FALL 2023 > > > > >
STATE OF THE MARKET

THE ALTERNATIVE VIEW

Artex

US COMMERCIAL INSURANCE MARKET DYNAMICS AT A GLANCE

PROPERTY: Insurance buyers are becoming more creative to secure coverage in what continues to be an extremely challenging market, driven, in large part, by the hardening reinsurance market and elevated recent catastrophe claims.

CASUALTY: A more moderate market is emerging. Social inflation, nuclear verdicts, and rising medical costs are, however, being closely monitored.

CYBER: Cyber has been somewhat flat, however claims activity has picked up again, particularly in light of recent widespread ransomware losses.

D&O: Plentiful capacity continues to impact supply-demand dynamics, with public companies seeing rate discounts.

THE BIG PICTURE

In the commercial property market, many buyers are experiencing their most challenging market in at least two decades, but within the casualty and liability classes, they are seeing less challenging conditions. The hardening reinsurance market remains a key factor driving capacity constraints within property insurance, which remained pronounced during the market's mid-year renewals.

As anticipated, insurance buyers with coastal exposures and/or less desirable risk profiles (national/risk management size, tougher occupancies, outstanding recommendations, etc.) have experienced more difficult renewals. They have taken what coverage they can get, where it is available, and have been ready to consider the alternatives.

The latest Alternative View market report is set against the backdrop of continuing global macroeconomic and geopolitical uncertainty. The impact of inflation on property valuations continues to compound many of these pressures.

Meanwhile, severe weather events so far during 2023 are adding further pressure. This situation is being exacerbated by the withdrawal of capacity from certain markets as carriers reassess the profitability of the business.

Catastrophic risks are pushing certain insurance buyers into a much more challenging marketplace than anticipated. In addition to traditional modelled nat cat perils, losses from severe convective storms, large hail losses, and tornadoes so far in 2023 are driving double-digit rate increases.

There have been numerous natural catastrophe events during the year to date, with severe thunderstorms a major driver of insured losses[1].

With expectations that global natural catastrophe losses could once again exceed $100 billion in 2023[2], it is likely insurance carriers will continue to reevaluate their exposures to extreme weather events.

[1] Severe thunderstorms account for up to 70% of all insured natural catastrophe losses in first half of 2023, Swiss Re Institute estimates | Swiss Re

[2] Insured Losses From Nat Cats Set to Top $100B for 3rd Straight Year (carriermanagement.com)

At this stage, it seems likely the challenging headwinds within the property business will continue through the rest of the year and most likely into 2024.

At 2023 renewals, a lack of capacity from incumbent markets is pushing buyers to seek alternative options, with a surge of business into excess and surplus markets and an uptick in inquiries around captive solutions. Clients are becoming more creative, and captive insurance, risk retention, and parametric coverages are among the options being utilized.

CAPACITY RETURNS TO CASUALTY LINES

We continue to see more moderate increases within casualty; with the rate of price increase beginning to moderate overall.

