Insight and intelligence on the 2023 Baden-Baden Reinsurance Meeting

insurance insider

Issue Two

BADEN-BADEN

Three dynamics to watch at Baden-Baden

With new leadership at some of the largest continentals, there will be close attention to how their tactics in changing lines of business will evolve

As reinsurers, cedants and brokers arrive in Baden-Baden to thrash out 1 January renewal terms, the underlying environment may well feel more relaxed than last year in the aftermath of Hurricane Ian.

Yet there are multiple shifting currents at work in the industry right now, which are trends to watch from a European reinsurance perspective: from the new directions set among the Big Four after a changing of the leadership guard to the shake-up among leading brokers.

At a line of business level, some segments are experiencing deterioration that will be closely watched, with cyber and casualty business two that are under the microscope right now.

Cyber: Ransomware rears its ugly head

In the early part of last year, there was a distinct reduction in the frequency of ransomware attacks, largely attributed to the onset of war in Ukraine. That lull, however, ended abruptly at the start of this year, with a 48% increase in attacks in the first five months of 2023, according to NCC Group data.

In fact, some sources believe the frequency of attacks is now even higher than during the first wave, which began to show in 2018.

At the same time, pricing in primary cyber business is tumbling, with low-double-digit rate decreases in excess layers and softening in primary layers as, in the London market at least, firms accelerate growth in the class.

Quota share reinsurers will be observing this trend closely. Meanwhile, as the excess-of-loss segment grows, reinsurers have been exploring use of ILS retro, but alternative capital providers remain wary of their ability to model the risks.

Casualty deterioration

Many in the market fear that more loss deterioration and inadequate reserving is to come from the soft years of the latter part of the last decade, and even that under-reserving is a structural problem.

> "Many in the market fear that more casualty loss deterioration and inadequate reserving is to come from the soft years of the latter part of the last decade"

As global economic inflation and – in the US – social inflation continues, this can only get worse. Reinsurers are already signaling that, having focused last year on property cat business, the 2024 renewal will be tougher for buyers of casualty treaty.

Changing European guard

Both Swiss Re and Scor have new leadership in place this year – at the top for Scor with Thierry Leger and in the second-tier ranks for Swiss Re.

As Scor's third CEO in recent years, Leger has said he is aiming for the firm to practice more disciplined cycle management, arguably a notable shift for any continental firm given the Big Four reinsurers' focus on relationships.

Other ambitious plans include doubling fee income and creating a new data platform to improve capital allocation and develop new products.

Swiss Re's restructure is internally seen as something that will drive leader accountability at the market unit level, making underwriting paramount, in contrast to a 2012 restructure that gave more power to client managers and led to a greater focus on growth.

With a turnaround on its CorSo business now effected, whether this restructure can have an impact on persistent casualty reinsurance losses remains to be seen.

There have also been serious changes to the broking order within Europe.

HowdenTiger last spring launched a major assault on European business through the hiring of Guy Carpenter Europe CEO Massimo Reina and more than 25 colleagues, sparking a lawsuit and eventually a courtroom-steps settlement of more than £50mn ($61mn).

Since then, Guy Carpenter has hired former Scor CEO Laurent Rousseau as CEO for EMEA and capital solutions, with former Pool Re CEO Julian Enoizi reporting to him as Europe chief.

The entrance of another large European broking team, potentially with the power to use strong existing client relationships, could add an impactful element of competition to this year's renewal.

INTERVIEW

RenRe's Dalton: Validus merger will bring European firepower

RenaissanceRe's impending purchase of Validus Re will give it the additional firepower to expand meaningfully in Europe at 1 January if conditions are suitable, according to the carrier's Bryan Dalton.

The global property CUO and interim Europe CUO told this publication that RenRe and Validus, when combined, will utilise existing European relationships to meet clients' needs in what remains a tough market for cedants.

AIG announced its agreement to sell Validus to RenRe for around $3bn in May, with the transaction expected to close in Q4.

"We've got a lot of conviction in the Validus team and the Validus portfolio," Dalton said.

