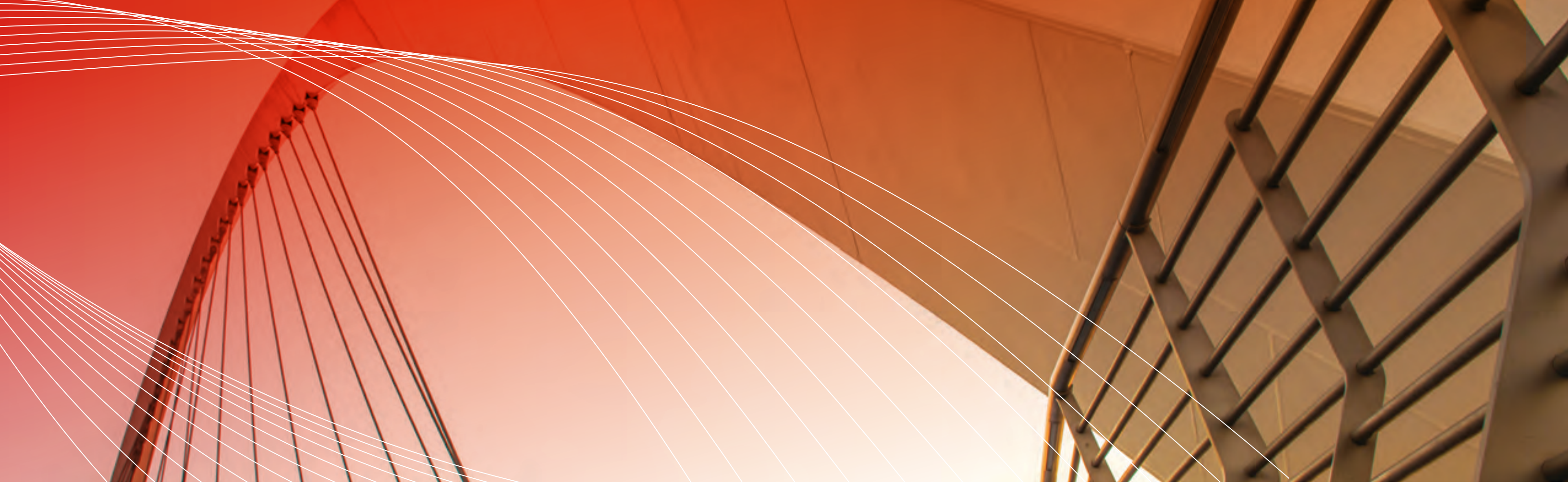
SPRING 2024 > > > > >

STATE OF THE MARKET

THE ALTERNATIVE VIEW

Artex



US COMMERCIAL INSURANCE MARKET

AT A GLANCE

PROPERTY: There has been some welcome relief for property buyers in the first quarter of 2024, with rate increases moderating and carriers offering more capacity. Clients are seeking more stability at renewal, but some constraints persist for the mid-market segment as well as for severely catastrophe-exposed risks.

CASUALTY: Carriers are maintaining discipline as they adjust to the "new normal" of heightened claims severity and brace for potential adverse loss development. Nuclear verdicts and larger settlements are more frequently hitting umbrella/excess layers, and, as such, insurers are being more selective and deploying smaller limits. Auto liability remains extremely challenging.

CYBER: Rates within cyber insurance are flat to down as competitive forces exert downward pressure on pricing. This is despite an increasing frequency of losses and growing exposure to AI-related cyber attacks.

D&O: The freefall in rates has begun to slow, but most insureds are experiencing a reduction in price at renewal. With plentiful competition and capacity, it is difficult to see when the cycle might start to plateau, unless incumbents are prepared to draw a line in the sand.

THE BIG PICTURE: SOME RESPITE FOR PROPERTY BUYERS

There was some slight respite for the property segment during the first quarter of 2024. This had been anticipated, with carriers posting robust financial results for 2023 and seeking growth in 2024. However, the speed at which pricing has moderated came as somewhat of a surprise after the difficulties of the previous year.

Insurance buyers are facing a more orderly and timely renewal, and there is less risk of non-renewal. That said, having experienced that pain during the course of 2023, they are continuing to explore all the options available to them, including captive insurance and parametric solutions.

