Insight and intelligence on the 2023 American Property Casualty Insurance Association meeting

in | insurance insider

APCIA

Day One

Three dynamics to watch at the APCIA annual meeting

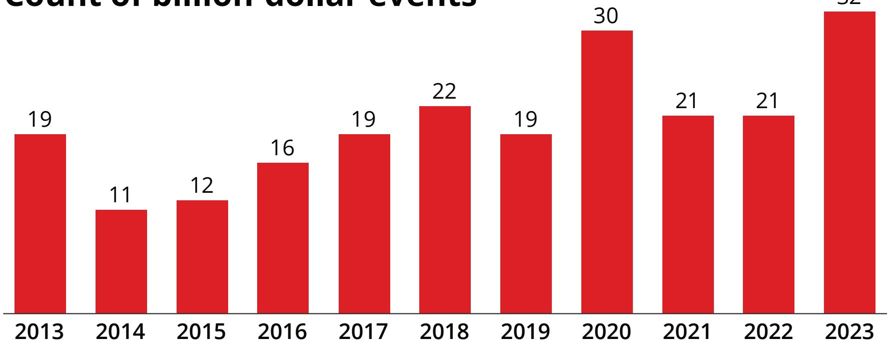
Last year's APCIA took place during the post-Hurricane Ian stand-off, but despite the greater calm and certainty surrounding the run-up to this year's 1 January renewal, there are several key themes to be debated at the event from cat frequency to social inflation impacts.

Hurricane Otis was yet another event to add to the 2023 tally, as (re)insurers headed for Boston. The high cat loss toll means pricing pressure remains in this area, while cedants are exploring options to refine their programmes in 2024.

However, attractive pricing for cat reinsurers, and the greater certainty they have in comparison to this time a year ago, means growth is back on the agenda for many reinsurers and a more orderly supply-demand balance is in play.

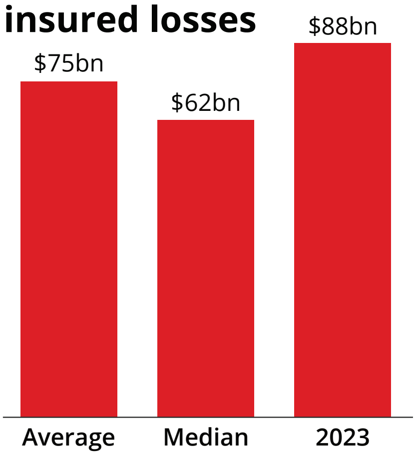
In contrast, there is more divergence in appetites and perceptions on the casualty markets. There have been signs of increased pressure on ceding commissions, but specific experience is more likely to steer a wider range of near-term outcomes, unlike the market-wide cat changes that were effected this year.

Count of billion-dollar events



Source: Aon

Aon Q1-Q3 global insured losses



Averages and medians since 2000. All losses are in 2023 $
Source: Aon

Finally, an ongoing question for reinsurers is one around the outcome and direction of this hard market.

The Irma to Ian loss years of 2017 to 2022 – and increasingly, the soft market casualty years of the late 2010s – are still hanging over APCIA discussions.

Aggregate and frequency covers: too soon?

From the cedants' perspective, broker sources have cited a greater concern among clients about securing cat frequency covers, after the availability of aggregate cover largely dried up in 2023.

But as conference season conversations got underway on the prospect of a return to aggregates for 2024 placements, there are signs that a number of reinsurers are reluctant to entertain this idea.

Higher retentions and a high-activity loss year for small-to-mid-sized events together mean insurers have taken a heavier burden from cat losses this year than reinsurers.

According to the National Oceanic and Atmospheric Administration, 24 separate billion-dollar weather and climate disasters were confirmed from Q1-Q3 2023, setting a record for the US after the country began compiling such data.

During the same time, severe convective storm losses in the US surpassed $50bn for the first time and generated 60% of global insured losses, Aon data showed.

One brokerage firm executive said that, in 2023, if clients were able to renew their aggregate protection at all, they were only able to place 50% of the expiring program.

"When these SCS events came along – and they did again – what used to be protected by aggregate reinsurance protection was now only 50% protected," the source said.

In addition, another major question cedants will be asking is around the availability of capacity at lower ends of the program.

