Insight and intelligence on the 2023 *Rendez-vous de Septembre*

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MONTE CARLO

From the 2023 reset to the 2024 price standoff

The paradox of "the best reinsurance market in years" is that there are still question marks over who wants a piece of it

Coming off the Irma-to-Ian loss years, it isn't hard to agree that it is indeed the best market in years, but whether it is the best in 20 years or 30 is more debatable. But the recovery has been largely confined to peak property cat risks.

Even within the cat market, some are still guarded over how much excess margin is available in light of climate change, although brokers are hopeful of more accommodative behaviour from reinsurers next year in this segment.

Meanwhile, there are emerging concerns over adverse development in softer casualty years from 2015 to 2019, as well as the downturn in professional liability rates. As a consequence, reinsurers are looking for more compensation from their long-tail portfolios via reduced ceding commissions.

The timeframe and magnitude at which new demand shows up may influence some of the near-term battle. But on the supply side, despite signs of new start-up activity, there is still general scepticism that any success on this front would tip the balance.

Moreover, with a very hard fundraising road ahead, and incumbent PE investors still waiting on exits, it remains to be seen how many get over the line. Even if a couple do succeed in raising several billion in aggregate, given demand growth, this is not expected to be a material influence on pricing trends, as it would equate to less than 1% of industry capital.

Reinsurers are conscious this means new supply is largely driven by their allocation of income growth and capital, and that they still need to prove the sector's appeal.

All this means that, after last year's major reshaping and restructuring, this year's run-up to 1 January looks set to be more of a straight face-off over pricing, with side quibblings over attachment points.

What might seem like a narrow band of contested margin may feel more meaningful to participants on each side. Can reinsurers secure their targeted incremental rate gain, or will more well-balanced supply allow brokers to force through the flatter or slightly down renewal they are targeting?

Aon has set itself apart as the hawk, albeit still in a muted way, by projecting "potential downward pressure on pricing" in the upper layers of cat coverage, with Guy Carpenter and, to a degree, Gallagher Re being slightly more doveish – at least in public comments.

Ultimately though, a bigger question remains than that of pricing. The question of "who wants this risk" is still a highly relevant one when it comes to the business reinsurers have just vacated this year: lower-layer cat risk.

The issue underlies the emerging conversations around new demand, which have focused not just on the prospect of cedants filling out top-layer coverage due to inflationary pressure.

That new demand has been long anticipated, but this year's *Rendez-Vous* has provided the venue for early-stage conversations around reinsurers once again offering aggregate covers or retention buy-downs.

Walking away from aggregates and pushing up retentions was the key achievement of last year's renewal. It led to the "upstreaming" of cat risk, as this publication has termed it, to primary carriers, and has shielded reinsurers from a difficult H1 of cat losses.

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COMMENT

Things are still not okay in reinsurance

As the curtain comes down on the millionth Monte Carlo *Rendez-Vous*, and the prices in the cafes and restaurants are presumably reset to their customary levels, the conference has again done its main job.

By facilitating a lot of collisions and dense information exchange, the *Rendez-Vous* has left participants in the reinsurance market with a clearer sense of trading conditions – even if the conference is too early for anything more than a provisional view.

As always, Monte Carlo exists on two parallel discursive planes. There is the public plane – an effective spinning room constituted by press conferences, tightly stage-managed interviews, and reports.

And there is the private plane, consisting of staccato day-time meetings and overlong dinners, where the more candid conversations take place between trading partners. (There are also, of course, a fair few literal private planes...)

Together, they shape the perspective and mood of the market participants, although the conference is disparate enough – and the picture typically complex enough – that attendees do not leave with a homogenous view.

And sometimes when they do – as with last year's conviction that the market would not clear at any price – they're simply wrong.

My central take this year is that the reinsurance market remains stressed. Even if things are shaping up as if reinsurers could deliver RoEs in the teens this year, things are not okay.

The psychological wounds of the past were serious, and the sector's redemption arc with capital will take time to play out.

A key barometer of that remains the dearth of external capital willing to contemplate a move into the sector, with sources continuing to describe a fundraising desert for reinsurance-focused start-ups.

Reinsurers also remain fretful about secular developments driving loss-cost inflation, including climate change, the hostile US tort environment, and enhanced geopolitical risk.

With these ratcheting issues, reinsurers are conscious that the ground they have won could be eroded quickly.

That is creating an environment where some believe RoEs on cat could be 30%-plus in a normalised loss year, but still seem to think growth should be sacrificed on the altar of further real-terms rate rises.

Good financial performance for some does not seem to be good enough. Reinsurers have a lot to prove.

Their resolve on rates will likely be tested because cedants are also unhappy participants in the reinsurance marriage.

After a long period in which reinsurers provided cedants with comprehensive and underpriced earnings protection, wrapped up in baggy T&Cs, the market has turned.

Cedants now find themselves trying to navigate their way through an environment with elevated attritional cat losses, with much more meagre reinsurance support that comes at a much higher cost.

This is causing angst. After many years of seeing reinsurers post worse results, US insurers – particularly with a personal lines skew – are performing worse. Much, much worse.

Given that they are often price takers on the front end, they are naturally looking to their outwards and looking to chip away at reinsurance rates, and barter to bring down their retentions.

But that's just the view from Monte Carlo's mid-September pre-price discovery. Let's pick this up in three months' time.

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Reinsurers will not accept a turning-back of the clock, that much is clear. However, some carriers will be interested in these deals for the right price, level and cedant.

But even the fact these conversations are being held points to an underlying problem: an attempt to pass back the hot potato of attritional cat risk.

The attempts US admitted insurers are making to remediate their books on the primary side – shedding risk and halting new policies – need to drive more money into the system on personal-lines books to address higher costs.

"[Retention] buydowns do not solve an economic problem," as one source said.

The conversations around these prospects may be drawn-out, and some reinsurers might not be at all interested at any price.

Although the pain some primary insurers have taken in the past year from cat losses might be a bone of contention in renewals, for reinsurers, the worry of this year's near misses is a reminder of the need for discipline.

Hurricane Idalia may have let Monte Carlo attendees off lightly, but the question of what would have happened if the storm had hit Tampa is an underlying reminder of the risks they are still running in the warm waters of the Atlantic over the coming months.

"We'll take the luck, but luck's not a strategy," as one reinsurer said.

But with that big-picture problem in mind, here are some of the more micro ways this has shown up in Monte Carlo debates and that will be discussed in months to come.

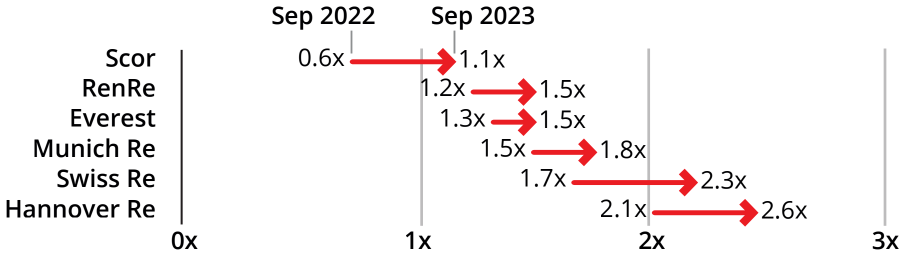
These are: how new demand will show up, a potential pivot in the casualty market, and clearing up terms and conditions after last year's overhauls.

1. New demand and top-layer pressure
Top layers are likely to be the immediate focus for increased cedant purchasing, reflecting not just inflation but also upcoming model change that will dictate requirements. Early conversation around the new RMS Atlantic hurricane model suggests uplifts in the range of 20%-30% are more common than the headline 5%-10% changes imply.

Conversations around aggregate coverages seem to be at an earlier stage. Some reinsurers will still be in the not-remotely-interested category. For others which have shown themselves to be more willing to grow into the cat space, it may be more a question of settling on the right price for the lower layers or considering whether retentions on some quality cedants overshot the required uplift for buydowns.

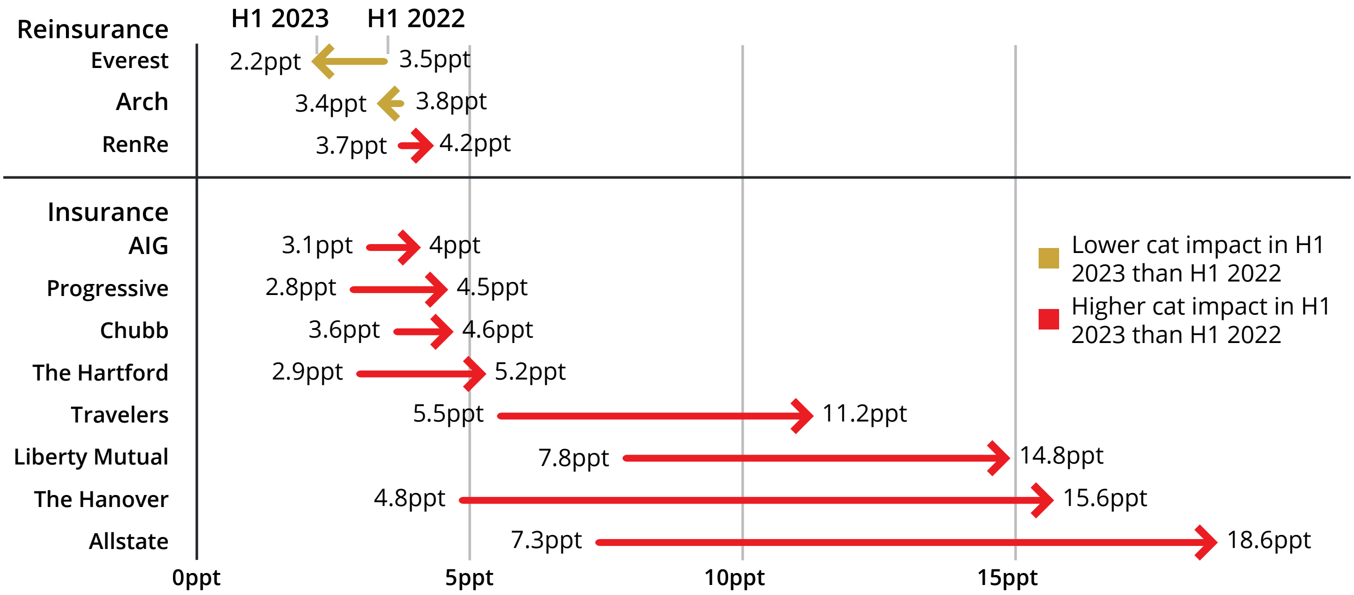
The remediation phase is over for some carriers and incremental cat capacity may be on offer – such as MS Amlin, as its CEO told us in a Monte Carlo interview that it would look for "measured growth", mostly with an eye on international top-layer cat business. But, as one source described it, there are still the "quiet quitters" who are content

