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

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MONTE CARLO

War exclusions debate to dominate 1.1 cyber treaty renewals

So far, no other reinsurer has come out publicly to align itself with Munich Re's stance on cyber war, leading to a patchwork of approaches at cedant and reinsurer level

The ongoing debate about updates to war exclusions is set to rumble on at the 1 January cyber treaty renewals, with many reinsurers still playing cards close to their chests on how they will assess various approaches to defining the systemic exposure.

At time of writing, Munich Re – the market leader in cyber reinsurance – had been the only reinsurer to state its position publicly, with a letter to cedants in April saying it would take "necessary steps" to ensure the risk it takes on is in line with its war appetite.

However, no other reinsurer has so far been so strongly explicit as Munich Re, even privately, with many reinsurers saying they would assess on a case-by-case basis. Swiss Re told this publication a war exclusion with specific reference to cyber war would be required, but it would be discussing this with clients – see full statement below.

The cyber insurance market is currently using a patchwork of war wordings across both sides of the Atlantic.

A mandate from Lloyd's on updating cyber war language has led to a flurry of around 20 approved wordings by the Lloyd's Market Association, not all of which perfectly fit Munich Re's appetite. In broad terms, the LMA wordings look to assess and put boundaries around the scale of a war event.

Meanwhile, in the US, cyber risk mitigation firm CyberAcuView has developed a wording said to be similar to the Chubb approach to assessing war exposures. This generally centres around the concept of "proximity of war" – where the reaction of the UN, NATO or governments determines whether the cyber attack is an act of war.

The CyberAcuView wording is understood to have been adopted by many major cyber insurers, although some US and European cyber insurers are said to have done nothing to their war language at all.

The lack of cohesion in the market at both cedant and reinsurer level has led to questions around whether buyers will be able to secure back-to-back coverage, or the limit they want, at the 1 January treaty renewals.

Sources told this publication that Munich Re has indicated it will come off treaties where the underlying exposure does not fit with its appetite.

It has been suggested that the reinsurer is agnostic to the approach cedants take, and will support a transition period to updated wordings, but will not tolerate a head-in-the-sand approach from cedants.

In conversation with this publication, Chris Storer, who heads up Munich Re's Cyber Centre of Excellence for global and North American reinsurance clients, said: "We are seeing progress, and many markets acting in a responsible way with regards to updating their cyber war language.

"It is our belief that any market that continues to neglect this issue is running a material risk. The most important thing is how do we as an industry create conditions for sustainable growth in cyber, and the exclusion of ruinous exposures, like cyber war, is key to that."

Swiss Re also gave its cyber war stance to this publication. CUO for specialty Anne Lohbeck said: "For cyber, a war exclusion with specific reference to cyber war is required. We acknowledge that the market is going through a development of exclusionary language, and we discuss what is acceptable with our clients and distribution partners in the specific context of each portfolio."

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inside

COMMENT

The war debate is just one part of a rapidly changing picture in cyber

In more than a decade of reporting on the (re)insurance market, there are few topics I have written on which have caused so much consternation and division as cyber war wordings.

This debate has been raging particularly fiercely in London over the course of 2023, with variations in LMA-approved wordings for Lloyd's carriers causing Munich Re to send a strongly worded missive over its stance.

Meanwhile, the US market appears to be plowing its own furrow, with a varied picture on how far markets are choosing to alter wordings (with some said to be doing nothing at all).

As we report in our lead article today, the debate over cyber war wordings is set to be the foremost topic of discussion at the coming 1 January cyber treaty renewals.

All in the cyber market are agreed that defining the scope of coverage for war events (or, in fact, any systemic event) is important for the longevity and sustainability of the cyber market.

But don't expect there to be any market-wide agreement on how they go about it any time soon.

Given the emotive response to this topic, it's perhaps natural that it has dominated discussion in cyber reinsurance circles.

However, it's worth noting that the loss profile for cyber is also changing in the underlying market and should too be in focus in the coming January renewal discussions.

Ransomware attacks are back on the rise after a lull in activity brought on by the Ukraine conflict. Frequency is on par with 2019-20 levels, but claims severity is not following suit so far – lending some strength to the argument that earlier remedial work is working.

However, while so much attention has been on first-party exposures in recent years, third-party, privacy-type exposures are starting to creep back into the picture.

Carriers are already seeing claims as the result of the wrongful collection of data clashing with the recent Illinois Biometrics Information Privacy Act. Other states are considering similar legislature, bringing scope for these types of claims to proliferate. Their third-party nature also puts them squarely in scope to be amplified by the phenomenon of social inflation.

This changing loss profile comes as rates in the cyber insurance space are nosediving – at a faster rate than many expected – as a result of increased capacity and competition, especially in excess layers.

The cyber market is somewhat unique. The high cession rate of sometimes more than 50%, and a concentrated number of reinsurance partners in the space, mean reinsurers have a relatively bigger influence over how the underlying market manages the risks.

Reinsurers have told me they are keeping a watchful eye on how pricing and terms are evolving. After 10 quarters of consecutive rate rises in cyber insurance, alongside tighter terms and much improved risk selection, the underlying market is in a far more robust position than it was before the first ransomware surge.

The mood on this front is therefore one of caution but not panic. Some in the reinsurance market have suggested that, if cyber has its own "D&O moment" and rates continue to decline into 2024, and then 2025, reinsurer margins may start to be impacted beyond what is tolerable.

It would be prudent for reinsurers and the wider industry not to let the emotion around cyber war wordings cloud the bigger picture in the fast-evolving cyber insurance space.

Catrin Shi
Editor-in-Chief,
Insider Publising Group

THE INSURANCE INSIDER TEAM AT MONTE CARLO

Editor-in-Chief | Catrin Shi
catrin.shi@insuranceinsider.com

Editor-at-Large | Adam McNestrie
adam@insuranceinsider.com

Editor | Fiona Robertson
fiona@insuranceinsider.com

Lead Reporter | Rachel Dalton
rachel.dalton@insuranceinsider.com

Senior Reporter | Samuel Casey
sam.casey@insuranceinsider.com

Editor, Trading Risk | Liz Bury
liz.bury@trading-risk.com

Lead Analyst/Director of Research, Inside P&C | Amit Kumar
amit.kumar@insidepandc.com

Managing Editor, Insider Engage | Meg Green
meg.green@delinian.com

Head of Events | Laura Brooke
laura.brooke@insuranceinsider.com

Product Marketing Manager | Luke Kavanagh
luke.kavanagh@insuranceinsider.com

Senior Marketing Executive | Michelle Heatherly
michelle.heatherly@delinian.com

Head of Subscription Sales | Brian Gelsomino
brian.gelsomino@insidepandc.com

Commercial Director ROW | Pierre Aghabala
pierre.aghabala@delinian.com

Head of UK Subscription Sales | Tom Lovell
thomas.lovell@insuranceinsider.com

Commercial Director, Events | Arry Langston
arry.langston@insuranceinsider.com

Strategic Account Manager | Adam Krise
adam.krise@insuranceinsider.com

4 Bouverie Street, London, EC4Y 8AX, United Kingdom
Tel main: +44 (0)20 7397 0615, Editorial: +44 (0)20 7397 0618
Subscriptions: +44 (0)20 7397 0619

Production
Senior Copy Editors | Simeon Pickup, Jamie Gallagher
Sub-Editors | Steve Godson, Pablo Gainza

LEAD

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The stance from Munich Re has led some cedants to request their brokers to replace Munich Re capacity on their programmes, or take that risk net, according to sources. Brokers suggested that, given that quota share capacity – where Munich Re plays – is fairly robust, this should be achievable.

Brokers are agreed that the cyber market needs better definitions around these exposures for a sustainable market, but are now faced with a complex challenge of arranging capacity around varying appetites for war risk.

Most in the market believe the cyber war question will not be definitively answered at the January renewal, with the likeliest scenario being a gradual drift towards one stance in the coming months or potentially years.

Many brokers are starting to stress-test various scenarios of reinsurer stances and are looking to plan for those, including the potential to use difference-in-conditions coverages which exist in other lines of business.

Jen Braney, Gallagher Re's head of international cyber and consultancy lead, also stressed that systemic exposures encompassed more than just war.

"You could have an okay war exclusion, but a very strong critical infrastructure exclusion," she said. "The industry shouldn't get too distracted by one clause. We need to look at wordings holistically."

> "The industry shouldn't get too distracted by one clause. We need to look at wordings holistically"

Rising reinsurance demand

The debate around cyber war comes against the backdrop of increasing demand for cyber reinsurance protection, following two years of rapidly rising premiums in the insurance space.

Quota share remains the dominant structure, and here brokers feel there is adequate capacity after many programmes at the mid-year renewal were oversubscribed. Some markets are also choosing to hold more net after benefiting from more than two years of compounding rate increases.

"I would say the QS market is holding steady," said Ari Chatterjee, CUO at Envelop Risk. "Any softening is on a deal-specific basis, perhaps because it was very well priced the previous year."

"In XoL, there is greater availability of capacity for deals around the $50mn-$100mn mark, but bigger deals are tougher to get done. The flood of ILS has not quite happened in the way people thought it might, but there are deals out there."

In terms of reinsurers thought to be demonstrating increased appetite at this coming renewal, sources pointed to the likes of Everest Re and Liberty Mutual Re. At the same time, the takeover of Validus by RenaissanceRe is likely to result in some cyber reinsurance capacity being taken out of the market, sources said.

"We anticipate modest growth in capacity offered by existing reinsurers, but we expect these to be capped by risk appetite constraints," said Conor Husbands, senior underwriter at Hiscox Re & ILS.