"We've got strong relationships in Europe because we have been trading there for 30 years. We anticipate taking in some folk from the Validus team both in Zurich and Bermuda with really deep relationships that we believe will help us establish our position as the number-one broker market."

Dalton said the company's focus post-closing will be to emphasise the combined entity's "deep risk expertise" and "an underwriting culture that wants to solve clients' problems", backed up by "strong balance sheets and material capacity".

He added that clients at the Monte Carlo Rendez-Vous and CIAB are "engaged" and "excited to have a different RenRe at the table".

"Our trading style will evolve over the next year or so to carry the responsibility that comes with the scale that we now have," Dalton said.

RenRe bought Tokio Millennium Re for $1.5bn in 2019, which brought a Zurich team that the company has built out since.

"We've got a team there that's dedicated to the continent, across property, casualty, specialty and credit and we think that the Validus team will complement it," said Dalton.

> "Our trading style will evolve to carry the responsibility that comes with the scale that we now have"

European growth

Dalton said that while the combined RenRe-Validus will be the fifth-largest P&C reinsurer globally, it will not rank as highly in the league table of European reinsurers.

"We're really hopeful that we will combine the two portfolios together and then we have the appetite, given the market dynamics in Europe, to be able to grow if it's helpful to our clients," he said.

RenRe has already been growing in European property reinsurance, having expanded meaningfully in the class after Bernd in 2021 and last year's French hailstorms.

"We don't see that as opportunistic growth," Dalton said.

"We really see those moments as opportunities for us to bring our expertise to bear and [be part of a] genuine desire to try and solve clients' problems."

The executive added that there will be a number of stressed regions within Europe as a result of 2023 cat events, citing Turkey and Italy as examples.

Here, he said, there will be "an opportunity for us to sit with our partners... and solve the problems that are continuing to develop".

Dalton stressed that RenRe is not preparing to demand steep rate increases across Europe, but instead to apply a differentiated approach depending on each client's attributes and performance.

"This time last year, we were looking for a stairstep moment in reinsurance so that we could continue to attract material capital," he said, referring to the reinsurance industry's unified push for rate and programme restructures.

That is a different scenario to this year's renewal, Dalton said.

"The conversation is moving to 'how is inflation interacting with people's portfolio?' and from there, 'are reinsurance terms adequate?'," he explained.

"It's a focus on adequacy and the underlying contracts as opposed to specific rate changes."

Dalton added that, while the main focus of renewal negotiations last year was cat excess-of-loss (XoL) business, this year property per-risk and casualty XoL contracts will be in the frame.

"Both we and our clients and brokers need to put some work in there because some of those products are challenging from a capital perspective," he said.

Dalton also said RenRe expects more demand for limit expansion from regional European cedants – a move that last year was only possible for large global insurers.

He added that RenRe's Top Layer Re, a joint venture with State Farm, and cat bond fund Medici, are solutions the carrier can offer for top-layer protection.

Bryan Dalton
Global property CUO and interim Europe CUO, RenaissanceRe

ANALYSIS

Aon steps up search for major US acquisition

Aon has moved up a gear in its search for an acquisition or acquisitions that will allow it to fulfil its ambition to enter the US mid-market and US wholesale segment, this publication understands.

This publication revealed in the spring that Aon became more active in considering scaled acquisitions in Q4 last year. (For background see: "Aon: The moment for dealmaking")

However, sources said that in recent weeks Aon's activity has intensified, with the firm meeting with a range of possible takeover targets.

It is understood that Aon has engaged with AssuredPartners as part of the latter's strategic process, which *Inside P&C* first revealed on September 7. An IPO is also believed to be under consideration for AssuredPartners, as owners GTCR and Apax look to maximize their exit options.

Sources have suggested that Aon has also met with Galway, owner of Epic and Jencap, and MDP-backed NFP, as it searches for a transaction.

Banking sources believe Aon could pull the trigger on a deal as soon as this quarter, or early next year.

