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

12 September
DAY 3
Tuesday

insurance insider

MONTE CARLO

Anti-ESG vs climate activism: How carriers can navigate a culture war

Insurance Insider explores how insurers can manage the dual, polar-opposite pressures of a litigious anti-ESG movement and net-zero climate activism

As if forging a path to net-zero wasn't complicated enough for global (re)insurers, recent developments have dumped another thorny obstacle in the way: an increasingly litigious anti-ESG movement in some US states.

The most explicit example of this emerged earlier this year, in a fashion that briefly damaged the industry from a PR perspective, when a carrier exodus from the Net-Zero Insurance Alliance (NZIA) unfolded.

As the UN-convened alliance unravelled, the departing founding members – Allianz, Aviva, Axa, Scor, Swiss Re and Zurich – provided little or no explanation. Had they all been spooked into silence by an ESG backlash in the US?

Munich Re, another co-founder and the first to leave, was the only major Continental carrier to flag the antitrust threat.

The subsequent exit of 19 more NZIA members reflected how an anti-ESG movement had gained momentum and crystallised in a legal, antitrust threat.

Naturally, the exodus precipitated further pressure from climate activists, even though every departing carrier had reiterated ongoing objectives to cut emissions.

Amid an ensuing swathe of media coverage questioning whether this kind of industry collaboration was feasible on net-zero, the underlying difficulty for insurers was clear.

With climate protestors in one corner demanding faster, tougher action to cut capacity for fossil fuel industries, and US legislators on the other, threatening antitrust lawsuits over collective action to cut insurance emissions, (re)insurers were entering precarious territory.

Capitulating to certain demands on either side could just fuel further climate protests from one corner or tempt more litigious warnings from the anti-ESG brigade on the other.

So how can such polar-opposite pressures be managed?

An ESG retirement question

Industry sources said an evolution in the language used across the industry on this topic, plus further transparency from individual firms on their net-zero objectives, may "take some of the canned heat" out of the invective coming from each side.

Many sources said they expect periods of volatility from both the anti-ESG and climate activism quarters as "the new normal" from now on, particularly when capacity starts to fall for fossil fuel activities, or when UN reports depict "scientific, objectively true" examples of climate change.

Depending on their employer's presence in certain US states, sources offered differing views on the extent of the antitrust threat posed across the Atlantic.

Some described it as an obstacle more to specific aspects of industry collaboration rather than individual climate goals, while others were outright dismissive.

A senior source at a carrier said: "This anti-ESG movement is a minor voice in the grand scheme of things. It will be a disruption and it will continue to be an annoyance, but it's not going to change anyone's (net-zero) pathway."

One underwriter suggested that a gradual retirement of 'ESG' as an industry term, with 'sustainability' as its replacement, might act as less of a "red rag to a bull" to legislators who remain culturally opposed to ESG.

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inside

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COMMENT

How hung-up should insurers get on Scope 3 emissions?

Creating transition plans for carriers is a cumbersome and intricately entangled exercise. But within this task, is anything more complicated than measuring Scope 3 emissions?

Probably not, and it would seem a zero-sum game to choose or establish a methodology for measuring Scope 3 that could be regarded as without fault.

The question of what proportion of an insurance policy should be attributed to a carrier's Scope 3 emissions still has different answers, with no independent authority able to stake a claim to the right answer. In that case, how hung-up should insurers be on finding a watertight answer to the Scope 3 question?

Scope 3 originates from the three categories of accounting standards for greenhouse gas emissions (GHG) established by the GHG Protocol.

The protocol emerged from a partnership between two global bodies, the World Resources Institute and the World Business Council for Sustainable Development, two more among the infinite number of alliances involved in net-zero protocols.

While Scope 1 and Scope 2 are generally perceived to be more straightforward, Scope 3 poses a series of questions that would test the most gifted actuary.

As Simon Tighe, group head of ESG at Chaucer told this publication: "If we provide an energy policy to a company, how much of their emissions are driven by having an insurance policy in place, provided by us?"

The most commonly used methodology so far that could help carriers solve this was conceived by the Partnership for Carbon Accounting Financials (PCAF) for the Net-Zero Insurance Alliance. This provides a formula to work out insurance-associated emissions but is well known for its flaws.

The formula involves as a starting point calculating an attribution factor by dividing premiums by customer revenue. The attribution factor is then multiplied by an insured's emissions to produce an insurance emissions metric.

As an example of its application to a high-emitting oil company, if oil prices rose sharply and everything else in the equation remained broadly flat, the amount of insurance emissions a carrier would record for that firm would decrease, year on year.

PCAF has said it will refine the accounting standard, but ESG heads explained to this publication that, ultimately, Scope 3 emissions will be just one component of interconnected data points insurers will assess, alongside the veracity of insureds' transition plans.

As one sustainability leader put it: "We could all easily fall down rabbit holes on Scope 3, and how perfect or imperfect the methodologies are. The important thing to look at is the overall detail of a downward trajectory for a client, that's what we're trying to achieve."

Another ESG head said: "There will be things we do have to solve, like trying to stop double counting of emissions when a bank lends to or invests in companies in the same value chain, and working out insurance emission complications when we're providing higher tranches [of cover] at lower premiums. Ultimately, there were always going to be imperfections at the start, and a few haven't even adopted PCAF yet."

It's not clear the extent to which UK regulators will put a scalpel to PCAF or other methodologies applied for Scope 3. Even if they did, against what criteria could they assess the efficacy of them?

As one underwriter said: "Like us, they'll have to start somewhere too: They won't have the right answers either."

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LEAD

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The underwriter added: "'Sustainability' might have a softer resonance in that it implies we're looking at a more sustainable way of operating, where we're embedding environmental concerns into decisions, rather than being thought of as virtue signalling – or worse, out to cancel somebody."

This sentiment echoes the view espoused by BlackRock CEO and chairman Larry Fink in June, when he set out an intention to stop using ESG entirely, due to its weaponisation by both sides of the debate.

Evolving legal threat

The US backlash against ESG investing has long been in the making, but the main antagonists only shifted their focus to P&C insurance in early 2023. This momentum reached a cataclysm in May.

At this point, as the NZIA's future looked bleak, a coalition of 23 attorneys general from various US states, including those from Texas, Alaska, Ohio, Kansas and Kentucky, issued a co-signed letter to NZIA members, warning that their decarbonisation targets may not comply with federal and state antitrust laws.

> "This anti-ESG movement is a minor voice. It will be a disruption and it will continue to be an annoyance, but it's not going to change anyone's [net-zero] pathway"
> **Industry source**

The attorneys claimed that a push to force insurers' clients to reduce emissions rapidly had driven up insurance costs, as well as gas prices – appearing to ignore the economics of inflation.

Reflecting on the extent of the threat from US legislators, one underwriter said it was exaggerated.

"The letter appeared to be disingenuous in its arguments, because the reality is that every insurance company is separate. We don't want to collude, we are acting on behalf of our own capital."

Another source added: "The movement behind this appears to see ESG as some kind of woke initiative. Perhaps they thought the NZIA was an easy target to disrupt and dismantle.

"But the fact remains that, as insurers, there's no end of alliances in which we're still collaborating and through them, we are not setting commercial goals together."

Divergence in a culture war

The antitrust argument reflects just one way in which the legal landscape is evolving in the US.

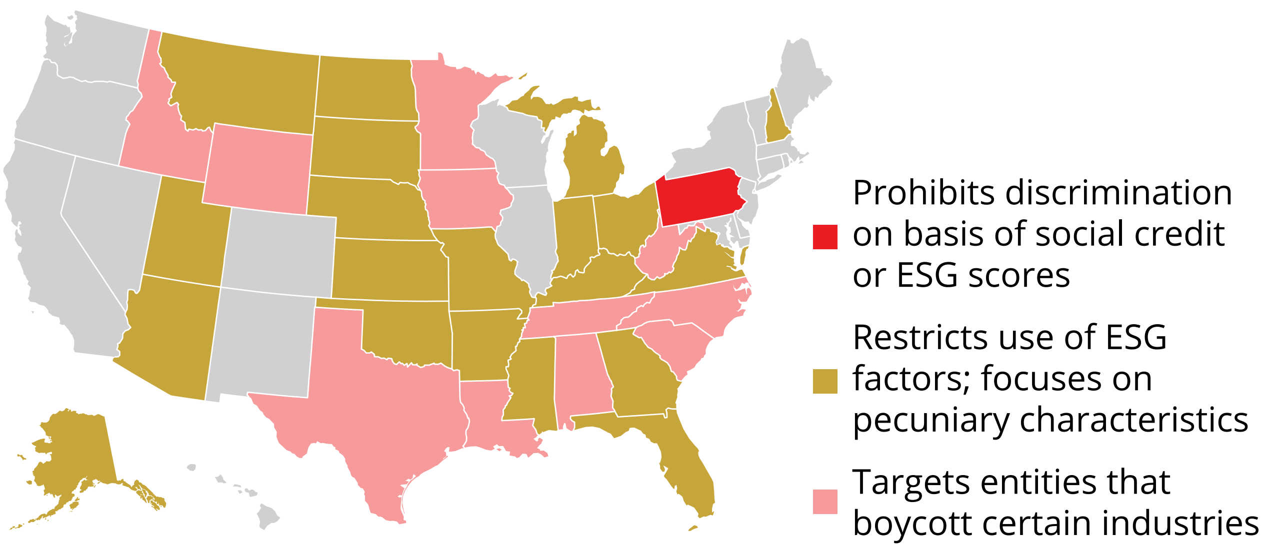
In another example, a wave of new legislation has swept through largely Republican states to ban investment firms and in some cases insurers from using ESG ratings punitively against companies.