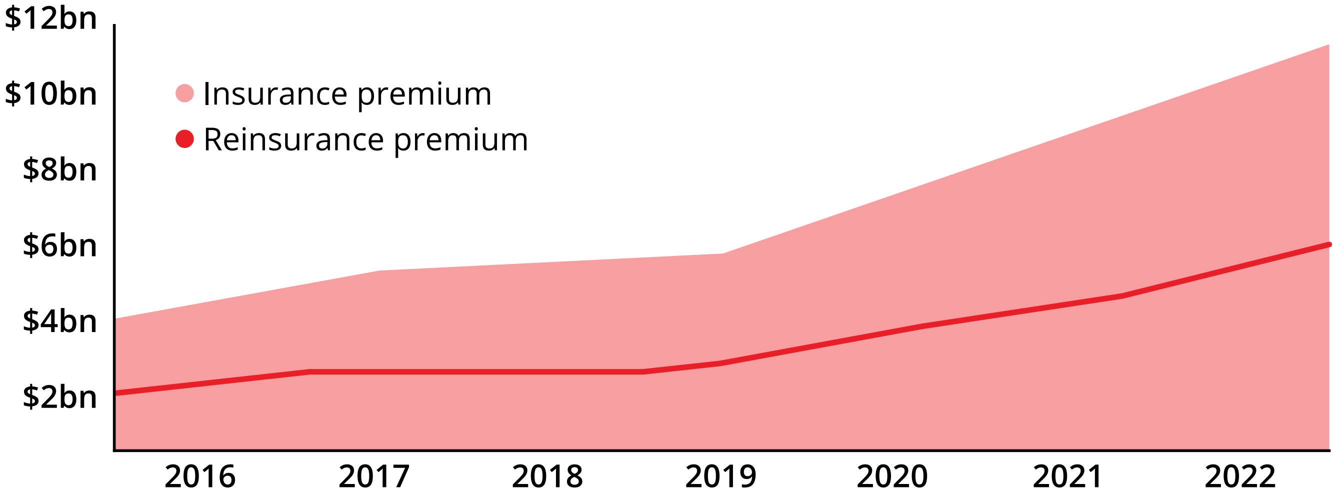
"The number of new market entrants is small, and they tend to deploy modest capacity compared with the established market leaders. We therefore expect pricing adequacy for our portfolio to remain strong."

There is increasing demand for event covers, as cedants become increasingly comfortable with attritional losses and seek to buy additional protection in the tail.

Guy Carpenter estimates there is just over $500mn of limit on event covers being placed right now. In comparison, stop-loss treaties still dominate the space with limits placed in excess of $5bn.

"After the rapid market correction and now instances of rates declining in some areas, insurance buyers are scrutinising the coverage they're buying and making sure it's fit for purpose. They're not shying away from challenging the

Cyber (re)insurance market projections



Source: Gallagher Re, NAIC, S&P Global and Swiss Re Institute structures that they've always purchased," said Anthony Cordonnier, global co-head of cyber at Guy Carpenter.

"Demand continues to increase as the market continues to grow. But I think buyers are a lot more sophisticated in their approach and are conscious that there are alternative solutions both in terms of the capacity they're accessing, but also the structures they're buying."

The reinsurance market will remain imperative for the cyber market, according to S&P Global, as primary insurers ceded approximately 50%-65% of cyber insurance premiums to reinsurers in 2022, depending on the region.

S&P does not expect the market to soften as it has for primary cyber insurance. This is evident from the reinsurance segment's higher rate adjustments so far in 2023, it said.

More rate increases are expected this year, but the ratings agency expects primary underwriters can absorb the increases without passing them on to policyholders.

S&P Global believes (re)insurers need to diversify their sources of back-up protection when expanding in the cyber space.

> "Insurance buyers are scrutinising the coverage they're buying and making sure it's fit for purpose. They're not shying away from challenging the structures that they've always purchased"

"With risk-adequate pricing, we see an opportunity for (re)insurers to partner with the capital markets and increase their capacity," it said.

"In our view, despite the many challenges, third-party capital could become a vital component in the development of a mature cyber insurance market."

At the current growth rates of the market, the industry will reach limits of what the cyber (re)insurance market can financially bear in the coming years, said Swiss Re's Lohbeck.

"To continue to support growing demand for cyber insurance, new capacity needs to be generated. Access to risk capacity from capital markets and/or government-backed schemes for the worst accumulation scenarios are options which are starting to be explored.

"Also, new products get explored that split cover into accumulating and non-accumulating components."

ILS potential

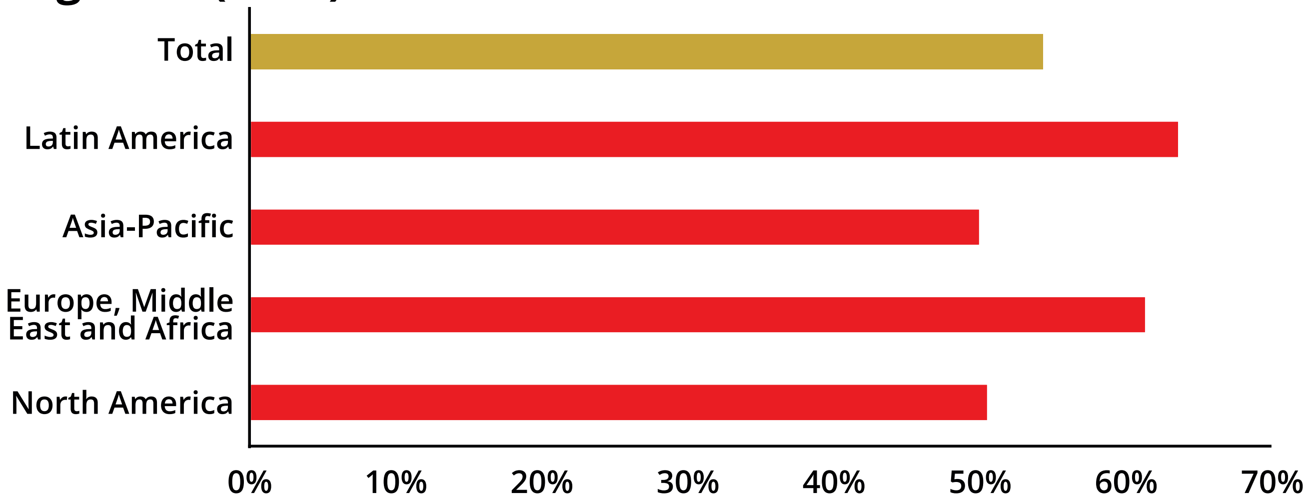
Following a watershed cyber ILS transaction for Beazley this year, the market has been speculating if this would effectively open the floodgates in the use of ILS capital for cyber reinsurance.

Beazley became the first (re)insurer to place cyber risk into the cat bond market, raising $45mn of a hoped-for upper target limit of $100mn with its Cairney deal in January.

The ILS market does want to fill a market need in cyber, but progress will be gradual, sources said. It was suggested that cedants are looking at ILS structures for both attritional and remote tail risk – although investors are generally showing a preference for remote cat risk in cyber at present.

"I think you will see growth in the space," said Theo Norris, cyber account executive for ILS at Gallagher Re. "We're not going to suddenly see billions and billions overnight, but I don't think we're too far away from some serious numbers once we got a few more structures and products."

Reinsurance utilisation: primary cyber insurance segment (2022)



Data is based on S&P Global Ratings' cyber insurance survey for global multiline insurers and global reinsurance groups
Source: S&P Global Ratings

Mereo aims to combine 'best of insurance and asset management'

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, this publication revealed ahead of Monte Carlo.

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.

Approached by this publication for comment, Duperreault said: "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.

"To that end, I believe Mereo's balanced risk allocation and structure is uniquely positioned to outperform if realised risk comes in below broad perceptions, but is also sufficiently diversified to protect the downside well, if market perceptions do materialise."

A representative for Mereo said the firm is "trying to combine the very best of insurance and asset management". They added: "Mereo aims to combine the expertise of its seasoned insurance C-suite with the post-modern portfolio theory risk technologies of multi-strategy hedge funds and do it at a best-in-class cost ratio."

Sources said Mereo is working on the raise with advisers including Kinmont. Inver Re Capital Markets, a unit of Ardonagh, is also advising management.

The rated Bermuda carrier will benefit from a partnership with a fund of third-party investors – essentially combining typical insurance and asset management structures.

Cornerstone investors will fund through the rated carrier and will earn fees and profit commissions on third-party contributions.

Sources said Mereo told investors that it expected to deliver uncorrelated, equity-like returns, with bond-like risk.

It is understood that Mereo would look to originate business from around 20-30 classes of business, creating a highly diversified book.

These would include a portfolio of classes such as auto, workers' comp, professional liability, commercial property, casualty, crop, marine, surety, energy, reps and warranties, medmal, cyber and A&H.

Mereo is understood to have engaged with multiple broking firms, with work underway to establish a diverse and non-correlating book of MGA business.

Initially, it would look to source business via various reinsurance structures, MGA relationships and other broker-related sources.

In phase one, this will mirror a "fund of fund" hedge fund structure. A second phase would include the build-out of underwriting teams onto the platform.

Tokio Marine's FICOH to hand ~$400mn Hawaii loss to reinsurers

First Insurance Company of Hawaii (FICOH), a subsidiary of Tokio Marine, looks set to cede a significant loss to its reinsurers following last month's Lahaina Fire, *Insurance Insider* has learned.

