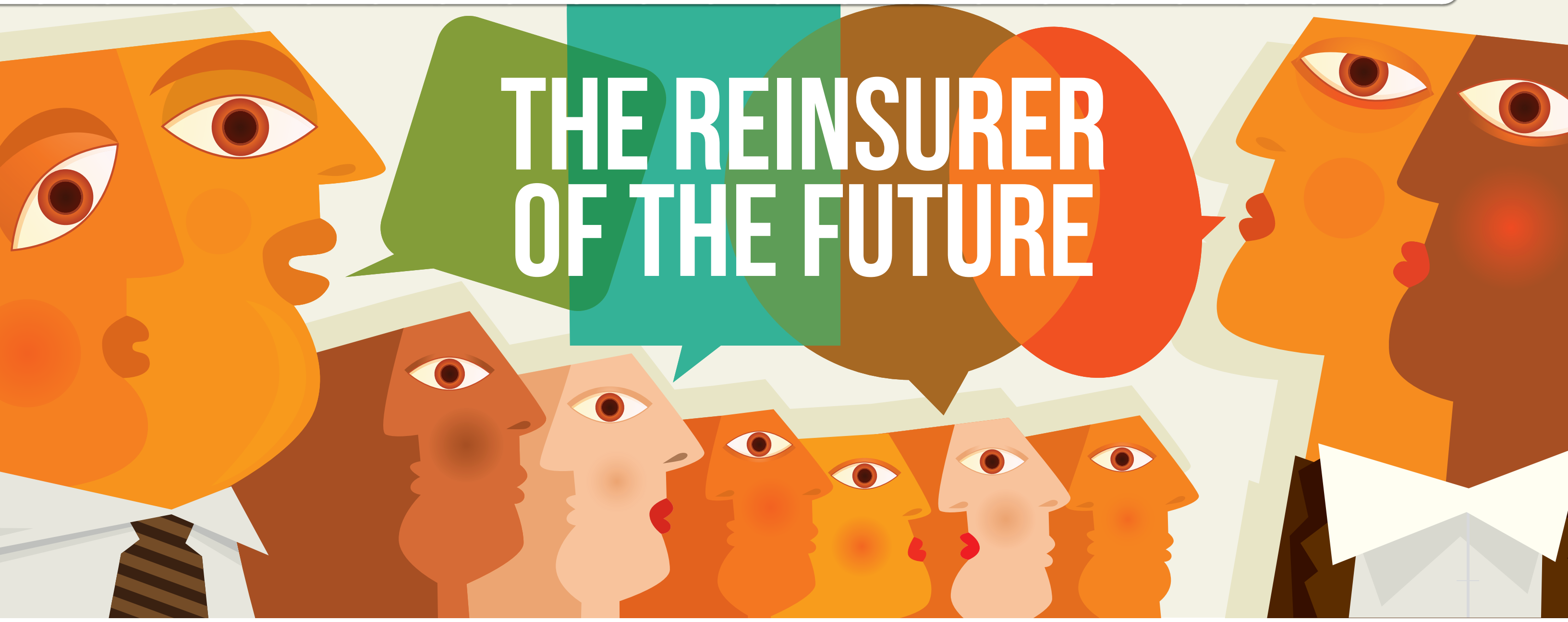

THE REINSURER OF THE FUTURE

Leading executives discuss what capabilities reinsurers will need to thrive in tomorrow's world

What will the reinsurer of the future look like? Will scale be an imperative in the years ahead?

Doris Höpke, board member, Munich Re: Well-diversified reinsurers that are able to address an ever more complex risk landscape with adequate solutions will have a key role. Effective and sustainable risk transfer is based on an unquestionable financial capacity as well as comprehensive risk expertise. This allows reinsurers to act as a reliable partner under challenging circumstances and to invest in innovation, talent and technology to support business development.

Jonathan Parry, CUO, QBE Re: Scale is important as it provides both efficiency and multi-class expertise, but there's always room for smaller reinsurers with specialist product expertise.

Frank Reichelt, head of northern, central and eastern Europe, Swiss Re: Reinsurers will further sharpen their profiles: on the one hand we will find full service providers with a huge range of expertise and know-how; on the other, pure capacity providers will continue to play their role in the market. Reinsurers that operate somewhere in between might fail on both ends.

