FALL 2024 > > > > >

STATE OF THE MARKET

THE ALTERNATIVE VIEW

Artex

COMMERCIAL INSURANCE

AT A GLANCE

PROPERTY: There has been further relief for property buyers as 2024 has progressed, with premiums increasing at lower levels and carriers offering more capacity. Clients are seeing more stability at renewal, but some constraints continue to persist for the mid-market segment.

CASUALTY: Nuclear verdicts and larger settlements have become the new normal, with capacity and rates for liability classes reflecting a more selective approach on the part of carriers. Commercial auto liability remains extremely challenging.

CYBER: Competition has returned to the cyber insurance market after a reset period. The market has grown in maturity, with wording clearer on how policies will respond to claims.

D&O: Public D&O continues to see downward pressure and expanding terms and conditions. With plentiful competition and capacity and the IPO rebound proving elusive, supply and demand dynamics continue to favor insurance buyers despite the potential for severe losses.

THE BIG PICTURE: FURTHER RESPITE FOR PROPERTY BUYERS, BUT SOCIAL INFLATION IMPACTS CASUALTY LINES

The commercial property market has changed quickly since the last *Alternative View Market Report*. After posting strong results in 2023, incumbent insurance carriers have been actively pursuing growth throughout 2024 and offering additional capacity for catastrophe business. Some new capacity has also entered the market, introducing fresh competition.

During the first nine months of 2024, there have been three dominant perils driving natural catastrophe losses globally: flooding, tropical cyclone, and severe convective storm (SCS). Those perils alone accounted for 85% of economic losses through the end of Q3 2024, according to Gallagher Re. The USD87 billion in global flood-related losses were 19% higher than the decadal average (USD73 billion). Tropical cyclone (27%) and SCS (27%) were the only other perils that accounted for at least 10% of economic losses.. As a result, carriers continue assessing their appetite for secondary perils.

Despite some welcome relief in the property market after the significant contraction of the past few years, commercial insurance market clients continue to consider the full range of risk financing options, including parametric and captive solutions. While inflationary pressures are easing in property lines, brokers and insurers continue to emphasize the importance of maintaining up-to-date valuations and detailed renewal submissions.

Within casualty lines, continuing trends around social inflation, nuclear verdicts, and rising medical expenses are here to stay, with runaway claims hitting umbrella/excess layers more frequently and litigators using the threat of punitive damages to drive higher settlement amounts.

This is particularly the case within commercial auto liability, which remains extremely challenging. The impact of social inflation and the increasingly long-tail nature of auto liability claims continue to present issues around adverse loss development for several carriers.[1]

Within umbrella lines, carriers continue to restrict how much capacity they are willing to deploy. As a result, it is taking more carriers to complete an excess tower, premiums have increased, and insurance buyers are working with brokers to come up with creative buffer layer solutions. According to the CIAB, umbrella premiums increased by 8.6% in Q3 2024, the highest increase across all P&C lines of business.[2]

D&O continues to buck wider trends in the market, with the public D&O market remaining very competitive. Excess capacity in the market is putting pressure on underwriters that budgeted for growth. An uptick in claims frequency and severity could dampen the appetite of the newer, more opportunistic markets, with such "boom and bust" cycles having been witnessed before.

Competition has also returned to cyber, which is good news for clients and indicative of a growing maturity within the market. While a reminder of the potential for systemic risk, the global cloud outage in July[3] is not expected to be a material insurance industry loss event.

[1] "Inflation Boosts US P/C Insurers' Reserve Risk in Casualty Lines." *FitchRatings*, 12 Jan. 2024.
[2] Q3 2024 P/C Market Survey, *CIAB*, Q3 2024.
[3] Wood, Daniel. "CrowdStrike: Why Did Insurers Get off Pretty Lightly?" *Insurance Business*, 09 Aug. 2024.

