Insight and intelligence on the 2023 Baden-Baden Reinsurance Meeting

insurance insider

Issue One

BADEN-BADEN

Baden perspective: Levelling up across the Continent

Reinsurers are taking aim at pockets of European risk that escaped retention and rate rises last year

Reinsurers are approaching the 1 January European property treaty renewals determined to continue levelling up pricing adequacy across the Continent, although a calmer process than last year is anticipated.

Sources told this publication that all participants – including cedants and their brokers – are keen to avoid the fraught and delayed process of last year, and all anticipate fewer pain-points in negotiations.

Reinsurers have stressed, however, that there is still work to be done to improve rate adequacy across the Continent, and even to lift retentions in some areas, with Italy attracting particular attention.

Negotiations are expected to focus on where the burden of frequency risk should sit in a continuation of last year's trend.

But early signs indicate little change to the conditions that prompted last year's market correction, along with a willingness on all sides to proceed in a more orderly fashion.

Sources expect further rate increases this year, although at this early stage numbers are difficult to pin down. There is a consensus though that the best cedants can hope for is to renew their programmes risk-adjusted flat, while reinsurers will push for high-single-digit increases at least.

Loss activity looms large

The first half of 2023 has not been quiet for meaningful cat activity in Europe.

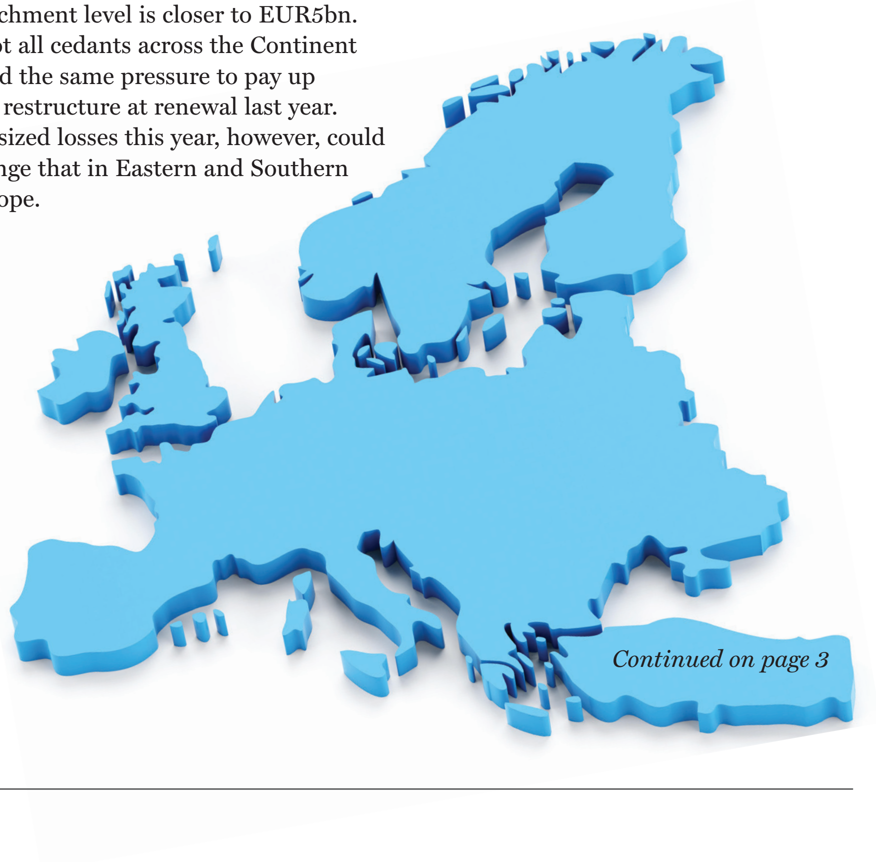
European insurers faced a number of mid-sized losses, including the earthquake that struck Turkey and Syria in February, flooding and hailstorms in Italy, and the worst flooding Slovenia has recorded in three decades.