Michael Pickel, executive board member, Hannover Re: The size and scale of a reinsurer has become more important than ever as clients reduce their reinsurance panels and demand more tailor-made reinsurance solutions. Beyond that, the reinsurer of the future will be a much more data-driven business than in the past.

Alkis Tsimaratos, managing director, head of western and southern EMEA, Willis Re: Client-centricity and capital agility will define the reinsurer of the future. Reinsurers need to evolve into business partners that can look at clients' needs across their portfolios. They also need to have the scale to access different pools of capital with different returns – whether those are internal pools or external ones.

> "The size and scale of a reinsurer has become more important than ever as clients reduce their reinsurance panels and demand more tailor-made reinsurance solutions"
> *Michael Pickel*

Jean-Paul Conoscente, CEO, Scor Global P&C: The reinsurer of the future will need to be adapted to the changing needs of its clients. But scale is only part of the answer: while the insurance industry is indeed concentrating and in need of reinsurers able to act as partners on a global basis, the nature of the demand of treaty clients is evolving as well.

Clients are now expecting from reinsurers not only capacity to protect them for capital and balance sheet events but also the ability to offer them new products, knowledge, advice, and support through technology to help them meet their growth and strategic objectives.

Jörg Bruniecki, head of global clients and broker management, PartnerRe: To remain relevant, reinsurers must continue to invest in improving their underwriting capabilities by better leveraging available data and technology and driving cost reductions in their back/middle-office functions.

Over time, we anticipate a bifurcation in the market with the top 10 larger, more relevant reinsurers at one end of the spectrum and specialist niche players at the other.

Where can technology most benefit the reinsurance operating model?

Reichelt: Data is increasingly important across various parts of the risk value chain and is helping ceding companies better understand their exposures, and ultimately purchase protection, more effectively. There are many ways to best make use of data analytics. Some of our solutions can be ready-to-use tools or approaches we can just "plug and play", others are tailored solutions we co-create with clients.

Pickel: Data analytics is a crucial capability for a reinsurer today. At Hannover Re we are already automating parts of our processes, especially with regard to decision-making. We aim to significantly increase the share