We would expect pricing to continue to moderate over the course of the year, in line with what we are seeing on the reinsurance side of the business. While less of a concern than during 2023, inflation is still an issue and carriers expect to receive up-to-date valuation data as part of renewal submissions.

A major catastrophe loss remains a significant factor that could affect the pricing and availability of capacity. Currently, there are forecasts for an above-average North Atlantic hurricane season, while the ongoing El Nino continues to drive severe weather across the United States.

In the first quarter, severe convective storms (SCS) accounted for 34% of total economic losses from natural catastrophes. At USD15 billion, this was 63% above the ten-year average.[1] In an early start to the wildfire season, the Smokehouse Creek fire in Texas during February and March was the largest ever recorded in the state. More recently, Texas has experienced widespread flash floods.

Portions reprinted or adapted from Q4 2023 Insurance Market Report, Gallagher, March 2024.

[1] "Q1 2024 Gallagher Re Natural Catastrophe and Climate Report," *Gallagher Re*, 17 April 2024, PDF file.

IN CASUALTY, SOCIAL INFLATION IS HERE TO STAY

Within casualty classes of business, clients also continue to face plenty of challenges. The new normal of nuclear verdicts, social inflation, and an aggressive plaintiffs' bar are keeping the market firm. The first quarter marked the 26th consecutive quarter of P&C premium increases, according to CIAB.[2]

Depending on the industry and loss experience, capacity does, however, remain available, and there is more choice at renewal in comparison to what we have been seeing on the property side of the business. That said, carriers are being more selective and typically choosing to play in the higher layers of programs with the expectation that clients will further build their retentions and make use of captive insurance.

Portions reprinted or adapted from Q4 2023 Insurance Market Report, Gallagher, March 2024.

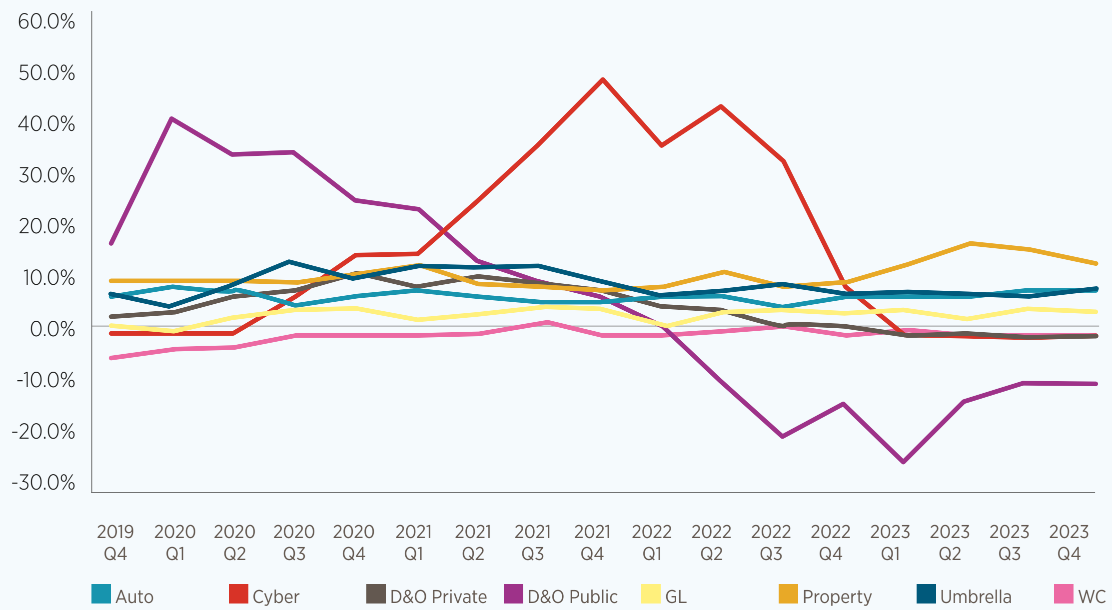
[2] "Q1 2024 P/C Market Survey," *The Council of Insurance Agents & Brokers*, 17 May 2024, PDF file.