Change in price-to-book multiple of selected listed reinsurers, 9 Sep 2022 to 8 Sep 2023



Source: S&P Capital IQ Pro

Across the board, primary carriers were hit harder by cat losses in H1 2023 than H1 2022



Source: S&P Capital IQ Pro

to keep sub-scale reinsurance books and find cat risk plays in the E&S or other segments.

The trend towards mid-to-top tiers is said to have already driven some competition at this level in the mid-year renewals. Given an apparently strong pipeline of ILS investor interest in the cat bond space – with other ILS capacity being still far more fragile – top-layer pricing is where pressure for softening will be felt first.

The equations over the supply/demand balance haven't shifted in terms of the amount of new demand coming through versus last year's discussions, although, given the held-back purchasing in 2023, dollar figures have been less discussed.

Aon's forecast of 5%-10% property cat demand growth would imply $20bn-$45bn of new demand, assuming $400bn-$450bn of global limits.

It estimated global reinsurer capital has rebounded by 10.7% since Q3 last year. However, as an offsetting factor, in the firm's pre-Monte Carlo media briefing, Aon's Reinsurance Solutions CEO Andy Marcell said he didn't expect a huge expansion of capacity in the property cat space.

Guy Carpenter chairman David Priebe told this firm ahead of Monte Carlo he expected demand growth to "correspond with growth of capital". The firm also pointed to oversubscription pressure for mid-to-top-layer cat risk.

From the major reinsurers' side, Scor was the punchiest, calling for double-digit rate increases in 2024. Ahead of the event, new CEO Thierry Léger told this publication he believed there was a $50bn gap in the supply/demand balance looming each year due to growing cedant needs.

> "Society needs to accept that the price of risk is increasing"
> **Hannover Re CEO Jean-Jacques Henchoz**

Hannover Re also emphasised the "dire" operating environment. "Society needs to accept that the price of risk is increasing, and then we can have a discussion on what the best measures are between mitigation, prevention, climate-change adaptation and then insurance as a response to manage volatility," said CEO Jean-Jacques Henchoz.

2. Casualty on the cusp

Cat risk may have captured the headlines over the past year, but reinsurers raised concerns over general casualty trends that some believe put the segment at an inflection point.

Some cedants are turning in sudden spikes in negative prior-year development on the 2016-19 years, and underlying trends are not yet well understood by reinsurers. Generally, social inflation and surging litigation costs have been a fear regarding longer-tail lines for some time. But these new loss-ratio trends will put more significant pressure on ceding commissions.

Some acceleration in falling ceding commissions began to show up in this year's renewal, but mostly with a focus on D&O or financial lines exposure, where underlying rates have been dropping. In contrast, the prior-year development issue was a more generalised concern raised.

However, Marcell had argued at the pre-Monte briefing that insurer discipline should fend off downward pressure on commissions. "The rate discipline, the limit utilisation, has been so terrific the volatility around the loss ratio has inevitably shrunk to a degree," he said.

3. Tidying up after the Great Reset

One focus for brokers and cedants will be ironing out some of the differential terms that proliferated last year in the rush job of the 1 January 2023 renewal.

Some of this will focus on achieving more individualised outcomes. As Bob Bisset, Lockton Re chair of global retro and property specialty, said in its Monte Carlo press conference, this year contrasts with the "truncated" decision-making process last year. "There's a longer run-up for cedants to tell their story."

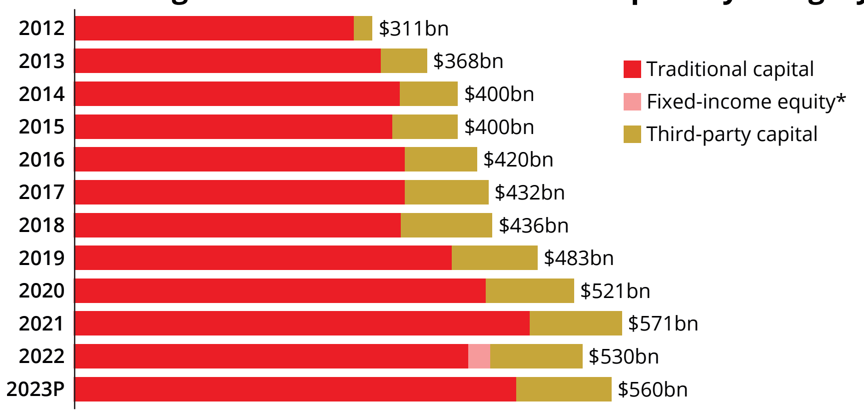
Reinsurers would have reason to support this clarification process from a contract-certainty point of view, but there are still likely to be points of fracture and wins that were more important to some carriers than others in looking to settle the differences.

For some, secondary-peril exposure may be a paramount concern. For many, due to the volatile political environment, terrorism add-backs will be carefully monitored and strikes, riots and civil commotion coverages still tightly controlled.

Despite these complications, a straightforward price battle may still feel more manageable and routine for market participants than last year's fearful Q4, when there were concerns about clearing the market.

But the paradox of the current market's appeal is likely driven by the rebound from a phase of highly challenging years for reinsurers. The relief is still tempered by fear.

Estimated global dedicated reinsurance capital by category



*For reinsurers that have ample cash liquidity to support potential shock losses, the fixed-income equity adjustment captures the amount of capital that AM Best anticipates will be recovered as bonds mature over time
Source: AM Best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Aon going in to battle for clients on renewal rates and terms: Case

Aon is relentlessly advocating for its client base in early renewal discussions in Monte Carlo, Aon group CEO Greg Case told this publication, as reinsurer public messaging signals the need for further rate rises following a year of hard pricing.

Responding to suggestions that markets naturally find their level on pricing and terms and conditions, Case rejected the idea that "the market will be the market, and the price will be the price" as "ridiculous".

"We're here to make the market, not take the market," he said. "We always go to battle [for our clients]."

In an interview at the Monte Carlo *Rendez-Vous*, the long-serving CEO stressed that it was Aon's job to deploy its content and capability to ensure individual clients do not get a market outcome.

"That's unacceptable from our perspective," he argued.

Aon has become embroiled in the recent Vesttoo crisis and is engaged in a lawsuit against the failing InsurTech relating to fraudulent collateral on $2.35bn of letters of credit relating to intellectual property (IP) transactions.

IP has been one of Aon's big bets in terms of efforts to create net new markets in insurance, with the broker repeatedly emphasising that the industry must find new solutions to address client need around protecting and leveraging intangible assets.

Questioned on whether the Vesttoo scandal changed the company's perspective on its work to foster new markets, Case reiterated the broker's commitment to a broader drive on innovation, and specifically to its IP financing product.

He said: "Are we fundamentally interested in innovation and all that comes with it, the highs and the lows? One hundred percent – absolutely focused on it because our clients require it. And our mission is to deliver on behalf of clients."

Case went on to say that the IP product, which offers companies another source of growth capital base tied to their intangible assets, had provided clients with $2.6bn of limit, with around $500mn of premium placed with 25 insurers.

He acknowledged that there are "continuous lessons to be learned in development", but also pointed out that this was true historically of other areas that are now core P&C products, such as D&O.

Clear Blue and subsidiaries record ~$50mn in reinsurance charges

Fronting carrier Clear Blue and its subsidiaries took $49.6mn in reinsurance charges for the write-down of collateral on run-off business in relation to Vesttoo and Corinthian Group, according to delayed Q2 statutory financial filings.

The company also said it has secured the replacement of all reinsurance on its ongoing portfolio of business through third-party reinsurers and an affiliated reinsurer.

Broken down by company, Clear Blue took a $25.5mn charge, Clear Blue Specialty took $15.8mn, Rock Ridge Insurance took $5.8mn and Highlander Specialty took $2.5mn.

Clear Blue's surplus stood at $87.1mn as of 30 June, compared to $107.6mn at the end of 2022. Clear Blue Specialty's surplus stood at $135.6mn, compared to $176.6mn as of 31 December.

As of 30 June, Highlander's surplus stood at $87mn, compared to $115.9mn at the end of 2022. Rock Ridge's surplus totaled $16.9mn, compared to $21.3mn as of 31 December.

In the statutory filing, Clear Blue confirmed it will retain the run-off business reinsured by Aon's segregated cell platform White Rock and Corinthian Group and will cover the risk associated with the business with cash withheld in the company and in premium trusts.

Clear Blue is also in the process of obtaining collateral to support the associated risk, which is expected to be obtained by the end of Q3, the filings state.