Top layers of towers are now receiving strong support from reinsurance capacity, but the lower ends of the tower remain challenging.

Continued on page 3

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In that regard, a major task for reinsurance brokers in the upcoming season will be the reallocation of capital within the tower and whether they can "horse trade" reinsurers to provide coverage for lower ends by leveraging the allure of higher layers in the reinsurance tower.

However, it seems clear that higher retentions are here to stay.

On Everest's Q3 earnings call, COO Jim Williamson said higher reinsurance deductibles had been a "necessary and appropriate" move.

He said there might be "some adjustments around the edges" for cedants that had not "landed in the right spot" on retentions, adding: "Fundamentally, I don't see any change in terms of going backwards on retentions."

Cat pricing momentum

There's no doubt that the cat momentum persists in the reinsurance market. A more nuanced question heading into 1 January, however, would be if the peak hardening phase is behind us.

Last year's renewal was described as a "war on all fronts" as reinsurers and cedants battled over pricing, terms and conditions, and structures.

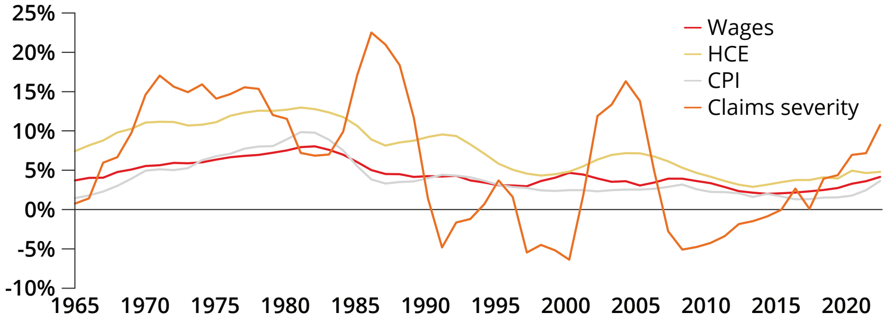
During Q3 conference calls so far, several reinsurer executives have expressed confidence that the dynamic and pricing momentum will continue in 2024.

However, the renewal discussions are likely to focus on how far reinsurers can secure ongoing incremental improvements, or safeguards against inflation, rather than the major changes of this year.

One school of thought is that, while property cat pricing levels are unlikely to drop, they are expected to largely remain where they are, just as 1 July renewals were not vastly removed from 1 January.

While cedants may be willing to discuss terms and conditions, or aggregates, in a market where reinsurance supply still falls under demand, they also know they are paying among the highest reinsurance costs in history.

US CPI, healthcare and wage inflation (five-year averages) and claims severity proxy



"Claims severity" refers to a proxy calculated as liability claims growth (claims incurred on a calendar-year basis) minus real GDP growth (as a proxy for exposure growth)
Source: Bureau of Labour Statistics, Oxford Economics, Centers for Medicare & Medicaid Services, AM Best, Swiss Re Institute

One reinsurer executive cited a case where a cedant with a strong balance sheet decided to form their own captive.

"We're starting to see that trend where sophisticated buyers are not going to sit there – [they're] not going to be just at the mercy of this," the source said.

Casualty quota share pressure

US casualty quota shares are increasingly a subject for debate as concerns around social inflation lend urgency to pressure on ceding commissions.

> "We can't get our hands around what is a normal loss expectancy on a claim"

Professional lines quota share treaties have seen cedes decline by an average of 2 points, while the movement for broader casualty lines has been relatively steady: flat or down by 1 point.

As a more dramatic move in H2 renewals, sources have told this publication that Chubb's casualty quota share has lost around 4 points, due to prior-year reserve development.

One of the first reinsurers to publicly report in Q3, Everest Re, said improvement to ceding commissions should "strengthen considerably" in 2024.

The downward trend marks a successful reversal for reinsurers, after ceding commissions rose by 2-4 points annually from 2019 to 2022 when the primary market hardened.

At its peak, cedes on the best books ran close to or above the 40% mark.

Despite the reductions, cedes on the most desirable accounts still hover in the mid-30s, which does not satisfy reinsurers who are looking at how social inflation and prior loss developments on older business are coming back to haunt clients.