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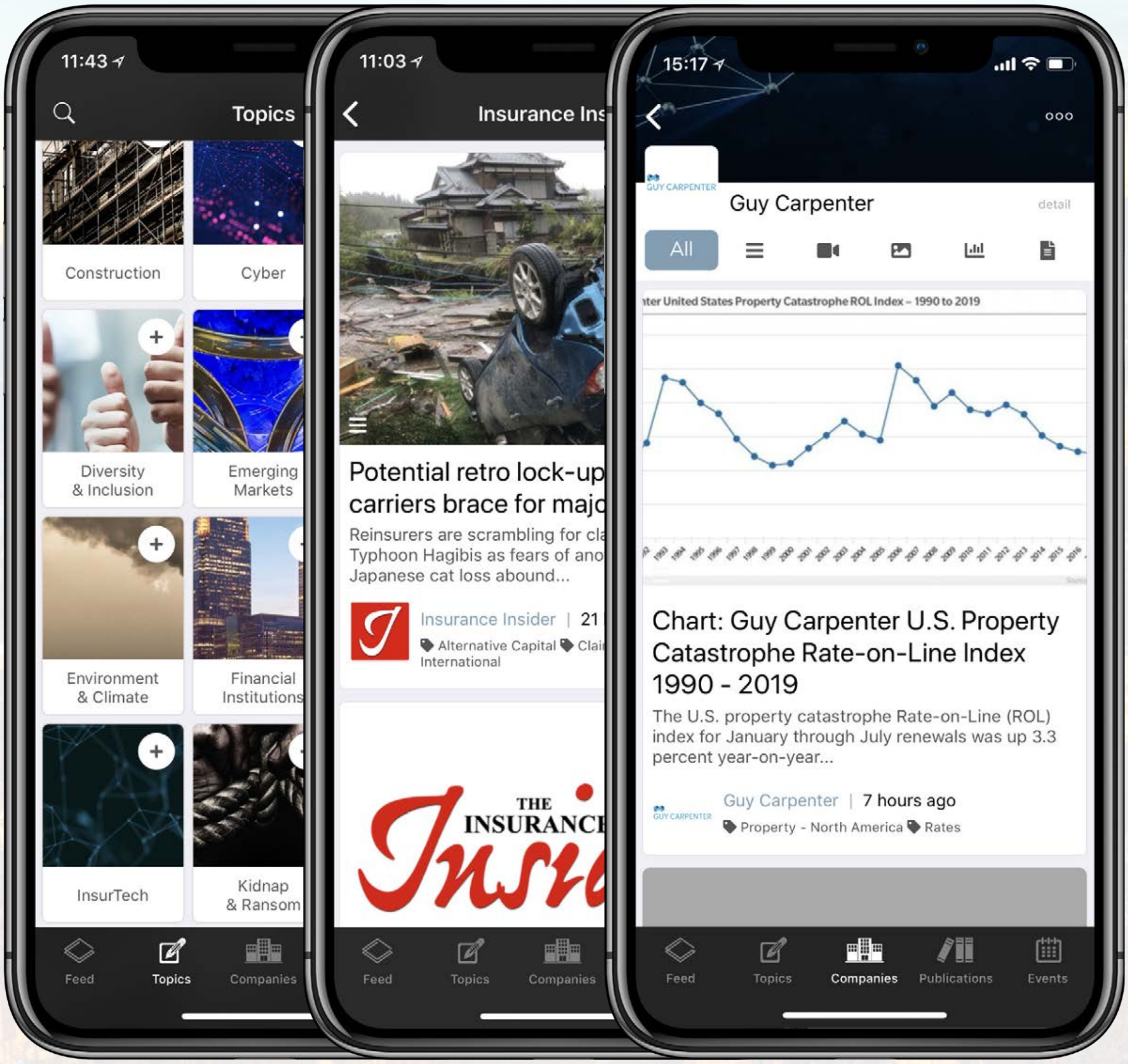

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of such automated processes within our operations wherever it makes sense.

Höpke: Risk transfer and risk management can benefit in many ways from technology and data. The reinsurance offering must include solutions that ultimately help cedants better serve their customer base, be it with new products, services, underwriting or claims settlement. Imaging technology can speed loss adjustment and ensure that insureds are indemnified more quickly after disastrous events.

Parry: The future of reinsurance is all about data. The better the data, the better insight we, as reinsurers, can get and the better the products we can offer our clients. It will also vastly benefit efficiency for both reinsurers and cedants, which will ultimately benefit their clients.

Tsimaratos: It is early days, but risk-tracking and mitigation emerges as a theme for technological deployment. Connected cars, homes and lives provide an enhanced framework for risk mitigation which, when embedded into a reinsurers offering, enables them to run more efficient risk mitigation and claims management, and ultimately more competitive pricing.

Bruniecki: Reinsurers' back- and middle-office functions will derive the biggest benefits from technology. The efficiency gains in distribution are not great enough in reinsurance to fundamentally disrupt a business model that is highly dependent on trust and relationships.

> "The future of reinsurance is all about data. The better the data, the better insight we, as reinsurers, can get and the better the products we can offer our clients"
> *Jonathan Parry*

Can reinsurers be cut out of the value chain? What can reinsurers do to prevent this?

Reichelt: Yes, unless reinsurers can add more value to the clients than other service providers. Start-ups and InsurTechs are not just challenging the business model of insurers, but that of reinsurers with a service-orientated business model too.

Conoscente: The value chain of (re)insurance is evolving. The clear separation of the past between insurance and reinsurance is blurring as the larger insurers are developing and acquiring reinsurance activities to optimise their capital base, hence gradually becoming competitors. We believe this blurring will continue and that reinsurers will need more and more insurance expertise to address their clients' needs for new products, knowledge and advice.

On the opposite side of the value chain, ILS has established itself as a credible source of alternative capital despite the difficulties it faced following the 2017 and 2018 losses. Reinsurers will need to further integrate the growing weight of these instruments within their strategies. They represent on the one hand a source of financial contestability and, on the other, a powerful risk management and retrocession tool.