A notable development has been the Senate Bill 833 in Texas, which bans insurers from using an ESG model, score or standard to charge a different rate to a business in the same class for the same hazard. The prohibition applies to all lines of business in Texas, except fidelity, guaranty, and surety bonds and crop insurance.

This is just one example, particular to insurers, of a legislative tidal wave. Pleiades Strategy, a climate risk consulting firm, recently published a study showing that at least 165 bills and resolutions against ESG investment criteria were introduced in 37 states between January and June 2023.

Although only 19 bills from these resolutions have become law so far, sources said the onslaught raised the importance of understanding contrasts between different states.

Ropes & Gray assessment of states' regulation of ESG



Data as at 11 August 2023
Source: Ropes & Gray

Key stats on climate litigation

- Just over 2,000 climate litigation cases have been filed to date globally
- Around 25% of the total was filed between 2020 and 2022
- More than 1,200 cases have been filed in the last eight years
- Just over 800 were brought between 1986 and 2014

They noted California and New York as slightly more aligned to the trajectory of climate legislation and regulation in Europe.

Yet another dynamic to manage is the amount of climate litigation coming from the opposing side, with pivotal cases launched in the UK and across Europe during the past year.

This publication has previously summarised the extent of litigation volumes, as well as select lawsuits where binding court decisions could have a lasting impact on the London market.

The divergent types of climate litigation among the 2,000 cases that have emerged since 2015 encompass not just greenwashing but also climate mitigation and attribution science – meaning the apportioning of liability and cost to insureds for climate-related damage, according to WTW analysis.

In this litigious landscape, sources said it was becoming increasingly important for carriers to conduct more robust internal interrogations of their public commitments on net-zero, given that activists are searching for anything a high court judge may reasonably conclude is misleading.

Collaborate to navigate

A sustainability leader at one global insurer said that, regardless of where climate pressures are coming from, the industry needs to build and not retreat from alliances, particularly ClimateWise and the Insurance Development Forum (IDF).

They argued that these bodies can provide practical tools on climate reporting and insight on participation in global sustainability projects, both of which "will be vital in the next 20 years".

One source explained that, as benchmarking between carriers on the climate transition will become more important, membership of ClimateWise will involve annual reporting on individual actions for the transition.

This will enable comparisons with peers and the ability to report on the overall progress made by the ClimateWise community, thereby building on the transparency of how carriers are changing their entire organisations.

With the NZIA depleted, sources said ClimateWise, the IDF, the Net Zero Asset Owner Alliance (NZAOA) and the Sustainable Markets Initiative Insurance Task Force will likely be the more important alliances. Sources noted the NZAOA's importance in setting protocols for transitioning investment portfolios.

On the underwriting side, although the PCAF methodology for measuring insurance emissions was a major piece of work conducted for the NZIA, carriers can deploy it outside of the alliance.

One source also believed that the anti-ESG campaigners have moved on from targeting insurance industry alliances.

"For those guys, I think it was mission accomplished. They went after the NZIA and got what they wanted. Having read their arguments about collusion on insurance pricing though, I think they don't even understand what syndicated risk means."

> "Some activists may not agree. They think we should be moving quicker in certain industries and removing capacity. However, we think we need to provide the opportunity to transition into a more sustainable path"
> **Simon Tighe, group head of ESG, Chaucer**

Appetite for engagement

While the anti-ESG threat appears to have calmed since a crescendo in early summer, activities from climate activists have remained consistent, with Lloyd's targeted the most often.

Protests against insurers and/or Lloyd's have become so frequent they're rarely newsworthy events in themselves. In one of the latest examples, at the end of August, a coalition of six activist groups protested outside the offices of various Lloyd's members. They were targeting carriers that they claim have refused to rule out insuring the East African Crude Oil Pipeline.

For Simon Tighe, group head of ESG at Chaucer, a key aspect of navigating the dual pressures along the net-zero journey is to recognise arguments from both sides.

"I understand the activist pressure to cut capacity – the world is on fire right now – I get it. However, we also need to accept that we need to enable the flow of investment into the technologies and methods that will remove carbon from the atmosphere, and offsetting emissions, before we can start cutting capacity.

"We've got to recognise that we are at a perilous point for the climate. Urgent action has to be taken."

Another sustainability leader explained that a challenge emerging from the activist side is that, after having little success in influencing the board decisions of global energy firms, they're trying "to use insurers as a back door to the board".

"We're stuck in the middle of that, in a perpetual culture war, and it's very hard to work out what we should care about most when looking at the transition plan (of insureds), their emissions, plus our own scope three emissions, amid all that pressure."

Tighe also argued that insurers need to be very clear not just about their intentions around climate, but also how they're trying to deliver on them.

Tighe added: "If you're not living it as a company yourself and setting a higher standard, it's just not going to work. We will only expect our clients to do what we are willing to do ourselves."

ANALYSIS

Vesttoo LOC scandal: What it has and hasn't changed in reinsurance

The bankruptcy court filings that emerged just before Monte Carlo laid bare the sequence of events that Vesttoo alleges led to its LOC scandal.

The detail was gripping – involving fake aliases and call-forwarding – but ultimately doesn't change much of the material impacts or near-misses for the reinsurance sector.

After all, echoing a finding in the report that "red flags abounded [internally] as early as 2021", as we had argued, in many cases there had been a sense within the industry that the firm's capacity had been used up despite some clear warning signals – use of Chinese bank LOCs, for example – even if the specific fraud was unforeseen or harder to detect.

As one source put it, there was a view that brokers had tried to "get the cheap capacity before it goes away".

This means the case is generally viewed as a specific rather than systemic failure, with further scrutiny likely on LOC providers, or a preference for cash collateralised trust funds, as is standard in many other parts of the ILS market.

Among brokers, it may prompt a review of practices whereby cedants are asked to take on more inherent due-diligence risk by signing disclaimers over the use of certain trading partners, as this is not going to protect the segment against E&O claims in itself.

As Vesttoo's participations had been most marked in the fronting segment, the direct impact on reinsurers has generally been somewhat lessened, relative to the primary market.

For some mainstream reinsurers the failure even brought up unexpected mid-year opportunities to consider. Cedants who found themselves exposed to the fallout had to explore options to replace and bolster coverage rapidly – whether in cat risk to compensate for unexpected capital strain in casualty lines, or in direct swaps.

Similarly, their relationships with fronting carriers may be enhanced by a flight to quality providers among that segment.

Fronting segment review

As this publication has argued, while the fronting segment remains under review by AM Best, there is a strong chance that fronting carriers will face more fundamental questions over their valuations and whether their risk-taking nature had been underestimated.

In essence, these businesses were being pitched as parallel businesses to MGAs or brokers. The best insurance service businesses over the last couple of years have been able to secure 18x-20x a heavily adjusted Ebitda multiple, with some curbing of multiples evident during the past year as the increased cost of capital started to bite.

The Vesttoo crisis will likely prevent any of these from securing those kinds of valuations in the near term.

Partially, this will reflect a worsened operating environment the fronts face in the aftermath.

It is likely that their growth will be checked by MGAs choosing to make different choices around capacity, with the trade-offs that come with using fronts and collateralised reinsurance no longer ignorable. (Sources have said this is already a boardroom-level preoccupation at MGAs, and some are known to have approached carrier-owned fronting units to explore moving business.)

In addition, fronts are likely to have to take on significant additional cost related to risk, compliance and underwriting to demonstrate their bona fides to trading partners. The second part of this evolution will be a move towards even greater risk-taking as a means of demonstrating skin in the game to persuade MGAs to work with them.

The consequences of Vesttoo will hurt the fronting companies, but the changes are less important than the role the crisis will play in uncovering what was already there.

Vesttoo timeline

2018: Vesttoo launched in Israel
Nov 21: Series B fundraise of >$15mn led by MS&AD Ventures and Mouro Capital
Feb 22: Vesttoo and Corinthian Re announce partnership with aim of creating investment-grade-rated securitisation of underlying reinsurance deals
Mar 22: Vesttoo completes aggregate stop-loss treaty, covering subject premiums of $270mn, for Lloyd's syndicate, brokered by Acrisure Re
Aug 22: Vesttoo and Clear Blue enter agreement to deploy $1bn in reinsurance capacity over upcoming year
Oct 22: Vesttoo's Series C funding round raises $80mn at a $1bn valuation, with investment co-led by Mouro Capital
Mar 23: AM Best gives indicative bbb rating to Vescor cat bond, emerging from Corinthian partnership, which is never completed
17 Jul 23: Following media article, Vesttoo says it has brought in third-party experts for an audit following "inconsistencies" and that several executives have departed
25 Jul 23: AM Best says it will conduct a review of fronting companies and places Clear Blue under review with negative implications
1 Aug 23: Vesttoo says it has taken "painful" choice to let go of many staff
9 Aug 23: Vesttoo appoints board member Ami Barlev as interim CEO after putting founding CEO Yaniv Bertele and chief financial engineer Alon Lifshitz on paid leave before their exit
10 Aug 23: White Rock files injunction seeking to freeze Vesttoo assets, detailing a sequence of events that started on 14 July when a client sought payment under an LOC ostensibly issued by CCB that was denied
14 Aug 23: Vesttoo files for Chapter 11 bankruptcy protection in the US

VIEW FROM THE TOP

Q&A: Guy Carpenter's Dean Klisura

Guy Carpenter president and CEO Dean Klisura responds to questions that are top of mind for the company's clients as they navigate a volatile and ever-evolving (re)insurance landscape. Topics include risk-transfer capacity and pricing, cyber, and public sector management of risks that threaten communities' prosperity and security

Will the factors that led to the reinsurance market recalibration at mid-year renewals following the challenges experienced at January 2023 continue into the January 2024 renewals?