The post-pandemic resurge has already started, as the annual sum of corporate nuclear verdicts bounced back to $18bn in 2022, from $5bn in 2020 and $8bn in 2021, according to PR and research firm Marathon Strategies.

"The courts are opening up on the casualty side, and they're opening up with vengeance," one carrier executive said.

Swiss Re also noted in a recent report that, with the current rotation from economic goods to services inflation, attention is shifting back to liability lines, where wages and health care expenditures are the key drivers for claims severity.

More fundamentally, sources cite an inherent difficulty to model social inflation and jury verdicts for its pricing. Litigation funding is also a major concern, but in reality, even obtaining data on this practice is a struggle, as only a fraction of US courts have mandated or are in the process of mandating the disclosure of such involvement.

"That's why to me, the casualty product is flawed right now," a source said. "We can't get our hands around what is a normal loss expectancy on a claim."

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Q&A: Aon's Liz Henderson and Tom Mortlock

Aon's Liz Henderson, Climate Risk Advisory lead, and Tom Mortlock, Senior Analyst, talk to *Insurance Insider* about how the business is helping its clients address the numerous challenges wrought by climate change

Aon has been involved in the climate space for some years now, so could you tell me what prompted the launch of Climate Risk Advisory?

Over the past several years we've been seeing an increasing need across a broader set of Aon clients to get more in-depth catastrophe and climate insights embedded in their organisation. That's been driven significantly by regulatory action, by investor questions, and by rating agencies which are starting to really look at climate change.

The need to disclose climate-related impacts will impact every organisation which participates in our economy across a wide spectrum of industries. One area of significant focus is on financial institutions, mortgage lenders and commercial loans that might have climate risk embedded in them that is not being quantified or communicated appropriately.

It became such an obvious unmet client need we decided it has to be an official aim and a primary focus for Aon.

Aon's Impact Forecasting team has developed a suite of catastrophe models for a range of perils and geographies; could you tell me how Climate Risk Advisory utilises those capabilities?

One of the benefits that Aon has is, not only do we have access to a wide variety of partners in catastrophe and climate modelling, we have our own in-house modelling team that's developing an independent view of risk. We can look at that model view, alongside other vendors, to help our clients really adapt a multimodal view of climate risk.

The use of Impact Forecasting allows us to look under the hood of models to try to help our clients understand the impacts of various assumptions on the hazard model or the impact on the vulnerability model and financial model and make adjustments to those assumptions which better reflect the organisation that we may be working with.

That ability becomes increasingly important as we're starting to talk to a wider set of clients in the commercial risk space.

You're now working with public sector and financial institutions entities. How has this new set of organisations responded to Aon's solutions? And what has Aon learned from these engagements?

Over the past several years we've seen increasing interest from both public sector and financial institutions in what has been – up until now – traditionally insurance-based analytics around catastrophe and climate risks. These sectors are naturally exposed to physical climate risks because of their longer-term investments in hard assets, whether they be public infrastructure with long engineered design lives, or residential loans on the order of decades.

For both sectors, climate has to date largely been a risk that can either be affordably transferred to the insurance market or comfortably retained. However, with an increasing risk profile across multiple geographies, combined with insurance affordability pressures, climate risk is now becoming a larger part of up-front investment and loan decision-making.

Most of the conversations we've had begin with a future climate lens, but quickly fall back onto helping these organisations understand the materiality of present-day weather and climate to their business. If you get the present-day risk view right, climate projections become far more informative.

For public sector clients, the focus is more on leveraging these analytics to help build resilience into either legacy assets or to undertake due diligence for new developments. For example, we're currently working with government clients to support cost-benefit analyses of where best to raise flood defence levels or property floor heights to reduce flood risk and inform planning policy.

How will Climate Risk Advisory develop in 2024 – where do you plan to augment your capabilities?

There are two big areas of focus for us. Aon is repositioning climate analytics across our Risk Capital organisation. We've created fresh teams to focus holistically on Risk Capital, which was driven by the need to create solutions across that set of clients in a consistent way. We're also focused on emerging risks and one key area is climate litigation and liability risks. We do see a rising need for analytics and risk transfer capabilities to help organisations manage political litigation related to climate change.