Höpke: Alternative capital is predominantly used in externally modelled nat cat scenarios and has not replaced traditional capital in other lines of business. Professional reinsurers are not only acting as capacity providers in nat cat risks, but also providing solutions in long-tail and specialty lines.

Furthermore, we serve our clients by providing additional value and services along the value chain. Therefore, we invest in innovation, data analytics and cyber topics to provide value-added solutions for our clients.

Tsimaratos: Some are already feeling the strain, such as smaller following players/syndicates. The era of silo underwriting is over and following markets with segmented appetite and limited client focus will be cut out except for some specialty areas. This will be of benefit to the more client-centric reinsurers climbing up the value chain by looking at the value of their capacity offering, not only the cost of it.

Bruniecki: The regulatory environment is not getting any easier and stakeholder expectations are high, diverse and complex. The risk landscape is changing rapidly, generating new opportunities to reinsure intangible assets such as cyber risks and intellectual property. Meanwhile, the insurance gap on tangible assets continues to be wide. To remain relevant, it is even more important that reinsurers work in close partnership with their clients to help find solutions to complex risks. Reinsurers that don't compete with their clients but rather are 100 percent focused on their clients' success will have an important place in the value chain.

> "The risk landscape is changing rapidly, generating new opportunities to reinsure intangible assets such as cyber risks and intellectual property"
> *Jörg Bruniecki*

What emerging risks are on your radar? Is the reinsurance industry equipped to properly handle these risks?

Tsimaratos: In order of importance, climate change, cyber and technology (AI and its implications). I would add political risk and financial instability as the world is undergoing fundamental changes which will no doubt have an impact. The industry is well equipped to not only handle these risks but, more importantly, to influence the way they develop. We have the intellectual horsepower as a community to respond, but competitive forces prevent us co-ordinating our response where appropriate.

Höpke: The most obvious emerging risk on our radar is cyber. Years ago we began building up expertise and entering into partnerships to effectively address cyber risks both within our internal risk management and in the form of insurance covers for our clients. The specific challenge of accumulation risks, from a global IT virus or data breach for example, is closely monitored by a team of specialists and our instruments are permanently being developed by using our internal expertise as well as by partnering with external cyber specialists.

Parry: Cyber is still front and centre among the emerging risks. Major insurers are now coming out to say they are addressing silent cyber. With some saying they will no longer accept silent cyber exposure by explicitly excluding or including,

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I believe reinsurers should and will follow this lead. In which case, cyber coverage would be excluded from general property and casualty reinsurance and separately insured/reinsured. So, rather than having the uncertainty of having it covered as part of other classes it will be protected as its own distinct class. It will go in this direction, but the question is how long it will take to get there.

Reichelt: Digital technology's clash with legacy hardware, risks emerging from the spread of 5G mobile networks, increasingly limited fiscal and monetary policy flexibility, genetic testing and its effects on the insurance industry as well as the effects of climate change on public health are the key risks we have identified.

Pickel: The industry's main focus is on cyber risks but we are also watching issues such as global warming, superbugs that could develop antimicrobial resistance and nanotechnology, to name but a few. The world is changing at a record pace and so are the associated risks. For reinsurers it's more important than ever to keep aggregate limits under control and make sure underwriting is risk-adequate.

> "Lack of historical data and common methodology for defining and assessing cyber events makes adequate pricing and modelling a real challenge"
> *Jean-Paul Conoscente*

Conoscente: Cyber risks are exponentially increasing, fuelled by the digital transformation of our society and the interconnectivity of the global economy, but cyber reinsurance remains a nascent market.

Lack of historical data and common methodology for defining and assessing cyber events makes adequate pricing and modelling a real challenge. Nevertheless, the industry is developing the tools and know-how to tackle these risks, and some commercial models are now available. Reinsurers have a key role to play in ensuring the conditions are met for the cyber risk coverage market to develop further.

How will the role of the reinsurance broker change in the marketplace of the future?

Tsimaratos: It will be deeper, broader and stronger. In the past 20 years the reinsurance broking industry is one that has seen the biggest changes in the reinsurance chain. We have moved from being isolated, transactional intermediaries to deeper strategic capital and earnings management advisers. Today, we are all asked to support our clients to make sense of a broader, more complex and changing environment. The more changes and complexities there are, the greater becomes the need for intellectual capital within our firms.