As a part of Vesttoo's bankruptcy case, it was determined that the vast majority of letters of credit (LOCs) issued by the InsurTech as it built its business have turned out to be fraudulent, the result of an elaborate deception that included impersonation of bank officials.

Initial investigations into Vesttoo's faked LOC controversy found that "red flags abounded as early as 2021", bankruptcy court updates show.

Since 2020, Vesttoo quoted 96 and closed 65 transactions with collateral totalling roughly $3.9bn, according to the filing.

LOCs issued by China Construction Bank underpinned about $2.8bn of these transactions, Standard Chartered $362.5mn and Santander $186mn.

Court filings issued during the Chapter 11 have alleged that the elaborate fraud hinged on a group of insiders led by ex-CEO Yaniv Bertele, who allegedly duped customers and also employees outside of the "ring of conspiracy".

'We're done with posturing from all parties': Arch Re CEO on 1.1

The upcoming 1 January renewals will require a collaborative approach with early discovery of risk appetite among reinsurers, according to Maamoun Rajeh, chairman and CEO of Arch Worldwide Reinsurance Group, who told *Insurance Insider* that the market should be "done with the posturing from all parties."

Rajeh said in an interview at the Monte Carlo *Rendez-Vous* that the mid-year renewals were generally a positive sign ahead of 1 January.

"I think [mid-year] was orderly not because markets got harder and not because clients got a better deal. I think it was because there was a reset of expectations. And I think that there was a price discovery," Rajeh added.

"That was early and that was collaborative. And I think that's what's needed at 1.1. I think we're done with the posturing from all parties. I think this is a market that calls for collaboration, and early discovery of price and appetite from an underwriter's perspective."

Rajeh added that it is "irresponsible" that most renewals come down to the last two weeks of the year, adding: "There's no reason and no place for that."

The CEO said the wave of team moves and M&A activity over the last year within the market was "a bit of a distraction", adding that fledgling teams will be trying to "prove their worth" at 1 January.

Rajeh also commented on the macroeconomic factors impacting the reinsurance market, noting that social inflation and climate change were two key areas of focus, as well as the deployment of capital and responsible pricing.

"I also think there's one more screw to drop. And I think that's casualty adverse development. We're starting to hear about it, but I really think it's got to be a factor," he added.

"I really do believe there was a block of years when that business was wholesale mispriced. You add to it inflationary pressures and it's a tough block of years. Going forward, you have capital that can't withstand further mispricing of risk."

Earlier in the week, Rajeh spoke about how Arch Re was one of the first reinsurers to begin "leaning in" to the hard market, which helped it pick up a sizeable share of the catastrophe segment at the mid-2022 renewals onwards.

At Monte Carlo, Rajeh has been pushing the importance of the industry improving on delivering clear, forward-looking communications around renewal times.

He sees the mayhem that accompanied the 1 January 2023 renewal not solely as a byproduct of hard-market distress, but also from an "ineffective and irresponsible" belief that delaying indicative pricing until late in a renewal will provide tactical gains.

To resolve this issue, he said "all it takes is more dialogue", adding that the renewal outcomes should be like a performance review in that "there should be no surprises".

IQUW lands in-principle approval for 'portfolio solutions' segment

IQUW has been granted in-principle approval from Lloyd's to launch a line in bespoke specialty policies addressing non-traditional, nascent and dislocated market risks, this publication can reveal.

The carrier's Syndicate 1856 is to launch its "portfolio solutions" line in 2024 in a bid to write business not traditionally supported by Lloyd's businesses.

IQUW said it would partner with brokers and MGAs on the products and is seeking to back diversified coverholders for the project.

The prospective launch comes after IQUW launched new political risk, crisis management and aviation products during 2022.

The portfolio solutions business will target three groups of risk.

First, it will seek out established portfolios of non-traditional risk such as auto extended warranty and subcontractor default.

Second, it will look to support products designed to tackle emerging perils such as digital asset insurance and gig-economy risks.

Finally, IQUW will look to exploit market dislocation where losses have created a shortage of capacity, such as in event cancellation after Covid-19.

The company said the launch is part of its aim to focus on "intelligent underwriting".

"We have been presented with multiple requests for support from brokers to service these risks, and our philosophy is to continually offer best-in-class service to our brokers and clients," it said.

"With the launch of portfolio solutions, IQUW is bringing capital to smaller markets that are currently underserved."

SPONSORED

Cedants are taking a strategic view of the cat bond market

Property catastrophe risk is growing around the world, primarily due to urbanisation, economic growth, global inflation and the impact of climate change. As the insurance industry faces the spectre of increasing catastrophe loss driven by multiple factors, it has been further sobered by loss amplification from recent extraneous factors of geopolitical conflict, supply-chain interruptions and a global pandemic.

Even excluding the impact of the Russia-Ukraine conflict and Covid-19, large insurance industry losses aggregated to $122bn in 2022. The resulting strain caused a material dislocation in the reinsurance market. Several major reinsurers have pulled back from property catastrophe risk to reduce volatility of their financial results and to appease their equity investors who have been pricing the sector below its book value. This pullback resulted in a shortage of capacity and one of the hardest property markets in recent memory at the 1 January 2023 renewals. The Guy Carpenter Global Property Catastrophe Rate on Line Index is at its highest level since 2000. Going forward, S&P is also proposing increased capital charges for catastrophe risk by factoring higher return periods, broader exposure base and contingent credit risk in their capital model.

In view of these evolving dynamics, ceding companies have started to take a more strategic approach to ILS. Specifically, they are incorporating catastrophe bonds as a core part of their reinsurance placement to access a different source of capacity, extend duration of their risk-transfer program to minimise annual pricing fluctuations, mitigate credit exposure by securing a fully funded cover, and create negotiating leverage in the market. Many companies are moving from an opportunistic issuance approach to a well designed laddered program that allows them to continuously access the market and add incremental capacity.

While catastrophe bonds historically have been a risk management tool for large primary companies and reinsurers, demand for and usage of them have broadened significantly over the past 18 months. Nine new sponsors tapped the catastrophe bond market for their very first issuance in 2022 and seven have already come to the market in the first half of 2023. These sponsors included national, regional, mutual and reciprocal US companies, international reinsurers, Lloyd's syndicates and a government risk pool. They have sought coverage based on parametric, index and indemnity triggers. In fact, several of these new sponsors have accessed the catastrophe bond market multiple times during this period.

Investors have responded to the demand with enthusiasm. A total of 42 separate catastrophe bond deals were completed by 37 unique cedants during H1 2023 for a total issuance of $9.3bn. This puts the catastrophe bond market on track for record issuance this year, with the total risk capital outstanding expected to exceed $40bn.

This activity is supported by fresh capital being injected into the space by pension and sovereign wealth funds, maturity of existing securities, and a rotation away from collateralised reinsurance and sidecar structures. Investors are attracted to disciplined pricing, rigorous disclosure and favourable terms and conditions. Recent legislative reforms in Florida have been very constructive. Further, the yield on the collateral invested in money-market funds has exceeded 5%, which results in the total coupon on catastrophe bonds typically being in the double-digit range, making them very competitive with other high-yield products. Most catastrophe bonds this year were oversubscribed in demand and have priced within or below the initial guidance. As the bond market remains active throughout the year instead of on discrete renewal dates, this positive momentum was conveyed early to the traditional reinsurance market and helped set the tone for more orderly mid-year renewals than was seen at 1 January.

More than $10bn of outstanding catastrophe bonds are scheduled to mature in the coming months and additional capital continues to flow into the market, setting the stage for robust ongoing issuance activity. As ceding companies optimise their risk-management strategy in the new normal paradigm of growing peak perils and limited appetite for volatility, capital markets risk transfer using catastrophe bonds has become a critical component of the solution.

How Guy Carpenter can help

The GC Securities team remains an industry leader in analysing, structuring and marketing ILS that provide clients with optimal solutions for their unique risk-transfer needs. The team takes a holistic, product-agnostic approach, extending beyond Guy Carpenter and employing knowledge and resources from across the Marsh McLennan organisation.

GC Securities is a division of MMC Securities LLC, a US-registered broker-dealer and member of FINRA, the NFA and SIPC.

By Shiv Kumar, president, GC Securities

Morocco gov expected to get $250mn parametric quake payout

A parametric insurance pool that benefits the Moroccan government is expected to receive a full $250mn insurance payout after an earthquake devastated parts of the country, sources told this publication.

Late on Friday, a 6.8 magnitude earthquake struck central Morocco, claiming nearly 2,500 lives.

In addition to the parametric pool, there is a further insurance pooling scheme covering Moroccan earthquake risk providing up to $1bn in cover, but only a partial payout is expected due to its different structure.

Gallagher Re brokered the parametric scheme and declined to comment on specifics of the pool or payout. However, it confirmed it was talking to the Moroccan government and reinsurers to establish the calculation of loss under the scheme in the wake of Friday's earthquake.

Gallagher Re said it was too early to be 100% certain, but it is likely that the uninsured scheme will be called upon.

The parametric solution is designed to provide coverage to uninsured people in the event of such an earthquake. It is intended to ensure a quick payout as the trigger is based on the Modified Mercalli Index (MMI).

A panel of more than 20 reinsurers, led by large global (traditional) reinsurers, sits behind the parametric cover. This type of programme typically fits within carrier ESG targets to provide coverage for uninsured risks and to address the disaster coverage gap.

Gallagher Re was appointed by Le Fond de Solidarité contre les Evènements Catastrophiques (FSEC) in 2020 to develop and place the scheme, triggered by quakes above magnitude 5 on the MMI scale.

FSEC was established to provide compensation for uninsured victims of manmade and nat cat events such as SRCC, terrorism, earthquakes, flood and tsunamis.

It provides compensation for those who suffer bodily injury or had their principal residence rendered uninhabitable due to a catastrophic event.