Liz Henderson
Aon's Climate Risk Advisory lead

Tom Mortlock
Senior Analyst, Aon

ANALYSIS

Midwest mutuals: Stress indicates a possible fracture point at 1.1

Key points

- Admitted lines exposure and undiversified portfolios have left some Midwest mutuals struggling to catch up on inward rate after investment writedowns, inflationary costs and retained storm losses
- Aggregate reinsurance, required for some firms, has been hit again in 2023 and is likely to be a major problem for 2024 renewals
- Consolidation is expected, but reinsurers may continue to scale back support of smaller players

Gulf insurers have borne the brunt of reinsurance rate corrections in the past couple of years, but a different, albeit similar market segment is emerging as a focus for concern ahead of this year's 1 January renewal.

Midwest mutual insurers are under stress following a couple of years of high convective storm losses, on top of the nationwide challenges plaguing the homeowners' and auto segments in particular — most notably inflation and claims severity trends.

While some of the largest mutuals are big enough to withstand these challenges, many of the minnow players have small capital bases and a high degree of reliance on reinsurance that makes them more exposed to reinsurance rate change as well as retained losses.

In this way there are some similarities to their Gulf domestic peers, although the regulatory and legal environments are seen as more favourable in the stoic Midwest than in Florida.

Financial pressures

In terms of scale in the Midwest region, only two mutuals have a 5% or more market share of P&C premiums.

Performance is also challenged, although one senior broker noted that it would be "a fallacy to say all the Midwest mutuals are struggling right now", with more diversified, commercial lines-oriented firms still performing well.

On a nationwide basis, AM Best studies have found that mutual P&C insurers posted collective underwriting losses of $31bn in 2022, equivalent to a 109.9% combined ratio that had deteriorated six points on 2021. Investment volatility last year led the mutual segment's surplus to fall by 7.8%.

Due to their structure, equity capital markets are not open to them, with limited options via the debt markets to raise capital if in need.

AM Best also noted that the number of negative outlooks on mutual carriers rose to 15% of the peer group — up from 9% in 2021 — while underscoring that many remain financially strong.

More than half the mutuals it rates are considered to have a "limited" business profile, with 64% geographically concentrated in a single state and close to 48% concentrated in their product offering.

These "limited-profile" mutuals may be many in number but their small scale is shown by the fact they write less than 5% of total premiums written by AM Best-rated mutuals.

Though 2023 data is not yet available, the convective storm loss activity this year has caused further stress amongst the segment, and geographic concentration can quickly cause a problem for mutuals if they happen to have got unlucky in weather strikes.

One concerning point for the segment, however, is that the hailstorm activity itself is not seen as unrepresentative but rather a new normal of costs that they will have to bear, reflecting changes in exposure and inflation.

In research studies, Aon has said more than 80% of the growth in SCS losses can be explained by exposure changes.

Moreover, in terms of fixing their underwriting losses, mutuals are often hamstrung by the concentration of their business in admitted lines, where repricing is a slower-burning correction than in E&S.

Many mutuals are seeking significant rate hikes from state authorities — as high as 60-80% in some cases. But those insurers that are looking to lift rates by lower levels are likely to get looked at askance by reinsurers in terms of whether they are making the corrections needed said one adviser.

Marcus Winter, president and CEO, North America, at Munich Reinsurance America, said that it would be prudent for mutual insurers to consider lifting rate and their policyholder deductibles as permitted by regulators, as well as to develop more granular modelling of their accumulation risks and perils such as severe convective storm, floods and wildfires.

"In particular the granular modelling and management of their accumulation exposures is critical to more stable earnings despite the challenging weather patterns in the Midwest."

Reinsurance patterns changing

In general, the reinsurance market's move to hike retentions in 2023 has favoured their results this year.

But while this means reinsurers are generally more content with occurrence coverage levels, grappling with the shrinking aggregate market and this year's loss activity is a crucial challenge facing Midwest carriers for next year.