The increasing frequency of mid-sized cat events prompted reinsurers to push up retentions at the last renewal, with one source postulating that, for North and Western Europe at least, a windstorm event would hit reinsurance programmes at an industry loss level of just under EUR2bn ($2.1bn). Now, that attachment level is closer to EUR5bn.

Not all cedants across the Continent faced the same pressure to pay up and restructure at renewal last year. Outsized losses this year, however, could change that in Eastern and Southern Europe.

Reinsurers are expecting EUR200mn+ in losses from Slovenian events this year, while it is likely that major Italian cedants will make some call on their reinsurance programmes following a run of dramatic weather events.

Slovenian insurance group Sava, for instance, bought in 2022 a cat excess-of-loss programme that attached at just EUR5mn for losses on its primary business. It is understood that retention levels did not move up this year for Slovenian cedants in line with peers in Germany and France, for example.



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Similarly, sources have repeatedly highlighted Italy as having so far been largely insulated from the sea-change in pricing and terms seen elsewhere in Europe last year.

The flooding that struck the north Italian region of Emilia-Romagna in May, combined with mid-sized hail losses later in the year, could be about to change that, however.

Sources agreed that Italian cedants will face pressure from reinsurers on their 2024 programmes.

Finally, the Turkish earthquake has led to questions around the value of relatively low-rate regions of Europe as portfolio diversifiers, given the length of the payback period following a large loss.

Outside the cat market, the spectre of Covid-19-related BI claims, having been dormant in the past few renewals, has also risen again as an issue. Complicating the process of this being put to rest, some claims disputes between reinsurers and cedants are yet to be settled and new litigation has arisen in the UK.

Supply vs demand

In autumn 2022, the market was tossing around vast numbers of \$10bn-\$20bn or more as it guessed at the amount of additional reinsurance capacity cedants would need to expand their programmes to keep pace with inflation.

In the end, despite attempts by some to secure sizeable new top layers, a number of cedants were unable to expand their programmes at efficient pricing and chose instead to lift retentions and shift their towers higher.

At the same point this year, cedants are clearly telegraphing a desire for more limit overall – but the question of whether reinsurers have the appetite to supply it remains, with their interest in growth perceived to be skewed to the higher-rated US market.

Brokers contend that reinsurers are now keen to grow into the positive market environment and will deliver additional capacity at the top of towers, for the right price.

They add that the largest insurers, and particularly those that have demonstrated a relatively consistent performance, are more likely to secure this capacity.

On the flipside, however, reinsurance underwriting sources have said they do not anticipate a huge upswell in top-layer demand, nor a vast increase in reinsurer capacity to change the fundamental supply-demand equation.

"There is no tsunami of new capital coming in," as one source put it.

Early reads on the retro market indicate very little change from last year in capacity levels and pricing, further restricting reinsurers' appetite to write significant amounts of additional business.

A major point of negotiation will be around aggregate capacity – which was rarely available this year. Brokers are looking to drum up interest from reinsurers in aggregates to provide insurers with multi-event cover, but at Monte Carlo, some reinsurers were highly wary of this idea, and it is clear that frequency covers will not be available at prior levels.

Structures, terms and pricing

Last year's renewal has been described variously as a "war on all fronts" (the Everything Everywhere All At Once renewal if you will), as reinsurers and cedants battled over not only pricing, but also terms and conditions and structures.

This year, however, participants expect a less fraught process, given that the industry's Overton Window of agreement on what constitutes a sustainable reinsurance structure has shifted significantly.

With attachment points and pricing up, and wordings tightened to exclude or limit a variety of risks including strikes, riots and civil commotion and political violence (PV), today's average European treaty looks very different to that of 12-24 months ago, although Europe escaped the extreme changes that some US cedants experienced.

One source said cedants who reluctantly accepted PV or terror exclusions may push to add this type of cover back into their programme – but added that the recent attack on Israel will only strengthen reinsurers' discipline around these perils.