On the umbrella side of the business, insurers are restricting how much limit they are willing to deploy. As such, it is taking more carriers to complete an excess tower. For larger, more complex accounts, there is a focus on using advanced actuarial and simulation modeling to drive optimal program structure. We are encouraging the creative use of self-insurance via captives and cell structures to introduce "buffer layers" and gain more direct access to reinsurance markets.

A question mark remains over prior-year reserve adequacy for the most recent casualty years, particularly within auto, where we are seeing a longer tail and increasing severity. Further adverse loss development will push underwriters to maintain a more disciplined approach and push for further rate rises moving forward.

Bucking wider trends within the wider property and casualty market is the softening trend within directors and officers (D&O) and the cyber insurance market. In both cases, the downward pressure on pricing results from high levels of competition in these markets and belies an uptick in claims frequency and severity.

MEDIAN YEAR-OVER-YEAR RATE BY LINE OF COVERAGE



Source: Gallagher

ALTERNATIVE RISK MARKET

AT A GLANCE

- Ongoing challenges in the US commercial property market continue to drive interest in alternative risk transfer solutions. We anticipate there will be further formation of property captives moving forward.
- While the capacity constraints in the property market have driven heightened interest in risk retention solutions, these are now a permanent tool in the tool chest, regardless of the market cycle.
- Even with rates starting to ease and capacity coming back into the US commercial property market, Artex anticipates that captive insurance will remain a long-term risk financing solution.
- We are seeing increased interest in group captive solutions in the middle market space for more difficult risks driven by some tightening of casualty terms and conditions. We expect this trend to continue.

THE BIG PICTURE: STRONG INTEREST IN CAPTIVES SET TO CONTINUE

The challenges experienced by many US and European property insurance buyers during 2023 have continued to drive demand for alternative risk transfer (ART) solutions, including single-parent captives, cell captives, and group captive programs.

In the US, a number of mid-sized corporate clients who had previously placed their insurance with a single carrier were faced with non-renewal as carriers reassessed their exposure to SCS and other extreme weather perils. As a result, many were forced into the excess and surplus lines markets, and there was pressure on retail brokers to create new programs, often at short notice.

Having had a year to ruminate on the challenges presented by a severely constrained property catastrophe market, insurance buyers have had time to explore the ART options available to them. As such, the demand for captive insurance remains high.

Clients want to remove the volatility and take more control. They see the long-term benefit of captives and how they can help manage risk. It’s a strategic approach for all market conditions.

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

Even as capacity returns to the commercial market and pricing and terms begin to ease, we would expect ART solutions to continue to feature more prominently as an essential part of companies' overall approach to risk financing.

In some of the more distressed classes of business, such as public sector institutions, agriculture, and transportation, captive and parametric solutions enable clients to secure coverage where it might not otherwise be available. We are also working in collaboration with brokers on the retail side of the business to provide more creative solutions, utilizing captives within different layers of program towers to access broader terms and offer clients a wider range of renewal options.

Among the trends for European clients is the uptick in interest in establishing onshore captives. Jurisdictions, including Italy, Spain, and the UK, are moving to introduce new pro-captive legislation. They are following in the footsteps of France, which licensed seven additional onshore captives last year (bringing the total number to 16), having introduced a new regulatory framework early in 2023.[3]

In addition to new formations, we see a continued move by existing parent companies to get more use from their captives by putting new, diversifying classes of business through their risk retention vehicles, such as cyber and employee benefits. In the case of emerging risks such as cyber, the captive can be used as an incubator to build up a clearer understanding of the parent company's risk profile over time.

Demand is also picking up for more European domiciles to offer protective cell company (PCC) legislation as the popularity of cell captives continues to grow. While European legislators have not gone so far as recognizing captives as a distinct class of insurance under applicable regulation, the European supervisor has agreed to take a more proportional stance towards "small and non-complex undertakings," a new class agreed upon by the Council of the EU and European Parliament in April 2024, which should encompass most European-domiciled captives.