Potential targets

Aon is expected to choose a platform with substantial scale. Galway – the smallest of the three - is likely to be sold off adjusted Ebitda in the $400mn-$500mn range, potentially pointing to a $7bn-$8bn enterprise value transaction.

NFP and AssuredPartners are substantially bigger. NFP reported $536mn of Ebitda to Moody's on a 12-month trailing basis to 30 September last year, suggesting that it is probably on course for ballpark $700mn of adjusted Ebitda this year.

AssuredPartners is being marketed to potential acquirers at around $800mn-$900mn of adjusted Ebitda, pointing to a likely valuation in excess of $12bn, and potentially closer to $15bn.

Aon: Potential takeover targets

Potential target	Estimated marketing Ebitda	Illustrative valuation at 16x multiple
Truist Insurance	$1,000mn	$16bn
AssuredPartners	$850mn	$14bn
NFP	$700mn	$11bn
Galway	$450mn	$7bn

Source: Insurance Insider reporting

Sources have also pointed to Truist Insurance as a possible target, with Aon understood to have made a preliminary approach for the firm earlier in the year at the time of its process only to be rebuffed. Truist subsequently sold a 20% stake in the insurance business to Stone Point.

With Truist Insurance's parent bank likely to need additional capital in the coming years, it is on a path to a sell down of its stake. However, the revenue dis-synergies resulting from retail/wholesale channel conflict between Aon and Truist's wholesaler CRC render a deal with Aon a long shot. Marsh is understood to be CRC's largest client, and could be expected to pull all of its business Day 1.

Benefits and drawbacks

All of the different potential deals offer Aon advantages and disadvantages.

Galway offers Aon both a mid-market retail capability, a top-10 wholesaler, an MGA platform in Paragon, and the biggest opportunity to drive margin creation. However, it has a significant amount of leadership that would look to retire, has a heavier weighting to the upper mid-market, and has not built the M&A machine of some other firms.

Aon would have to either pre-empt or come out on top in a sale process for AssuredPartners, which could create upward pressure on valuation and lower execution certainty. The firm has not grown strongly organically and is perceived to have further to go on integration. In addition, founder Jim Henderson is expected to retire in relatively short order post-deal, with succession now in place in the form of CEO Randy Larsen and president Paul Vredenburg.

The firm has an MGA operation which is likely to be attractive, but lacks wholesale broking.

NFP, meanwhile, is a more integrated business that has a well-oiled M&A machine, and also would bring a recently united MGA platform. However, some believe that the firm's culture could be more challenging to integrate into Aon. In addition, it has a higher weighting to benefits and wealth than peers – and it is not clear that this is Aon's focus. In addition, the market is also watching for the possibility of a management transition at some point with Doug Hammond now in the top job for a decade.

Truist Insurance, meanwhile offers wholesale and retail at scale, including significant MGA operations, with the business around the $1bn mark in Ebitda. However, revenue breakage in CRC would be huge, and McGriff has been a low growth business that has been quiet on M&A.

As previously argued, the time looks to be right for Aon to pursue a major transaction. This reflects the expectation that market-driven organic growth

Aon has spent $22bn on buybacks since 2012

FY	Share repurchased	Price per share	Total repurchase cost
2012	21.6mn	$52.16	$1.1bn
2013	16.8mn	$65.65	$1.1bn
2014	25.8mn	$87.18	$2.3bn
2015	16mn	$97.04	$1.6bn
2016	12.2mn	$102.66	$1.3bn
2017	18mn	$133.67	$2.4bn
2018	10mn	$143.94	$1.4bn
2019	10.5mn	$186.33	$2bn
2020	8.5mn	$206.28	$1.8bn
2021	12.4mn	$286.82	$3.5bn
2022	11.1mn	$289.76	$3.2bn