Sources said early indications suggest FICOH – which is owned by Philadelphia Insurance Companies – would cede around $400mn of losses to its panel of reinsurers.

It is understood that the estimate is based on early claims information and is likely subject to change as the loss develops.

Sources said Tokio Marine has also been in the market looking to buy a back-up cover.

Tokio Marine is perceived as a long-term buyer of reinsurance with a good track record around payback post-loss.

FICOH is just one of the sources of substantial losses for cat reinsurers resulting from the shock wildfire event, with many of the insurers impacted buying down to relatively low attachment points.

The Tokio Marine company is one of a handful of small domestic firms that write 100% of their business in Hawaii.

According to Moody's figures, FICOH is the largest writer of commercial property in the state overall, while it also writes homeowners' insurance.

Karen Clark & Company has estimated that the Lahaina Fire could result in losses of $3.2bn and is likely to be the second-largest insured loss in the state's history.

In late August, RLI disclosed $65mn-$75mn in net Hawaiian wildfire losses in its Q3 results.

Reinsurer gains to persist amid fragile macro outlook: Munich Re

Munich Re expects promising underwriting conditions to persist in the reinsurance space coming into 1 January renewals as the macroeconomic and geopolitical outlook remains "fragile".

Although reinsurance capital has partially recovered, rising to $461bn this year after declining to $434bn in 2022, the level of global capacity was not enough to shift underwriting conditions.

"The main message that I would deduce is we don't have a massive capital inflow and that means the market dynamics are not changing," said Munich Re's CEO of reinsurance Thomas Blunck, speaking at the firm's Monte Carlo *Rendez-Vous* press event.

The reinsurer was vocal on trends in the cyber market, where it has taken a standout stance around cyber war coverage.

Head of global clients and North America Stefan Golling said the cyber market would be "dead" if it did not control its accumulations.

"If we overexpose our overall balance sheets then I think the cyber market is dead before it has even achieved a meaningful size," he said.

Golling said Munich Re was prepared to give up business rather than expose itself to accumulations which it viewed as unsustainable.

"If that means that we have to give up business to avoid that uncontrollable exposure, then no doubt we are prepared to give up business," Golling said.

Quizzed on the trajectory of cyber pricing, he said the cyber market "needs to be careful not to become complacent", and that Munich Re would use its dominant stance in the line of business to push for ongoing rating discipline.

More broadly, executives from the German reinsurer said there was little prospect of reinsurers giving up ground on improved conditions that have been achieved.

Inflation is expected to be a dominant factor in renewal discussions.

Blunck said secondary perils accounted for 80% of nat cat losses in H1 2023.

Golling noted that the market dynamics meant "underwriting matters again".

The executive said there was a "focus on the basics" as carriers looked to monitor accumulations and exposures.

Following years of high cat claims, Golling said an $100bn insured loss year for nat cat was the "new normal".

"It would be naïve to hope that the last few years have been exceptions," he said.

Social inflation was also repeatedly raised as an issue for the casualty market, especially in the US.

Scor anticipates low-double-digit 2024 reinsurance rate increases

Scor has used its Monte Carlo Rendez-Vous press conference to set out an expectation of reinsurance rate increases in the low double digits for 2024.

P&C CEO Jean-Paul Conoscente said he anticipates price increases across all lines and geographies next year.

Conoscente noted that, despite a "big shift" in property cat pricing in 2023, cat activity has been "sustained" in H1, albeit with more of the burden now falling on cedants given recent increases in reinsurance programme retentions.

"For us to be a long-term reinsurer, we need more than one profitable semester," Conoscente said, adding that reinsurers' returns on equity still barely cover their cost of capital.

He said that, in particular, pricing must rise further in US casualty and property cat business – while on property insurance, he was not confident that cedants are yet charging the "true" price for their product.

The firm estimated that risk-adjusted P&C reinsurance rates were up by 5% in 2023 renewals, in presentations delivered at its investor day ahead of Monte Carlo.

Scor's programme of reinsurance portfolio remediation has been well documented and, while Conoscente emphasised that much progress had been made, especially in cat, the carrier will "remain highly vigilant" in some lines of business.

In particular, Conoscente said Scor is wary of developing loss trends in strikes, riots and civil commotion coverage and of the increase in subsidence caused by drought in European countries.

> "For us to be a long-term reinsurer, we need more than one profitable semester"

Speaking at the same event, Scor's new CEO Thierry Léger said that, in general, demand for reinsurance is on the rise.

"Scor is well placed and will create value," Léger said, emphasising messaging delivered last week in the publication of Scor's new three-year strategy, 'Forward 2026'.

Léger also said Scor expects some industry insured losses to arise from the 6.8 magnitude earthquake that struck central Morocco, including Marrakesh, on Friday, claiming at least 2,000 lives.

Conoscente clarified though that the gap between the economic and insured losses from the quake will be large due to relatively low insurance penetration in the country.

SPONSORED

French riots of 2023: Strikes, riots and civil commotion protection

The riots that happened in France between 27 June and 4 July 2023 are the costliest to have occurred in France in the past 20 years. The unexpected destruction of public and commercial buildings has created uncertainty over the future of strikes, riots and civil commotion (SRCC) protection.

The riots were catalysed by the fatal shooting of 17-year-old Nahel Merzouk by the police on 27 June in Nanterre, Paris. A peaceful protest outside the Nanterre police station followed and escalated into a riot.

Over several nights, violence spread across the country, peaking around 29-30 June. On 1 July, 45,000 extra police were deployed and violence dropped dramatically, with order largely restored by 4 July.

The riots were distinctive for the intense targeting of public buildings, notably police stations and town halls. In addition to being the most expensive riots in recent French history, they stand out for the intensity of damage done over a period much shorter than the weeks-long 2005 riots and the months-long 2018-19 Gilets Jaunes demonstrations.

The 2023 riots in France are estimated to have generated at least EUR650mn in damage, according to the French Federation of Insurance. For context however, no riot in France has come close in cost to the Chilean 2019, American 2020 or South African 2021 unrest.

Applicability of terms/viability

Unlike storms or floods, destructive civil unrest can begin anywhere and spread rapidly, posing a systemic risk to entire nations. In recent years, in Latin America and South Africa, SRCC costs have overtaken extreme-weather event costs. The unpredictability of these events is leading to restrictions in SRCC coverage, risking access to protection, and may require public sector support.

In most reinsurance treaties in France, political violence coverage – which includes SRCC – applies to one city and those adjacent to it[1]. The recent riots show the limits of this: Paris and Lyon both saw large-scale SRCC events and are not adjacent to each other, and will be classed as two separate events, despite the same common cause: Merzouk's death.

The most common period of coverage is 72 hours. Incidents were at their most intense across 28-30 June, a 72-hour period. Intense urban unrest (in one city) lasting more than 72 hours is a rare occurrence, as the number of targets diminishes and government response time permits mobilisation of security forces.

Beyond geographic and temporal

Some riots may involve large-scale individual acts of destruction, for example the total razing of a number of buildings. More commonly, however, they comprise large numbers of smaller damage incidents. Each of these may fall beneath the retention limit of reinsurance coverage, but can still quickly add up across multiple cities and multiple nights of unrest. These multiples are the reality of riots and are making coverage of riots increasingly prohibitive.

The difficulties of covering SRCC in France following such riots are likely to result in one of three outcomes: primary insurers taking full responsibility, reinsurers agreeing to share the burden of SRCC, or creating a state-backed pool for SRCC. Without change, there is a risk that coverage might be withdrawn from vulnerable French communes.

Modelling

Guy Carpenter is conducting scenario and accumulation modelling of SRCC risk using impact footprints and target data points. We have an extensive library of impact footprints built from observed historic incidents in South America, North America and Europe. These have been adapted for specific urban geographies and the extents, severity and targeting vary. Our Sunstone® target database includes 1.3 million targets around the world. Of the 64,000 political violence targets in France, more than 50,000 targets across 29 target types are relevant to riot.

With such a large and granular dataset, we are able to identify risk areas in different regions. Target accumulations are key to finding exposure at risk and form the anchor points to realistic disaster scenarios.

The nature of riots varies from society to society, the political landscape and the motivation of the crowd. This is captured in the footprints we have created and by filtering our broad target database.

Having successfully deployed this methodology to a number of clients to identify probable maximum loss and provide an innovative aggregation approach, we are now automating the process for greater efficiency and to service a wider client base.

Guy Carpenter partners with our clients by bringing together the power of analytics and advisory via a multi-model approach to address ever-changing, complex SRCC and terrorism risks.

Disclaimer: this note is of a general nature. The commercial, actuarial, technical and legal elements presented below for the French market may differ in practice from one insurance company to another.

By Brendan Clifford, Threat Analyst, Political Violence Advisory, Guy Carpenter, and Stephen Hudson, Head of Political Violence Advisory, Guy Carpenter

1. Source: ABREF (Association of Reinsurance Professionals in France) insurance insider

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Fiona Robertson
Editor
fiona@insuranceinsider.com

Brian Gelsomino
Head of Subscription Sales
brian.gelsomino@insuranceinsider.com

Cat bond inflows a highlight in mixed ILS outlook

ILS markets have acted as a stabilising force in the property cat space in 2023, offering a way for cedants to manage concerns over counterparty diversification and pricing in a hard cat market, according to sister title *Trading Risk*.

ILS investors began piling into the cat bond segment particularly in the first half of the year, with around $2bn raised across a handful of ILS funds with cat bond strategies.