The recent adjustment seen in available capacity hinges on market expectations of supportable returns. With that, we expect the market to remain firm at 1 January and more stable conditions should carry forward. Cedant differentiation will remain a major factor as market drivers are expected to linger into 1 January 2024 renewals, and reinsurers' emphasis on quality programs will endure. Price adequacy across lines and supportable structures should drive sufficient capacity levels.

For cedants, greater retained risk across the business in 2023 may impact volatility in 2024, necessitating increased strategic portfolio management. Guy Carpenter uses our market presence, longstanding depth of experience, and industry-leading analytics to equip our clients with innovative risk and capital solutions.

As the cyber market becomes a more significant component of the global (re)insurance industry, what are the factors that need to be addressed to further the broad potential of this line of business?

In the last few years, cyber coverage has expanded and been refined with a wider availability of products. The market has rapidly grown on a global scale, but capacity constraints and lower penetration in certain regions and industry segments highlight the fact that there is much room for further growth.

Improvements in risk quality, a diversifying portfolio base, and advancements in cyber catastrophe models have been major contributors in attracting capital to the cyber market. The recent market cycle has expanded the range of cyber reinsurance structures to improve alignment of risk appetite with reinsurance needs. Event covers and nascent ILS structures have spurred alternative capital providers to begin supporting cyber risk.

Now more than ever, cyber industry participants need to utilise a technical, data-driven approach to assess the potential industry loss size. As the underlying data quality improves and modeling continues to evolve, so will the ability of the cyber market to create a more accurate view of an industry loss and ultimately draw new capacity into this sector.

We are at a juncture where, in order to unlock the potential of the class and take the essential next step to close the protection gap, we need to jointly solve the challenges around capacity. This means efficiently matching up risk and capital across the transaction chain, from insurance and reinsurance solutions to retrocession.

Guy Carpenter and Marsh McLennan have recently proposed a series of bold and innovative initiatives in the public-private sector risk mitigation and recovery arenas. What do you see as the role of the (re)insurance industry in shaping the public sector risk landscape?

We see ourselves as a key player in support of governments to address hard-to-manage risks that threaten the prosperity and security of communities around the world. One recent initiative reinforcing that commitment is Marsh McLennan's effort to develop a war-risk pool to insure the reconstruction work required to rebuild Ukraine's infrastructure and shattered economy. The initiative applies the strategic advisory expertise of Oliver Wyman with the risk transfer expertise of Marsh and Guy Carpenter.

We expect the war-risk pool would allow a conventional property insurance market to function, enabling investment to flow at the proper levels. A key element would be the provision of a government backstop, for instance, by G7+ governments, comparable to the types of public-private partnerships developed by a number of G7 countries for various perils, including terror risk, albeit on a larger scale.

Our work in the context of Ukraine is just one example of the power of Guy Carpenter, and Marsh McLennan as a whole, to support the public and private sector in addressing critical global risks.

INTERVIEW

Hannover Re: Reinsurers are underestimating political risks

Chairman and CEO Jean-Jacques Henchoz sees affordability of insurance becoming a politicised issue, while discussions on preventive measures remain on the sidelines

A hard property cat market isn't just headline news for the reinsurance market these days: the rising costs of cover are becoming political issues in cat-exposed spots such as Florida and California, and more widely.

The dynamic partly highlights the value that reinsurance companies bring to the global economy, Hannover Re chairman and CEO Jean-Jacques Henchoz says. "Reinsurers draw attention to the price of risk," he notes, sending signals to insurers that they must charge adequate rates at the primary levels.

But as the affordability of insurance becomes a politicised issue, reinsurers must be attentive in turn to how the pricing signals they are sending are handled.

"The corollary is that we cannot be alone in tackling climate change," he says. "My plea is that politicians, governments, international institutions… pay more attention to the need for climate change adaptation."

A task that has become essential to climate change response is prevention: making sure building codes are in place, infrastructure is resilient and development in hazard-prone areas is avoided.

These preventive actions, in turn, will motivate (re)insurers to adjust the price of risk. But "the political debate today is not recognising this", Henchoz says, because it's easier to "target the insurance industry when prices are too high".

Of course, there are roles the reinsurance industry can play and Henchoz says carriers must be self-critical and cannot simply respond to risk through exclusions.

Instead, the industry can stay relevant by finding new ways to access and structure risks to help narrow the protection gap.

But amid this politicisation of the rising price of coverage, the Hannover Re CEO argues that reinsurers are underestimating political risks in general, despite the recent lesson of Covid-19 on the kind of pressure that can be brought to bear on carriers.

There is a societal view, he adds, where (re)insurers are perceived to "have a societal role to play in paying claims, even if they are not legitimate from a legal point of view".

"I think the industry needs to recognise that there is an element of political risk in everything we do."

One example is the steady increase of trade barriers facing reinsurers – one that jeopardises the notion of pooling capital to pay for significant losses.

As of April, more than 27 countries had or were developing restrictions to freely conduct business on a cross-border basis, thus limiting the capacity of global reinsurers to spread risk globally and to prevent domestic concentrations of risk, according to the Global Reinsurance Forum.

Such limitations increase the cost of doing business, Henchoz says, which in turn contributes into a "strange situation" where political and regulatory development makes risk-taking more costly, while society says risk-takers are charging too much money.

> "The industry needs to recognise that there is an element of political risk in everything we do"

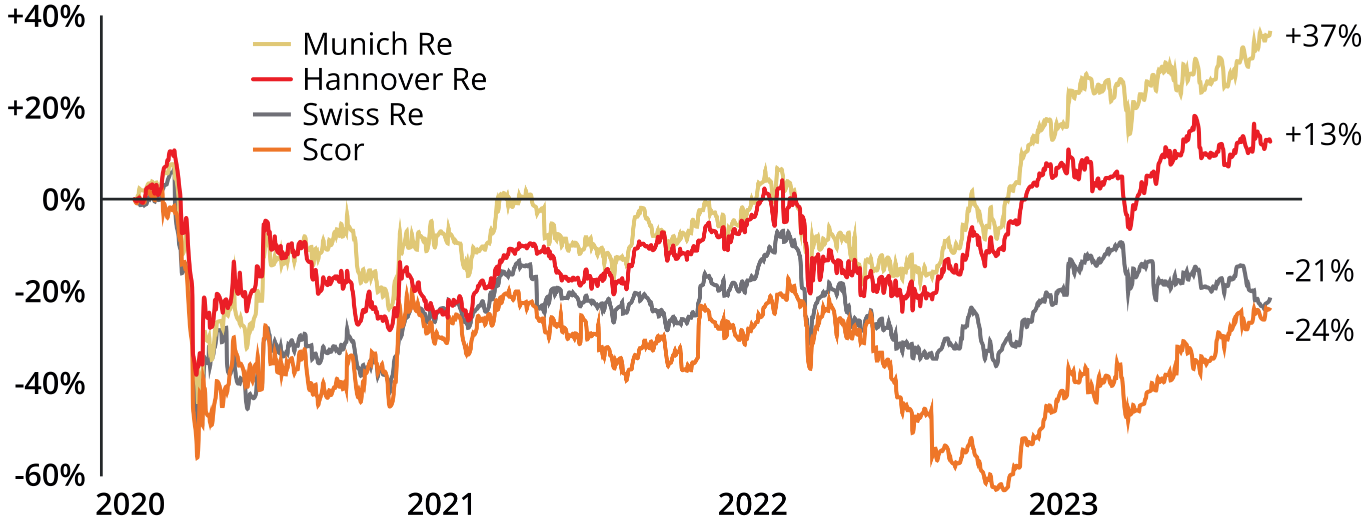
Managing volatility

Henchoz describes the 2023 market as part of a "logical reaction" to many years of losses for the reinsurance industry.

"We're in a phase where the supply demand equation has changed radically in 2023," he says. "If now is not the time to make the necessary adjustments, when will the time be, is the question I'm asking myself."

In that sense, the messaging for the remainder of this year will "not see any changes", the chairman stresses, as

Cumulative % change in Hannover Re's share price since the beginning of 2020, compared to peers



Data as at 29 August 2023
Source: S&P Capital IQ Pro

carriers are still taking huge risks in a highly volatile environment.