Nicolas Moinier, partner advocate of FSEC at Gallagher Re, said: "We have been engaged with our client, FSEC, since the earthquake struck on Friday night with our team working around the clock ever since to produce figures in real-time as the calculation of loss estimates continues.

"We are also in conversation with reinsurers as our goal will obviously be to ensure any payment due can be in the hands of the Moroccan people as quickly as possible."

Cloutier: Public market access to open opportunities for Aspen

Chairman and group CEO Mark Cloutier has said it should be no surprise that Aspen may be exploring new sources of capital or a liquidity event, after this publication revealed it was auditioning bankers for an expected H1 2024 IPO.

"The business is in a position where... in the coming 24-36 months we would like to have access to capital markets in order to take advantage of potential opportunities we might see," Cloutier said, in a video interview with this publication during the Monte Carlo *Rendez-Vous*.

After its portfolio repositioning, Aspen's current focus is on managing the cycle.

"Now what you'll see us doing is pulling levers as the different lines of business go through their trading conditions," he added. "They don't all move at the same time as we know."

Asked about his expectations for 1 January, Cloutier said it was "dangerous to set expectations for this sector".

However, due to a challenging macroeconomic environment and uncertainties reinsurers are facing in both short- and long-tail uncertainties, Cloutier said he did not see reasons for deterioration in rate or terms and conditions.

"We're looking for 1.1 to be another year of firm pricing."

Tizzio: US casualty to be key focus for Axis at 1.1

Casualty will be a key focus for 1 January 2024 reinsurance renewals, more so on the North American side than European, Axis Capital CEO and president Vince Tizzio told *Insurance Insider* at the Monte Carlo *Rendez-Vous*.

Tizzio added that markets engaged in mortgage, credit, and surety will "have an opportunity to be careful and deliver cedants solutions that they value" at 1 January, given the interest rate environment.

On where the best growth opportunities are, the CEO said that, in reinsurance, Axis will continue to focus on credit, surety and mortgage businesses, while its casualty business has been meeting cedants' expectations.

Public market D&O was a segment his professional lines team watched "with a little bit of cautiousness".

Last year, Axis pivoted from property reinsurance to focus on specialty coverage and eliminate cat exposure.

In addition, Axis decided to non-renew three cat bonds on 1 July, switching instead to indemnity coverage – a move Tizzio said was another result of the company's shifting appetite.

"When you non-renew a substantial segment of property cat, you have the opportunity to realign your reinsurance purchase to keep it with [today's strategy] as an insurance company – that's the sum and substance of the decision."

Loeb supports SiriusPoint's team and strategic direction: Egan

Investor and Third Point Re founder Daniel Loeb remains supportive of SiriusPoint's team, strategy and direction after his withdrawn bid to take the company private, according to SiriusPoint CEO Scott Egan.

In an interview with *Insurance Insider* at the Monte Carlo *Rendez-Vous*, Egan said Loeb is a supportive board member who brings a "wealth of experience" to the company.

Earlier this year, Loeb, who is the largest individual investor in the company with a 9.3% holding via various Loeb and Third Point vehicles, pulled out of pursuing a potential buyout of SiriusPoint, after the parties could not find an agreement on a valuation.

"We couldn't reach agreement but that is now in the past," said Egan when asked about Loeb's mooted takeover plans.

"In fact, he went on record at the time as saying he supported the team, he supported the future direction and he supported the strategy, and therefore we're absolutely focused on executing against that, and if we do that, we think that Dan will be a very happy shareholder," added Egan.

Egan also stated that, while the $788mn merger between Third Point Re and Sirius International Insurance Group in 2020 "hasn't been without its issues", he added that SiriusPoint has refocused the business strategically, bringing both companies together "not just infrastructurally, and strategically, but also culturally as well, which often people miss out on".

Swiss Re: Rebalancing of risk sharing must continue

Hurricane Idalia is a reminder of the new normal cat environment and that reinsurers must keep ensuring they do not pick up attritional losses, Swiss Re's P&C head Urs Baertschi says

Hurricane Idalia's pass over Florida's Big Bend ahead of the Monte Carlo *Rendez-Vous* served as another reminder that the (re)insurance industry is in "a new normal" of catastrophe loss activity, Swiss Re P&C reinsurance CEO Urs Baertschi says.

It is also a signal that the rebalancing of risk sharing between insurers and reinsurers that took place in 2023 must continue, he adds.

The lifting of reinsurance retentions in this year's renewals reflected the fact that primary insurers are the part of the insurance value chain which are best suited to absorb attritional losses – and that reinsurers are returning to their role of being the shock-absorbing carriers.

From 2017 to 2022, reinsurer returns were hit by a disproportionate amount of attritional losses, he says.

The rising cost of loss events may have muddied the issues before this year's reset. "There's a difference between losses and volatility," Baertschi explains. Even large loss events are still attritional events if they are recurring frequently.

Two thirds of losses in the last decade were caused by secondary perils

Peril	% of insured losses 2013-20	% of insured losses 1983-2012
Severe convective storms	35%	30%
Floods	12%	13%
Wildfires	7%	2%
Other	7%	7%
European winter storms	4%	9%
Droughts	1%	1%

Source: Swiss Re Institute

Although there has been no single major loss event to date this year, there has been a high level of minor international events, from the Turkish earthquake to New Zealand floods.

However, while some of these events are unusual, the Swiss Re CEO is quick to note: "They're not surprise losses." Swiss Re's Sigma data shows that severe convective storms made up 68% of H1 insured cat losses – which reached $50bn and the second-highest H1 level since 2011. This highlights the increasing costs of secondary perils.

Yet, despite this high loss tally, the bulk of 2023's cat losses have been kept within the insurance frame.

So far, for reinsurers, 2023 has therefore been a proof point of why they needed to adjust retentions.

"You can't just simply pass losses along the value chain – it's like squeezing a balloon and it pops out somewhere else," Baertschi says.

In turn, this means the industry focus now shifts to what must be done to bring more premium income into the system at the primary level to make it sustainable.

However, rising insurance costs are becoming more of a political issue in various cat-exposed parts of the world, such as Florida and California where consumer choice is evaporating.

Insurers are at the frontline of the political pressure, but it also impacts many (re)insurers.

"I think our industry has a bit of an image problem," Baertschi admits. "We're being viewed as the bad guys, whereas actually what we have is a product that is meant to pay claims to those people who really need it at that time."

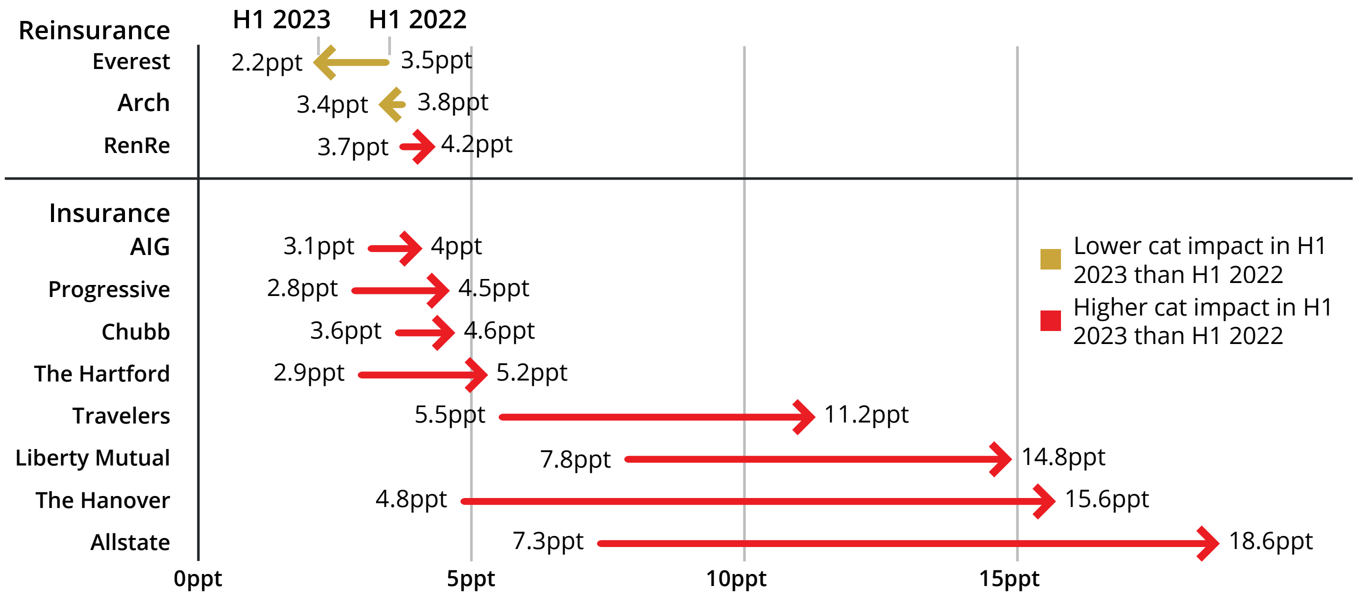
"There is an awareness gap that the industry needs to tackle," he continues.

"We also have an opportunity here to explain how we're very additive to the societies that need us during the times that really matter."

This also goes back to having adequate rates for the risks being taken though, as capital providers cannot do so for free or sub-par returns.

> "You can't just pass losses through the value chain – it's like squeezing a balloon and it pops out"
> **Swiss Re P&C reinsurance CEO Urs Baertschi**

Across the board, primary carriers were hit harder by cat losses in H1 2023 than H1 2022



Source: S&P Capital IQ Pro

Casualty concerns

Even though reinsurance returns are now expected to be more positive as a result of the decisive turn in the cat markets, the Swiss Re CEO says it is early to judge success after H1 2023 results.