The inflows and appetite on the investor side were matched by a strong pipeline of new issuance from repeat and new sponsors, resulting in a record $10bn of cat bond limit placed in H1.

The strength of demand on the sponsor side had served to maintain pricing at levels that stayed attractive to investors, while coming off the high peaks seen around the end of last year which had made deals at that time look difficult to manage from a sponsor point of view.

Spreads on US property cat bonds tightened by about 15%-35% in Q1-Q2, according to Aon's ILS annual report.

The healthy supply-demand dynamics meant spreads were also settling at a palatable level for cedants, who in some cases were opting to carve out a chunk out of their cat treaty layers and place the limit into the cat bond market.

Favourable economics were also accompanied by the fact that issuing bonds has become a smoother and lower-cost process.

This has meant the hard market effectively acted as a calling card for ILS, offering sponsors more flexibility to triage providers across reinsurance and ILS and encouraging new issuers to dip their toes into the cat bond market.

The future will tell whether this limit will stay in the cat bond market by way of return issuance, or how much more risk could transfer to capital markets through the ILS route.

Uneven recovery

Despite a buoyant cat bond market, the recovery across the ILS world has been a lot more fragile and uneven.

ILS fundraising in general remained challenging, with heavy cat loss years from 2017-2021 still looming in investors' memories, and events including hurricanes, flooding, severe convective storms and wildfires frequently dominating the news headlines in H1.

At the same time, ILS funds have found that, in some cases, investors have had little choice but to divest their ILS positions, owing to the "denominator effect". This is where, due to big falls in equity markets and mark-to-market write-downs in the wider bond space, owing to interest rate rises, pension funds' positions in alternative assets became overweight.

Meanwhile, the collateralised reinsurance segment had lost a lot of its shine for investors who have had capital trapped over several years against potential claims development. ILS fundraisers are however continuing to steer the conversation to private ILS, as bond spreads have fallen.

Following the hard market renewal in January 2023, projected returns were in the teens for many ILS strategies, and at around 20% for mid-high-risk strategies.

The latest numbers from the Eurekahedge ILS Advisers Index show returns of 7.8% for the seven months to 31 July, across the 26 ILS funds that the index tracks.

For the pure cat bond funds, the gain was 8.3% and for private ILS, 7.5%, for the period.

Given the pressures on fundraising, ILS writers are, like all cat reinsurers, keenly hoping for a good 2023.

The top tier of ILS managers – those with AuM of more than $2bn – added around 2% in AuM to reach $77.9bn in H1, *Trading Risk* data shows.

Schroders and Twelve Capital were among those benefiting from inflows relating to cat bond strategies.

Overall, 11 of the 18 managers in *Trading Risk's* top tier increased their AuM during the first half of the year.

Current $2bn+ ILS managers ($bn)

Firm	Jan '23 AuM	Jul '23 AuM
Fermat CM	8.6	9.7
Nephila Capital	7.4	7.2
RenaissanceRe	6.2	6.9
LGT ILS Partners	6.1	5.5
Leadenhall CP	5.5	4.9
Schroders Capital	4.3	4.4
Aeolus CM	3.3	3.9
Pillar CM	3.1	3.9
Elementum Advisors	3.7	3.8
Scor IP	3.2	3.5
Twelve Capital	2.6	3.4
Neuberger Berman	3.1	3.2
Securis IP	3.6	3.1
Alphacat Managers	3.1	3.1
Hudson Structured CM	3	3
Swiss Re	2.9	3
Stone Ridge AM	2.6	2.9
Credit Suisse	3.9	2.5
Total	**76.2**	**77.9**

Source: Trading Risk

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INTERVIEW

Scor's Léger: $50bn annual capacity gap to drive continued underwriting discipline

Scor's new CEO said demand is to outstrip supply as cedants grow and exposures expand

The global reinsurance market faces a roughly $50bn gap in capacity each year – and that will drive continued hard market conditions in the medium term, according to Scor CEO Thierry Léger.

In an interview with this publication, Léger, who took the reins at the French reinsurer earlier this year, laid out Scor's evolving underwriting philosophy and its key messages to the market ahead as the renewal season kicks off.

The executive's comments come after the publication of his first three-year strategic plan as CEO, which set out Scor's continued caution on climate-exposed business and its desire to increase its participation on lines such as engineering, marine and international casualty.

In a wide-ranging interview, the executive covered:

- Scor's appetite for business following a period of underwriting remediation
- The availability of capacity and the alternative solutions to traditional treaty products to which clients are turning
- The impact of the difficult 1 January 2023 renewals and how reinsurers and cedants can recover their working relationships

Market messaging

Scor has been through a turbulent few years following an attempted takeover by Covea and rapid changes to its leadership, but Léger used the interview to telegraph to cedants that the ship's course has been righted.

"Scor is very positive about the environment and our positioning," he said.

"Scor is ready. We will support our clients, we have capacity and we have the expertise."

He warned though that market conditions are unlikely to soften very far at this renewal or the next.

"Capacity continues to be scarce," said Léger.

"We have been through many difficult years. We need to replenish our balance sheets after these difficult years to build the capacity that is required to cover cedants' needs because there's a huge gap today between the demand and the offer.

"To fill that gap, we will need to make profits to replenish our capital, which really means that the prices need to go up further."

He added that Scor has shifted towards a more disciplined underwriting model.

"Technical underwriting has been at the core of Scor and, with this new strategic plan, what we do at group level is capital steering," Léger explained.

"So capital steering is something we will invest much more in on a group level.

"What we do there is define the lines of business where we want to grow more or less to get to the best possible portfolio in any given time, and that evolves.

"This much refined capital steering is a real change and will be a steer to the teams on the ground. At a group level, we are becoming more technical."

The CEO added that the desire to make coverages clearer is a reaction to recent losses.

"It started with Covid on the P&C side," said Léger.

"It triggered certain coverages that in our view should not ever have been triggered. There is a desire to make very clear what we mean when we sign a contract.

"We are in a phase where we are rather restricted and that is an ongoing trend."

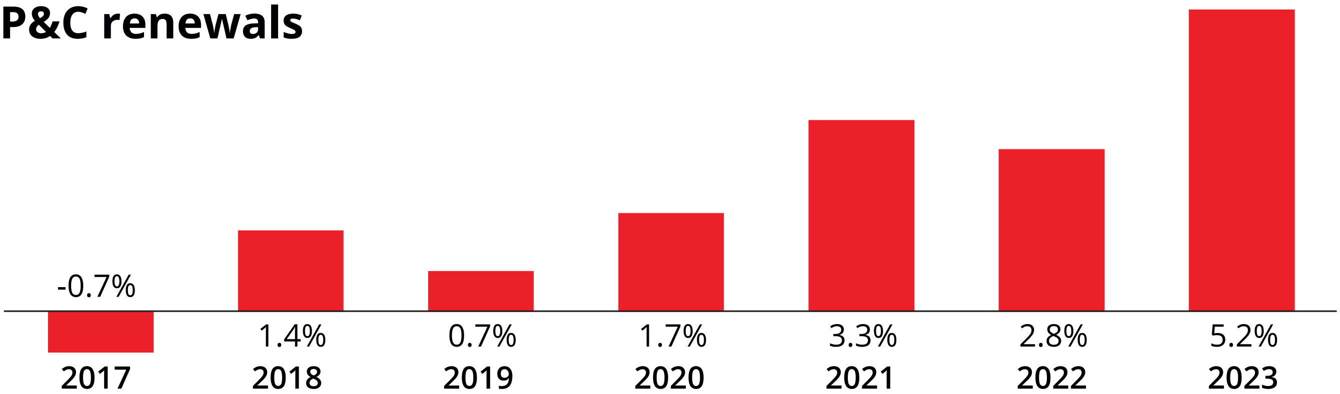
Léger highlighted cyber as a particular example of a line of business where clarity is crucial.

"Cyber is an incredible opportunity for the insurers and reinsurers," he said.

"Premium in cyber will be multiplied many times. What's really important is to learn from losses and constantly clarify the wording."

He added that the presence – or otherwise – of coverage for strikes, riots and civil commotion (SRCC) in property treaties is another area of focus.

Risk-adjusted price developments for main reinsurers at the P&C renewals



Source: Scor analysis, based on individual company publications

"Due to the polarisation of the world, we have seen huge civil unrest in Chile, in South Africa, in France – just those three were massive and led to really large losses," he said.

"This is going to get worse before it gets better. I expect the insurers to have a very strong focus on SRCC."

Controlling cat exposures

As outlined in its new three-year plan, Scor is continuing to take what it calls a "prudent" approach to climate risk.

This follows a major remedial programme undertaken over the past few years, in which the carrier has reduced its participation on lower layers of programmes in a bid to avoid frequent secondary-peril losses.

Léger stressed that Scor's approach to climate-change exposure does not equate to a wholesale retrenchment from cat business.

"Climate change does not equal nat-cat," he said.

"What we mean by the most climate-change-exposed risks are risks such as flood, avalanches, extreme heat, extreme drought. Those are directly climate change impacts but there are nat-cat elements that are not at all or only to a small extent impacted by climate change."

He added that climate-change-exposed lines are "not the big bulk of our business".

"They became more of our business over the last five, six years, as suddenly we saw climate change impacting the whole world," said Léger.

"At 1.1 2023, we removed ourselves from these risks – not the big risks, the smaller, more frequent events."

The impact of this, the executive said, has been that clients have retained a far larger proportion of this year's nat-cat bill than they would have done in previous years.

Recovering from 2023

Léger acknowledged that cedants had been through a bruising renewal at 1 January this year, in a process beset by delays, confusion and sudden price increases.