GLOBAL REINSURANCE MARKET

AT A GLANCE

- Global reinsurance dedicated capital totaled $766 billion at half-year 2024, an increase of 5.4% versus the restated full-year 2023 base, according to Gallagher Re. Growth was driven by both the INDEX* companies and non-life alternative capital.
- A subset of 16 reinsurers shows the reported combined ratio further improved to 84.5% (2023 HY: 87.0%). The underlying combined ratio also continued to improve to 93.6% (2023 HY: 96.1%).
- The reported ROE remained exceptionally strong at 19.6% (2023 HY: 19.2%). The underlying ROE increased to 15.5% (2023 HY: 13.6%), supported by improved underlying underwriting margins and higher running investment income.
- Whether viewed on a headline or underlying basis, reinsurers' ROEs continue to comfortably exceed the industry's cost of capital.
- Overall, the industry is in a strong position to absorb any potential future volatility. This includes losses from Hurricanes Helene and Milton in the second half of the year.

THE BIG PICTURE: A WELL-CAPITALIZED INDUSTRY WITH AMPLE BUFFERS

Global reinsurers delivered another strong set of results in the first half of 2024, according to Gallagher Re, with an ongoing improvement in underwriting profitability, an exceptional return on equity (ROE), and a continued building of capital. Underlying profitability continued to excel due to a lower underlying combined ratio and higher recurring investment income. The sector's underlying ROE improved again markedly and remained well above the industry's cost of capital.

*The Gallagher Re INDEX group of reinsurers

As a result, the reinsurance industry is in a strong place and has ample buffers to absorb potential headwinds in the second half of 2024. This includes losses from Hurricanes Helene and Milton, in addition to other potential sources of volatility. At the time of writing, claims from the two storms were expected to cost re/insurers between $35 billion and $55 billion.

The sector's combined ratio improved by 2.5 points year on year to 84.5% as of H1 2024, as the percentage of natural catastrophe insured losses covered by reinsurers fell to 5.8% from 7.7%. It is the strongest combined ratio recorded since the Gallagher Re Reinsurance Market Report was launched in 2014 and was mainly driven by a lower attributional loss ratio and a lower load for Natural Catastrophe.

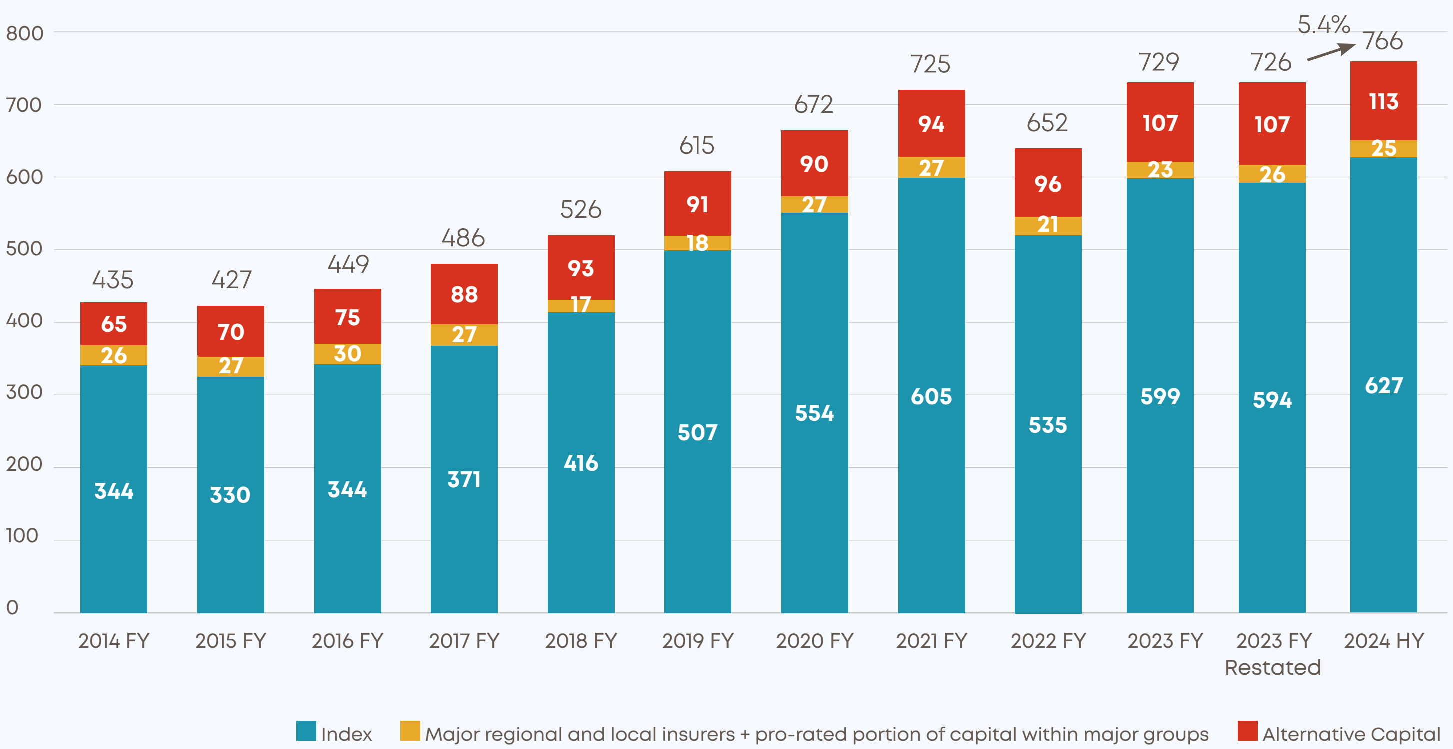
The reported ROE marginally increased to 19.6% as of the end of July 2024, reflecting improved underwriting results and higher running investment yields, putting the industry in a good position to absorb earnings volatility during the latter part of 2024.