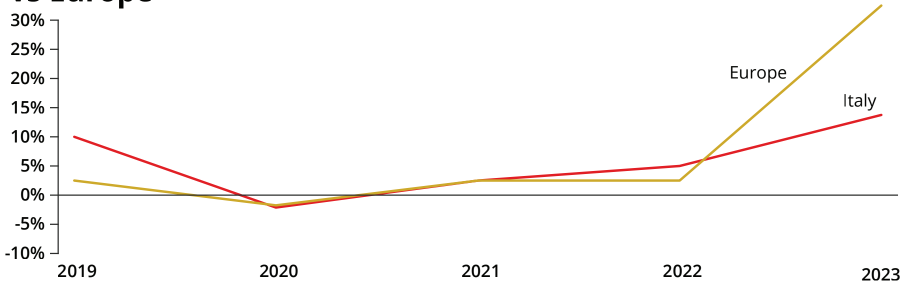
Similarly, while cedants may want lower retentions, sources on both sides of the negotiating table saw any movement here as highly unlikely, given reinsurers' successful avoidance of much of this year's cat burden to date.

Select major European losses YTD 2023

Month	Country	Event	Insured loss
February	Turkey	Earthquake	\$6700mn
May	Italy	Flooding	\$1000mn
July	Italy	Hailstorms	\$2070mn
August	Slovenia	Flooding	\$350mn

Source: Munich Re, government of Slovenia

Median price movement on clean property cat treaties, Italy vs Europe



Source: Gallagher Re

ANALYSIS

Postcard from CIAB: Casualty creeps into the conversation

The top brass of the P&C (re)insurance market gathered at The Broadmoor hotel in Colorado Springs recently as the 2023 conference season rumbled on.

After three days of senior executive meetings, here are three key thoughts for the London market and reinsurance audience.

1. Reinsurance-casualty takes over the conversation

The messaging from reinsurers has not vastly altered since Monte, but the emphasis has changed.

Across all conversations, the rapidly changing picture in US casualty — particularly general liability — is causing concern.

The market is battling the consequences of a structural and cultural change in the way cases are brought, litigated, and treated by the courts. The plaintiffs' bar has been supercharged by litigation funding, and lawyers increasingly being remunerated on monetary outcomes, rather than hours worked.

Consequently, loss severity is spiking at an alarming rate. Some talked about seeing loss trends as high as 10-12% on excess casualty books.

Meanwhile, the back years of 2015-2019 are still burning. Sources suggested there have been significant upwards revisions in loss picks, in some cases in the double digits for a given accident year.

This is also not contained to US cedants — with a number of sources noting that European insurers are seeing US exposure creep into their books (and into their reinsurance programmes) as a result of the US footprints of international clients.

Limits had already been curtailed in the market hardening in GL — even if that has eased a little. At the conference, sources were talking of an expected acceleration in rate, although no one ventured to what magnitude (and this will vary by where you choose to play in the tower). Some have chosen to also invest in their claims function to help insureds manage their defence costs, and hopefully bring settlements lower.

But reinsurers are nevertheless making some bold statements that ceding commissions on casualty treaties need to come down meaningfully, with pressure too for primary players to drive rate ahead of loss trend, and keep limits tight.

It's worth saying that pressure on ceding commissions from reinsurers has featured as a topic of debate for a number of years with little effect. Some cedants believe by flexing their panels they may be able to escape the 2-3 point ceding commission drops talked up by harder-line markets like Munich Re and Swiss Re.

There isn't yet the suggestion that there is a major withdrawal of capacity from the casualty treaty space — and the jury is still out on where the market will land for the 1.1 renewals. However, the strong desire to grow in casualty treaty seen especially in the 2021 renewals, and to a degree into 2022, is likely to have passed.

2. Property cat and the need for sustainability

The messaging on property cat, meanwhile, has been more consistent with that put out at Monte Carlo, although some brokers believe some of the reinsurer posturing in September has softened a little.

Brokers' requests for rate decreases are still being heavily pushed back, and reinsurers are still demanding rate increases.

There is certainly talk among reinsurers that significant rate rises are needed on European cat treaties — not least because the space has been inadequate for so long, but also because of the elevated loss activity seen on the continent this year.