"Reinsurers and insurers have a business-to-business relationship," he said.

"The quality of a relationship is measured by how we go through difficult moments. In many instances, the relationship can actually be better after the crisis than before the crisis."

The difficulty in the run-up to the January 2023 renewals, which Léger termed a "dislocation crisis", has had a lasting impact.

"It is not going to last forever but it's still there: the shock, the disappointment, the frustration, all these feelings," he said.

"We will face some of that in the expectations of our clients of the next renewal."

Nevertheless, Léger said he anticipates a "much more orderly" renewal at 1 January 2024 "because the capacity gap is now very clear to everyone and everyone is working on it".

That capacity gap, Scor estimates, is around $50bn per year.

"My expectation is that the [supply] will increase relatively slowly," said Léger.

"Every year this market needs at least $50bn in new capacity, because that's about the growth that we expect. The high volatility this world is facing will increase reinsurance demand."

Reinsurers will not be able to supply increased capacity in line with demand, Léger pointed out, meaning cedants must face the reality of holding more risk net.

This in turn is to drive demand for alternative reinsurance solutions, which Scor has named as a priority growth area.

As part of its new strategic plan, the carrier has committed to doubling premium from alternative solutions – such as solvency relief quota shares, multi-year stop-loss, combined adverse development covers and contingent reinsurance – in the next three years.

"Structured solutions are by nature tailored to you," said Léger.

"It's going to be more difficult to find solutions to reduce volatility. It's going to be easier if it's a capital-oriented solution."

> "It's going to be more difficult to find solutions to reduce volatility. It's going to be easier if it's a capital-oriented solution"
>
> **Thierry Léger, CEO, Scor**

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Robust value prop key for clients

Just how major reinsurers respond to the uncertainty and obvious nerves about the potential for major losses to continue to climb will underpin many of the conversations in Monte Carlo, says Anthony Izzo, Everest's head of global facultative and reinsurance distribution.

Setting the framework for these crucial renewal negotiations has been at the forefront of Everest's preparations this year, which has seen the revamp of its global reinsurance distribution strategy come to fruition, says Izzo: "We want to deeply understand and map our clients' objectives so we can ensure our strategy meets their desired outcomes. This means working closely with our key broker partners and their clients to truly understand why they buy reinsurance, their pipeline of cessions and how they match the Everest appetite to the opportunities.

"The brokers appreciate our transparency and our determination to be up front in terms of our strategy. Of course they want no surprises. No-one can promise that any more but we aim for 'very limited surprises'."

It goes without saying that most clients want to discuss rates as they limber up for the hard 1 January negotiations ahead and get a sense of what to expect, whether it will be more of the same or whether new trends will emerge: "The 1 January 2023 renewals saw a hardening of the market in most classes in rates and terms. Obviously, the big questions for everyone at Monte Carlo are where is the market going to land at 1 January 2024 and what are the continued implications for property cat rate increases.

"I think it will be a more orderly market with continued pricing and term and conditions discipline," Izzo cautiously predicts.

However it pans out, he is confident Everest is equipped to respond with effective solutions to meet the challenges brokers and clients bring to the table: "Treaty reinsurance continues to be an excellent solution for our clients' needs, especially from the property perspective. There is increased frequency of events, overall volatility and claims – for instance we have had the first tropical storm recorded in California in 84 years. I envision continued hardening of rates, perhaps not to the extent of 1 January 2023, and a continued exercise of underwriting discipline. We will be deploying some incremental capacity increases if pricing and terms meet our thresholds.

"We have the capital to support this, having raised $1.5bn back in May. This was an over-subscribed situation and we intend on deploying it appropriately."

Whatever twists and turns lie ahead in the renewal negotiations, Izzo is clear where the focus will be: "Our goal is to successfully deliver a robust value proposition to our brokers and clients as we continue to raise the Everest profile. Many of our regional leaders are here in Monte Carlo to support of our efforts."

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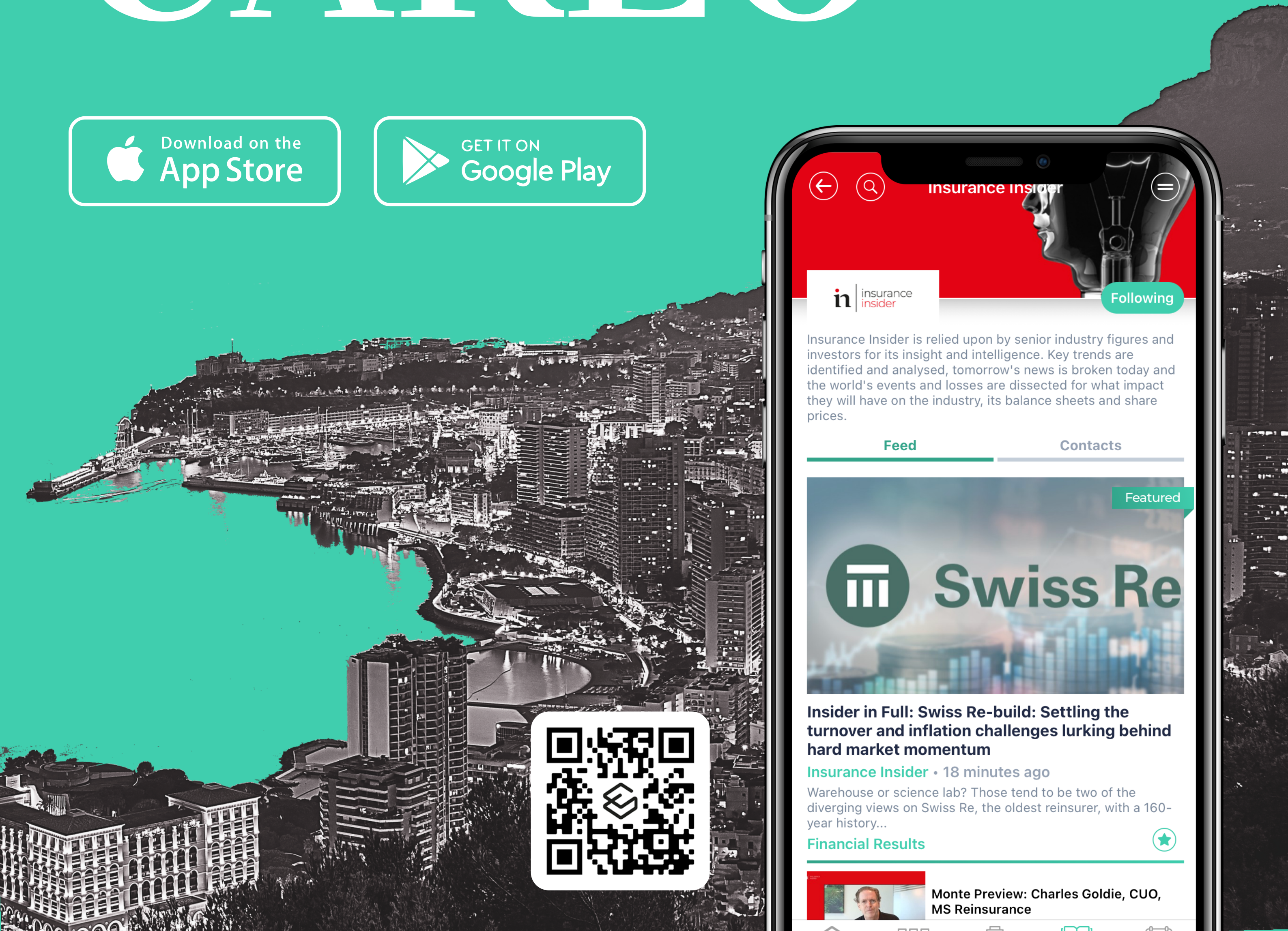

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FORWARD 2026

SCOR's Strategic Plan for 2024-2026

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ROUNDTABLE

Our virtual roundtable polled senior industry figures on the biggest questions facing the reinsurance industry. Today, we look at the influences steering M&A market conditions

Do you expect we will see further divestment of reinsurance arms, in the same vein as AIG's sale of Validus Re?

Kathleen Monaghan, head of corporate finance, Aon Capital Advisory: The capital-intensive and highly brokered nature of reinsurance, especially property cat reinsurance, will benefit scaled players with sophisticated strategies around capital management. Purely on an efficient frontier basis, we expect hybrid (re)insurance carriers to deploy capital towards lines of business with higher ROEs and less volatility.

We believe the unit cost of reinsurance has improved for reinsurers, and many hybrid (re)insurers may explore opportunities to divest in the near-to-long term while taking advantage of the current market environment. We expect buyers of reinsurance companies to be strategic in nature; sellers will need to prove their technical capabilities to advocate for their value and talent.

Andy Beecroft, head of M&A advisory, GC Securities: There are not too many similar examples in terms of the scale and (relative) independence of Validus Re, but there is speculation that at least one large insurance/reinsurance group has been exploring options. The biggest question here is "where is the capital going to come from to acquire the business?".

There are significant attempts to raise balance-sheet capital for reinsurance businesses at the moment, but there have only been a limited number of successful capital raises.

GC Securities is in regular contact with private capital in relation to investment opportunities in the sector, but there is still some scepticism from investors around reinsurance due to climate change, inflation and historic performance etc, and so someone committing to acquiring a large reinsurance book requires a significant amount of conviction. Capital allocating to the sector might want to participate in a more passive/short-term way while rates remain hard with the option to exit if rates soften significantly.