"We cannot possibly have the reinsurance industry producing 5% [returns]," he says. "I think the market acknowledges that – even if it's difficult to accept in practice on a single renewal basis."

In his words, Hannover Re is in the business of managing volatility but is not aiming to deliver volatile results. The days when there was a "gentleman's agreement" granting reinsurers several years of payback to recover after major cat losses is long gone.

Maintaining that balance is a challenge, he admits, but he points to some key factors that have helped Hannover Re to mitigate the impact of the post-2017 volatility on its net results.

These are its relatively high use of retrocession capital, cautious reserving strategies and its pursuit of the "best possible diversification".

The latter requires discipline in hard markets, Henchoz notes, as carriers must be careful not to chase outsized growth in pockets of rate growth.

Somewhat different

More than four years into the job, CEO Henchoz expresses confidence in seeing Hannover Re's tagline of 50+ years – the "somewhat different" reinsurer – put into everyday practice among his employees.

To realise this identity, a few years ago the firm summarised its internal key values around three points: (1) responsibility, and giving underwriters ownership of the profitability of their book, (2) the "we spirit", meaning a partnership approach in client dealings, and (3) drive and an entrepreneurial mindset.

"Of course, we have different views on terms – there's always negotiations but whatever we do, we try to do it with a long-term perspective," the executive adds. "We might be opportunistic on pieces of business, but we are not in a transactional game. We are in a partnership game."

That qualitative aspect of the business is hard to quantify. But in terms of stock prices, Hannover Re has fared relatively well among its continental peers, showing a cumulative price increase of 13% since the start of 2020.

> "We might be opportunistic on pieces of business, but we are not in a transactional game. We are in a partnership game"

Fronting business

In terms of business profile, one aspect that differentiates Hannover Re from incumbents is its presence in the fronting space – which is going through a time of turmoil and controversy sparked by ILS InsurTech Vesttoo's alleged use of fraudulent letters of credit (LOCs) as collateral.

As a reinsurer with significant equity, similar to Arch Re or Allianz Risk Transfer, the firm is somewhat apart from the US primary fronting companies, which often have lower equity and retain less risks.

To this end, Henchoz says he does not see the case posing fundamental challenges to the firm's fronting business. There are lessons to be learnt in terms of the due diligence process, but the LOC issue is at the core of Vesttoo's problem, not the ILS market (which more often uses cash collateral), he notes.

"In the end, this is not the business model which is in question – it's just the governance and the controls which need to be looked at."

On the contrary, the fronting industry is seeing a "flight to quality", he adds, meaning companies will be looking for very secure partners. In his view, cases like Vesttoo's can accelerate the company's fronting growth.

Splitting cyber perils could be 'transformational' for capacity

Splitting cyber reinsurance covers into constituent parts for first-party and third-party exposure could have a "transformational effect" on cyber capacity, according to Lockton Re.

The All Risk Cyber Challenge report from Lockton Re argued that cyber reinsurance products should be divided into distinct first- and third-party risks, as well as systemic risks.

The report said splitting cyber perils "will enable more effective risk transfer to reinsurers, and further down the value chain (retro/ILS) capacity in a more targeted and scalable fashion."

Patrick Bousfield, senior broker and chair of the Lockton Cyber Centre, Lockton Re, said current cyber reinsurance products were offering "three for the price of one" and that splitting up coverages could have a "transformational effect" on capacity.

He added: "The current market suffers from a finite supply of reinsurance capacity and a key reason for this is the divergence of appetite between reinsurers comfortable with short-tail (first-party) and long-tail (third-party) risks."

Lockton Re described reinsurers' existing strategy of dealing with cyber policies as "a game of whack-a-mole with ever-evolving cyber perils creeping up, and old ones coming back to haunt loss development".

Many insurers are heavily reliant on quota share reinsurance, but reinsurance capacity is limited due to concerns about aggregation risk.

The division of coverage, Lockton Re argued, could extract third-party liability emanating from cyber policies out of cyber reinsurance treaties, to place it with casualty or liability-focused reinsurance products.

The broker added that cedants could continue to purchase cyber standalone treaties on the first-party and catastrophe specific exposures, with first-party claim examples including data breaches and cloud outages.

Oliver Brew, London cyber practice leader at Lockton Re, said: "Separating first-party cyber reinsurance where possible can increase participation, making it easier to build new capacity aligned with varied reinsurance appetites."

The report said the separation of first- and third-party risk would allow clients to utilise two pools of intellectual knowledge and capacity among reinsurers.

The report also noted that the use of exclusionary language is intended to limit the market's exposure to unmanageable catastrophic risk: firstly, critical infrastructure and, secondly, war.

Bousfield described the focus on cyber war wordings to minimise aggregation risk as "looking at the symptom not the disease".

Lockton Re said there is an evolving category of cyber catastrophe insurance product, which specifically addresses systemic risks.

Cyber events have no major impact on stock markets: Guy Carp

Guy Carpenter has found there is a "lack of clear connection between any observable historical cyber events and a stock market downturn", in a report aiming to address ILS market concerns over the correlating nature of cyber risk.

The broker said it had studied the financial market impact of cyber events to dispel fears among ILS managers and their end investors that cyber risk correlated to financial market risk.

This ILS manager mindset had "led to limited capital deployed to date due to the potential 'double whammy' scenario", the reinsurance broker said.

The report, 'Double Whammy? Examining the Correlation Between Major Cyber Events and Broad Market Performance', analysed 14 major cyber events between 1 January 2000 and the present day. These spanned four different event types, including mass breach and vulnerability events, mass service outages, critical infrastructure compromises and financial markets compromises.

It assessed the distribution of market returns on the S&P 500 in the immediate and near-term aftermath of the 14 events, finding that none had significantly impacted market returns.

Guy Carpenter's and Marsh McLennan's analysis found that the impact of all 14 events fell within a range categorised as "random noise" in the market.

"Our analysis demonstrates the lack of statistical correlation between widespread cyber events and stock market performance," said Jess Fung, North American cyber analytics lead at Guy Carpenter.

"The study highlights that, unlike natural catastrophe risks, the probability and impact of cyber-related risks can be mitigated with human intervention and AI-based cyber management tools," Fung added.

The report did note though that the impact of cyber events on the S&P 500 average 30-day performance was "very similar to that of major hurricanes", with both resulting in large one-time losses but no strategic changes in economic activity or investment.

NEWS

Former TMK duo explore reinsurance start-up

Former Tokio Marine Kiln (TMK) reinsurance heads Will Curran and David Huckstepp are testing the water for an underwriting start-up, *Insurance Insider* can reveal. Sources said plans for the treaty start-up are at a fairly early stage.

Curran exited TMK in 2022 when the firm dropped treaty reinsurance after a strategic review of the business.

The underwriter became head of reinsurance in April 2019, replacing Huckstepp, who left for a career break.

Huckstepp was appointed deputy head of reinsurance at Syndicate 510 in 2000 and succeeded Andrew Carrier in the head role in 2007. Curran, well respected in the treaty space, has worked for Beazley, Wellington and Catlin.

This is the second example of a major reinsurance start-up that has emerged during Monte Carlo *Rendez-Vous*.

Earlier during the event, *Insurance Insider* exclusively revealed that former AIG, Marsh McLennan and Ace CEO Brian Duperreault is targeting a surprise return to the sector as chairman of reinsurance start-up Mereo Advisors.

Sources said Duperreault has teamed up with investment executives Lawrence Minicone and Jason Miller to form a new underwriting business that would constitute a Bermuda-based rated carrier, with an associated fund structure.

It is understood that Mereo will focus primarily on underwriting, in contrast to the asset risk-focused hedge fund reinsurance structures used elsewhere.

Sources said Mereo is currently working with investors and regulators, with a view to launching towards year end. Capital-raise targets tend to be relatively elastic based on demand, but sources suggested the team was likely to look for $1bn+ of commitments.

Duperreault told this publication: "I believe now just might be the best time in my career to be launching a reinsurance company. To me, perceived risk is probably higher than actual risk, but time will tell."