After several years of reporting an underwriting loss, the return to profitability marks a period of improving sustainability in pricing across the sector.

That said, if interest rates continue to decline, this could lead to a reduction in running yields again over time. However, long-term interest rates would need to decline by more than 2 points from current levels for the underlying ROE over time to reduce to levels in line with the weighted average cost of capital, all else being equal.

REINSURANCE DEDICATED CAPITAL INCREASES FURTHER FROM PREVIOUS HIGH POINT

Total reinsurance dedicated capital (USD B)



Source: Reinsurance Market Report: Results for Half Year 2024." *Gallagher Re*, Sept. 2024. PDF download.

ALTERNATIVE RISK MARKET

AT A GLANCE

- Interest in alternative risk transfer solutions remains strong despite stabilizing US property rates and a general flattening across European and Asia-Pacific retail lines, particularly for cyber and D&O insurance.
- Rising healthcare costs are driving growth in group captive formations, with captive funding of employee benefits gaining momentum.
- Mature captives are exploring diversification into areas such as employee benefits, loss portfolio transfers to release capital for new business lines, and even parametric solutions.
- In North America, Alberta is gaining traction as a captive domicile, offering tax and proximity benefits over offshore locations, while Texas and Georgia are also growing in popularity. In Europe, Italy and Spain are following France's lead in promoting onshore captive formations.
- Captive syndicates are attracting interest, particularly from multinationals with Gross Written Premium (GWP) in excess of $30 million, with Lloyd's platform offering financial strength, global licensing, and a solid reputation.[4]

THE BIG PICTURE: CAPTIVE MARKET EVOLVING TO MEET DEMAND

The captive insurance market is rapidly evolving and is driven by regulatory reforms, commercial market conditions, and technological innovation.

Although property insurance prices are stabilizing in the US, challenges remain for buyers in catastrophe-affected areas, particularly those exposed to secondary perils such as SCS. Recent events, most notably Hurricane Milton, could negatively impact wholesale ratings in 2025, with overall market conditions prompting insurers to focus on specific industries and geographic locations to seize new opportunities.

"Health costs are skyrocketing for US companies, and they are looking at how to fund this differently. The concept of medical stop-loss insurance is gaining traction in the captive market, particularly for group captive solutions."

Barry White
EVP, Sales, Analytics and Advisory
Artex Risk Solutions, North America

[4] "Experts Say Lloyd's Captives Could Take Off This Year." *Davies*, 26 Jun. 2023.

> "Captives are becoming increasingly integrated into corporate risk strategies, regardless of market conditions. Instead of merely reacting to rising premiums, organizations are recognizing that captives offer a more adaptable, long-term solution that allows them to adjust as market conditions fluctuate."
>
> **Michael Matthews**
> Commercial Director
> Artex Risk Solutions, EMEA

Against this backdrop of commercial market uncertainty, a number of captive domiciles are attracting interest from insurance buyers. Alberta has emerged as the preferred domicile for Canadian firms interested in captive ownership, offering proximity advantages and potential tax benefits over offshore locations.