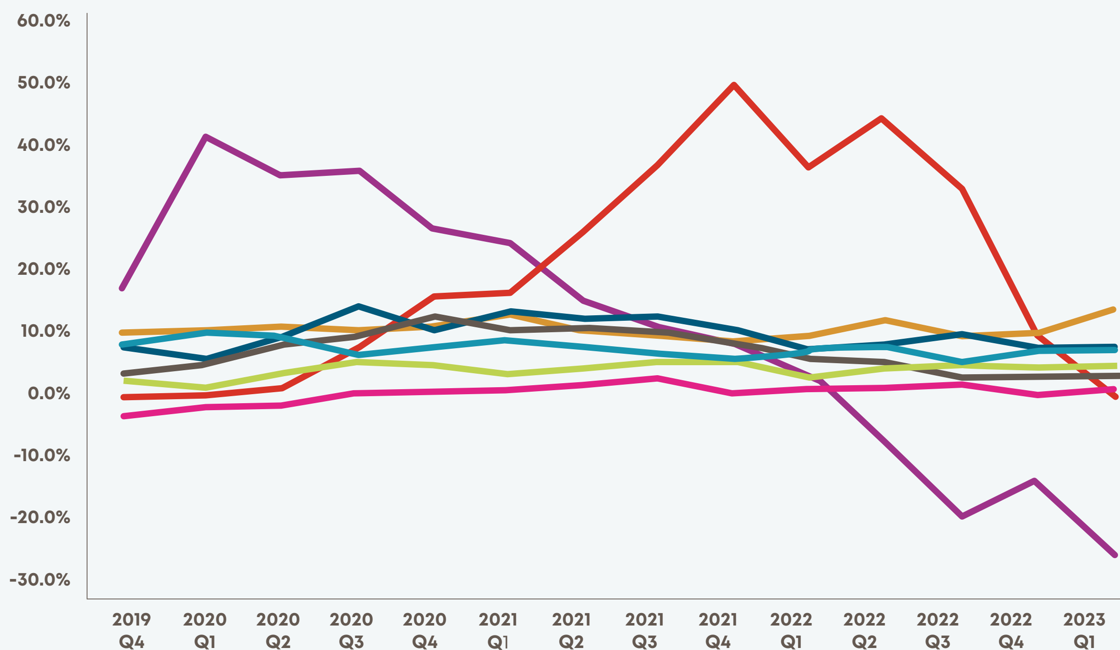
This reflects current supply-demand dynamics and reduced claims frequency. There continues to be a greater choice of markets at renewal, and capacity is also returning to mid-excess layers.

Social inflation and nuclear verdicts continue to influence casualty claims, and this should drive further rate increases going forward. Carriers are closely monitoring claims relating to emerging risk areas, most notably those involving PFAS chemicals and biometric privacy breaches.

Elsewhere in the market, we are seeing fewer constraints as capacity and competition return to umbrella/excess and D&O classes. Most accounts are renewing at flat to single-digit rate increases, with more options at renewal, albeit with exposures continuing to grow and higher pricing year-on-year.

Cyber insurance rates remain flattish for now, but with claims activity picking up and data breach losses from recent large-scale ransomware attacks continuing to increase, cyber insureds could see further price rises. Going forward, we anticipate rating adjustments as cyber carriers continue to get comfortable with the underlying risk they are assuming.

Median Year-Over-Year Rate by Line of Coverage



Source: Gallagher US Clients

REINSURANCE MARKET:

THE UNSEEN INFLUENCE

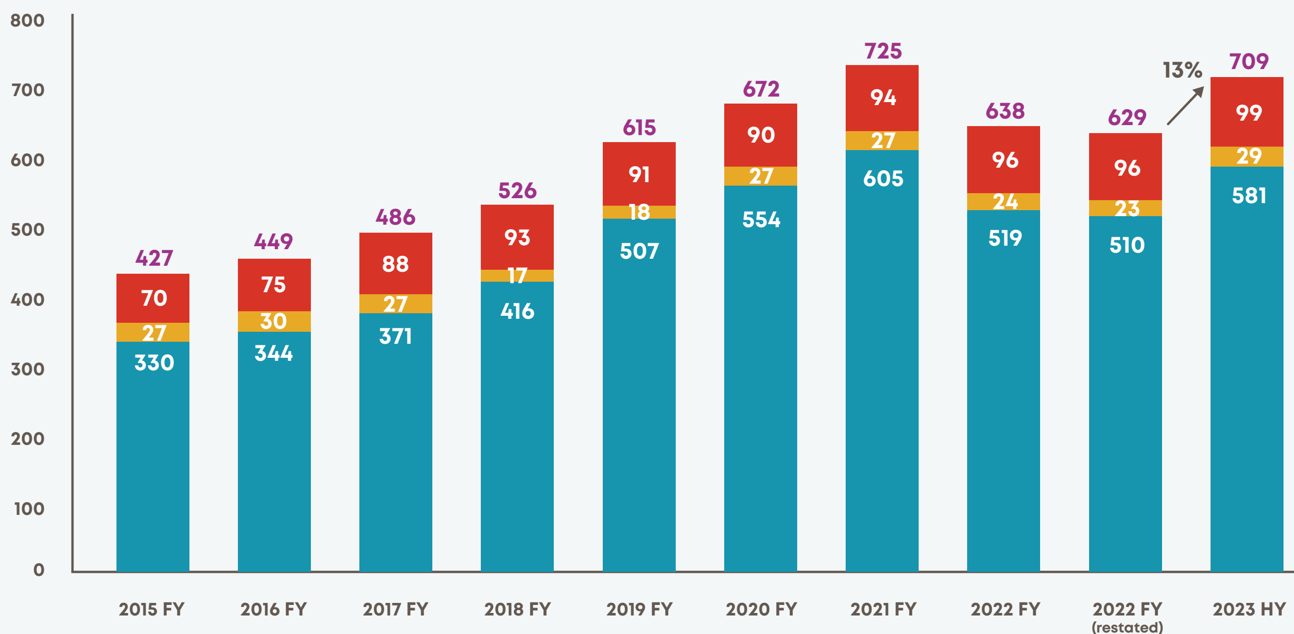
We remain in the midst of a perfect storm as far as property market dynamics are concerned, with the rising cost of reinsurance being the dominant trend.