The start-ups would be launching in a reinsurance market where conditions have improved materially, with larger-cap Bermuda carriers reporting H1 RoEs in the 14%-23% range, representing historically attractive earnings. However, fundraising for new firms from private equity has been highly challenging, with institutional investors known to be wary of catastrophe-driven volatility.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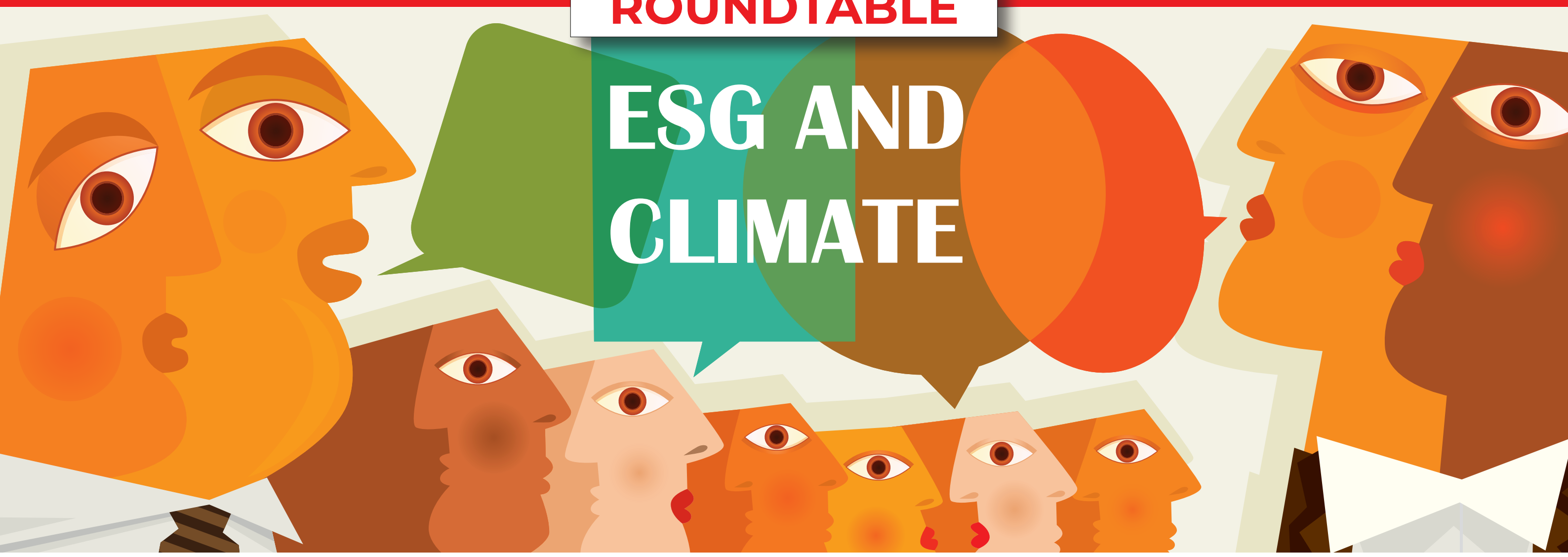
ROUNDTABLE

ESG AND CLIMATE



Our ESG virtual roundtable polled experts on how the industry can collaborate on net-zero objectives after the collapse of the Net-Zero Insurance Alliance (NZIA)

Sven Althoff, board member, Hannover Re: "Even though the NZIA played an important role, cross-industry collaboration on combating climate change already takes place outside of the alliance. Therefore, despite our departure from the NZIA, we continue our work with other entities such as the Insurance Development Forum (IDF) to enable society to adapt to climate change."

Jean-Paul Conoscente, CEO, Scor Global P&C: "The alliance is a means to deliver on the industry commitments, it is not the commitment per se. The work done as part of the alliance has allowed us to come up with an industry-wide approach to the quantification of a carbon-emission footprint on insurance underwriting. This in itself has been a huge achievement.

"We are now able to leverage this achievement individually to set our own interim targets to deliver on our long-term commitments. There continues to be a need for further collaboration on methodologies to assess greenhouse gas (GHG) emissions for the areas that have not yet been addressed, such as reinsurance underwriting."

Silke Jolowicz, head of sustainability, Munich Re: "Global issues such as climate change need a joint effort, not just across the insurance industry but across different industries and especially within an adequate political framework.

"Munich Re continues its work through the Net-Zero Asset Owner Alliance (NZAOA) and through sharing knowledge on climate risks in insurance initiatives such as the IDF. In addition, we work across industries with our solutions in the green tech sphere, to insure for example the performance of photovoltaic and battery storage."

Gianfranco Lot, CUO P&C reinsurance, Swiss Re: "Swiss Re firmly believes in the need for an open, global, transparent, expert-driven dialogue on standard-setting in the climate space. Our sustainability strategy remains unchanged and our commitment to the Paris Agreement and net-zero is unwavering. Swiss Re is doing its part to promote the transition to a low-carbon future and has committed to net-zero carbon emissions by 2030 in our own operations, and by 2050 in our underwriting and investment portfolios. We have dedicated frameworks and policies to support decarbonising our insurance and reinsurance underwriting portfolios. Within our underwriting business, we continue to advance the net-zero transition by providing risk-transfer solutions to mitigate risks associated with renewable energy infrastructure projects and helping to unlock the funds necessary to advance the energy transition."

> "Cross-industry collaboration on combating climate change already takes place outside of the [NZIA]"
> **Sven Althoff, board member, Hannover Re**

Rachel Delhaise, head of sustainability, Convex: "The industry collaborates extensively on various aspects of our business and has done on climate matters for more than 12 years, such as through ClimateWise.

"In particular, it makes sense to develop and manage the data we will use for informing net-zero goals as efficiently as possible, and to adopt a collaborative approach. Having common principles underpinning our transition plans is a strength. This is why so many insurers are supportive of the Principles of Sustainable Insurance, the Principles of Responsible Investment, and why they remain members of the NZAOA."

Katy Reyner, climate change regulatory lead, Guy Carpenter: "Despite the unravelling of the NZIA, there is still plenty of room for cross-industry collaboration. For example, there is an opportunity for stakeholders to develop uniform data standards to achieve transparency between cedants and reinsurers on the nature of the underlying exposures to physical and transition risks."

Insurers that have left the NZIA can now pursue their own processes to gather data on, and measure, underwriting emissions. Won't negotiating different methods be a big headache for brokers and insureds?

Reyner: "While there will inevitably be an adjustment period, there are sufficiently robust reporting frameworks and standards to foster consistency over the long term. Many jurisdictions have transposed Task Force on Climate-Related Financial Disclosures recommendations into national law and upcoming European Sustainability Reporting Standards will contribute towards harmonisation.

"The disclosure standards prepared by the International Sustainability Standards Board (IFRS S1 and IFRS S2) were recently endorsed by IOSCO, which also indicates a trend towards achieving consistency in the long run. There remain challenges around availability of data, particularly for carbon emissions from treaty business where methodologies do not exist yet, but other guidance from the Partnership for Carbon Accounting Financials (PCAF) or external accreditation bodies such as Science Based Targets will assist navigating these disparities."

Delhaise: "Transition plans should be specific and bespoke to every insurer, but it makes sense if the methodologies we adopt to report investment or insurance-associated emissions are aligned. If the PCAF methodology for reporting emissions is what we deem useful collectively as an industry, we ought to try to refine it as we use it. I don't think we should be reinventing the wheel and trying to disclose information under separate methodologies."

Conoscente: "There is a global standard for measuring GHG emissions: the PCAF. This remains a potential standard for reporting. There is a need for convergence and Scor is confident that this will happen in the years to come.

> "If the PCAF methodology for reporting emissions is what we deem useful collectively as an industry, we ought to try to refine it as we use it"
> **Rachel Delhaise, head of sustainability, Convex**

"It is of utmost importance to move from transparency, as the regulation will do, to comparability, but this may take more time. Succeeding in reaching net-zero by 2050 is a challenge that can only be tackled collectively. All actors in the value chain, including reinsurers, insurers, brokers and clients, will have to work hand in hand."

Althoff: "A standardised methodology for calculating insurance-associated emissions is important for the insurance and reinsurance industry because it would also set a common understanding for data requirements from our value chain. The same set of data requirements would reduce the burden for our counterparties and for us as well. We would welcome the prevention of too many different methodologies as this could otherwise lead to non-comparability of emissions data from insurers and reinsurers. Therefore, industry collaboration continues to be the right forum for developing future methodologies."

Lot: "I cannot comment on the methods used by our peers. However, Swiss Re remains fully dedicated to effective methodologies for gathering data on, and measuring underwriting emissions. We aim to continue to measure our insurance-associated GHG emissions based on established and publicly available methods, such as the PCAF Global GHG Accounting and Reporting Standard Part C and the CRO Forum carbon footprinting methodology. These standards and methodologies provide a solid basis to measure and report emissions, and to track progress towards reaching net-zero goals."

Tim Ronda, president, Howden Tiger: "The NZIA did a lot of good in terms of bringing insurers together to agree principles and approaches in an aligned direction. We're seeing a lot of value in other forums, such as the Lloyd's Sustainable Markets Initiative and IDF, not only in aligning our industry behind common goals but, even more so, to build on the groundwork the NZIA has established."

How concerned are insurers about the growing threat of climate litigation against major corporates in terms of D&O/liability risk?

Delhaise: "Climate litigation has seen a very notable rise in the number of cases in the last couple of years. The total number of climate-change-related cases from around the world has more than doubled since the Paris Agreement in 2015, with more than 2,000 ongoing or concluded climate cases as of October 2022. What makes climate litigation particularly concerning is the systemic nature of climate-related cases. Also, the nature of the cases is different to usual litigation; often the case is driven by claimants not necessarily looking for financial compensation but looking to influence the net-zero plans of firms in certain sectors. These could potentially be long-term cases with material defence costs."

Lot: "While we have not yet seen many decisions in favour of plaintiffs in cases against corporates, and therefore no significant insurance losses, climate-change litigation has the potential to cause moderate losses in the short-to-medium term for certain segments of casualty insurance, certainly to defence costs and possibly for indemnity as well. Swiss Re is closely monitoring the litigation landscape and continually assessing its exposures."

Given their commitments to net-zero, how can insurers ensure that they themselves are not open to climate lawsuits on fiduciary duties or greenwashing?