Jean-Paul Conoscente, CEO, Scor P&C: The value of reinsurers has improved compared with two years ago thanks to the current hard reinsurance market. However, on the buyer side, the increase in interest rates does not facilitate M&A: increasing cost of debt and preference to use cash for fixed income (offering more yield certainty than M&A transaction) complicates the financing. Players that can rely on equity issuance will be the most likely buyers.

> "Consolidation has always been a part of the insurance brokerage story"
> **Kathleen Monaghan, head of corporate finance, Aon Capital Advisory**

Rob Bredahl, CEO, Howden Tiger: The stated rationale behind divesting Validus Re was a reduction in earnings volatility. It is logical that primary insurers will continue to prioritise core portfolios.

Where this involves non-core reinsurance arms, this may involve divestment as seen in the case of AIG with Validus Re. On the other hand, improving reinsurance profitability metrics are making reinsurance businesses more appealing. This is arguably a great time to be allocating more – rather than less – capital towards reinsurance activity, so it depends heavily on company strategy.

Jason Howard, president, Acrisure International; chairman, Acrisure Re: AIG's sale of Validus Re was driven by a variety of factors, such as changes in their capital allocation priorities and desire to focus on core businesses. Further divestment will be driven by companies looking to streamline their business model and manage their volatility of their portfolio. Further divestment is likely driven by a range of issues including liquidity needs and capital efficiencies, among other factors.

ROUNDTABLE

Hannah Watkins, managing director, BMS Re: A properly managed reinsurance business can make great returns, but it does involve carefully managing your way through the cycle. Reinsurers' roles may develop further to become a portal to the broader capital markets. They are perfectly positioned for this – modelling tools, proximity to clients etc. While the exit from reinsurance has been mainly driven by cat risk performance, it is still possible to construct a balanced and diversified portfolio of business.

One of the main issues the industry has faced has been the over-concentration of cat risk in portfolios. However, it is always the responsibility of C-suites and boards to measure stakeholder returns. So, with all this in mind, my view is that, yes, there will be further divestment.

Kevin Fisher, president, IQUW: Everything has a price. However, I don't think we will see many other transactions as acquisitions are very hard to do given reinsurance is a people business and integration is key. A requirement for scale may overcome this hurdle and could be a compelling rationale for mergers. .

We have seen the arrival of a number of challenger reinsurance brokers in the last few years. At what point will they have to consolidate to truly challenge the biggest three players?

Conoscente: The reinsurance broker world is in a transition period. In the journey from the union of single brokers under the same banner to a coordinated and consolidated organisation, challengers are not halfway yet. They need to add a layer of consistency, which is essential for both regional to global insurers and the top 10 reinsurance players.

Sven Althoff, board member, Hannover Re: Hannover Re has always worked closely and successfully together with brokers of various sizes. While size will always play a role for a broker in order to offer the full service required by many clients, there will always be a raison d'être for specialists – be it in local markets or lines of business.

> "We expect a gradual return to increased IPO levels, although the market remains sluggish"
> **Rob Bredahl, CEO, Howden Tiger**

Monaghan: Consolidation has always been a part of the insurance brokerage story. Due to the cashflow-driven nature of distribution, economies of scale can be more impactful than in balance-sheet businesses. It's not size or access to customers alone that matters; the biggest players have the ability to leverage data, see breadth and depth across markets, and advise on issues beyond the distribution-focused transactions.

Watkins: It depends on whether the goal is to challenge the Big Three. The landscape has changed considerably over the past five years. Given the pace of acquisition of certain broking houses, it is inevitable that others will look to scale via acquisition to ensure relevance. However, not all are looking to take on the biggest three players.

Do you expect more IPO activity this year following the successful listing of Skyward Specialty and also Fidelis' balance-sheet business?

Beecroft: This can be considered from two angles: listings in the UK vs US stock markets. It seems unlikely that there will be UK listings. Interest in listing on the UK markets remains relatively limited, and Conduit's perhaps unjust share-price journey post-IPO is not likely to change investor appetite. The US markets present a more attractive opportunity.

The Skyward IPO, for example, has been viewed to date as a success. In terms of Fidelis, this is a very different entity and the IPO provided liquidity to the selling shareholders who have primarily benefited from the value created in the Fidelis MGU. In the current subdued M&A market, an IPO may be seen as the most realistic exit route for existing shareholders looking for near-term liquidity.

Conoscente: Other names in the sector seem to be sounding the market around optionality – e.g. Axa/XL Re – with "dual track" (M&A or IPO) perceived as the main road. However, the current macro uncertainty and high interest rates have made IPO a less conducive option, as evidenced by the low volume in H1 2023.

Bredahl: We expect a gradual return to increased IPO levels, although the market remains sluggish. This is broadly a reflection of a normalised inflation and interest rate environment, increasing investor discount rates and resulting in divergence between private market valuations and investor expectations.

Alongside this, insurance profitability will be improved by rate increases, which should make IPOs more appealing. We would expect businesses cannot remain in an indefinite holding pattern, and there will be some increased activity this year, although it will likely remain muted compared to longer-term average levels.

Monaghan: IPO activity has been relatively stable in our industry. The likely IPO candidates are typically private-equity-backed or spin-offs from existing companies. We have seen PE focus its attention more on distribution than on balance-sheet companies in recent years, with the exception of a few notable buyouts. Generally, we expect companies will want to show a strong two or three years of growth and profitability to maximise their IPO success.

Howard: Skyward Specialty's principal purposes of the offering are to increase its capitalisation and financial flexibility. In addition, Skyward Specialty utilised IPO proceeds to make capital contributions to its insurance company subsidiaries to support the growth of its business. Market conditions will continue to impact further IPO activity but, as companies look for liquidity and financial flexibility, it is not unlikely that there could be further IPOs.

Do you think we have seen a topping-out of MGA multiples?

Conoscente: MGAs remain attractive acquisition targets, with leaner operations and lower overheads tending to mean higher margins compared to retail agencies.

However, the MGA space is made up of roughly two types of companies: niche MGAs that either write very specialised business or who have specific distribution channels, and MGAs that write standard business using the MGA form to provide better remuneration to the underwriters.

Current reinsurance markets dynamics are set to challenge the second type of MGAs, which rely heavily on fronting carriers and abundant reinsurance capacity. In addition, fading inflation coupled with slow waning of rate rises may lead to lower income and cash generation, while increasing cost of debt and wage inflation may weigh on profitability. It sets the stage for a slow squeeze of the MGA sector and a likely deflation of valuations.

Fisher: Currently investors generally assign higher multiples to fee-generating business than they do to balance-sheet businesses. After years of anaemic underwriting returns, the current strong underwriting returns that are likely to persist into the medium term, coupled with improved investment yields, may well change this dynamic.

Monaghan: The acceleration in MGA valuations has been aided by trading among PE buyers and sellers invoking roll-up strategies to scale the businesses. For valuations to decelerate and/or decline, we believe two things would need to happen: (1) dry powder dries up, and/or (2) MGA growth becomes limited due to reinsurance/fronting capacity constraints.

There appears to be slow-downs in fundraising from PE, and we are in the midst of a hardening, or hardened, reinsurance market. We expect the winners will be those that are niche and best-in-class underwriters.

“It sets the stage for a slow squeeze of the MGA sector and a likely deflation of valuations”
Jean-Paul Conoscente, CEO, Scor P&C

Howard: MGA multiples have followed a similar trajectory to retail assets where YoY pricing has continued to what is an all-time high in pricing today. MGAs have been key to many brokerage companies, including Acrisure, as they look to execute on their value-chain compression strategies.

Why do you think there hasn’t been more acquisitions of Lloyd’s businesses despite the turnaround in performance and prevailing market conditions?

Althoff: During the years 2015-2019, Lloyd’s saw an uptick in M&A. Given the poorer performance of the market between 2018 and 2020 in general, and the fact that capital has become a tighter resource than in the past, in addition to investment alternatives due to the rise in interest rates, we think the M&A market is in a waiting position. This said, it is fair to assume that eventually investors will look for attractive targets given that Lloyd’s remains a successful and profitable marketplace.

Bredahl: Although reported CORs have notably improved over the past two years, (FY22 COR 91.4%), Lloyd’s five-year average COR is still about 5 points higher than its cohort’s. Additionally, there may be a valuation gap between businesses and potential acquirers, owing to more expensive capital in a higher-interest-rate world.

Fisher: Investors will want to see evidence of sustained underwriting profit. We are currently seeing price adequacy in multiple lines of business which we expect to continue. Headwinds exist, M&A volumes are down significantly year on year and, while we strongly believe in the Lloyd’s model and the multiple advantages it provides, there simply aren’t that many Lloyd’s platforms that would be available for acquisition.

Beecroft: There haven’t been many recent transactions primarily because we are still in the hard phase of the market cycle. Shareholders are reluctant to sell when underwriting conditions are still strong or strengthening.

Also, many transactions happened in 2020/21 (Inigo, Ark, Beat, Mosaic, Blenheim, Apollo, IQUW etc.), and so for those companies, there needs to be sufficient time for capital to be deployed, and demonstrable profitability and capital appreciation achieved before justifying a significant premium-to-book valuation that will be needed for shareholders to truly achieve their desired goal.

Watkins: Market conditions and results have improved but we must remember that we are only just starting to see such results. If we are honest, Lloyd’s businesses had to endure tough results for several years. Investors might want to see these positive results successively before any strategic decisions are made.