Another trend of note is the growth in interest in mutual insurance, where solutions are not readily available within the commercial insurance market. It follows the successful incorporation of a cyber mutual in Belgium in 2022 by a group of European organizations. The global mutual and cooperative sector's share of the total insurance market rose to an eight-year high of 26.3% in 2022, according to data from industry body ICMIF.[4]

[3]Harrison, Luke. "Europe's 2023 Captive Highlights: More Domiciles, PCCs, Risk Portfolios Broadening," *Captive Intelligence*, 20 December, 2023.
[4]"New Global Mutual Market Share Research From ICMIF Reveals the Mutual Share of the Total Insurance Market Is at an Eight-Year High," *ICMIF*, 25 April 2024.

In Europe, we're seeing more interest in the mutualization of risk, where smaller organizations come together to create buying power and share risk.

Michael Matthews
Commercial Director
Artex Risk Solutions, EMEA

What we saw in 2023 and heading into 2024 was a significant shift in risk appetite around secondary perils and frequency loss perils. A tightening of terms and conditions and higher attachment points meant insurers were holding significantly more of this exposure on their own balance sheet.

Kathleen Faries
CEO, Artex Capital Solutions

GLOBAL REINSURANCE MARKET

AT A GLANCE

- The redistribution of risk between primary and secondary markets within property catastrophe re/insurance during 2023 stimulated a greatly improved equity story for reinsurers. Reinsurer valuations have significantly improved as a result.
- Global reinsurance dedicated capital totaled USD729 billion at full-year 2023; underlying return on equity (ROE) was up materially, from 12% to 14.3% for the year.
- The reinsurance industry combined ratio improved from 98.5% to 96%, making 2023 the reinsurance sector's strongest performance in the last ten years. This was driven by a light natural catastrophe load and improved investment income.
- Although reinsurance dedicated capital reached a new peak in 2023, capital growth over the past three years (+8%) has been outpaced by premium growth (+18%) as a result of both underlying demand and inflationary pressures.
- The most recent reinsurance renewals, on April 1, saw an increase in capacity available at the top end of programs and a slight moderation in pricing and terms and conditions.

Portions reprinted or adapted from 1st View: Heading Out of the Woods, *Gallagher Re*, 1 April 2024 and Reinsurance Market Report: Results for Full-Year 2023, *Gallagher Re*, 8 April 2024.

THE BIG PICTURE: HEADING OUT OF THE WOODS

Global reinsurers reported a significant improvement in underwriting profitability and ROEs in 2023, which supported an increase in their capital base. Many companies reported some of the best reinsurance underwriting conditions in over two decades. The radical redistribution of risk between primary and secondary markets in property catastrophe and specialty segments has stimulated a greatly improved ROE story for reinsurers.

Underlying ROEs were materially higher from 12% to 14.3% for the year due to a further reduction in underlying combined ratios and higher recurring investment income. On an underlying basis, the combined ratio continued its downward trend, from 98.5% to 96%, driven by a lower attritional loss ratio and normalized natural catastrophe load.

Portions reprinted or adapted from 1st View: Heading Out of the Woods, *Gallagher Re*, 1 April 2024 and Reinsurance Market Report: Results for Full-Year 2023, *Gallagher Re*, 8 April 2024.

Whether viewed on a headline or underlying basis, reinsurers' ROEs now comfortably exceed the industry's cost of capital. Given recent rate increases and reinvestment rates, it is likely that reinsurers' underlying ROEs will continue to trend upwards and remain meaningfully above the cost of capital.