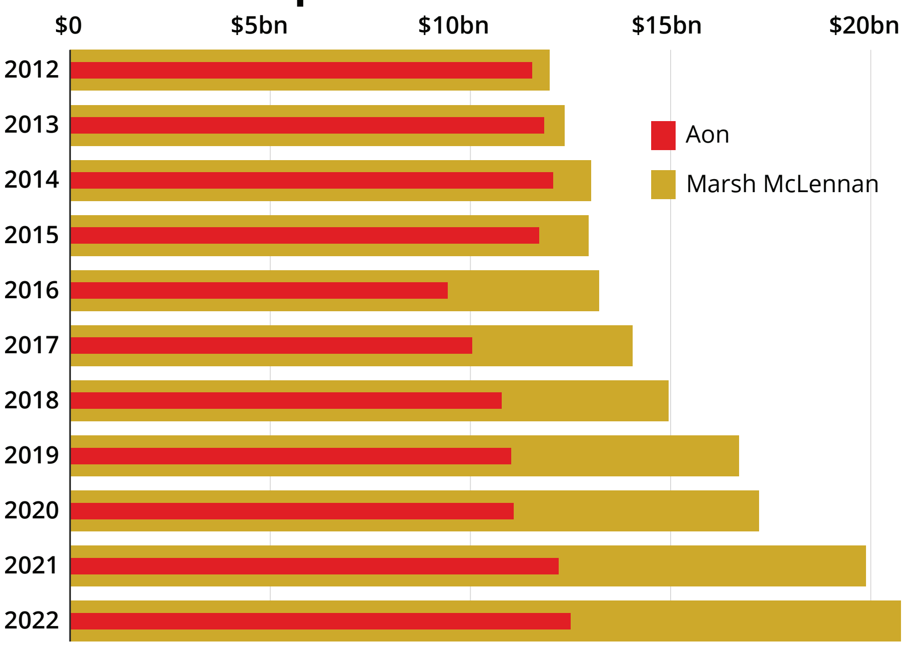
Source: Company financial reports

will fade in the coming quarters. In addition, there are an increasing range of available assets willing to consider strategic sales alongside other financing options given the higher cost of debt's cooling influence on PE interest. (For background see: "Broker M&A: When private equity's interest cools")

There has also been some downward movement in platform valuations since last year's peak.

Further, after just over two years, enough time has likely passed since the abortive Willis deal to give Greg Case and his management team the freedom to move.

Aon annual reported revenues



Source: S&P Capital IQ Pro

The potential interest of the antitrust regulators in the US remains a potential wildcard that could upset Aon's efforts to buy into new segments, or new parts of the value chain. Sources perceive a mid-market play as lower risk given that Aon is not active in the segment.

Vertical integration in the value chain through a sizeable wholesale acquisition is seen as more likely to draw adverse interest from the FTC or DOJ.

Capital deployment

Aon's capital deployment framework has long favoured share buybacks, as it seeks a high cash-on-cash return, with the approach helping drive remarkable share price appreciation in recent years.

If a management team values its stock highly, this is always likely to be perceived as a higher return on capital for cash generated.

However, it is understood that Aon is preparing to flex its capital deployment framework owing to the perceived strategic imperative to enter new markets.

Aon is likely to frame such a move in terms of servicing a broader range of clients, and opening up new markets for growth.

However, it likely also owes something to the reality that size matters in broking.

Aon has allowed itself to be outgrown significantly by Marsh McLennan. In 2012 Aon's revenue base was 96% the size of Marsh McLennan, and in 2022 it was 60% its size.

As previously argued, short-term this may not matter in terms of serving clients or driving shareholder returns. But in an industry where consolidation has been a huge driver of value and the consolidation game is far from played out, Aon will suffer in the longer term from sitting on the sidelines and buying back stock.

Short-term rational can be long-term irrational.

Aon has headroom to take on roughly $5bn of additional debt to fund M&A without endangering its rating, but would also be able to deploy its free cashflow alongside issuing shares.

Aon declined to comment.

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Q&A: Kelly Superczynski and Roger Gascoigne, Aon's Reinsurance Solutions

What is the backdrop for European insurers' need for capital management?

European insurers' capital positions have remained strong throughout 2022, despite the economic headwinds of inflation and high interest rates, with average solvency ratios in the European Economic Area stable at over 200%.