"We're talking about one half of a year; this follows six years in which the reinsurance industry did not earn its cost of capital... it takes much longer than just half a year to rebalance the sustainability of the value chain."

In particular, Baertschi says the firm's outlook on casualty reinsurance is "still quite negative".

"In casualty insurance markets some conditions have improved... but that has not necessarily flowed to reinsurance."

He expects social inflation fears will lead to more focus on addressing these casualty issues.

Last year, Swiss Re's messaging on its expectations for renewals was around the "double double half" ask – doubling cat retentions and rates and halving ceding commissions.

Baertschi gives no specifics on what the firm is looking to achieve this year, but says on the casualty side the firm would be looking to discuss a combination of limit management, wordings and commissions with clients.

On the nat-cat market, he expects the overall market to grow as a result of underlying drivers such as urbanisation, inflation and climate change.

However, when pushed on whether the firm itself would look for net growth in the cat space, Baertschi avoids a definite response, saying the firm "remains constructive" in supporting clients with cat capacity.

Baertschi will be taking a more prominent role in Swiss Re's Monte Carlo delegation this year. He has taken on the P&C divisional leadership after a broader restructuring earlier this year that followed the departure of group CUO Thierry Léger to Scor.

He was previously the EMEA regional reinsurance CEO and he has served on the group executive committee since September 2019. His early years at Swiss Re focused on the private equity and investment business.

Baertschi says the restructuring has been done with the client experience in mind.

"What we're looking to do is to make more of our decisions closer to the clients, to make them faster and to be more responsive to them."

> "We have a lot of data and it's important we bring that to the table for the [sustainability] conversation"
> **Swiss Re P&C reinsurance CEO Urs Baertschi**

Aside from the political challenges of the price of cat risk, the ESG area is another topic that has been more of a thorny one for carriers this year. Amid an ESG backlash in US conservative areas, and the effective collapse of the Net-Zero Insurance Alliance (NZIA), carriers are having to tread a more delicate balance in pursuing their sustainability goals.

For Baertschi, it seems that a key part of his vision for (re)insurers' contribution to the ESG and net-zero debate is in trying to return to the numbers.

Reinsurers have a lot of data, and it is important they bring that to the table.

"We believe that what this topic needs to really make progress is an open and transparent and expert-led conversation and to that the insurance industry can contribute in a meaningful way."

Along with others, Swiss Re has reiterated that its individual commitment to carbon reduction goals has not changed, despite the NZIA withdrawals.

From a broader view, Baertschi believes the new era of geopolitical and economic risk means there will be more demand for reinsurance protection.

"The risk landscape will keep evolving and you know with that, the whole value chain will need to keep evolving too."

trusted **/trə-stid/** *adjective* Regarded as reliable or truthful.

Engage, Innovate, Grow Efficiently

ROUNDTABLE

PEOPLE AND TALENT

Our virtual roundtable polled senior industry figures on the biggest questions facing the reinsurance industry. Today, we look at the talent challenge and recruitment strategies

A poor talent pipeline has exacerbated wage inflation in (re)insurance. Is there a short-term fix to this challenge, or must the sector wait for the bubble to burst?

Louisa Blain, insurance consulting leader, Aon Human Capital Solutions: In reality, most of the headlines we see about the insurance-industry hiring crisis and rocketing employment costs are an oversimplification of a complex and multi-dimensional talent problem facing our sector. Aon's latest salary-prediction data for 2024 for insurers suggests a fall in budgeted increases relative to 2023, which is actually in line with the wider financial services sector trend and quantum (5% in the UK, 4% in the US). Our recent talent conversation series with 20 insurance CEOs tells a more nuanced story.

They are keenly aware that, without the people with the right skills in place, they will have to alter the quality of what they do – or deliver less. Neither strategy is an option. To deliver this ambition, the insurance sector needs to attract and retain talent, at all levels, from outside the industry – at scale and now.

Keith Harrison, international CEO, Lockton Re: There is no lack of young talent to enter and support our industry. However, we need to put more emphasis on finding it, courting it and developing it with a longer-term lens, which will allow a more diverse talent pool capable of being more multidisciplinary. Currently, the industry lacks diversity and is too siloed, which limits the long-term health of the market.

The current market environment, where we are seeing some disillusionment with larger, more hierarchical organisations and the rise of challenger brands on the broking and underwriting side, has encouraged movement of talent, and that is what has created wage inflation. There is no short-term fix to this issue, but there is certainly a medium-term one. However, it requires businesses to invest for the long term, which is often at odds with the short-term demands of large public companies and time-constrained private equity businesses.

Hannah Watkins, managing director, BMS Re: We discuss this a lot across BMS Group. It is felt that the hiring freeze in the early '90s is still being felt today, creating a talent gap between the ages of 45 and 55. We need to learn from this and ensure we develop our own talent with the knowledge of our most experienced team members. There is no short-term fix, but we need to build robust training programmes to capitalise on the current reduction in hiring across financial services. It's crucial to showcase the high esteem in which the industry is held and emphasise its resilience in economic downturns. This field offers substantial potential for growth to those who actively pursue it.

> "The insurance sector needs to attract and retain talent, at all levels, from outside the industry – at scale and now"
> **Louisa Blain, insurance consulting leader, Aon Human Capital Solutions**

What skill sets do the (re)insurance sector need to attract new talent, in order to future-proof the industry?

Thomas Blunck, CEO of reinsurance, Munich Re: Although there is no single answer to this, skills around data and data models, analytics and artificial intelligence and its applications have a growing relevance to be at the forefront of our field and serve our clients well. In addition to industry-specific capabilities, we should not forget human-centric skills such as critical thinking, problem-solving and being able to successfully work in diverse teams and hybrid work settings.

Skills have a shorter lifespan than in the past – some of what we have learned and has served us well before will not necessarily be crucial in the future. This shift demands that our employees – as well as new talent – have a mindset of continuous learning. The willing and

ROUNDTABLE

openness to unlearn and re-learn is extremely important.

Rob Gibbs, president and CEO, SiriusPoint International: The rise of automation, digitalisation and AI is a big challenge to all industries, including (re)insurance, and we will need to attract people who are able to work hand in hand with the evolving technological landscape. We also need to find and retain those with the skills to fully utilise the best data technology, AI and data analytics available to understand and mitigate the complex risks around climate change and the prospect of growing geopolitical instability. However, the (re)insurance sector has always been a people industry where experts leverage their relationships to deliver for our mutual clients. This is key and cannot be underestimated or forgotten.

Blain: Insurance industry leaders are adapting their businesses to manage digitalisation, for example, while staying relevant in a shape-shifting risk environment. Meanwhile, game-changers such as climate risk, socioeconomic and geo-political upheaval are heaping uncertainty on to the macro outlook. This highlights the need to attract people with the right balance of technical skill and behaviours to collaborate and tackle emergent risk, while having a mindset to embrace a fast-changing business environment into the sector.

Jean-Paul Conoscente, CEO, Scor P&C: The industry is being exposed to the dynamics of virtually all [economic] sectors – diversity in skills is key. We need talent able to assess climate change, geopolitical situations, hyperconnectivity, social inflation, energy transition, cyber risk, etc. Along with actuarial and data analytics skills, the industry needs to attract technology skills to foster innovation, both for internal efficiency and for our clients.

How can the industry make itself more attractive to younger generations who are potentially less attracted by financial or wealth-creation incentives?

> "The industry lacks diversity and is too siloed, which limits the long-term health of the market"
> **Keith Harrison, international CEO, Lockton Re**

Blunck: I am a firm believer that our industry has an incredible amount to offer. It is, therefore, more about providing authentic insights into what we do and how the reinsurance industry plays a vital role in addressing some of the most urgent global challenges and social issues of our time. The younger generation especially is driven by purpose and wants careers that align with their values and make a positive impact to the world. Therefore, it's become increasingly important to showcase how our industry contributes to the greater good. Sharing stories of how we help to rebuild communities devastated by natural catastrophes, how we have prioritised tackling climate change and how we contribute towards achieving global net-zero emissions, as well how we facilitate adoption of new technologies, are just a few aspects that make a career in our international company both exciting and meaningful.

Gibbs: Empowerment and a clear route to progression motivate young professionals, as does a purpose and vision that applies to our company and the communities we serve. I joined the industry straight from university as a first-generation university student in my family. I have travelled to 21 countries, insured some amazing risks and set underwriting strategy in Chile the day after the 2010 earthquake. We all need to tell these stories and demonstrate the openness of the industry to talent and what experiences it can provide.

> "It's crucial to showcase the high esteem in which the industry is held and emphasise its resilience in economic downturns"
> **Hannah Watkins, managing director, BMS Re**

Blain: At an organisation level, working with other sectors has emphasised the value of using data to personalise the employee value proposition to attract and retain talent with different expectations, and insurers can learn from this: commtech and pharma are stand-out examples.

Using workforce intelligence in this way creates the opportunity for insurers to tailor the employee experience, aligned with the evolving expectations of those entering the workforce and highlighting the variety of opportunities, interesting exchanges, formal and informal personal development, financial reward and sociable, dynamic working environment available. Aon's market data indicates 65% of candidates report they have discontinued a hiring process due to an unattractive employee value proposition and culture. Given the sector's talent challenge, getting this right is vital.

The industry still has a long way to go in terms of more diverse representation at senior levels. What are the barriers to succession and how can we deconstruct them?

Blain: Integrating this broader mix of skill sets, diverse experiences and personalities won't be easy. In the near term, at least, individuals will have to learn to recognise, respect and value differences in expertise in a way that hasn't previously been experienced. Achieving cohesion and collaboration between colleagues with different experiences and backgrounds is a big cultural challenge, and it calls for a renewed focus on engagement and belonging. It follows that people who can manage this sort of transformation are also going to be more in-demand and opportunities will evolve.