As we wrote at Monte Carlo, reinsurers feel the need to provide good returns and show they can be an attractive long-term value proposition for capital. Sustainability continues to be a major talking point and in many carriers' minds, it is too soon to be entertaining the idea of a concession of rate and terms on a broad basis.

3. E&S enthusiasm

The mood on E&S is buoyant, and overall the conference had a fairly upbeat feel.

There is certainly some positivity that the momentum which has continued in E&S for longer than many expected will continue for a while longer.

Reasons given by the optimists include the clear challenges the admitted market is facing, particularly in personal lines, in managing the consequences of changed weather patterns and elevated cat risk.

The constraints of rate and form at admitted players is leaving them unable to move quickly enough in adapting to this change, which is driving more submission flow to E&S.

One of the first questions any broker is asking is whether there is any new cat capacity for property.

The answer is not always favourable — and any additional limit being put up is often at a steep price. There are also black spots such as Florida habitational for which market appetite is extremely rare.

Brokers are increasingly suggesting self-insurance or sometimes parametric solutions to clients for their property risk.

Optimists argue that greater uncertainty and risk across society — be it geopolitical, macroeconomic or climate — can only increase the demand for E&S solutions.

It is worth noting that not all in the market are so bullish. Some venture the warning that continued growth in the E&S space could attract the eye of regulators and politicians, particularly as E&S involvement in the personal lines space grows.

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Q&A: Nikhil da Victoria Lobo

Swiss Re's head of P&C reinsurance for Western and Southern Europe talks to *Insurance Insider* about the European renewals environment and how risk is evolving in the region

How are the 1.1 renewals shaping up for Western and Southern Europe?

At Monte Carlo, a common word heard was 'orderly'. The message for Baden-Baden is that we expect it to be an orderly renewal, which means the market should find a clearing price in a more normalised fashion, but that doesn't mean we won't be having hard discussions with clients.

Those hard discussions are going to fix a lot on topics like strike, riot and civil commotion – we've talked a lot about more geopolitical instability and that shows up in insurance too.

It's going to be reflected in discussions around things like property per-risk coverage, which we know has been a segment that has been unprofitable for many years, and we're also going to see it perennially in the discussions around natural catastrophe coverage, because with inflation we expect EUR4bn-EUR5bn more of demand in the EMEA region, and we haven't seen capital coming into the sector, so that's going to put pressure on leading reinsurers like Swiss Re to step up and help its clients.

We often speak about managing aggregation in property lines, but how do you expect this to evolve in casualty lines?

Aggregation is always brought up in the property context, but as we know, there are events that lead to risk being spread across the casualty class too. A good example of this is PFAS, so-called 'forever chemicals'. I remember when I joined Swiss Re over 20 years ago, we had a report talking about nanotechnology and nanochemicals, and now, 20 years later, we start to see the first litigation from PFAS-type chemicals showing up.

PFAS is an emerging risk as we have seen claims being filed against major manufacturers. Those claims have been primarily filed in the US, but we also see growing awareness for the topic in EMEA. This is the kind of risk that we see could be spread across various casualty lines.

Which other emerging risks are top of mind?

In EMEA, we have been a little privileged not to be prone to the same jury-type awards that we see in the US, but pressures around social inflation and the litigation environment are similar, because some of the frustrations we see against corporations or the public sector are as high in Europe as they are in the US. We see an uptick in litigation funding in Europe, and a jump in class actions.

The second is climate risk beyond the property context. For the month of August, the insured losses caused by storms, hail, lightning and floods in Germany added up to EUR1.5bn, according to the German Insurance Association. EUR550mn of that was for motor claims. Climate is not just a property issue; it's a casualty issue and it's also going to show up in other places such as life and health, so those are the kinds of risks that make me a little concerned for the future.

And looking out over the horizon, where are you seeing the best growth opportunities?

One is in public private partnerships. One of the markets I cover is Turkey. I'm glad, despite the tragedy, to have been able to support this market in its time of need this year, and if you look at the market loss, which we think at Swiss Re is about $5.3bn, a good chunk of it will come from the Turkish catastrophe insurance pool. And that demonstrates compulsory insurance can make a difference. In my past life I worked with governments in Mexico, the Philippines and the Caribbean, and in all of these cases, we used parametric insurance, and it can help.