However, a simple pan-European average hides some significant issues at the bottom of the range, with many countries experiencing significant declines in solvency in entities at the bottom of the scale.

Many European insurers that sought to strengthen their balance sheets by issuing debt in the low-interest-rate environment will be now faced with a significant hike in interest costs once the instruments mature, potentially opening the door for cheaper reinsurance-based solutions.

A succession of natural catastrophes in Europe – including floods in Italy, Slovenia, Croatia and Greece; the earthquake in Turkey and Syria; wildfires in Southern Europe, particularly Greece; and heavy rainfall in the Nordics – are likely to result in higher retentions in certain jurisdictions.

Reinsurers are actively promoting multi-year spread loss solutions to provide coverage at lower layers, albeit with a larger share of losses being borne by the cedant. However, the message to insurers is clear: where such solutions offer potential relief, it is vital to start the discussion process immediately.

What impact will IFRS 17 have on European capital strength and earnings?

On 1 January 2023, IFRS 17 went live for listed European insurance groups, as well as individual entities in certain jurisdictions, after lengthy and costly implementation projects. It is still too early to gauge properly the impact on equity or earnings, with companies only recently having published their first half-year results.

Nevertheless, we can already see the elimination of implicit prudence reserving buffers and the impact of higher discount rates have increased earnings volatility for non-life insurers. Life insurers, on the other hand, have been forced to explain falls in equity of up to 50% as future profits are deferred and recognised over the contract duration.

While European insurers still plan to manage capital based on solvency metrics, which remain unchanged, there will inevitably be increased pressure from shareholders and regulators to explain variances in financial results.

In addition to the direct impact on capital, accounting for reinsurance contracts under IFRS 17 differs from historical practice, which could significantly influence the viability of some structures, and so insurers are strongly advised to review the terms and conditions of existing and future reinsurance treaties.

What should companies learn from the broader challenges of the past 12 months?

The lesson is that companies need diversified sources of capital. Over-relying on a single form of capital such as a quota share treaty or a low-attaching catastrophe excess of loss, or relying on your own surplus or your own retained earnings, may lead to operational weaknesses.

Recent market volatility has exposed weaknesses in a number of balance sheets, and so we're talking to our clients about the need for considered and diversified capital solutions.

Furthermore, if you're nimble and flexible and have a capital framework that allows you to move capital around quickly, it is easier to take advantage of opportunistic market conditions.

Having a capital framework that incorporates multiple forms of capital is hugely important too for optimising your capital and being able to match capital and risk effectively.

How are clients responding to your advice, and are you seeing any trends in your service provision?

There's an increasing interest in private debt deals in the US. We're also seeing the structured reinsurance market step up to support some of the property catastrophe retention increases we saw earlier this year, meaning that structured reinsurance, which is a small piece of the reinsurance market, will offer multi-year, multi-event type solutions, as well as capital relief quota shares and other structured quota share solutions. So, we're seeing a part of the market gaining momentum in order to support some of the more challenged areas.

There are some reinsurers retrenching and reducing the volume of property catastrophe exposure, but then we see other reinsurers that are really good at capital allocation and have a nimble capital framework being able to allocate capital quickly take advantage of reinsurance market conditions in the property catastrophe space. It's interesting to see how all these dynamics are at work in the market, and consequently, the range of strategies being deployed.

ANALYSIS

Aviation and the AerCap deal: What comes next

Key points

- Sources said that if similar deals to the AerCap-Aeroflot agreement are widespread in their adoption, the overall claims tally could fall to $2bn-$4bn
- Lessors understood to include SMBC and Air Lease are understood to be in talks with carriers
- AerCap's negotiations with S7 are being closely watched, as the first private airline to look to strike a deal. It could provide a template for other private carriers to follow
- Sources said regulators have set an end of September deadline for all lessor-airline deals to be agreed, but this could be extended
- Some argue that, in the wake of a deal, it is now more difficult to argue that this is a war claim for lessors

The announcement of a landmark settlement between number-one aircraft lessor AerCap and state-backed Russian airline Aeroflot has raised the prospect of a significant reduction in the $12bn+ claims bill being faced by aviation insurers.