Conoscente: From the point of view of a reinsurer, brokers have a fundamental role in the value chain. They face the same challenges and opportunities as we do, including market and pricing trends and the impact of technology, and we find answers to these together. To coin a word widely used these days, we are part of the same ecosystem and we see them as true partners.

Bruniecki: It has already changed considerably and the transformation is ongoing. Brokers have a role as trusted partners for their clients to make the best capital and risk management choices, where reinsurance is just one solution in a spectrum of possible alternatives. Beyond that, clients are seeking advice from their broker partners on a broader spectrum of issues.

To satisfy this demand, brokers will need to find and retain talent from a more diverse range of disciplines with collaboration at the heart of successful broking businesses. That is not an easy nut to crack.

Reichelt: Brokers are acting in a highly competitive environment – similar if not even tougher than the one for reinsurers. No surprise that we have seen M&A and continuous rumours about more to come in this respect. Currently brokers are competing with knowledge companies like reinsurers, consultants, specialised service providers on who can offer best know-how and solutions to the customers.

> "Brokers are acting in a highly competitive environment – similar if not even tougher than the one for reinsurers. No surprise that we have seen M&A and continuous rumours about more to come"
> *Frank Reichelt*

Pickel: Consolidation of the broker industry has certainly been a dominant topic over the past few years. The large brokers have all expanded their scope and built out their advisory and analytics capabilities.

I see this as a plus for Hannover Re because we have such a preferred partnership position that we can grow along with them. Yet we will also see new models emerging, maybe more specialised and regional players entering the broker market. We are keen to engage with incoming players if they differentiate themselves and bring new ideas.

CONTRIBUTORS

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Michael Pickel, executive board member, Hannover Re

Frank Reichelt, head of northern, central and eastern Europe, Swiss Re

Alkis Tsimaratos, managing director, head of western and southern EMEA, Willis Re

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 centres, 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

The Insurance Insider EVENTS

The London Market Conference
7 November 2019 | 08:15 - 16:00
(followed by networking drinks)
etc venues 155 Bishopsgate,
Liverpool Street,
London, EC2M 3YD
#InsiderLMC

***Insider* Progress**
20 November 2019
Hyperion Insurance Group,
One Creechurch Place,
London, EC3A 5AF
#InsiderProgress

***Insider* London**
28 January 2020 | 08:15 - 16:05
(followed by networking drinks)
etc venues Fenchurch Street,
8 Fenchurch Place,
London, EC3M 4PB
#InsiderLondon

(Re)insurance Claims Congress
5 March 2020
etc venues Monument, 8 Eastcheap,
London, EC3M 1AE
#InsiderClaims

***The Insurance Insider* US Honors**
23 April 2020
Guastavinos, 409 East 59th Street,
New York, 10022
#InsiderHonors

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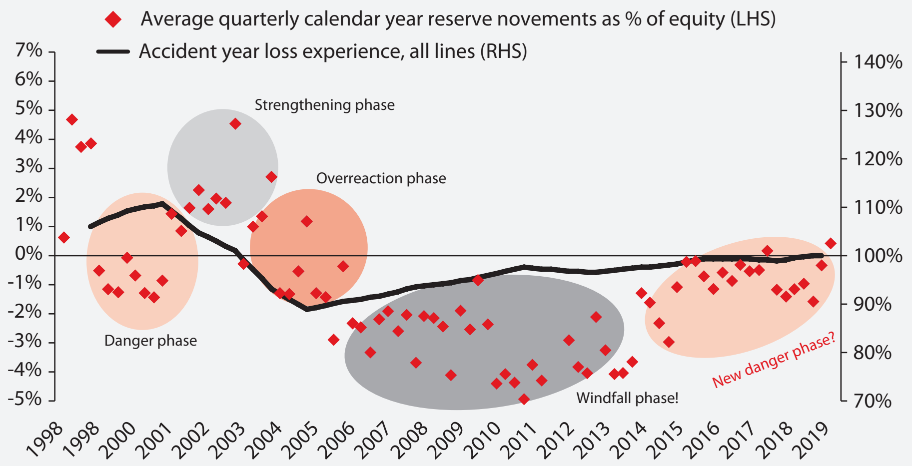
Emerging from the shadows

Casualty (re)insurance is often overshadowed by developments in property lines. As the last two years have shown, the human impact and devastating damage caused by catastrophes such as hurricanes, typhoons, wildfires and earthquakes tend to dominate the headlines.