I think a second area is clearly renewable energy. We expect investments in green energy will generate additional energy-sector-related insurance premiums of almost $240bn by 2035, and our sector has a lot to contribute. Swiss Re has invested more, for example, in new parametric products for solar, and this makes renewable energy more feasible.

And the third area for me is leveraging the data we have – new technology platforms – to develop better insights for insurance companies and drive improved insurance resilience.


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Q&A: Jan-Oliver Thofern

What are the key capacity trends you are seeing in the region at the moment? How has this changed since the last Baden-Baden conference?

The market has changed significantly since early 2022. Last renewal season was a very difficult one and, at one point, there was uncertainty about whether there was enough capacity to complete all placements. We saw price increases and terms were tightened at higher retention levels.

Moving into 2023, globally we've seen improvements. The Asian market renewals where we observed price increases were still significant, but not quite as high as we saw them in 2022.

During the US renewals again there have been increases, but the overall trend is pointing down now.

Is the sentiment around capacity changing? We saw more optimism in Monte Carlo this year compared to pessimism in 2022? Why is that?

In Monte Carlo we saw a swing in the mood of reinsurers. Due to our global reach and market position we can see well who is reducing, who is flat and who is increasing their cat capacity. I think there are two reasons for that. Number one: there was moderate loss activity globally. Germany had about EUR2bn of cat losses and globally we were at about EUR55bn. Number two: the risk profile of the reinsurers in their portfolios has changed and improved noticeably after retentions have been increased. Losses have therefore attached to the balance sheets of insurers rather than reinsurers. We are seeing combined ratios of around 90%. As a result, due to retained earnings and some capital raises, there's more capital available and we expect a much more orderly renewal with price pressure in certain segments of the business.

Another driver of that improvement is that the threat of further interest-rate increases has moderated. Insurers and reinsurers are also seeing great returns on the money they invest and more capital is coming back into the market. We expect retained earnings and fresh capital to add about EUR10bn to the market.

What is your view on ILS markets? How are they developing and changing?

Bigger insurers are using ILS as a component of their overall risk mitigation strategy.

However, for the most part this has been limited to large insurers. This hadn't trickled down to the more regional insurance companies, but this is happening now.

The thought of adding a separate, uncorrelated source of capital is attractive and so we are going to see more activity on this with smaller providers taking advantage of ILS as part of their strategy.

What is your personal view on the risk landscape?

A key takeaway is that the risk landscape is pretty much dominated by the recent inflationary trends. It's important to keep track of that, especially in an environment where we expect reducing inflationary impact. We must make sure we're able to present the risk in the proper way to the reinsurers.

Sometimes there is a tendency to simplify the risk analysis on the reinsurers side.

What are your thoughts on the renewals market in general?

Capacity wise, we expect a very orderly renewal this time around unless something dramatic happens.

And we expect there will be enough capacity also for additional purchases, which we predict will come to the market.

You have to take into account portfolio growth and the level of protection companies are looking for. In the past renewal, firms may not have purchased extra protection simply because the capacity wasn't available or the price was too high. Now we assume more competition among the reinsurers.

Jan-Oliver Thofern
CEO Germany for Aon's Reinsurance Solutions

ANALYSIS

Marine and energy treaty at 1.1: Reinsurers to hold firm

Specialty reinsurance underwriters are poised to hold firm on terms and pricing in the upcoming marine and energy reinsurance renewals, with early indications suggesting price rises could coalesce in the single digits this year, according to a market canvass conducted by this publication.

Sources said they are anticipating more orderly negotiations than those during a hectic run-up to 1 January 2023, when reinsurers achieved a radical overhaul in contract structure and pricing, which left brokers scrambling to confirm coverage in the run up to the new year.

Sources said that just as much focus will be directed to terms and coverage for the 1 January 2024 renewals.