Watkins: As an industry, we recognise this is an issue and are working to fix it. But there is no quick fix. We all need to ask ourselves why and how we can prevent this happening in the future. Ultimately, the long-term solution is to ensure we question the status quo. We all recognise that the skill sets required of our businesses in the near term are going to change – can some senior positions be filled by talent outside of our industry, potentially bringing a fresh perspective to what has been a very traditional industry that has and is accelerating its modernisation?

Conoscente: If we continue to follow traditional recruitment paths, looking only for professionals having 20+ years of experience in (re)insurance, we will not succeed. The industry needs to enlarge its pool of talent.

Firstly, by creating internally a pipeline of future diverse leaders from the recruitment of entry-level roles that we accompany at every step of the career. Secondly, by trying to be creative in leveraging candidates' skills in potential positions beyond the one they have applied to, which might not always be the perfect fit. Thirdly, by looking externally at experts who belong to other industry sectors. This is not only true for IT, legal and marketing, but also for core business functions. Scor was among the first to hire engineers as underwriters.

How can the industry plan succession better to mitigate the oncoming retirement cliff-edge?

Blunck: The impending retirement of a considerable number of experienced and knowledgeable employees within the insurance industry has the potential to significantly impact the sector. However, there are various effective strategies to mitigate this impact. Early initiation of succession planning is crucial, well before the retirement cliff-edge is imminent. Adequate time is needed to identify and groom potential successors, providing them with the necessary skills and knowledge for key positions. To build a strong and diverse pipeline of top talent, organisations should create talent pools from the outset. These talent pools should be carefully nurtured through various development opportunities and targeted programs.

Harrison: A truly collaborative culture is the key when it comes to effective succession planning. Experienced and seasoned professionals need a career pathway that both encourages and rewards them for sharing their knowledge and relationships with the next generation. But this is about much more than a process – this is about the right culture. Rewarding people solely on their individual performance and production and working with a plethora of P&Ls thwarts the ability to incentivise the sharing of opportunities and expertise, and the successful transfer of knowledge and relationships, which is so vital to the succession of the industry.

> "Skills have a shorter lifespan than in the past – some of what we have learned and has served us well before will not necessarily be crucial in the future"
>
> **Thomas Blunck, CEO of reinsurance, Munich Re**

Blain: Adopting a skills-based, not role-based, workforce-planning strategy aligned with their business strategy enables insurers to better identify where to 'build', 'buy' or 'borrow' talent with greater flexibility and manage forecast market trends, including senior leader and technical expert retirements.

Identifying priority skills gaps and time horizons can then inform sourcing and recruitment decisions, talent development, workforce mobility, innovative mentoring, agile knowledge-transfer solutions and value-proposition tailoring to be very attractive pre-retirement, slowing the exit process while maintaining engagement and adjusting workload according to need.

> "The rise of automation, digitalisation and AI is a big challenge to all industries, including (re)insurance, and we will need to attract people who are able to work hand in hand with the evolving technological landscape"
>
> **Rob Gibbs, president & CEO, SiriusPoint International**

Conoscente: Succession planning is not a sufficient answer if it does not come with a knowledge-transfer plan that must be in place much earlier than the legal retirement age.

To mitigate the risk of losing expertise, a better mapping of employees' skills and appetite for new skills needs to be developed. A data-driven industry should not be lacking people analytics. In this exercise, if strong dependencies emerge, key experts will be responsible for identifying and training eager junior staff.

Watkins: There are a few things we should be considering here. First, we should look to create leadership teams. It's not effective to anticipate that a high-performing broker excels both as a people manager and as a leader. Instead, identify the team's strengths and enhance them collectively, minimising the reliance on a single key individual.

Second, we should establish shadow executive committees – these would provide emerging talent with opportunities to engage with various aspects of the business and understand the essential factors involved in devising visions, implementing strategies and preparing for the future. Finally, we need to look outside of our industry. That instantly brings fresh ideas and perspectives.

Louisa Blain, insurance consulting leader, Aon Human Capital Solutions

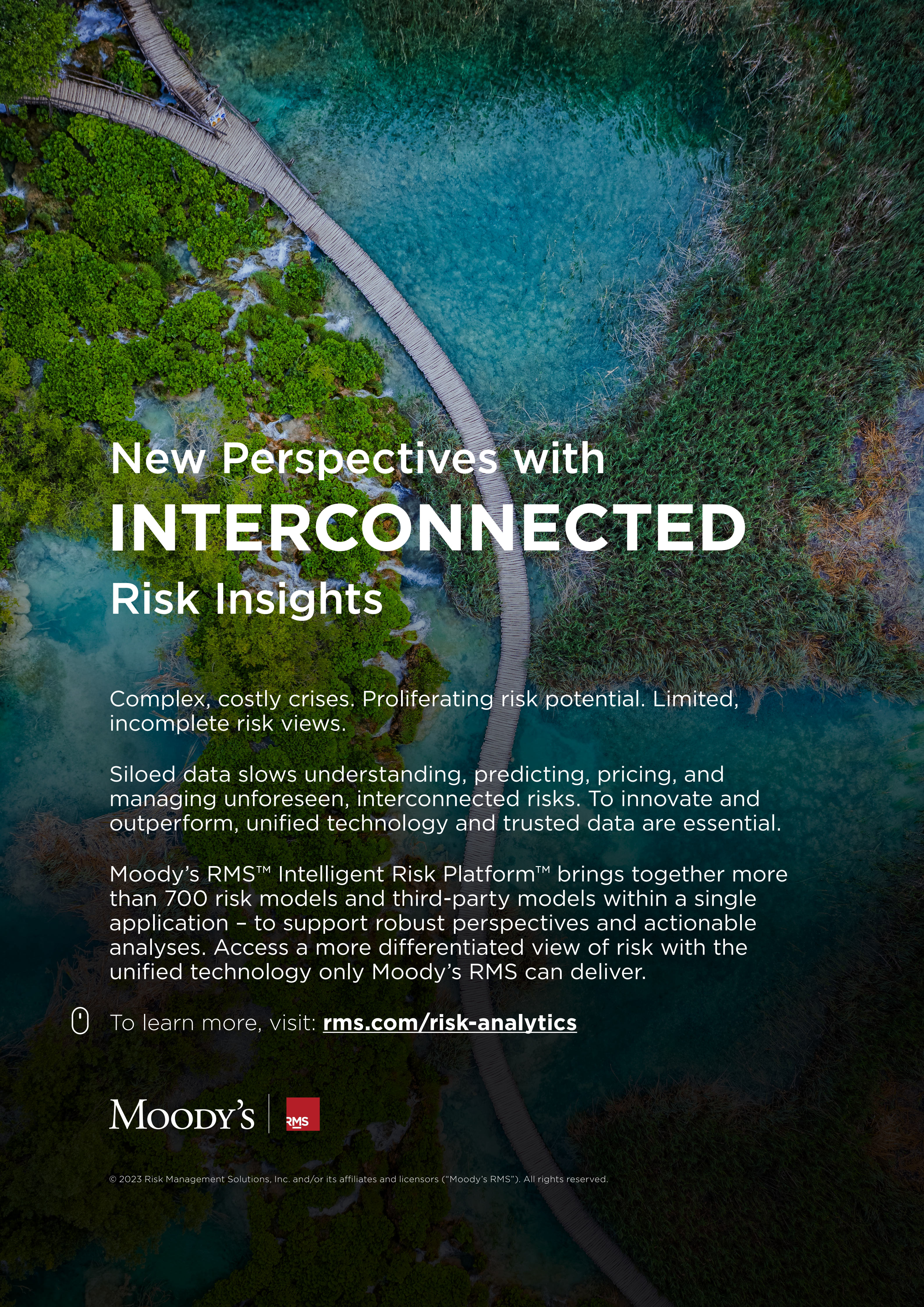
Keith Harrison, international CEO, Lockton Re