Kathleen Monaghan, head of corporate finance, Aon Capital Advisory

Andy Beecroft, head of M&A advisory, GC Securities

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

Rob Bredahl, CEO, Howden Tiger

Jason Howard, president, Acrisure International; chairman, Acrisure Re

Hannah Watkins, managing director, BMS Re

Kevin Fisher, president, IQUW

Sven Althoff, board member, Hannover Re

interoperability **/in-tər-´ä-p(ə-)rə-´bi-lə-tē/** *noun*

Ability of a system to work with or use the parts or equipment of another system.

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ANALYSIS

ChatGPT and insurance part one: A realist's guide to use cases

The spectrum of views on prospects for ChatGPT's commercialisation in underwriting ranges from those hailing it as a harbinger of the next industrial revolution to cynics perceiving it as a "data protection trapdoor".

Several global insurers among the more optimistic cohort are now trialling the AI tool across underwriting and front-end processes, as they seek to accelerate automation of manual tasks and optimise customer service.

Many sources said ChatGPT and the use of generative AI tools have profound implications for underwriting and claims, and that it will accelerate automation at a speed "the market hasn't yet fully grasped".

In the first of a two-part analysis on a potential mass adoption of ChatGPT and similar applications across the industry, this article explores the use cases.

Part two will examine data protection and governance challenges that need to be resolved, but there are enough case studies where ChatGPT is being used in a live environment, or a pilot phase, to suggest many firms are embarking on a rapid adoption curve.

As one source remarked: "One could assume these generative AI solutions will start to play a meaningful role in many large insurers within the next 18 to 24 months."

Definitions and delineations

This article focusses largely on OpenAI's ChatGPT, which is effectively a chatbot using a generative pre-trained transformer (GPT) model, but also encompasses other GPT models that operate in a similar way. There are different GPT models, but essentially, they provide the architecture that enable applications like ChatGPT to provide human-like answers.

AI tools such as ChatGPT and Google's Bard, another chatbot, are described more widely as large language models (LLMs), meaning they can be trained to process vast data sets and generate answers to questions based on that data.

In future, these terms could become more embedded in the industry vernacular, as GPT applications undergo further iterations and results-based case studies emerge from underwriters, assuming no major data protection incidents scare them off.

Material benefits

A starting point is ChatGPT's potential to automate manual underwriting processes. This has been showcased in a pilot run by InsurTech Artificial Labs with brokers and carriers to embed ChatGPT into the pre-bind stage of its algorithmic underwriting platform.

The AI tool is being used in the test to extract and structure data from US property submissions in any format, allowing underwriters to unearth relevant risk data, interrogate it and make faster decisions. Isolated parts of documents were shared with ChatGPT that stripped out personal or sensitive information to comply with data protection regulations.

Such examples demonstrate ChatGPT's potential to extract submission data from unstructured sources, such as emails and broker presentations, to examine qualitative and quantitative data.

In other cases, ChatGPT is being used in a live environment: Swiss insurer Helvetia is experimenting with it to answer customers' questions on insurance.

The carrier, which claimed to be "the world's first-ever listed insurer" to launch a direct customer contact service based on ChatGPT, told this publication it wants to gain insight into how customers perceive the service and if the tool can help set new benchmarks in convenience and customer access.

Although Helvetia acknowledged that information security and data protection are the biggest challenges in its trial, a spokesperson added: "ChatGPT promises many efficiency gains in the summarisation of large amounts of text. In underwriting, this can definitely bring advantages, especially for products which are not fully standardisable."

Similarly, Swiss Re group digital and technology officer Pravina Ladva told this publication that new AI applications such as supervised learning (a sub-category of machine learning) can enable smarter triaging.

The reinsurer is using them to help triage life and health (L&H) underwriting and "simplify the customer journey".

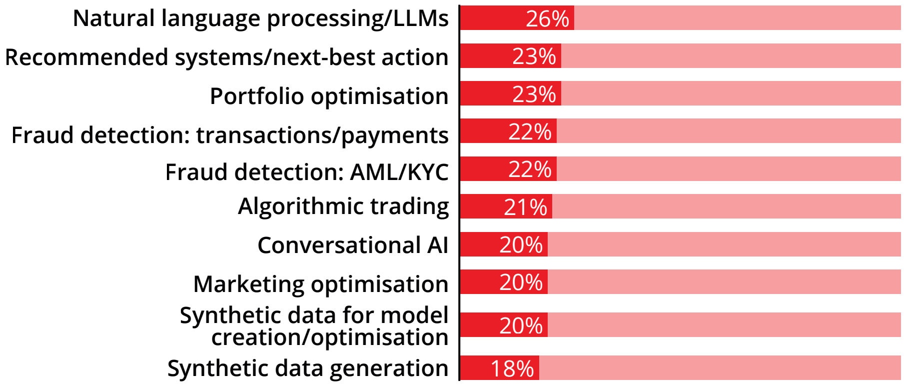
Global business leader at AdvantageGo Ian Summers agreed that triaging in underwriting is where GPT models are most likely to proliferate.

He explained that underwriters are accumulating increasing amounts of data which are manipulated, ranked and scored to facilitate triage and technical ratings.

"To me, this is the area that will advance most quickly – the ability for trusted data sources to be crunched and annualised in real time with proprietary rating models applied and outcomes presented for human approval."

There are a handful of other use cases that each have implications too numerous to explore in detail here, but one senior underwriter told this

Most frequently cited AI use cases in financial services



Source: Nvidia's 2023 State of AI in Financial Services Survey Report

publication that ChatGPT has "great potential" to help carriers improve models that identify fraud patterns.

Consequences for claims

Most sources identified claims as an area where GPT models could alter processes for assessing claims litigation, and extract data for insights to improve underwriting.

One executive highlighted ChatGPT's ability to interrogate the mass of publicly available case law on the internet, which may provide insight when carriers are weighing up potential claims litigation.

The source added: "You could ask ChatGPT, 'on the basis of probability, what is the potential likelihood of winning this case?' You'll have an answer in seconds. In future, could that answer save fees from some expensive barristers?"

Others agreed that while ChatGPT's emergence undoubtedly has longer term implications for lawyers providing advice on claims litigation, there's no immediate existential threat, due to risks around the veracity of its responses.

There are other aspects to the impact on claims. Zurich, the only major continental (re)insurer so far to speak publicly about a ChatGPT trial, confirmed earlier this year that its testing out the tool with claims data.

Chief information and digital officer Ericson Chan told the *Financial Times* in March that Zurich was feeding in six years of claims data to identify the specific cause of loss across a range of claims, with the aim of refining its underwriting.

Automation velocity

There are also compelling use cases for brokers and insureds to use GPT models.

Dan Prince, CEO of digital underwriting platform Rethink, part of the Howden Group, said that among brokers, the key will be the efficacy and safety of how they train a GPT model.

He added: "You're looking at a data extraction tool that could be applied across all forms of documents – proposal forms, risk engineering reports, claims reports, schedule of values, and the slip for example.

"After extraction, it provides an opportunity to place data sets in a structured fashion, which could in turn mean a quantum leap for the automation of certain processes. You will still need a human in the loop, but these generative AI tools could increase the velocity of automation."

Another source mooted the idea that insureds could start using ChatGPT to ask important answers on the likelihood of a payout due to a specific loss event, to inform their buying decisions.

Another said it could play a role in assisting compliance with anti-money laundering and know your customer (KYC) requirements, by trawling data on a client's transaction history, for example, and flagging suspicious activity.

> "Many LLMs answer questions in a very confident but factually incorrect manner"
>
> **George Beattie, head of innovation, CFC**

One executive at a major carrier said it could also act in future as precursor to the proposal form, accelerating the initial risk assessment process.

Unsubscribing to the hype

It's appropriate to pierce through the hype around these use cases, in light of the obvious risks, notably ChatGPT's proclivity to "hallucinate" false responses.

George Beattie, head of innovation at CFC and a purveyor of innovation in the London market, said: "Many LLMs answer questions in a very confident but factually incorrect manner. There have been cases of convincing-sounding reference material being completely made up. This is explicitly risky for insurance business – where the factual basis for information (like underwriting data), and its provenance is vitally important."

He explained that CFC has been looking at AI and LLMs for some time.

"We have one of the largest technology teams in the market working on a range of solutions. We believe that in commercial insurance, there will continue to be considerable value in maintaining a human touch."

The great leap forward

The raft of use cases outlined here are clearly at a nascent stage, and some household insurers are not touching ChatGPT, largely because of data accuracy and data protection concerns.

There appears to be a consensus though that GPT models represent a major leap forward in AI that the London market will have to reckon with somehow.

GPT models are becoming increasingly available for use in insurance, through providers including Eigen Technologies, US data and analytics firm Planck, and claims management tool InsuranceGPT from AI firm Simplifai.

The insurance industry can expect more options to become available in the coming months, as the practical use of GPT models moves to the live environment.

The key for London market firms will be how effectively and safely they train a GPT model in the complex terms of P&C and specialty insurance.

INTERVIEW

Lord Mayor of City of London sets out Monte Carlo mission

Nicholas Lyons plans to champion the London market's expertise on cyber and climate risk, and discuss ideas for a consolidated systemic risk pool

The Lord Mayor of the City of London, Nicholas Lyons, has set out the rationale for his maiden trade visit to Monte Carlo, where he aims to champion the London market's expertise on cyber and climate risk to CEOs, and convene talks on ideas for a consolidated systemic risk pool.

After publishing a report on an unprecedented, multiple-market strategy to secure the long-term prosperity of the City of London, the Lord Mayor is focussing efforts on the London insurance market during the next week, highlighting the depth and breadth of its capabilities to the (re)insurance market but also to UK politicians.