Jolowicz: "Our climate ambition is implemented as an integral part of our business strategy which aims to ensure the long-term success of Munich Re. The key to credibility is to implement effective measures, as we do with our investments in renewables, and transparently report on progress against targets. We've done so annually for many years and the report is independently audited."

Delhaise: "This area is receiving more attention. We need to understand the transition plans for the sectors we operate in, as well as for our individual clients, and ensure our own commitments (both short and longer term) reflect this reality.

"We should not underestimate the complexity of building a robust, realistic transition plan. However, the good news is that by really leaning in to understand the transition of these sectors, this will not only inform our management of transition-related risks but help develop the opportunities associated with such enormous change."

Ronda: "On the fiduciary side, yes, insurance carriers and fund managers must fulfil their fiduciary duties to shareholders and policyholders first and foremost. Again, we don't think fulfilling sustainability commitments conflicts with either. A sustainable risk is safer and better for policyholders and more profitable for shareholders."

Conoscente: "(Re)insurers have a critical role to play in tackling climate change. This means, among other things, aligning with international objectives [such as] the Paris Agreement and science-based trajectories based on the latest IPCC reports. An articulated strategy to reach individual commitments, aligned with science should prevent greenwashing. Ultimately, aligning with fiduciary objectives will also protect the business model of the company in the long run."

Can you give any good examples of how the industry is insuring the transition to net-zero?

Althoff: "Hannover Re is supporting the expansion of sustainable technologies through coverage of renewable energy projects such as wind power onshore and offshore, photovoltaic or geothermal energy. In addition to building and preserving specialised underwriting knowhow around the world, we support special covers for the adoption of innovative technologies."

> "A sustainable risk is safer and better for policyholders and more profitable for shareholders"
> **Tim Ronda, president, Howden Tiger**

Conoscente: "Deploying capacity for low-carbon (re)insurance and engaging with clients on their own commitments and strategy are at the core of insuring the transition to net-zero. Projects such as green hydrogen plants, solar panels, offshore interconnectors and wind farms are contributing to the transition. They require heavy investments and generate complex insurance needs from construction to operational stages that only a qualified pool of technical experts and underwriters can manage."

Ronda: "Carbon markets will play a vital role in the transition to a low-carbon future. Howden recently helped to develop a world-first carbon-credit invalidation insurance solution to increase confidence in the voluntary carbon market. The product, which is wrapped around books of independently verified, high-quality carbon credits, provides cover for third-party negligence and fraud. This product provides buyers with a layer of security combined with independent verification from established, reputable bodies, helping buyers to purchase with confidence."

Jolowicz: "Munich Re offers long-term performance covers for green technologies to reduce both the business risk for manufacturers and the risk for energy-project investors and operators. Another concrete example is the African Energy Guarantee Facility, an initiative supported by the European Commission and further public players, as well as local primary insurers.

"We offer insurance coverage for political risks connected with renewable energy projects in Sub-Saharan Africa."

Delhaise: "At Convex we are keenly supporting renewable energy, notably onshore and offshore wind. An example that comes to mind is on the casualty side of the growing US offshore wind market, where we have taken a lead in developing appropriate wording for this risk and where the market is now dominated by London underwriters."

Reyner: "Insurance can act as a positive enabler and many in the industry continue to work towards the transition to net-zero. In addition to international reporting standards, the National Association of Insurance Commissioners continues to lead a revised and thorough climate change questionnaire that has been adopted across 16 states, accounting for over 80% of GWP in the US.

"From a resiliency and mitigation standpoint, the insurance sector continues to drive the conversation between private and public sector entities. Innovation in the modelling and scalability of technologies, as well as risk-transfer solutions will continue to be crucial going forward."

Sven Althoff, member of the executive board – P&C, Hannover Re

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

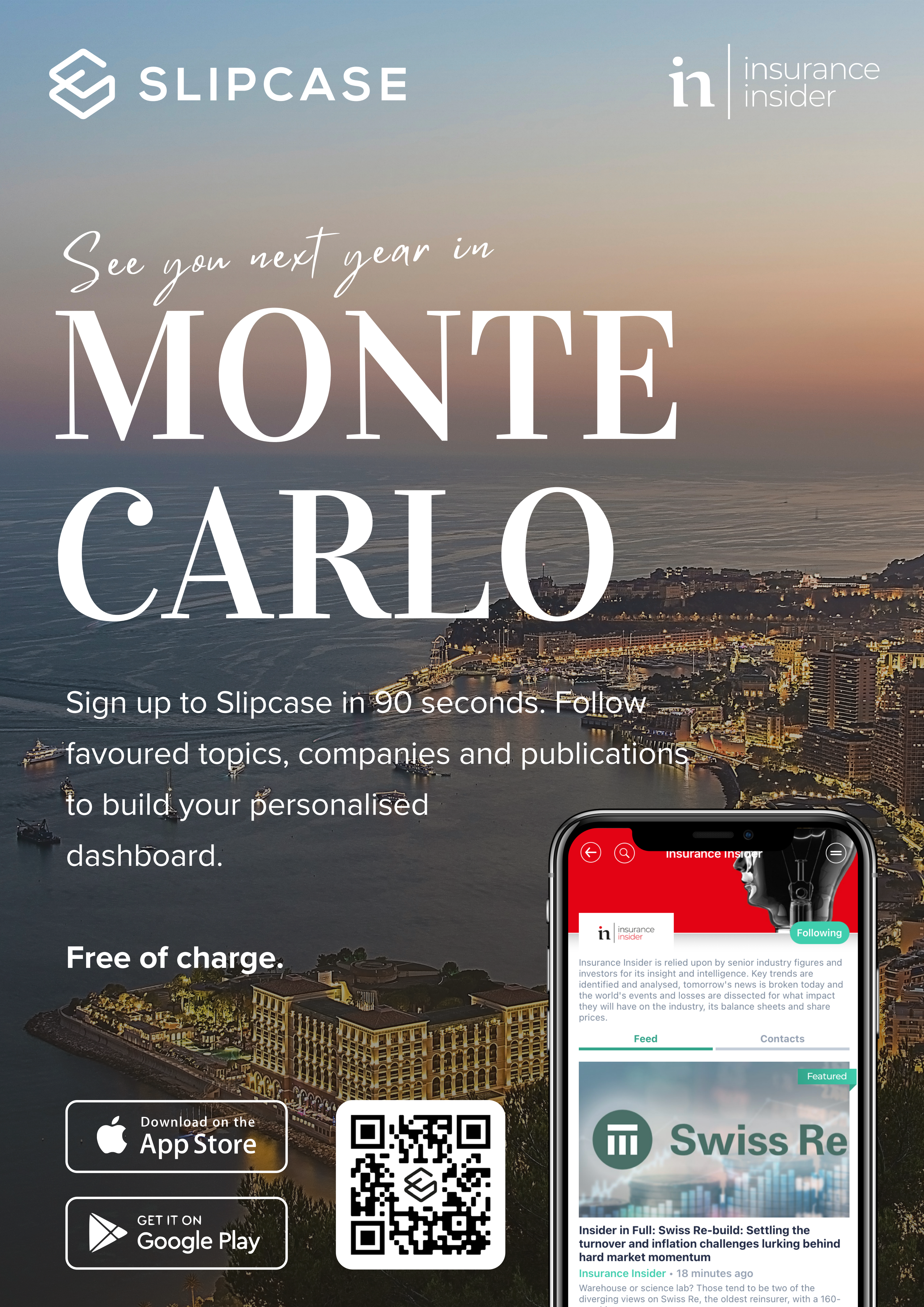
Silke Jolowicz, head of sustainability, Munich Re

Gianfranco Lot, CUO P&C reinsurance, Swiss Re

Rachel Delhaise, head of sustainability, Convex

Katy Reyner, climate change regulatory lead, Guy Carpenter

Tim Ronda president, Howden Tiger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Warehouse or science lab? Those tend to be two of the diverging views on Swiss Re, the oldest reinsurer, with a 160-

interoperability **/in-tər-ˊä-p(ə-)rə-ˊbi-lə-tē/** *noun*
Ability of a system to work with or use the parts or equipment of another system.

Engage, Innovate, Grow Efficiently

Validus sale: RenRe's land grab blunts the fallout for hard market

First it was the old-school Berkshire Hathaway mega-line deals, then it was Everest Re's $1.5bn equity raise, and then the more dramatic news of a major M&A deal in RenaissanceRe's $3bn acquisition of Validus Re.

All these things are pointing to the idea that the cusp of the reinsurance hard market has been reached as higher rates have begun to entice carriers to lean into growth, after the Bonfire of Cat Limits throughout 2022.

We have already started discussing what these trends suggest about how long hard market conditions can last, and this topic was clearly on the minds of analysts.

In this context, the acquisition is the ideal type of land grab for RenRe to have carried out from the viewpoint of the broader reinsurance market, giving the Bermudian the ideal way of acquiring growth with the least impact on competitive conditions.

The Validus portfolio is ready-made and avoids RenRe having to compete on future prices to secure larger lines. Moreover, the consolidation removes a competitor from the market, even if it was arguably a diminished force in recent years compared to its pre-AIG standing.