Meanwhile, brokers are optimistic that in a more orderly market, they will be able to achieve clearer and more aligned coverage for cedants, with reinsurers approaching the renewal without the fear of unquantifiable losses relating to the war in Ukraine.

"Broadly speaking, it is about making sure that the achievements reinsurers made last year are not lost and that we are not imminently moving back towards a 2022 or 2021 market," said Christian Silies, head of global aviation, marine and energy reinsurance at Sompo International.

"The point that reinsurers made over 1.1 was that coverage needs to be paid for, and the terms and conditions and the wordings should be tight rather than broad."

In particular, reinsurers want to ensure all aspects of reinsurance coverage have appropriate, more specific levels of premium attached, and any re-bundling of contracts that were restructured last year is unlikely.

"The days when one plus one equals one and a half in terms of pricing are over," Silies said. "Nowadays it is probably two."

With Ukraine exposures more clearly understood than last year – despite ongoing uncertainty around potentially vast aviation claims – brokers said that there is an increased appetite from reinsurers to write marine and energy business.

Key points

- Reinsurers are looking to hold firm on coverage and pricing in upcoming marine and energy treaty renewals
- Sources estimate prices coalescing in the single digits and a more orderly renewal
- Contract structure is not anticipated to change substantially, following the de-bundling of composite policies
- Sharp scrutiny is being applid to net-zero transitions in energy portfolios

> "It is about making sure that the achievements reinsurers made last year are not lost"
> **Christian Silies, head of global aviation, marine and energy reinsurance at Sompo International**

Nick Croxford, global head of marine and energy at Gallagher Re, said that at this point last year, reinsurers were "fearful", but that the atmosphere had now changed.

"They didn't know what losses from Ukraine would materialise," Croxford said.

"I think they were comfortable at 1.1 with the pricing and standards they achieved, and now it is a green light to write business."

Inflation also remains a key point of discussion, while retention increases implemented last year are expected to be broadly unchanged.

In addition, the market is paying closer scrutiny to underwriting plans relating to the energy transition, with ESG increasingly incorporated into reinsurance underwriting decisions.

The ramifications of Ukraine

Russia's February 2022 invasion of Ukraine sent shockwaves through the (re)insurance market, but it only became clear in the final weeks of the year how dramatically specialty reinsurers would react.

Composite deals had previously been commonplace in the specialty market – bundling in lines including marine, energy, aviation and political violence – but in many (but not all) instances, these structures were drastically reshaped.

In particular, reinsurers were keen to generate additional premium income for political violence business, which sources said had been incorporated into contracts for negligible premium in soft market years.

Furthermore, a series of exclusionary wordings were introduced, largely relating to war coverage.

Reinsurers adopted a defensive stance, producing their own wordings, creating significant concerns about potential gaps in coverage and leaving many carriers running marine war risks on a net basis in Ukraine following the renewal.

Christian Silies
Head of global aviation, marine and energy reinsurance at Sompo International