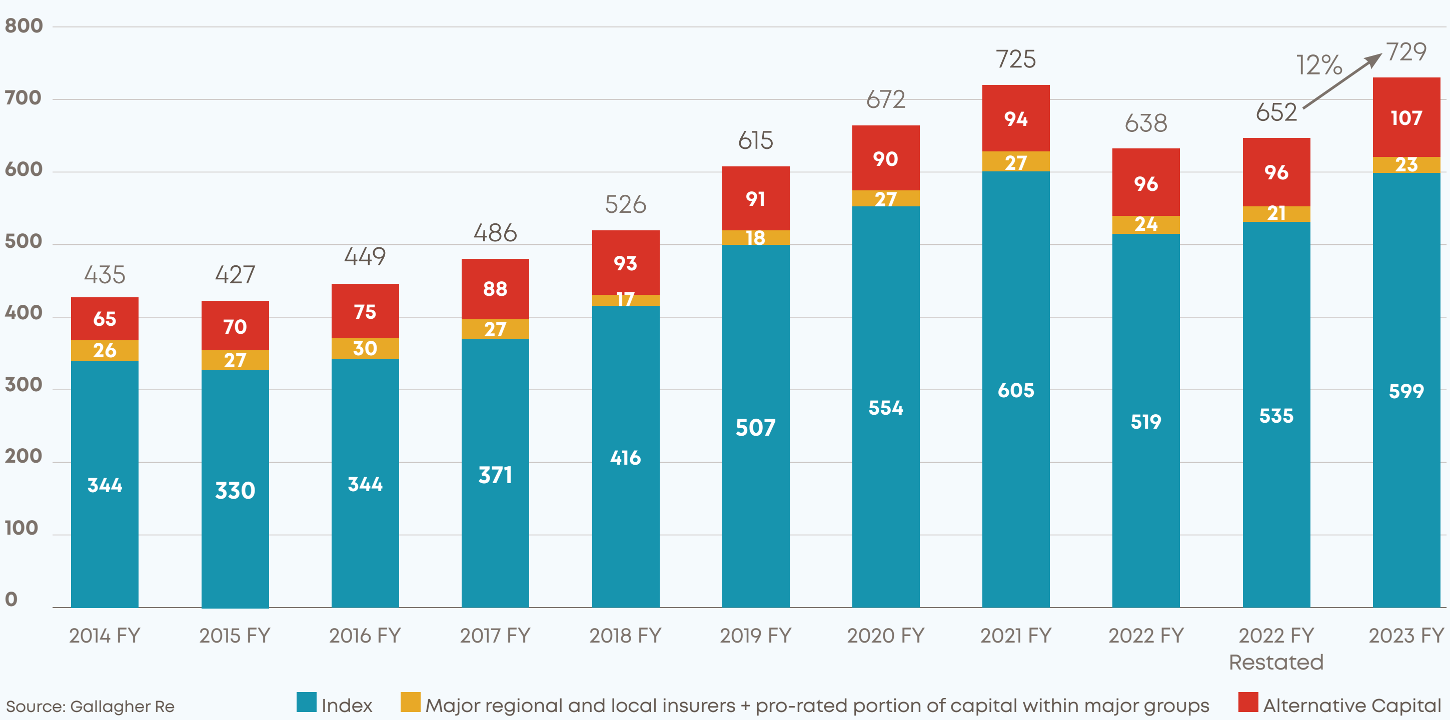
Global reinsurance dedicated capital totaled USD729 billion at full-year 2023, a rise of 12% versus the restated full-year 2022 base. Growth was driven by both traditional reinsurance companies and non-life alternative capital.

At the April 1 renewals, there was a continuation of reinsurance markets moving to "risk on" in the search for growth seen at the seminal January 1, 2024 renewal. This resulted in an increase of available capacity at the top end of programs and an incremental improvement in risk-adjusted pricing.

Moving forward, the combination of increased capacity coupled with increased appetite should lead to an easing of terms and conditions for clients.

REINSURANCE DEDICATED CAPITAL RISES, SURPASSING THE PREVIOUS HIGHPOINT OF 2021 FY

Total reinsurance dedicated capital (USD B)



Source: Gallagher Re

ALTERNATIVE CAPITAL MARKETS

AT A GLANCE

- Non-life alternative capital rose by USD11 billion, or 11%, from USD96 billion to USD107 billion in 2023, supported by growth in catastrophe bonds, which contributed approximately USD6 billion of the increase.
- The key drivers of last year's robust performance were retained earnings resulting from reduced loss activity and higher collateral yields, net inflows, and mark-to-market gains.
- While we have yet to see a significant major influx of new capital, we anticipate further improvement in pricing from a cedant perspective.
- Collateralized reinsurance continued to reduce on a relative share basis during 2023, in line with developments seen in 2022.