The casualty market rarely gets the same level of attention, even though it has been the main catalyst of nearly all past market turns. Its underlying complexity, driven by human behaviour and other (medical, legal and economic) factors, makes it difficult to assess financial losses and, by extension, the adequacy of underwriting. Long-tail risks are particularly vulnerable to unanticipated developments that are not priced at policy inception. The asbestos crisis of the 1980s took seven or so decades, and a revolution in injury law, to manifest, while prolonged uncertainty about the UK Ogden rate has forced carriers to readjust their assumptions.

Calendar year reserve development by quarter for top 35 global P&C carriers vs accident year reserve experience – 1998 to Q2 2019



Source: Guy Carpenter

Claims environment

Favourable conditions in liability lines – for example, a benign inflationary environment and historically low loss experiences – have nevertheless supported underwriting results for much of the current decade. This period of low loss cost inflation and frequency has enabled carriers to release redundant reserves into earnings, thereby compensating for historically low investment yields, as well as elevated catastrophe losses.

But the situation now appears to be changing as a combination of higher loss costs, increased severity and growing instances of adverse reserve development are squeezing carriers' margins in a number of liability classes. Spiralling litigation, higher costs and bigger jury awards (and attitudes) have coincided with some prominent carriers rethinking underwriting appetites and pulling back or withdrawing capacity.

Although these factors can be difficult to quantify, some areas are clearly seeing increasing pressures. Federal securities class actions (and costs) in the US, for example, have risen in recent years. The number of companies being sued for securities claims has nearly doubled in the last three years, while median settlement values jumped last year to reach a decadal high of $13mn, according to National Economic Research Associates. This has coincided with rising legal services costs.

This is indicative of increased loss frequency and severity observed in several classes, including the US commercial motor market most prominently, but also directors' and officers', medical malpractice, general liability and other liability lines.

It typically takes a significant amount of time for long-tail claims trends to emerge fully. The loss potential associated with opioid addiction is just one example that could have serious implications for the sector on this front. Furthermore, the degree of change that is to come with technological disruption, the shift to intangible assets and the transfer of liability from individuals to large manufacturers has the potential to redefine liability risks like never before.

Enough in reserve?

There is therefore growing evidence that loss-cost pressures are starting to build in the casualty market. The recent, and often notable, pricing increases observed in several business lines support this theory. Given the smaller pool of carriers operating in the global casualty market, it is more vulnerable to capacity constraints should carriers' claims assumptions change.

The difficulties posed by estimating total ultimate losses for long-tail business mean sector capital levels become uncertain when reserves, which can represent multiples of annual earned premiums and equity, begin to appear deficient – even at the margin.

While reserve adequacy is notoriously difficult to predict, the analysis shown in the chart above implies that the sector may be in a danger phase in which carriers are continuing to release reserves even as accident-year experience indicates that redundancies are diminishing. The overriding trend in recent years towards fewer reserve releases is clear to see and may partly reflect the deteriorating claims environment. Notably, Q2 2019 was only the second time since 2004 that the sector experienced net reserve strengthening.

At the very least, our research indicates that carriers can no longer rely on reserve redundancies to protect or enhance profits as they have done since the mid-2000s.

Value of reinsurance

This backdrop points to the value of reinsurance solutions. Freeing up capital can enable carriers to enhance capital management strategies and improve capital efficiency. Transactions can take many forms, including new quota share programmes, adverse development covers and loss portfolio transfers. Although market conditions are tightening in some areas, cover remains available for those with the foresight to move quickly. It is clear now is the time to seek protection.

Carolyn Morley
Managing Director and Chairman of Global Casualty, Guy Carpenter

Julian Alovisi
Head of Research and Publications, Guy Carpenter

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