One analyst in fact questioned whether taking out a competitor could in fact extend the potential for a hard market – a leap further (and a stretch) from the idea that it does not hinder the hard market.

CEO Kevin O'Donnell did not give a direct yes or no, but said: "I think this market has legs...And we will continue to leverage into the market. So I think it's all systems go, and this just gives us a bigger platform to trade off."

Of course, pushing together two very similar portfolios might mean some fallout, in terms of cedants looking to reduce their concentration of exposure to one provider. This would be a more favourable trend in terms of prolonging the hard market, as more demand would be freed up, and fresh demand has been slower than reinsurers might have hoped to arrive on the scene.

But the potential for this fallout is diminished because Validus had cut back so much in recent years before pivoting to grow in the 1 January renewals, as had RenRe. O'Donnell said on the analysts' call that the firm is factoring in a retention of 90% of the Validus book.

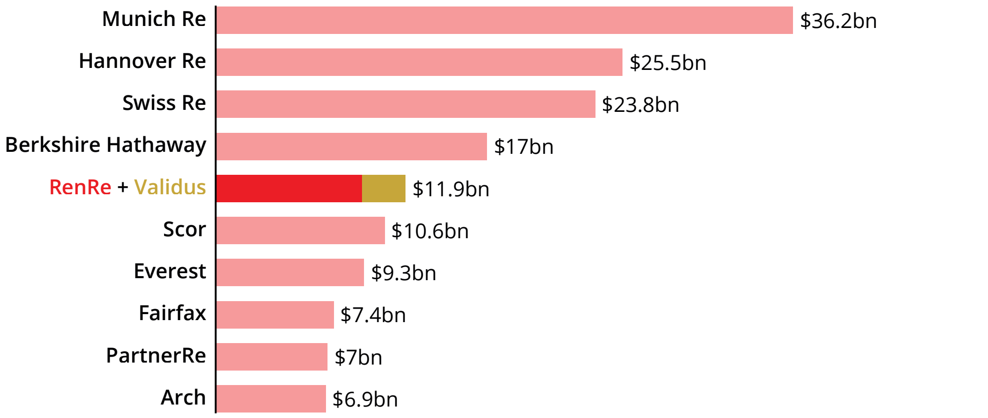
On a personnel front, the consolidation should also be somewhat easier than a typical peer-to-peer acquisition because a lot of Validus personnel had already left as the firm bedded in under AIG.

AIG Re CEO Chris Schaper remains with AIG as a global CUO.

The question of scale

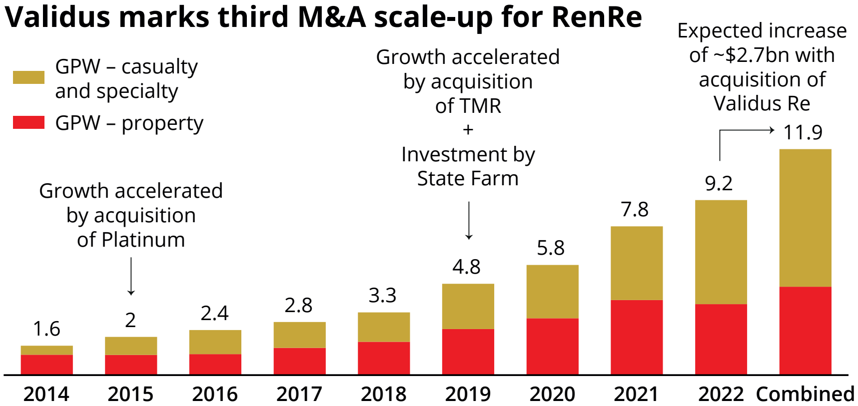
This is RenRe's third similar acquisition after Tokio Millennium and Platinum,

Largest P&C reinsurers by 2022 GWP



China Re, Korean Re and GIC Re excluded
Source: S&P Capital IQ Pro via RenaissanceRe

Validus marks third M&A scale-up for RenRe



Source: RenaissanceRe

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Validus Re is weighted less towards property than RenRe's standalone book of business

Share of gross written premiums					
Entity	**Property**	**Casualty**	**Specialty**	**Credit**	**Total GWP**
RenRe (standalone)	41%	36%	12%	12%	$9.2bn
Validus Re (Targeted*)	35%	36%	19%	11%	$2.7bn
Combined	39%	36%	14%	11%	$11.9bn

*The portfolio which RenRe expects to renew
Source: Company reports, Insurance Insider

and the deal clearly puts it further down what we described as the lonely road of the focussed pure-play reinsurer.

It also highlights the idea that scale wins in the reinsurance market niche. As we have noted, the combined portfolio would put RenRe as the fifth largest reinsurer, enabling it to move ahead of Scor and Everest by premiums written.

However, the injection of Validus capital that the deal brings, along with a portfolio that is less skewed to cat risk than RenRe's own, means that even as its exposures grow, the probable maximum losses will be flat to down as a percentage of shareholders' equity, O'Donnell explained on the analysts' call.

This is one fiscal advantage of the scale, but there are also gains to be made in terms of negotiating leverage.

In the current hard market, there has been a shift towards more bilateral, early deal-making whereby carriers with big lines to offer can secure early signings.

In contrast, pure subscription market players will not be able to leverage the same gains as larger peers from this phase of higher rates or risk having smaller lines signed down.

On top of cost savings, RenRe also devoted some time on the analyst call to explaining that it will drive some efficiencies from the Validus book from bringing in more third-party retro to support the portfolio. By retaining less Validus risk net, and sharing some of the portfolio with ILS vehicles like DaVinci Re and others, O'Donnell explained that "we require less capital to support this business than Validus Re".

RenRe already benefits from much larger scale on the ILS market than Validus through its AlphaCat brand, and it's arguable that the franchise won't add as much value as Validus itself, although the firm is set to gain an undisclosed investment from AIG.

A separate advantage of scale is in the ability to invest in understanding and modelling risk, particularly as the climate warms. Here, RenRe and Validus would likely be seen by the market as relatively efficient spenders on investment in this space already but efficiency savings will be a post-deal target.

However, it is also worth noting that there can be some downsides to reinsurance scale. One of the biggest questions is whether the larger reinsurers simply become an index for market returns.

O'Donnell's comments on the analyst call around how similar the books were tend to underscore this concern – although his reason for raising this point was simply to discuss the complementary nature of the books and how well the assumed risk was understood by RenRe.

But as reinsurers are having a hard time differentiating themselves with equity market investors, this means that a land grab in itself from RenRe may not be enough to prove the value of this acquisition.

Ascot and American Family are among top similar-size counterparties for RenRe and Validus Re

Ultimate parent company name	Premiums ceded to Validus in 2022	Premiums ceded to RenRe in 2022
American Family Insurance Group	$11.4mn	$11.6mn
Assurant	$12.1mn	$8.4mn
Everest Re Group	$7.8mn	$12.9mn
Palomar Holdings	$6.3mn	$5.5mn
Ascot Insurance Company	$16mn	$23.5mn

Source: S&P, Insurance Insider

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.

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Q&A: Aon's Liz Henderson

Ahead of the Monte Carlo Rendez-vous, Liz Henderson, Climate Risk Advisory lead at Aon, talks to this publication about how the firm is assisting clients to make better decisions in their approach to climate change

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

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

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

It became such an obvious unmet client need that we decided it has to be an official aim and a primary focus for Aon to help companies navigate this potential volatility.

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

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

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

In terms of the academic partnerships, these enable us to continue to evolve our thinking. We also recognise that there is active research examining the impact of more carbon in the atmosphere, and we want to find ways to bring this academic research to our clients more quickly and help to fund the advancement of this understanding for all players.

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

There's a lot of data and methodologies out there and it can be hard to tell a robust view from something less reliable. Often when we approached clients, they would tell us: "We're not ready to start."

As we've shown them new capabilities, they've become more open, but the real eye-opener is when we ask them what their risk appetite is. Aon can tell them how to answer that question. It's going to have to become a foundational skill set within financial institutions and public-sector entities.

Where do clients need the most assistance in terms of assessing and mitigating climate risk, and building business resilience?

Most clients are early in their journey, so they need to undertake an ERM (enterprise risk management)-like approach for climate change. We help break down the internal organisational challenges around climate change and identify data providers to feed into risk management. We can also help them understand how each of their teams can use the climate data they receive.

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

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

What climate issues will be top of mind for reinsurers and this year's Monte Carlo event?

When you're looking at insurance and reinsurance transactions that are coming, the biggest issues are going to be around one question: do we feel the pricing improvements that have been seen over the last year are adequate to account for the near-term impacts of climate change on results? I expect there will be continuing conversation around frequency-driven perils like severe storm and wildfire.

RESEARCH

The Taxman Cometh for Bermuda companies

Key points

- Bermuda announced plans to introduce a corporate tax rate of up to 15% by 2025 for multinational companies with annual revenues exceeding EUR750mn, under the OECD's global minimum tax law
- The effect on earnings appears manageable, based on applying the 15% to 2025 street estimates
- International business activities, which include reinsurance, make up a third of Bermuda's GDP. It's in the territory's best interests to keep the industry
- Bermuda players under ABIR generate more than $128bn in premiums and account for at least a third of global capital
- Bermuda has a number of direct and indirect ways to reduce the burden, including duty changes, payroll taxation and tax credits

Bermuda is no stranger to discussions on taxation, and moves to address it. Over the years, Bermuda's role in insurance has moved from the captives and excess liability providers of the 1970s and 1980s to companies providing short-tail and property catastrophe coverage over the 1990s and 2000s, spurred by Hurricane Andrew in 1992, the WTC tragedy in 2001, and the KRW hurricanes of 2005.