The deal, which complied with all "applicable sanctions regimes" and was approved by the US Department of Commerce and the US Department of the Treasury, has also created a pathway to the avoidance of years of litigation.

In a best-case scenario, a succession of similar, successful negotiations with affected lessors and airlines could shrink the industry claims tally to a fraction of the $12bn-$15bn worst-case scenario previously discussed. There is huge uncertainty, but sources said that if similar deals are widespread in their adoption the overall claims tally could fall to $2bn-$4bn.

> "With hundreds of millions of dollars spent on legal bills and major uncertainty hanging over them, all sides have an incentive to reach deals"

But where the ultimate quantum lands after a strenuous period of negotiations will heavily depend on the outcome of a number of complex discussions and scenarios due to play out in the coming weeks and months.

The aviation market is currently operating under the cloud of what could be its largest ever loss event, with the seizure of 400+ leased planes by Russia in the wake of the Ukraine war.

The claim is subject to major coverage disputes that have spawned dozens of lawsuits already, with questions not only around whether coverage was still in place at the time of the seizure, but the cause of loss and how claims might be spread across interlocking all-risks, war and contingent war policies.

This publication first revealed that AerCap was in talks with Russia's flag carrier, Aeroflot, in February of this year. In a statement issued to this publication at the time, Aercap denied that it had engaged in any talks with Aeroflot or other Russian airlines.

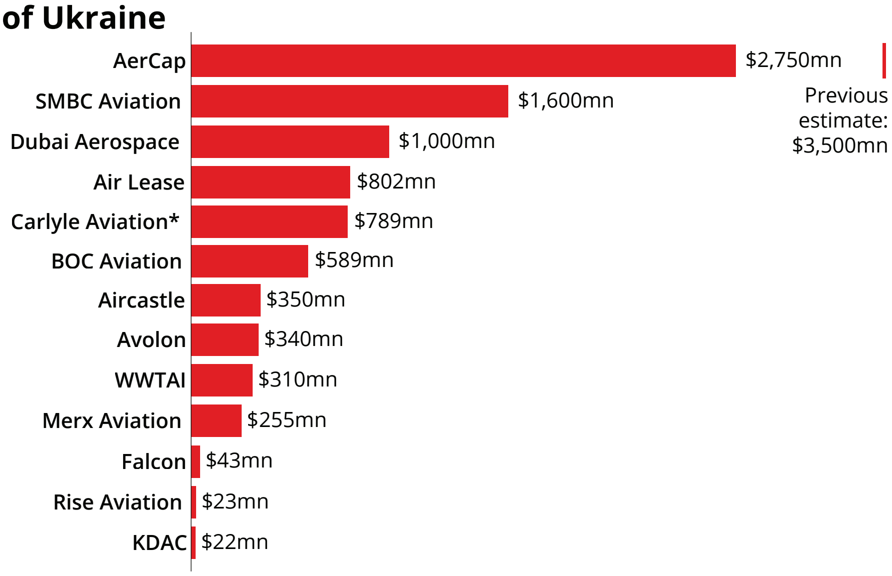
In September, it then announced that AerCap had struck a deal with Russian airlines Aeroflot and Rossiya, a subsidiary of Aeroflot, to sell some 17 aircraft and five engines.

In doing so, AerCap said it had reduced its insurance claim from $3.5bn to around $2.75bn.

What the deal certainly has done is start to build a framework which other lessors and airlines could effectively copy to agree similar settlements.

A significant reduction in the total claim value makes the prospect of a commercial settlement between insurers and lessors more likely. In this scenario, the settlement would likely see

Possible aviation market claims from Russia's invasion of Ukraine



*Carlyle Aviation has lodged other claims, the value of which is not known
Source: Company reports

ANALYSIS

All-risks market leaders

- AIG
- Allianz
- Axa XL
- Chubb
- Global Aerospace
- La Réunion Aérienne
- Starr

payments made by both the all-risks and the war market, with the lessors also obliged to accept some financial loss.