Hannah Watkins, managing director, BMS Re

Thomas Blunck, CEO of reinsurance, Munich Re

Rob Gibbs, president and CEO, SiriusPoint International

Jean-Paul Conoscente, CEO, Scor P&C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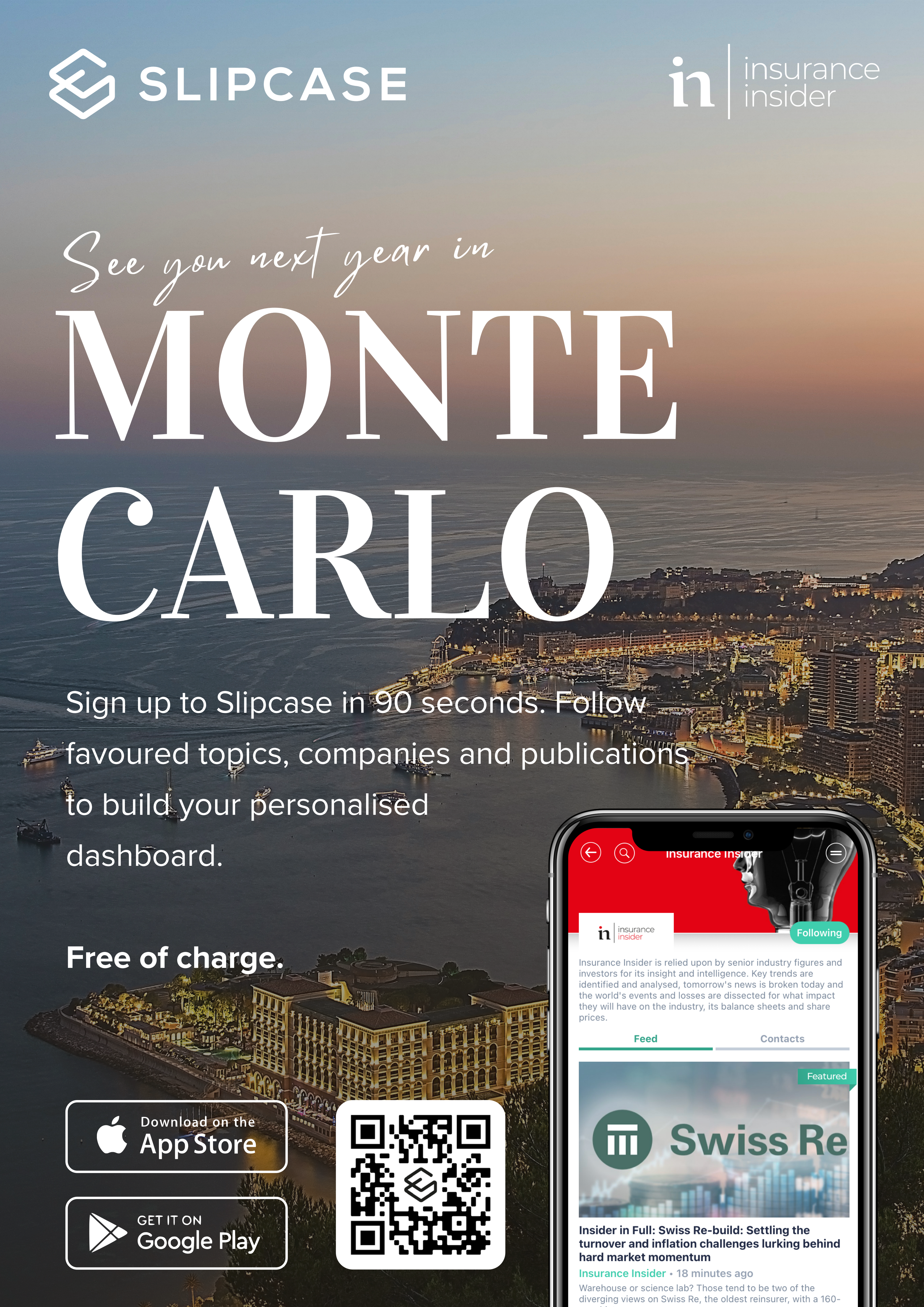
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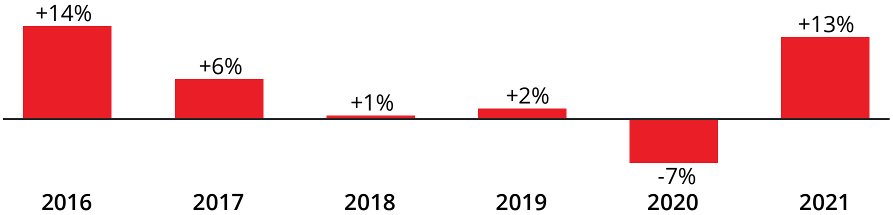
OPINION

Legacy: Dreaming of being Enstar

Net profit/(loss) reported by Catalina Holdings (Bermuda) Ltd as % of average equity, FY2016 to FY 2021



Source: Company financial reports

Commercial lines insurance is a tough business to succeed in.

You don't know your cost of goods sold and can easily be surprised, including long after you have written the business. You are subject to all kinds of shocks, not least natural catastrophes that render earnings volatile. Brokers are ever more powerful and regulators are suspicious. Plus, with limited intellectual property and the differential on cost structure typically narrow, it is tough to build any enduring moat.

But for all its drawbacks, live underwriting beats the hell out of legacy.

On paper, the segment should work because moving liabilities and assets from the live sphere to the legacy sphere creates greater flexibility around capital, investments and claims that creates value.

Live carriers, meanwhile, have incentives to transact with the legacy market given the need to gain finality and the attractiveness of capital release – the third-party run-off space is solving problems their counterparties have.

However, for a number of years the sector has underperformed, with a succession of missteps and accidents hitting legacy carriers.

These include Armour, Axa LM, Catalina, R&Q and Darag, and even better-regarded names such as RiverStone (in its prior incarnation pre-split) ran up significant losses as early as the mid-to-late 2010s. Others including Fortitude, Berkshire Hathaway and Swiss Re have either been incredibly selective or slumbered entirely in recent years.

Some of the challenges reflect the classic carrier problem of too much capital chasing insufficient risk, while others are a function of the advent of private equity capital that was undisciplined.

However, some of the challenges also stem from structural issues in legacy. These include the need to compete with counterparties retaining risk, which can interact unhelpfully with the asymmetry of information and the dark arts employed in broker-run processes.

Legacy also faces a shallow executive talent pool, owing to the greater prestige the insurance industry places on live underwriting and broking. Other issues include the need to do deals to support the fixed cost base of the legacy machine, the tendency for legacy firms to misidentify their key measure of success as executed deals, and the elevated regulatory risk they face.

Last of all, it is unclear who the natural owners of legacy businesses are, given their complexity, volatility, uneven growth and the reputational issues live carriers face if they own them.

However, while there are good reasons that legacy isn't for everybody, there is cause to believe that it could be heading for a cyclically more interesting period.

After a series of years when the news flow has included blow-ups, self-dismemberment, regulatory investigations and surrender sales, 2024 and 2025 could finally offer the incumbents still standing a chance to make decent returns.

They had better hope, however, that the party remains quiet enough that they don't wake the slumbering giants.

Here's a quick summary of my key points below:

- The legacy market has underperformed in recent years as excess capital – much of it undisciplined private equity money – has weighed on deal pricing
- Legacy is also hurt by the "retention" problem where counterparties can look to keep business if they don't find highly favourable terms
- Other issues include aggressive broking, deal fever and a relatively small executive talent pool
- It is unclear who the natural owners of legacy businesses are, with public markets, live carriers and PE all problematical
- Poor results, higher interest rates and deals focused on better priced years could point to a more cyclically interesting period to come

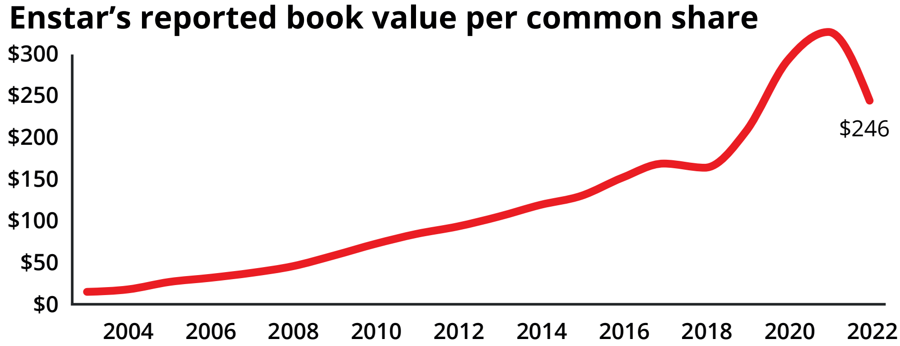
Winning in legacy is not automatic

An impression grew in the 2010s that the success of Enstar (and Catalina on a smaller scale) meant there was a clear model for making a success of run-off.

Enstar has compounded book value long-term by 15.7%, and Catalina was delivering double-digit ROEs consistently in the first half of the 2010s.

The theory underpinning the sector is relatively clear. Moving liabilities and assets from the live sphere to the legacy sphere unlocks value because of the greater flexibility here.

Legacy carriers do not need to support an A- rating, and so can support the



Source: Company financial reports

same book with less capital. In addition, the freedom from ratings agency oversight allows them to work the assets more aggressively than a live insurer.

Last of all, because they do not need to write new business, legacy acquirers can play dirtier on claims.

There is also a clear value proposition for clients with the legacy market either able to offer capital release from supporting old claims or to deliver finality on toxic books.

Looking at Enstar's results and these sector mechanics, many management teams dreamt of being the next Enstar.

However, it has become increasingly clear that winning in legacy is not automatic, and that Enstar did so by building a better claims machine, due diligence team and investment engine than the rest of the market. Of course, with a 30-year operating history, Enstar had a first mover advantage, but it also exploited that and retains a competitive advantage over peers.

Many of the other firms, including those that brought in private equity capital during the heady 2017-20 run, have learned there is a string of obstacles that leave legacy acquirers at significant risk of underperformance and set a high hurdle on execution.

So what has gone wrong?

The most important issue is the legacy market is over-capitalised, with too many different bidders chasing each deal.

Back in 2010, most of the deal-flow was a tug-of-war between Enstar and Catalina, with occasional interventions from Fairfax-owned RiverStone and White Mountains, and a small number of planet-sized Berkshire Hathaway deals.

By 2020 that group had grown to 12, with Enstar and Catalina also having to service much larger capital bases. Even with the maturation of the legacy market towards a greater number of capital release deals, demand was not able to keep pace with supply, and pricing suffered in winner-takes-all processes where only one idiot was needed.

The opacity of the industry makes it extremely hard to chart this capital growth, along with non-dedicated capital. Should you include Berkshire's gargantuan capital base? How about life-focused Fortitude?

But Enstar's shareholder equity went from $1.2bn at the end of 2010 to $6.7bn in 2020, and you also added a string of companies with a couple billion of equity.

Enstar has changed the way it discloses its returns on managing the liabilities, but its recent results show five-year returns on its run-off liabilities of only around 3%. Although this metric was not disclosed, it is understood that it was much higher a decade ago.

The industry also became a hot spot for private equity investment, with the likes of Apollo, Kelso, Aleph, Crestview, Cinven, Aquiline, Oaktree, Carlyle and CVC all buying in to (or founding) platforms and injecting growth capital.