Bermuda's low taxes and looser insurance regulation allow quicker formation of companies after significant events. This has put the Island at the center of the global insurance marketplace. Multinational carriers are able to lower their taxes by ceding to offshore reinsurance companies, vs the much higher tax rates in the US.

However, these successes have attracted naysayers attempting to address this disparity. Long-term followers of insurance will remember the Neal bill and other attempts over the years to close the gap, all met with varying levels of success.

These efforts culminated in some success with the Tax Cuts and Jobs Act of 2017, with US corporate income tax reduced to 21% and the establishment of a base erosion and anti-abuse tax (BEAT).

Recently, news broke that Bermuda was evaluating (likely) raising the corporate income tax in 2025 under the OECD's global minimal tax rule.

This rule would apply to Bermuda companies that are part of global franchises and have revenues of more than EUR750mn.

As is often the case with discussions on taxation, the idea differs from the actual impact. We look at the financial implications, the role of Bermuda (re)insurers in the economy, steps that can be taken to alleviate the pressure, and retaliatory measures that might not gain much traction as we head to the 2024 elections.

A 2025 tax rate shift would have minimal impact on publicly traded names

The table shows the street estimates for Ebit in 2025, with a projection of the impact of the straight 15% tax. Original estimates are in the single or low-double-digit range. If we apply a 15% tax rate, the incremental earnings reduction appears manageable, especially taking into account the fact that the 15% can be reduced.

Insurance is one of the biggest drivers of the territory's GDP, and it will take steps to maintain it

International business, including reinsurance, accounts for nearly a third of Bermuda's economy.

One of the bigger challenges of the new OECD rules is the "top-up provision" under the Undertaxed Profits Rule (UTPR).

Under UTPR, additional tax can be applied to a company's subsidiary by any other country under the OECD, where the company does business to bring the tax to at least 15%.

For Bermuda, it made sense to come under the OECD umbrella rather than watch another government like the US tax these companies and benefit from additional revenues.

Using ABIR statistics as a proxy, Bermuda is at least a third of the global market, which makes flight less likely

Using Association of Bermuda Insurers & Reinsurers (ABIR) data as a proxy, several major companies are established on the Island and generate close to $128bn in premiums which are at least a third of the global traditional capital of $435bn as of 2022 (AM Best).

For insurers and reinsurers, the Island will continue to provide ease of company formation and capital movement, access to a talent pool, expedient regulation, and a central location to access many jurisdictions.

On the other hand, based on our

2025 est. Ebit and tax expenses at select Bermuda-based reinsurers ($mn)

Carrier	Est. Ebit	Est. tax expense	A/T earnings	Calc. tax rate	Calc. tax expense at 15% of Ebit	New A/T earnings	2025 earnings reduction
Arch	$3,441	$321	$3,120	9%	$516	$2,925	-6%
Everest	$3,086	$386	$2,701	12%	$463	$2,623	-3%
RenRe	$2,104	$75	$2,028	4%	$316	$1,788	-12%
Axis	$921	$109	$812	12%	$138	$783	-4%

Source: FactSet, Inside P&C

discussions and the draft document, Bermuda could take several steps to address the additional tax burden directly or indirectly. These could include:

- Use of tax credits for R&D, property, etc. that benefit economic activity
- Review of payroll taxes providing a modest offset if lowered
- Reducing the overall cost of living, including examining the level of import duty

Unclear impact of House Ways and Means Committee rhetoric

Adding to the complicated scenario, House Ways and Means Committee Chairman Jason Smith unveiled the HR3665 – Defending American Jobs and Investment Act. This tax doesn't target the Bermuda companies but introduces graduated rates of additional taxation up to 20% on companies with operations in countries identified by the Department of the Treasury as levying extraterritorial or discriminatory taxes on US firms.

This means that if any country charges a top-up tax, companies from that country doing business in the US could be open to retaliatory action.

How far this will go is unclear as only around 4.5% of all bills become law.

In summary, any impact from raising the tax rate appears manageable, with the Bermuda companies factoring this into their planning. Bermuda seems to be taking steps to keep the tax consistent with guidelines and offer other incentives to stay put.

Bermuda reinsurance metrics ($mn)

Carrier	2020 GPW	2020 net income	2020 total equity	Carrier	2021 GPW	2021 net income	2021 total equity
AIG	$585	$75	$893	AIG	$607	$185	$933
Arch	$10,088	$1,466	$13,929	Arch	$12,752	$2,239	$13,546
Argo	$3,233	-$54	$1,858	Argo	$3,181	$7	$1,735
Ascot	$1,819	$150	$1,747	Ariel	$525	-$17	$0
Aspen	$3,704	-$40	$2,998	Ascot	$2,836	-$30	$1,712
Assured Guaranty	$472	$362	$6,643	Aspen	$3,938	$30	$2,775
Awbury	$134	$20	$50	Assured Guaranty	$415	$389	$6,292
Axis	$6,827	-$120	$5,296	Awbury	$361	$17	$64
Canopius	$356	-$50	$429	Axis	$7,686	$619	$5,411
Chubb	$41,261	$3,533	$59,441	Canopius	$321	$37	$466
Convex	$1,095	-$179	$2,478	Chubb	$46,780	$8,539	$59,714
Hamilton	$734	-$141	$1,512	Conduit	$379	-$42	$981
Hannover	$997	$261	$2,042	Convex	$2,115	-$148	$2,400

Source: FactSet, Inside P&C


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ART moves up the agenda

Alternative solutions are even more attractive now that retention levels are rising across the board, but capital availability and appetite for volatility are limited, according to Vincent Foucart, CEO of Scor P&C Solutions

The buzz around Monte Carlo this year is all about what some have called a 'once in a generation' hard market. But Vincent Foucart, CEO of Scor P&C Solutions, takes a more measured view.

"For me this is a necessary technical adjustment that's taking place: it's not a 'once in a lifetime' event. Risk professionals across the market understand that the reinsurance part of the risk-transfer chain has not earned its cost of capital for half a decade," he says.

"If people want a reinsurance market that fulfils its role as a reliable shock-absorber and capital provider, reinsurers have to earn their cost of capital, plus their management expense at least, otherwise their shareholders will withdraw their capital."

Foucart believes the market is in a period of adjustment towards a new normal made necessary by a riskier world: climate change, social inflation and geopolitical risks are here to stay, he says.

"The new risk environment calls for a discussion between risk carriers that is about more than price, with reinsurance programme structures, terms and conditions, and available capacity all under review."

> "Risk professionals across the market understand that the reinsurance part of the risk-transfer chain has not earned its cost of capital for half a decade"

As a result, in order to optimise risk-financing and capital relief, cedants are naturally looking more closely into what alternative solutions and, specifically, structured reinsurance can offer them.

"We've experienced a surge in structured quote requests because buyers want to test available options: surplus relief proportional reinsurance or aggregate XL using the traditional method of mutualising risk over years – plus incorporating a structured way of doing it."

Structured reinsurance is essentially a tool for capital and volatility management, Foucart explains.

A typical capital management case would be where a cedant's business is impacted too heavily by one line – the weight of motor third-party liability, for example, creating an imbalance in their solvency risk assessment. In such a case the group internal model of a well diversified reinsurer would be a more efficient answer than the standard formula of a direct carrier.

In terms of volatility management, a multi-line/multi-year structure makes it possible for cedants to achieve a balance between risk transfer and risk financing, whereby the financing mechanism is defined by funding premium; similarly, loss participation schemes can be introduced into reinsurance treaties.

But structured solutions are not intended to help cedants circumvent the technical adjustments that are so necessary in the traditional reinsurance programme, Foucart adds.

"A lot of reinsurers have adjusted the attachment point of their programmes upwards. And this is happening on the corporate [insurance] side, primary insurance and retrocession side. So everyone is looking for ways to manage their retention," he explains.

"The alternative solution expert won't be any more willing than their 'traditional' counterpart to come up with a quote that is not economically viable. At Scor, we want to help our clients manage their retentions and regulatory capital requirements – but we do not put traditional and alternative in competition with one another."

The reduction in available traditional reinsurance capacity has inevitably brought ILS back into the alternative solutions picture, albeit with a more cautious approach from investors.

"The collateralised segment of ILS especially expanded dramatically over recent years. But recently, after taking losses, investors have re-allocated somewhat and also rebalanced, with a partial return to the cat bond segment," Foucart says.

With an adjustment to its weight and position in a typical programme that takes account of investors' returning appetite, ILS does have a bright future, Foucart concludes.

In the wider world of risk-financing solutions, Foucart doesn't envisage big changes to regulation or supervisor "sentiment" that could be an obstacle to cedants exploring alternative methods. "Compared with 20 years ago and the rise of financial reinsurance, the industry today is very disciplined in terms of satisfying real risk transfer tests," Foucart stresses.

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