Often described as a driving force, the reinsurance sector is experiencing its most dislocated market since 2005. This is having a direct impact on both how much protection carriers themselves can afford and, as a direct result, the limits they themselves are able to offer.

The hardening reinsurance market has been triggered by a series of major catastrophe losses – including losses in excess of $50 billion in relation to Hurricane Ian – and a lack of substantial new capital entering the market. Traditional global reinsurance capital declined between 2021 and 2022, but alternative reinsurance capital continued to grow.

Reinsurance dedicated capital increases but remains below 2021 FY levels

Total reinsurance dedicated capital (USD billion)[67]



Source: Gallagher Re ■ Alternative Capital ■ Major Regional and local reinsures + pro-rated capital within major groups ■ Index

PROPERTY:

INFLATIONARY IMPACTS CONTINUE

Global inflation and economic uncertainty are causing an increase in the cost of capital, driving up loss costs and adding to rising property rates. Supply chain backlogs are easing in comparison to 2022 but remain a factor when considering potential rebuild and restoration costs.

Generally speaking, the increased cost and uncertain availability of construction materials and labor are resulting in more downtime and business income losses, which are becoming a larger percentage of the overall loss.

Carriers are demanding up-to-date valuations where inflation has caused insurable amounts to rise, especially in regions that are exposed to natural catastrophes. This is in part due to additional concerns around the impact of a "demand surge" on loss costs following an event.

We are seeing an increased focus on inflation in all renewal discussions, with underwriters seeking to better understand how clients are determining the replacement value of their assets. Many of these are being updated for the first time in a while, and this is creating significant operational friction.

Clients who have seen values remain unchanged and/or unsupported are seeing their rates increase dramatically, a reduction in capacity offered and, in some cases, submissions falling to the bottom of the pile.

Increased values are, however, leading to more demand for all-risk covers and increased cat limits, further exacerbating the ongoing supply-demand imbalances in the property market.

CASUALTY:

RATE INCREASES MODERATING; EXPOSURES STILL UP

There is more competition in the low-to-mid layers of the excess liability placement, while the lead umbrella marketplace remains limited. More markets are willing to provide rate relief above certain attachment points in the excess liability tower.

Pockets that remain challenged include large auto fleets, New York construction (where state labor laws continue to pose a challenge), and certain parts of the real estate sector.

Auto liability rates have yet to stabilize, and there is no sign this will reverse anytime soon, as an increase in jury awards, general inflation, and the activities of third-party litigation funders continue to drive pricing upward. Supply chain disruptions and labor shortages have eased, but the cost of repairs remains much higher than in the pre-pandemic era.

Looking ahead, the combination of social inflation and nuclear verdicts will continue to shape how underwriters price the business, with the longer-tail nature of casualty claims bringing an additional layer of complexity.

However, the rate increases of the past three years have gone a long way toward creating a market that is more stable and sustainable from a carrier perspective.

Insureds are using all the tools at their disposal to minimize the impact of the hardening market, buying what they can this year and demonstrating a willingness to consider all the alternatives.

ALTERNATIVE RISK MARKET:

INSURANCE BUYERS SEEK OTHER OPTIONS

Looking ahead, clients continue to anticipate an extremely challenging property renewal and are resigned to the lack of wholesale capacity. Buyers are left with little choice but to retain more of the risk on their own balance sheets, opt for self-insurance, or seek co-insurance for certain layers.