Private equity money has a high cost of capital and, as these legacy acquirers tried to deliver 20%-plus returns, they rushed to deploy capital and did so injudiciously, generating losses.

Capital issues exacerbated by structural issues

These capital-driven issues have been exacerbated by a number of structural challenges in the space.

First, the legacy market originates risk via wholesale or secondary transactions. This leaves it at the mercy of (re)insurance companies' willingness to transact – and these counterparties can always choose to retain the books if they do not like the terms on offer.

As such, legacy acquirers must compete not only with each other but also with retention – creating a dynamic where counterparties can opportunistically approach the market, and only transact if they find dumb capital.

Unfortunately, this situation is exacerbated by the huge asymmetry of information between the (re)insurer looking to hand off the book and the legacy acquirers. Also, over the last five years the involvement of reinsurance brokers on the sell-side has been dialled up significantly. Brokers employing the dark arts of corporate finance have done a good job of driving legacy acquirers to offer more attractive terms by maximising competitive tension.

Legacy CEOs seem particularly prone to succumb to deal fever – perhaps because it is easy to misidentify the key value-creating activity of these firms as deal origination and negotiation.

Successful proponents of M&A in the legacy (and live) markets tend to stress that the true testament to deal-making prowess is the willingness to walk away right down to the last minute.

In addition, legacy has a shallow executive talent pool, leaving some run-off players with untested leadership.

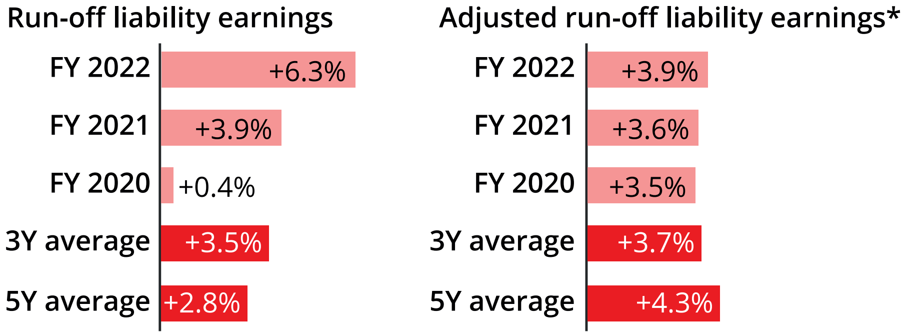
Given that there are only a small number of legacy acquirers with a long track record, the large cadres of experienced executives that you see in the live market do not exist in legacy.

The problem has been exacerbated by the industry's focus on underwriting/placing new business, not claims and servicing – which tends to steer the strongest talent in this direction.

The pressure to transact at all costs that undisciplined private equity can create is also a function of the high fixed cost bases that they need to sustain.

By way of example, in 2020 Catalina had general and administrative expenses of $101mn at a time when it did little deal-making. The firm – which had

Annual rates of return obtained by Enstar on managing its run-off liabilities



RLE = prior-period net incurred losses and adjustment expenses divided by average net loss reserves
Adjusted RLE = RLE excluding impact of changes in discount rate on the fair value of certain liabilities and the amortisation of fair value adjustments relating to purchased subsidiaries
Source: Company financial reports

$1.36bn of equity – ran up a net loss of $83mn that year.

Legacy firms also face elevated regulatory risk due to the still widespread perception that they manage insureds' claims aggressively.

Catalina stands as something of a cautionary tale. In 2019, the legacy acquirer was subjected to a Section 166 probe from the UK's PRA.

The company had to sit out UK dealmaking for around two years, suffered major management distraction and cost pressure. It never recovered its position and is now in the midst of a strategic pivot to focus on life run-off.

Finally, it is unclear who the natural owners of a legacy firm are with public markets, live carriers and private equity all having drawbacks.

Enstar – the only legacy name to have traded publicly – is poorly understood in the public markets. The business has delivered long-term total value creation that outstrips US specialty insurers such as WR Berkley and Markel, but trades at a worse multiple than Axis.

Live carriers are also bad owners of legacy businesses, with the two business models mixing poorly due to cultural mismatches and reputational challenges.

Private equity meanwhile offers expensive money and a short time horizon that creates additional risk.

This issue around finding the right capital to support the business has created exit challenges for private equity that to date have not been resolved.

A more cyclically interesting period?

While there are numerous reasons that Enstar's success has not been easily replicable, there is cause to believe that it could be heading for a more cyclically interesting period.

Armour, Axa LM and R&Q all are out of the market for new deals, whether the last acknowledges it or not. Catalina has not pulled out of P&C entirely but is only looking at bilateral deals, and has a preference for life deals.

And as previously reported, Aleph and Crestview have appointed Nomura to explore merger deals for Darag that would take out another competitor. (A range of legacy acquirers are examining the deal, but it is hard to see a transaction done at any premium, and existing backers will likely have to accept structuring to protect the acquirer's downside.)

Fortitude, meanwhile, after making bullish noises about P&C deal appetite under the leadership of James Bracken, has kept its powder for life deals since Alon Neches took the helm, despite looking at the available deal flow. (Indeed, as a whole the life run-off space with its more predictable liabilities, larger deal size and roughly 10:1 asset leverage has very much been putting P&C in the shade.)

All told, there is less capital chasing deals, and multiple sources suggest that deal pricing is better now than it was six to 12 months ago, although irrationality has not disappeared.

If another carrier or two were to get hurt – as some in the segment think likely given recent deal activity – the pricing outlook could improve substantially, and even without that, the trajectory is positive.

Deal flow also remains robust, according to underwriting and broking sources, with insurers looking for capital release to fund growth.

Two other features of the market are changing that promise improved returns.

First, the deals being marketed increasingly have more exposure to newer, better-priced underwriting years.

Legacy sources said most deals in the market have 2020 and 2021 exposures, and a lot have 2022 business.

Increasingly deals have unexpired exposures, which some legacy carriers dislike due to the volatility it brings. However, the books are likely to run off more favourably than in recent years, as the balance of the portfolios moves away from the soft-market years of 2014-19.

Second, the investment environment has improved materially for legacy acquirers as a result of the rapid round of interest rate tightening from central banks.

Given investment leverage at 3-3.25:1 at legacy acquirers, the increase to around 500 bps on new money yields that is already bleeding in and which will continue through 2024 and 2025 represents a huge earnings lever.

This does increase the legacy acquirers' cost of capital, but, due to the leverage in the model, this will not be commensurate with the increase in returns.

Those in the P&C legacy market that have held on are likely to be targeting a double-digit-to-teens return in the middle of the decade, (and one that will not be wiped out by future adverse development).

The challenge is that if the returns look good, more capital could be drawn in.

Private equity is likely to be more cautious this time, but Berkshire Hathaway, Swiss Re and Fortitude have plenty of firepower if they are woken from their slumber.

DATA

Explore Insurance Insider's legacy market deal tracker

Based on our reporting and other data, this publication has put together a database of legacy transactions in the non-life insurance market. In the table, you can see which companies have been most active in the market so far in 2023.

RiverStone has completed the most deals (four), though their value has not been disclosed or reported.

In terms of the dollar value of reserves acquired, Enstar leads the way with $2.1bn. Its largest transaction was a $1.9bn loss portfolio transfer with subsidiaries of QBE on a diversified portfolio of European, North American and international business, which was announced in February.

You can explore the complete, interactive database on our website at *bit.ly/insider-legacy*

Acquirer	2023 deals	2023 reserves acquired ($mn)
Enstar	2 reported deals 0 where transaction size not reported	2,147
Compre	1 reported deal 1 where transaction size not reported	1,300
Marco Capital	1 reported deal 2 where transaction size not reported	245
RiverStone	No reported deals with transaction value 4 where transaction size not reported	
Darag	No reported deals with transaction value 3 where transaction size not reported	
Catalina	No reported deals to date	
R&Q	No reported deals to date	
Premia	No reported deals to date	

Source: Insurance Insider

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Reduced reinsurance cover will make P&C results more volatile

Reinsurers have reduced the supply and increased the price of natural catastrophe coverage this year, forcing many cost-conscious primary insurers to retain more catastrophe risk themselves. We expect primary insurers' financial results to become more volatile as a result, with more geographically concentrated and specialized companies worst affected. In contrast, diversified players should be able to adjust by swapping out some catastrophe risks for increased exposure to other risks.

Moody's estimates that, for rare, medium-sized catastrophe events occurring once every 100 years, primary insurers will bear around 10% more of the insured losses this year than last. The increase rises to 10%-15% for smaller events occurring once every 10 years.

Hence, if reinsurance protection had been at current reduced levels already last year, the French primary P&C market would have absorbed additional losses of EUR700mn from the 2022 hailstorms. We therefore expect catastrophes to have a more negative impact on primary insurers' combined ratios in 2023.

The impact will likely be more modest for large, diversified companies. This is because they are able to trim some of their gross exposure and take on more business in non-catastrophe lines to compensate. It will be more difficult for less diversified players to replicate this strategy.

Some may be forced to surrender market share or accept an increase in their reinsurance costs to avoid additional catastrophe losses. Alternatively, they may attempt to push through offsetting price increases, although the scope for price rises in the primary insurance market is limited by rising inflation and intense competition.

Positively, we foresee no material change in insurers' solvency because of their increased catastrophe exposure. This is because their reinsurance protection has declined mainly for smaller catastrophe events, whereas exposure to larger events is a more significant driver of capital requirements.

Benjamin Serra, Senior Vice President and Analyst, Moody's Investor Service

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Having the right perspective to optimize capital, navigate markets and reduce volatility requires an advisor who can help you achieve your business goals.

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