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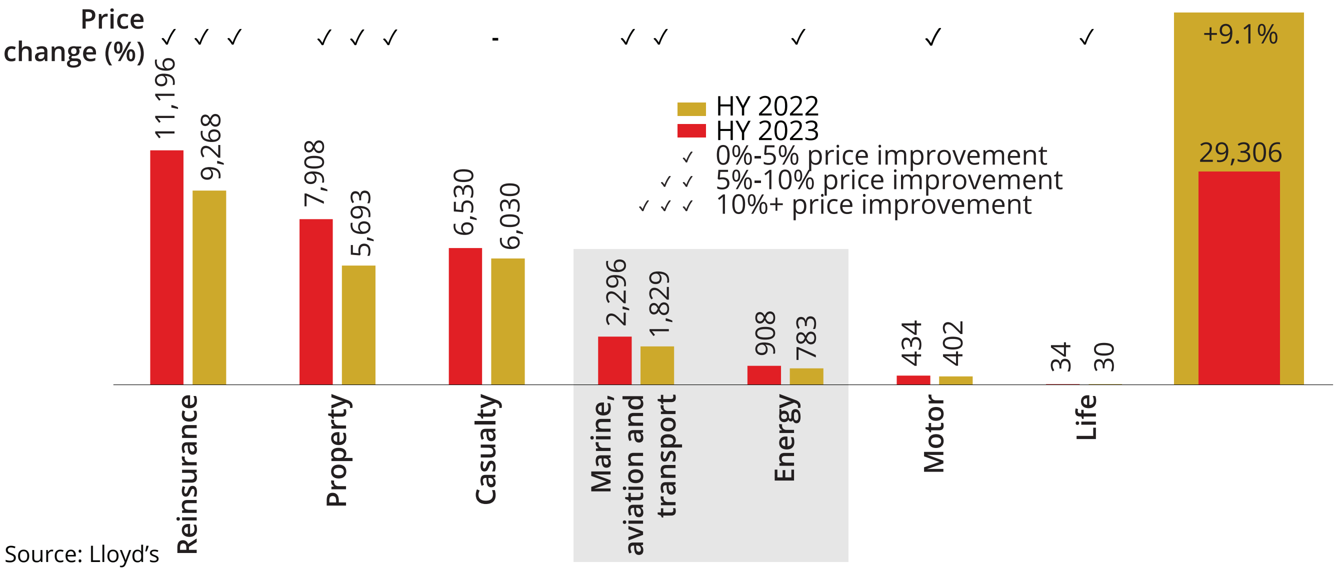

Source: Lloyd's

Hannover Re – amongst the largest players in the specialty market – caused particular commotion with its exclusionary wording, as well as its move to exclude indirect losses from the war.

Key to the reinsurer attitude was a huge unknown about the eventual scale and impact of claims stemming from Ukraine, with the majority of marine claims only crystallising from February 2023, a year after the invasion was launched.

"One of the key challenges at 1 January 2023 was that you had unquantifiable losses coming out of Ukraine," said Jim Summers, global head of marine and energy specialty at Guy Carpenter.

"That lack of clarity led to a defensive position being taken by reinsurers in terms of pricing, terms and conditions, and event definitions around terrorism."

While deals ultimately got home, the situation was chaotic.

Aspirations for standardisation

Approaching this renewal, brokers are pushing hard to deliver aligned coverage that meets the demands of clients, which were effectively operating as forced buyers last year.

"What we want to ensure this year is that clients are able to purchase the types of cover that best meet their risk and capital needs," said Summers.

"We want to get to a place where we can have one structure and one set of terms, and one set of event definitions."

Reinsurers also said there was a willingness to push for more uniformity of coverage.

"I completely agree that is desirable," said Silies of Sompo International.

"This is where the reinsurance market has not delivered. Unified clauses would have been desirable."

Nuanced approaches

In a market that looks set to be more favourable for buyers, brokers are optimistic that more attractive deals can be achieved for cedants with strongly performing books.

Gallagher Re's Croxford said that reinsurers adopted a "blanket approach" last year, however this looked set to change.

"We want to differentiate our clients," Croxford said.

"Last year there was a blanket approach but now there is appetite to partner with well-performing cedants."

> "Last year there was a blanket approach but now there is appetite to partner with well performing cedants"
> **Nick Croxford, global head of marine and energy at Gallagher Re**

Another major change in last year's renewals was increasing retentions, which has made some marine and energy losses this year painful for the direct market, with insurers swallowing higher net claims costs.

However, it is not anticipated that there will be significant changes to retention levels at upcoming renewals, especially given the positive dynamics in primary market pricing.

"Generally, in a harder market if your underlying book is sound then taking a higher retention can be a healthy thing to do," Summers said.

Reinsuring the transition

While war coverage is set to be the key talking point of 1 January, there is an increasing focus on ESG in underwriting decisions, with reinsurers wanting to see tangible energy transition plans within energy portfolios.

There is increased demand for renewable products, but traditional fossil fuel risks are still the mainstay.

"Supporting energy majors who are themselves going through a transition seems a wise strategy," Sompo International's Silies said.

"We are going to be a partner in that transition as well. We are giving our clients time, but that transition is happening."

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.

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