THE BIG PICTURE: RETURN TO STABILITY

Artex anticipates a promising shift in the reinsurance and insurance-linked securities (ILS) markets, characterized by a return to stability. The landscape is primed for a smoother reinsurance renewal cycle, with capacity coming back into the space. This signifies a renewed confidence among reinsurers and investors alike, and as the industry recalibrates, stakeholders can anticipate a more structured and balanced marketplace.

Investors continue to be attracted to the market due to its strong fundamentals. As a diversifying asset class, ILS and collateralized reinsurance offer liquidity and robust risk-adjusted returns. After a strong performance in 2023, Artex is witnessing a small uptick in interest from investors, including hedge funds and pension funds.

Established long-term ILS investors continue to actively engage with the sector, drawn by its stability and potential for strong returns. Concurrently, we are seeing some newer capital entering the market, which may be signaling a growing recognition of attractiveness across different investment strategies.

Portions reprinted or adapted from 1st View: Heading Out of the Woods, *Gallagher Re*, 1 April 2024 and Reinsurance Market Report: Results for Full-Year 2023, *Gallagher Re*, 8 April 2024.

Asset managers and hedge funds that may have previously invested in cat bonds as their first diversifying asset class may now be interested in private collateralized reinsurance.

Scott Cobon
Managing Director, Insurance Management Services
Artex Capital Solutions

Risk-adjusted returns are significantly up over the last 24 months and that has driven some nimble capacity into the ILS market, both in the form of collateralized reinsurance and cat bonds.

Kathleen Faries

CEO, Artex Capital Solutions

From a catastrophe (cat) bond perspective, the first quarter of 2024 unfolded with remarkable vigor, marked by robust issuance figures. For only the second time in the ILS market's history, quarterly issuance for Q1 2024 exceeded USD4 billion, and at USD4.23 billion, issuance was 30% higher than Q1 2023 and is above the 10-year average for the period by roughly USD1.1 billion.[5]

Although concerns surrounding trapped collateral and loss creep have been a feature in recent years, investors are ready to move on. Looking ahead, there is robust appetite for cat bond issuances focused on the peak perils. As investors recalibrate their strategies, they are drawn to opportunities that offer exposure to high-value perils, recognizing the potential for attractive risk-adjusted returns in these specialized segments of the market.

Despite the increased frequency and severity of secondary perils, their impact on the ILS market has been minimal, with only a muted effect on collateralized reinsurance, demonstrating its resilience in the face of an evolving risk landscape. This is due to the bulk of losses being absorbed within the lower layers of catastrophe programs as risk has been successfully redistributed between primary and secondary markets within the property catastrophe space.

A shift in attachment points and changes in terms and conditions could indicate a change in market dynamics, paving the way for softer conditions. Such adjustments often reflect evolving risk perceptions, regulatory changes, or shifts in investor preferences, all of which can influence pricing and overall market conditions.