Meanwhile, US states such as Texas and Georgia are becoming popular hubs due to self-procurement tax variations. While Bermuda remains a popular captive domicile, taxation and travel considerations (especially post-COVID-19) are increasingly front of mind for prospective owners. Businesses are choosing onshore domiciles to avoid high out-of-state taxes, which can exceed 4.5%.

The rising cost of healthcare in the US has also driven the growth of medical stop-loss programs within group captives, which now account for 14% of the captive market. The proportion of group captives in the wider captive market is expected to grow nearer to 25% in the next four years.

With health insurance comprising around 7% of private sector employers' employee compensation costs,[5] a further increase in captive medical stop-loss programs seems likely. Two Department of Labor exemptions for funding employee benefits through captives indicate that ERISA-related benefits, such as life and disability insurance, could increasingly be included within captive programs.

In Europe and APAC, commercial insurance markets are softening, especially in sectors such as cyber insurance and D&O liability. Increased capacity is fostering competition among insurers, but with premium increases still outpacing inflation, buyers continue to be challenged by insurance costs, increasing the appeal of alternative risk transfer options.

Europe is experiencing a rise in captive formations, with Italy and Spain following the lead of France, which has seen 16 new captive formations over the past 18 months.[6] Additionally, the launch of the first Lloyd's captive syndicate under the Lloyd's Captive Syndicate platform is gaining is gaining industry attention.[7]

[5] "Employer Costs for Employee Compensation — June 2024." *U.S. Bureau of Labor Statistics*, 10 Sept. 2024. PDF download.
[6] Successful first year for French captive regime, but market eyeing further regulatory progress - Captive Intelligence
[7] Apollo launches the first captive syndicate of the modern era at Lloyd's – Apollo Group

Interest in cell captives is growing more widely, particularly in APAC, whether as a precursor to establishing a full captive, as a vehicle for running off legacy business from standalone captives, or from public sector organizations looking for a fast-to-market risk transfer vehicle. Cell captives also appeal to public sector clients and larger firms where the risk function is facing internal approval challenges to the establishment of wholly owned captives, but where a cell captive may enable transition to a full captive in the future.

Mutualization models are gaining momentum in Europe, especially in sectors such as housing and education, where public sector groups are pooling risks to enhance cost efficiency. However, issues around risk data sharing and intellectual property protection remain sticking points for some industry sectors.

Across all regions, mature captive owners are re-evaluating their solvency positions and considering risk diversification options. These include loss portfolio transfers to release capital for re-allocation to new business lines and integration of employee benefit programs to increase solvency capital. Captive owners are also exploring parametric solutions to address climate-related risks.

With pricing and coverage for casualty risks becoming ever more challenging due to social inflation, we anticipate a lot more discussion next year around captive participation in excess casualty programs to manage the increasing costs.

However, the biggest challenge for the captive industry is expected to come from regulation. Companies are re-evaluating domicile choices in response to the impact of new IFRS accounting standards on operational costs for jurisdictions including Malta, Singapore, and, to a lesser extent, Dublin. Meanwhile, the OECD's global taxation policy will have an immediate impact on Bermuda-based captives.

Institutional investors, particularly pension funds, are generally hesitant about allocating further in this asset class due to lingering structural limitations. However, there is interest in solutions, such as contingent capital structures, and we are working to solve the broader problems of trapped collateral by leveraging our size and diversification of client base with innovative products.

Scott Cobon
Managing Director, Insurance Management Services
Artex Capital Solutions

ALTERNATIVE CAPITAL MARKETS

AT A GLANCE

- The ILS market is undergoing a reset, with Bermuda-based reinsurers maintaining discipline as they prioritize long-term sustainability over short-term gain in a bid to reassure investors.
- An influx of capital into cat bonds and sidecars suggests investor optimism remains strong around these products. Still, long-term growth may require additional innovations, such as parental guarantees, to draw in institutional investors and improve returns
- Casualty collateralized reinsurance is gaining traction, driven largely by MGAs seeking additional capacity beyond traditional reinsurance channels.
- There is continued interest in the Lloyd's market as a means of diversifying property cat portfolios with casualty and specialty risks via structures that bring efficiencies for investors' backing Lloyd's syndicates, such as London Bridge 2 PCC.
- As the renewal season approaches, stakeholders anticipate a cautious outlook with sustainable terms and conditions and adequate risk/return pricing continuing.