Well connected in the London market, Lyons was Miller chair for eight years and remains on the board. He also has a seat on the board of Convex, chairing its audit committee, and previously worked with Lloyd's chair Bruce Carnegie-Brown at JP Morgan.

He is the first Lord Mayor with London market credentials to fly the flag for P&C and specialty insurance.

The Lord Mayor acknowledged however a limited sphere of influence of his conversations on whether global firms decide to place business in London. He also pointed out that he didn't want to cut across the lobbying activities of financial trade bodies such as the London Market Group and UK Finance, but moreover complement them.

He said: "London has a richer mix of international firms than any other city. There are more international firms with a branch or subsidiary here than any other financial centre so, as a representative and an ambassador for London's global financial centre, these companies are my constituents.

"Whenever I'm abroad, I'm there as an ambassador for the UK's financial and professional services and for London as a global financial centre. I talk to finance ministers, to heads of central banks, to the chairman or CEOs of sovereign wealth funds, banks, insurance companies and asset managers. I'm there to highlight the depth of expertise we have here."

London's cost and complexity issue

It was put to the Lord Mayor that, as his conversations with (re)insurer and global broker CEOs unfold, the cost and complexity of placing business in London will likely come up – however persuasive he might be.

He responded: "The cost of intermediation [in London] has always been an issue, it's something the industry has been wrestling with for some time.

"There is a constant desire to try to use technology more effectively, to see whether or not that can reduce the cost of intermediation. The truth is that London is as successful as it is because of the depth of expertise here. People recognise that Lloyd's in particular brings together an incredible mix of talent.

"It's the access to that and the ability to underwrite specialty risks on a tailor-made basis that makes London a standout centre. At the end of the day, people will be prepared to pay a premium for an outstanding service and a tailored product."

Lyons added however that the London market should always be looking at expenses and ways to reduce the cost of intermediation.

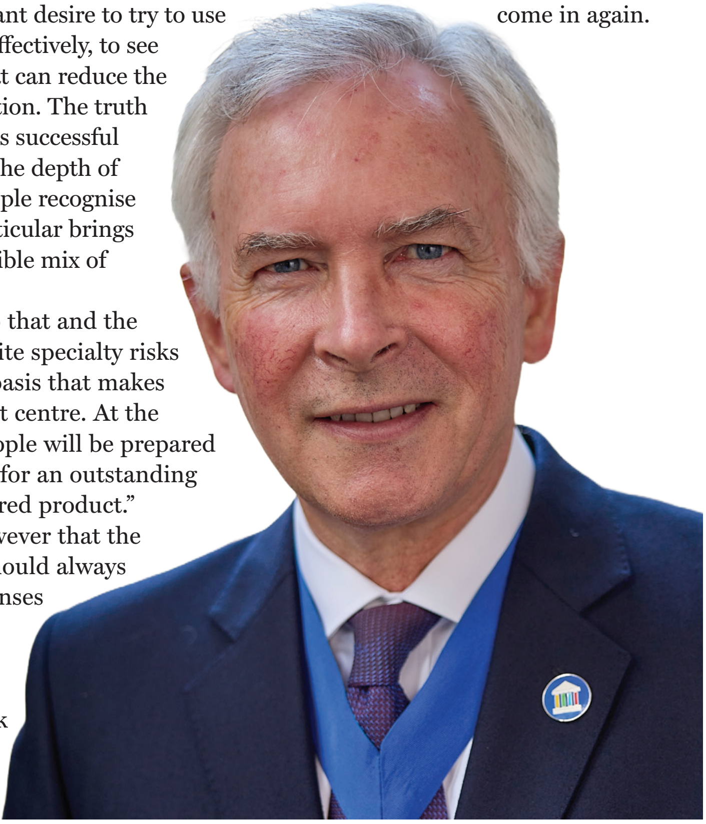
"But I don't think it's an existential threat," Lyons added.

Systemic risk pool

While at Monte Carlo, Lyons is aiming to showcase the breadth of climate risk expertise across the London market, but he's also aiming to engender conversations about a systemic risk pool.

"When you think about climate, about cyber and pandemic risk, these are areas where we need as an industry to have a blueprint of how the private sector interacts with the public sector. We know that the scale of [systemic] claims in any of those areas could bankrupt the private insurance sector."

In that context, Lyons said the UK needs structures in place for systemic risks with a government entity taking the first layer, the private sector taking the next three or four layers, and then at a next level, the government would come in again.



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He added: "When you look at a Pool Re or Flood Re, those are funded largely by premiums and if you don't have a lot of claims, you get a significant escalation of capital building up in these vehicles.

"So is it sensible, is it economic, to have three or four separate pools? Or is there a logic in saying, well, let's have one catastrophe pool, which could be incredibly well capitalised, that serves a purpose for climate, cyber or terrorism risk, where you'd have a more effective use of capital."

Lyons added that, at the time of the pandemic, many conversations played out between insurance executives in Bermuda, the US and London on the concept of a pandemic risk pool, but it never got off the ground.

Brexit barriers

Another aspect of the Lord Mayor's visit to Monte Carlo is to reaffirm London's competitiveness in the wake of Brexit.

Treasury ministers have been eager to capitalise on shedding some EU rules

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> **Lord Mayor of the City of London Nicholas Lyons**

to bolster the City's position, which has materialised in the various regulatory reforms and a new competitiveness objective for regulators.

While Brexit has forced some London market players to open branches abroad or in Europe, Lyons downplayed the level of its impact.

He said: "The London market is much more connected to the US and to Bermuda than Continental Europe. There's no doubt though that a lack of open access to Continental European markets, as a result of Brexit, meant that people have had to find other ways to write that business, by setting up a branch or subsidiary in Europe for example but from a P&C point of view, Brexit is a bit of a sideshow."

Despite Brexit upheaval and political turmoil in Westminster during the past 18 months, Lyons shared encouraging sentiments toward London from his meetings with the most powerful CEOs in the global financial sector.

On his first trip to New York in his role, he met Michael Bloomberg, BlackRock CEO and chairman Larry Fink, and Jamie Dimon, CEO and chair of JPMorgan Chase & Co.

"The question I put to them was, you've got huge investments of people and assets in London, but how do you see London, how important is it as a part of your global strategy? Every one of them said that London remains absolutely key for them.

"We're very bad at promoting ourselves... There are a hell of a lot of great things that we should be banging the drum about, because financial and professional services are a real jewel for this country."

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Q&A: Aon's Kelly Superczynski

Kelly Superczynski offers her perspectives on capital adequacy, the impact of inflation, and the changing ratings framework

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

Many insurers and reinsurers are experiencing reductions in capital adequacy. Capital has been declining over the past 18 months due to factors such as unrealised losses resulting from interest rate rises, equities market volatility and increased catastrophe losses from the recent frequency of events coupled with higher reinsurance retentions.

Persistent inflation is also continuing to impact capital. Companies need to buy more cat limit for the same set of exposures as structural repairs are more expensive. Loss ratios continue to tick up, and some companies are even reporting adverse loss development, as auto and building repairs simply cost more than plan – both labour and materials.

Further, the past year has been a pretty challenging renewal period for a lot of insurers, with reinsurers raising rates and insurers being forced to raise retentions – a lot of firms had to increase retentions on their property cat programmes.

This means that, in 2023, you still have this frequency of small catastrophe events, where a fair amount of exposure might have been ceded to reinsurers in the past, but now those losses are being retained by insurance carriers. It all combines to put further constraints on insurers' balance sheets and capital.

What about rating agencies? What impact do they have?

S&P, which for many insurance and reinsurance companies is currently the primary capital constraint, is changing its model. The implementation of that new model is likely towards the end of this year, and notably, the new model has softened those capital requirements for many companies.

For some insurance and reinsurance companies, AM Best is likely to be the capital constraint going forward, and we are noticing there is a learning curve to ensuring companies understand how their business risks, and how their strategic decisions, impact AM Best's capital adequacy calculation.

What should companies learn from the current challenges?

The lesson is that companies need diversified sources of capital. Over-relying on a single form of capital such as a quota-share treaty or a low-attaching catastrophe excess of loss, or relying on your own surplus or your own retained earnings, won't cut it. The current market volatility has exposed weaknesses in a number of balance sheets, so we're talking to our clients about the need for considered and diversified capital solutions.

How important is it for capital advisors to provide clients with a holistic outlook?

Holistic means understanding all available forms of capital, and it's essential that our clients are aware of the options available to them. There are a number of forms of capital available to insurers and reinsurers: traditional reinsurance, structured reinsurance such as legacy reserve sales or capital relief quota share, debt, and equity to name the obvious ones.

But clients should also examine alternative risk-transfer solutions such as catastrophe bonds or parametric covers and structuring solutions such as captives and internal reinsurance vehicles to support capital optimisation. We help clients to review a wide range of capital opportunities so they can make better business decisions.

What impact do legacy dynamics have on capital provision?

Legacy is becoming a bit of a misnomer because the transactions now often include both discontinued lines and, for a number of companies, active lines of business as well.

In this particular area of the market, there is actually material capital coming to support these transactions, which makes for an interesting dynamic when you compare it to the rest of the reinsurance sector where capital is entering at a trickle.

Reserve transfers entail insurance organisations handing reinsurers their assets and insurance liabilities, and the asset managers aligned with the reinsurers have the opportunity to invest a bit more aggressively than an insurance company because they are regulated in a slightly different way, which is how the reinsurers make most their profit on these transactions.

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

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

So, we're seeing a part of the market gaining momentum in order to support some of the more challenged areas.

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