More favorable renewal pricing and terms exist for clients with secure incumbent capacity and attractive risk profiles, including those with up-to-date valuations. Buyers with single, admitted carriers and a clean loss history are achieving a better result in the current market.

A strong risk profile helps prevent claims and losses, putting clients in a stronger position to manage costs and optimize their total cost of risk. Risk profiles can be improved through risk exposure reduction, implementing loss prevention programs, and selecting appropriate insurance coverage.

Insureds are using all the tools at their disposal to minimize the impact of the hardening market, buying what they can this year, and demonstrating a willingness to consider all the alternatives.

Existing captive owners are continuing to make more strategic use of their vehicles by using built-up equity to navigate through some challenging market conditions, particularly in property. These captive owners are benefiting from broader, more affordable coverage that is tailored to their risk profile and built up equity is allowing a buffer layer to be incorporated before transferring risk to the marketplace.

They are also gaining more direct access to reinsurance markets at a time when these relationships really count, as access to capacity is paramount. Buyers with captives are funding additional layers throughout their programs.

Meanwhile, the challenging market is pushing non-captive owners to explore risk retention solutions for the first time as they carry out due diligence on the various captive jurisdictions and structures and assess the set-up costs and time involved.

ALTERNATIVE CAPITAL MARKET:

SHIFTING AND REBALANCING

Over the past 12 months we have seen and felt the impact of the "rebalance" across investment portfolios. Institutional investors were managing mark-to-market bond portfolio losses that essentially threw off their asset allocations, and ILS was one of the asset classes that in many cases saw a reduced allocation given its performance over the last five to seven years.

This, coupled with some traditional markets losing their appetite for natural catastrophe volatility, has caused a tightening of capacity and a hardening of property catastrophe pricing.

The market impact has varied. On the buy side, we have seen increased deductibles and retentions, and sellers have pushed for tighter, more favorable terms and conditions. These conditions appear to be holding through the mid-year renewals.

The catastrophe (cat) bond market has seen an increased interest from investors throughout 2023. We continue to see capital moving from the collateralized reinsurance higher expected loss layers into the cat bond market where typically the expected loss is lower.

That said, Artex Capital Solutions has seen a 17% increase YOY in the overall assets we administer across the ILS Fund space. The story here is more about the move to cat bonds, and pushing for better, more sustainable terms, rather than reductions in the overall capital invested.

The sidecar market is continuing to see modest growth during this rebalancing phase. Almost all reinsurers currently have access to a dedicated sidecar facility, which continues to be an attractive option for off-balance-sheet capital for many.

Even with a major event such as Hurricane Ian, the 2022 vintage of sidecars has fared reasonably well, with returns typically ranging from a small loss to high single-digits. Meanwhile, mid-year incepting deals partially benefited from the significant rate increases from January 2023.

The story here is more about the move to cat bonds and pushing for better, more sustainable terms, rather than reductions in the overall capital invested.

Some existing investors are taking advantage of the improvement in terms and conditions over the last 12 months in keeping with or increasing their investment allocations.

Increases in allocations from existing investors have occurred particularly where there has been a good track record and a proactive strategy for maximizing return and opportunity in this market. New investors to the asset class have been limited and mainly coming from family offices, high net worth individuals, and hedge funds.

There is still interest in finding a sustainable and efficient way to invest in non-nat cat lines of business. Lloyd's and London Bridge 2 offer more efficient access to Lloyd's syndicate business for third-party investors, for instance. This is sparking interest from investors who are interested in accessing specialty lines, with the inherent leverage of the Lloyd's infrastructure proving an additional draw. If we are going to expand the asset class, these type of initiatives are important.

Securitizing cyber risk has also been a topic of discussion in 2023. There is no doubt that capital markets are best placed to step in where there is a significant capacity need that the traditional market is unable to fully meet. However, capital market investors, just like traditional markets, need to become much more comfortable with their ability to properly structure, analyze, and price cyber exposures before committing large sums of capital to this risk.

This will happen with time, loss events, and investment into models, as it did with property cat. There were a handful of private deals done in 2023 thus far, and we would not be surprised to see a public issuance before year-end or early 2024.

Artex Capital Solutions will continue to support and facilitate the efficient and well-managed access to risk for investors across the industry

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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