Hannover Re's managing director for North American treaty, Axel Freiboth, noted that the geographic concentration

Top 10 mutual insurance firms by largest Midwest market share in 2022

Company	Market share	Rank (mutuals)	Rank (all insurers)
State Farm	11%	1	1
Liberty Mutual	4.7%	2	3
American Family Insurance	3.7%	3	6
Auto-Owners Insurance	3%	4	9
Nationwide	2.5%	5	11
West Bend Mutual Insurance	1%	6	26
Acuity. A Mutual Insurance	0.8%	7	30
Farmers Mutual Hail	0.7%	8	35
Kentucky Farm Bureau	0.7%	9	36
EMC Insurance	0.6%	10	39

Data for all NAIC lines of business.
Source: S&P Capital IQ Pro

of some mutuals lies behind the decision of some states to mandate purchase of aggregate excess-of-loss (XoL) covers.

"With the hardening of the market for the January 1, 2023 renewals, the availability of these covers essentially vanished and coverage was at best available only for a specific limit, if at all, with few exceptions," he noted. "These aggregate covers, partially mandated by state regulations, performed again at a loss in 2023 because of the high frequency of cat events.

"As such, the expectation is that there will be no availability for aggregate covers going forward. This will put many small Midwest carriers in jeopardy.

Brokers may look to create "synthetic" aggregates by structuring occurrence deals that would respond on an occurrence basis for third or fourth event triggers — but one broker suggested that the "jury's out on whether it's saleable or not".

German reinsurers continue to be a key trading partner for regional mutuals, but domestic reinsurers and Lloyd's writers have been pulling back in recent years, sources noted.

Munich Re's Winter — who said the firm had not actively reduced its capacity for this market segment — noted that some cedants have also been switching reinsurers to try to optimise their structures and panels.

The firm's clients tend to have separate XoL property and quota share casualty placements. "Those separate placements typically also allow for a more flexible structuring of capital relief transactions," he added.

But other sources noted that some regional mutuals have used multi-line treaties where capacity has retrenched.

Meanwhile, with some mutuals performing a reinsurance function to other peers in themselves, their operational challenges have impacted this source of reinsurance capacity.

Wisconsin Re is one such example, as it had reinsured 34 of the 44 mutual insurers in the state, and also operated a direct auto insurer 1st Auto.

Wisconsin's Commissioner of Insurance has now taken control of the insurers' assets through a rehabilitation process, and public documents show Wisconsin Re had incurred $75.9mn of claims in 2022 — triple the $25.7mn it took in 2020.

The Commissioner is evaluating options for Wisconsin Re including creating a reinsurance pool with certain restrictions for members, such as a minimum surplus to participate and receive cover, or paying assessments if losses are above target. An alternative is for other mutuals to merge into the reinsurer.

Similarly, the Des Moines Register has reported that Grinnell Mutual and Farmers Mutual Hail Insurance have told some small-town Iowa mutuals that they can no longer reinsure them.

One thing is certain, as Hannover Re's Freiboth said: "There is a lot of uncertainty in the market right now and it will be a very challenging renewal period for the Midwest Mutual insurance market."

Consolidation path ahead

All of these challenges mean that the segment is seen as highly likely to experience a shake-up in its membership base in the near-term.

This could take various forms of M&A, from a roll-up led by a larger insurer to mergers of smaller companies.

AM Best analyst Lauren Magro told this publication that consolidation was "definitely a possibility" as mutuals sought more geographic or product line diversification.

However, one broker said that whilst it might be a challenge for reinsurers to deal with small regional companies, their participation helped to create "a healthy ecosystem".

In a recent interview, John Smith, president and CEO at Pennsylvania Lumbermens Mutual (PLM), told sister title Inside P&C that there could be a shake-out of smaller cedants that had relied on aggressively priced reinsurance and regularly handing off losses. "The business model probably doesn't work for them if the price of reinsurance goes up."

However, there are still the questions of underlying rate adequacy that must be addressed by these carriers.

As one broker put it, for these Midwest mutuals: "Reinsurance is not the saviour – but it wasn't the problem to begin with."

Optimize and Diversify Capital Strategies

As a more stable market brings optimism, Aon's focus this renewal season is creating capacity to enable insurers to diversify with new sources of capital.

To help our clients make better decisions, we are building stronger reinsurer partnerships, accessing diversified capital sources and driving differentiation so clients feel seen and understood by trading partners.

Discover more on our Reinsurance Renewal Season Platform.