THE BIG PICTURE: MATURING INVESTORS LOOKING TO GO TO THE NEXT LEVEL

While at the time of writing, the overall impact of the 2024 hurricane season has yet to be fully assessed, modeled estimates of market losses from the 2024 hurricane season suggest this will be an insurance and reinsurance earnings year rather than a reinsurance capital event, adding to the impression of another year of robust performance for reinsurers.

With reinsurance combined ratios in the 80s, substantial surplus capacity has been generated, which will need to be redeployed somewhere. Few, if any, new traditional balance sheets are being set up, and while there is more capital available in the ILS space, much of it has gone into cat bonds. However, there is some new interest from hedge funds and private equity in the space, presenting an opportunity in the market.

One of the key themes that emerged from the Monte Carlo Rendez-Vous in September was Bermuda reinsurers' intention to maintain discipline. While the ILS market in Bermuda had a successful year in 2023, the sector is focused on building a sustainable market that will convince investors of its ability to generate consistent returns over the longer term.

The efforts of portfolio managers to course-correct on attachment points and terms and conditions show their willingness to adapt and move towards sustainability. Nonetheless, some investors still view the private market sector with some caution and are conservative in their approach, with lingering concerns about uncertainty and volatility in the private ILS market.

Institutional investors are the most hesitant, likely due to losses incurred over the past seven years, exhibiting reluctance to invest further or expand existing investments until they are convinced that recent market changes represent a true reset.

However, institutional investors' willingness to find solutions for addressing structural risks is an indication that their involvement is entering a new phase, where they are seeking to evolve the way they deploy capital.

It has been estimated the ILS market could double in size to around $200 billion by 2032, according to analysts at one investment bank, who said conditions for "broad ILS market growth" included normalization of collateralization bid-ask spreads, growing demand for insurer protection, improved third-party modeling of weather perils, increased opportunities for expansion outside of the core North American market, and increases in other lines of business, particularly cyber and flood.[8]

[8] Evans, Steve. "ILS Market Has 'Meaningful Growth Opportunity' to $200bn by 2032: Jefferies." *Artemis*, 01 Oct. 2024.

> This market is undergoing a reset. We don't expect terms and conditions to soften, and while there might be some softening of pricing, I believe there's a strong commitment to maintaining discipline around a sustainable overall return on risk.
>
> **Kathleen Faries**
> CEO, Artex Capital Solutions

The cat bond space has seen exceptional growth, driven by an increase in new sponsors and investor interest, spurred by the exposure certainty, risk-remote structure, attractive insurance risk spreads, and collateral yields.

We are still seeing interest in casualty and MGA sidecar arrangements, and several entities are working on efficient ways to secure casualty. The need for accurate, real-time data to give investors comfort around casualty risk and duration is challenged by the industry's typical cycle of quarterly reporting. However, at Artex we are optimistic that there will be a shift over time of capital flows to casualty.

The desire for greater diversification is also driving interest in the Lloyd's market. Investors looking to balance property catastrophe portfolios with specialty and casualty coverage by backing Lloyd's syndicates, including interest in utilizing London Bridge 2 PCC.

Private quota share transactions and ILW capacity are also proving attractive to investors, demonstrating the growing overall interest in the ILS market as a source of diverse investment options for investors seeking diversification and access to different insurance market segments.

At Artex, we are hopeful that underwriting discipline will continue and ILS investors will regain full confidence in the sector's ability to perform and deliver acceptable returns over the long term. We anticipate that discipline on pricing will flex first, with attachment points and terms and conditions likely to hold firm for the most part for at least another 12 months.

The market is becoming more sophisticated and potentially more complex as investors are maturing and looking to take their participation to the next level. The industry will need to continue innovating and exploring new opportunities and alternative structures to ensure the continued growth and success of the ILS market.

THE **ART** OF **RISK**

At Artex, we believe there is more to alternative risk management. As a trusted leader and provider of diverse (re)insurance and ILS solutions, our global team operates at the intersection of art and science — where creative thinking meets expertise and superior outcomes are made. That's how we're able to fully understand our clients' needs and deliver the most comprehensive solutions available.

Established in more than 35 domiciles internationally, we're here to help you make empowered decisions with confidence, reduce your total cost of risk, and improve your return on capital. At Artex, we believe in finding you a better way.

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