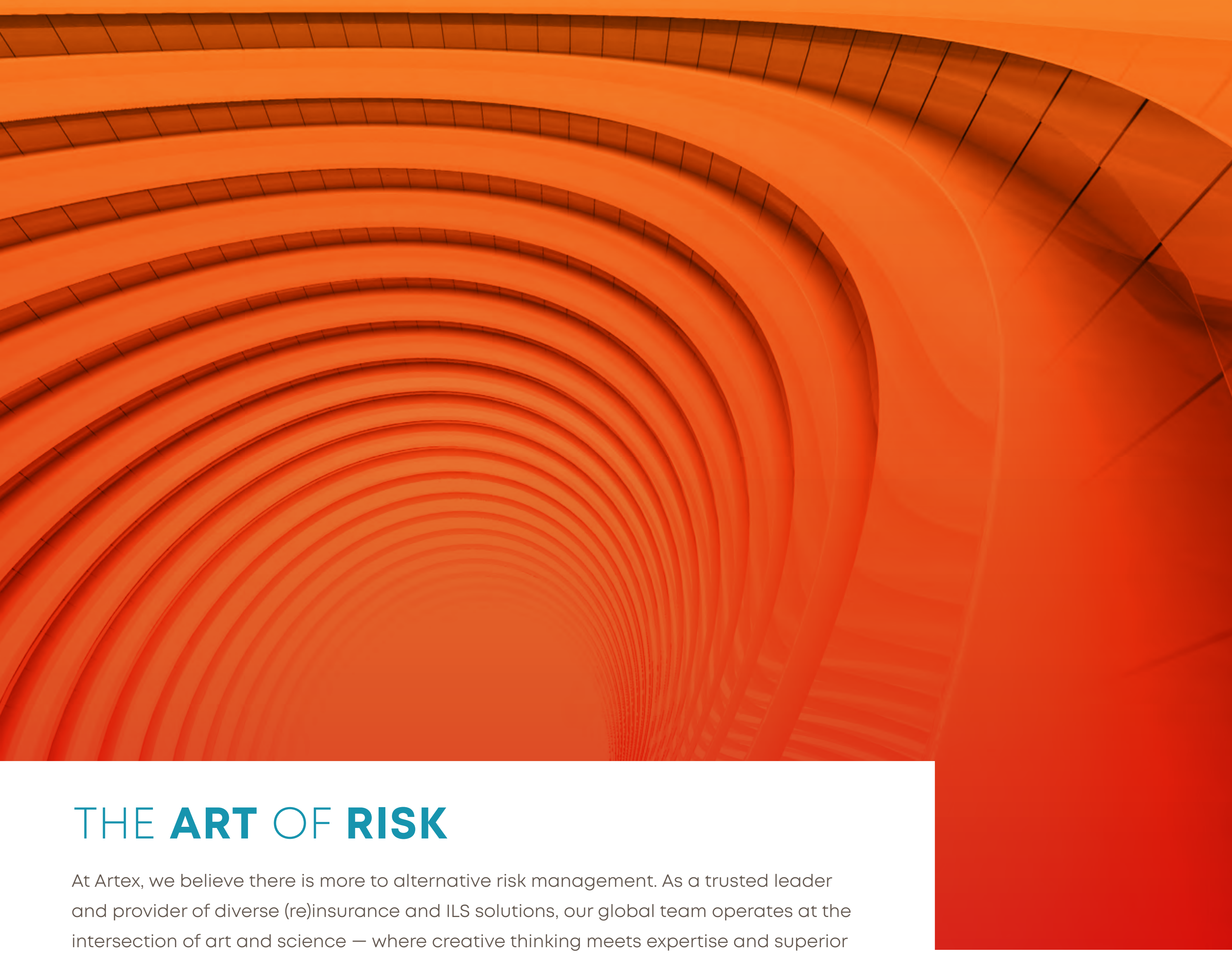
As and when attachment points start to shift, reinsurers and investors may need to reassess their risk appetite and strategies to adapt to evolving market dynamics. While we have not yet seen a significant influx of new capital, other than into some of the best-performing ILS funds, we would anticipate further improvement in pricing and terms from a cedant perspective as the year unfolds.

Current forecasts for the Atlantic hurricane season indicate above-average activity is likely,[6] intensifying cedants' focus on risk mitigation solutions within the ILS market. Given the anticipation of a potentially active season, hedging practices are gaining importance as a proactive measure to manage exposure to potential losses, and we are seeing a lot of interest in industry loss warranties (ILWs).

The outcome of the season will inevitably influence pricing trends and investor behavior, if the market is tested by a major loss and, in particular, if elements of that loss are unexpected/unmodeled.

Lastly, the impact of Moody's RMS version 23 is expected to negatively impact modeling output, especially for named windstorms in the Gulf Coast and Floridian regions. Anticipation of the new model release is already causing a tightening of cat bond spreads,[7] but it has not yet been widely adopted, and we expect to see more impact later in the year.

[5] "Q1 2024 Catastrophe Bond & ILS Market Report," *Artemis* (Q1 2024), PDF File.
[6] "Seasonal Hurricane Forecasting," *CSU Tropical Weather & Climate Research*, tropical.colostate.edu.
[7] Evans, Steve. "Cat Bond Spreads Widen in Secondary Market, RMS V23 Said Having an Effect," *Artemis.bm*, 8 May 2024.



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.

Artex

artexinfo@artexrisk.com
+1 630 694 5050
artexrisk.com