However, with reinsurers still likely on the hook, a further negotiation between cedants and reinsurance partners would need to take place. Sources said that to date, getting their reinsurers to the table to discuss potential losses had been difficult.

With hundreds of millions of dollars spent on legal bills and major uncertainty hanging over them, all sides have an incentive to reach deals. But it will be a challenge to secure airline-lessor deals, and then to follow them up with commercial settlements with insurers that depend on an agreed split between all-risks and war insurers, and an agreement from reinsurers around what they will pay.

The challenge of these parallel negotiations will be made worse by the time pressure. Sources said regulators have set an end of September deadline for all lessor-airline deals to be agreed. There has been speculation this could be extended until the end of the year, but even this would leave parties to the negotiations sprinting to the finish line.

Contingent war market leaders

- Atrium
- Axa XL
- Beazley
- Chubb
- Fidelis
- Liberty Specialty Markets
- Tokio Marine Kiln

There are also a number of complexities and nuances which need to be navigated before the (re)insurance industry has a clearer picture on what its final loss bill will look like. We explore these below.

Next in line

Firstly, AerCap is the only lessor to have publicly disclosed a deal with a Russian airline, and, while its claim is the largest, the reduced claim would still have a material impact on insurers were they to pay it.

Sources told this publication that some lessors – but certainly not all of them – had notified their insurers they had opened conversations with Russian carriers but that the talks were still in their infancy. These lessors are thought to include number two leasing company SMBC and Air Lease Corp.

One factor for consideration is that settlements are understood to be based on the fair value of the aircraft at the date of the invasion – creating a mismatch between those values and total insured values.

Sources told this publication of their frustration that not all lessors had entered into talks with Russian airlines. "I don't understand why they wouldn't be trying to talk [to Russian carriers]," one source said.

One underwriter, meanwhile, said the deal "significantly weakens lessors' claims" because they need to prove that all avenues have been exhausted for insurers to pay a claim.

At the same time, other airlines are negotiating their own deals with AerCap.

It is understood S7 is one of the Russian carriers, aside from Aeroflot and Rossiya, open to buying the planes in its possession. Its deal is being closely scrutinised as the first private airline to strike a deal with a lessor – and could provide a template for other private carriers to follow.

However, given that the Russian government is funding the purchase of the aircraft, a major question mark is whether a private company would be comfortable with what would effectively be nationalisation.

Court documents from earlier this year show that S7 had applied for and received permission to return some aircraft, although this seemingly never materialised.

Other Russian airlines believed to be pursuing deals with lessors include Ural Airlines and low-cost carrier Smartavia.

> "The claims are now likely to fall more heavily on the all-risk market, sources said"

All-risk vs war

Senior market sources also noted the deal between Aeroflot and AerCap had changed the dynamics of the claim.

At the beginning of the conflict, there was much speculation about which market the claims would fall into, but the picture might now be a little clearer.

Because the planes have not been seized or nationalised, as many lessors claimed, but rather have been bought, the claims are now likely to fall more heavily on the all-risk market, sources said.

One source told this publication that, in the wake of the deal, it is now "very difficult to see how this is a war peril".

This could actually be beneficial for lessors, as aviation all-risk policies, unlike aviation war policies, do not have annual aggregate caps.

For instance, AerCap initially sued its all-risk insurers for $3.5bn, but it sued its contingent war insurers for $1.2bn, due to the aggregate cap.

Sources told this publication that they hoped the AerCap-Aeroflot deal would serve as a wake-up call to all-risk insurers, as they have "buried their heads in the sand since the start of this conflict".

The all-risk market has remained relatively soft. This is in stark contrast to the aviation war market, which has remained exceptionally hard, with average rate increases of around 100% at the last key renewal date.

One senior market source told this publication the all-risk market, after Russia's invasion of Ukraine and the subsequent legal fallout, had been in "total denial" over its position.

SMBC declined to comment.

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.