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REINSURER OF CHOICE

PERSPECTIVES

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AN OVERVIEW OF 2019 & A LOOK AHEAD TO 2020:

A continuously evolving insurance and reinsurance market

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Introduction

2019 and beyond were destined to be challenging for global reinsurance, coming on the back of record catastrophe years in 2017 and 2018. Many market players pondered whether market-wide hardening was finally going to take hold. Despite the pre-renewal discussions at conferences such as Baden-Baden or SIRC hinting at hardening, Trust Re's market insights indicate that these expectations have again fallen short of reality - at least in the Afro-Asian territories. Additionally, a clear disconnect has developed between Facultative and Treaty reinsurance business: traditionally, hardening took place in Treaty before affecting underlying insurance business; currently, however, the market is experiencing a U-shaped curve with Insurance, Facultative and Retrocessional business showing increased pricing, while Treaty pricing is largely unchanged.

As a customer-centric company supporting the (re)insurance industry in Asia, the Middle East and Africa, we highlight key trends identified during 2019 from both a global and proprietary perspective, and offer our take on the factors most likely to characterise 2020.

A Multifaceted Market

According to major reinsurance broker Guy Carpenter[1], reinsurance renewals at 1 January 2020 were shaped by deteriorating loss experience, a lack of new capital inflows and increasingly challenged environments in the primary insurance and retrocession markets. Outcomes varied significantly by geography, line of business and cedent. The market can be seen as somewhat multifaceted; in lines of business where underlying performance remained positive and profitable, renewal terms and conditions were as expiring, or in some cases, even showed modest rate decreases. On the other hand, significant rate increases were seen in specific markets - typically as a result of either successive years of losses, a deterioration in underwriting performance or a shifting perception of risk. These changes in risk appetite have resulted in the reduction, or complete withdrawal, of capacity from these markets – a significant shift from the general trend of the last decade typified by excess capacity.

[1] https://www.gccapitalideas.com/2020/01/02/january-1-2020-reinsurance-renewals-reflect-asymmetrical-market/

The Trust Re Perspective

Since July 2019, Trust Re has witnessed an upward trend in rate increases for industrial Facultative business, especially in the Energy and Power sectors. This was due to a series of large losses around the world impacting these sectors over the past five years, and more specifically to a few very large market losses in the Middle East. Moreover, a contraction of capacity in Lloyd's (including the closure of some syndicates), stricter controls by underwriters on the deployment of capacity and an overall increased focus on profitability have helped produce at least 15% rate rises on loss free accounts and in some cases over 100% for accounts with losses.

However, commercial property risks (which tend not to be capacity driven) have only seen modest rises. Instead, there have been greater restrictions imposed on cover and conditions for accounts with losses. Nevertheless, the deteriorating results in this sector have resulted in some restrictions in capacity as well as leading to stricter applications of terms and conditions. This phenomenon is quite apparent in India, where domestic reinsurers have significant influence in the market.

Pricing of Construction and Specialty lines has remained mostly flat, with modest rises on loss-making accounts or infrastructure projects. However, coverage for extensions on construction projects (especially infrastructure and civil works) has come under some capacity and pricing pressure due to elevated loss frequency in recent years (especially in the Middle East).

Terms on non-Specialty Proportional Reinsurance Treaty business did not see much change, either in commissions or in restrictions on coverage provided, but there has been increased resistance to unnecessary growth in capacity. On the other hand, Proportional placements on Specialty lines such as Energy were extremely difficult to finalise; the lack of reinsurance support for Specialty lines forced some companies either to discontinue covers altogether or opt for more XOL placements (where pricing was significantly increased).

For Non-Proportional Treaty business, we have seen rate rises of about 5% on average, with more on loss-making accounts. The biggest increases have been on Treaties exposed to Energy and Power business due to two main factors: the risk appetite of several major capacity providers has gone down, resulting in smaller line sizes; and previously-substantial regional market reinsurance capacity has reduced. This reduction in supply in the face of the continued demand for capacity has naturally resulted in pricing increases.

At this point, Trust Re does not expect to see continuing significant changes in its key markets during the first half of the year, although there will definitely be continued upward pressure on catastrophe-driven accounts. The renewals in April and July (many having substantial catastrophe exposures) will confirm this.

A Firming Market

Overall, we are in a “firming” but not yet fully “hardening” market. Significant variations in pricing and capacity continue to cause divergence, largely depending on the loss record, product line, risk location and individual client relationships[2]. The 2017 and 2018 catastrophe losses were definitely a precursor to an increase in rates and a tightening of terms, but as we have seen, this did not happen across the board.

Containment of cost is key

Since 2018, reinsurers have proven quite resilient in the face of substantial market losses but as a result (and as noted by WTW in its review of the 1.1.20 renewals), have become much more judicious in terms of how they allocate capital[3]. This trend is exemplified by the general pullout by many reinsurers from the Marine line of business due to the underperformance of this market segment. This same shrewdness and conservatism continues to impact traditionally volatile lines of business (such as Aviation), as higher- volatility business incurs larger capital charges – which then need to be factored into the rating of this business. These actions are indicative of reinsurers’ drive to improve margins through both increasing rates and reducing operating costs.

Risks on the horizon

The management of “emerging risks” is another factor which may in future substantially impact the reinsurance market and affect overall pricing. Quantifying the likelihood and impact of emerging risks is often very difficult because losses have rarely (or never) happened; therefore, modelling and pricing these risks is quite difficult.

We currently see this with ILS business; not only has there been a slowdown in the issuance of new ILS since the large market losses of the last few years, but also, as we discussed in our article *“The Convergence of Reinsurance and Alternative Capital: Supporting Insurance Demand”*[4] published in November 2018, there has been a certain amount of frustration from reinsurance buyers because ILS structures require a significant amount of risk assessment and modelling which may not be available for many lines of business or territories for some time, if ever. Modelling is currently limited to certain lines of business, for example CAT.

Additionally, investors need modelling for comfort yet such modelling is not always available or it lacks accuracy. Accordingly, more traditional reinsurance structures will continue to play a key role where ILS is not a viable option.

The Society of Actuaries (SOA)[5] has identified a list of the major emerging risks through a survey they have conducted in recent years. As can be clearly seen in the table below, Cyber/networks has been identified as the top emerging risk in three out of the four years. This is concerning, given the substantial protection gap (some observers believe almost 100%) in cyber insurance coverage and the growing interconnectedness of various entities along the insurance / reinsurance value chain.

2 https://www.willistowerswatson.com/en-CA/Insights/2020/01/willis-re-1st-view-january-2020-markets-diverge

3 https://www.willistowerswatson.com/en-CA/Insights/2020/01/willis-re-1st-view-january-2020-markets-diverge

4 “The Convergence of Reinsurance and Alternative Capital: Supporting Insurance Demand” Planning & Performance Management Department Trust Re, November 2018 https://www.trustre.com/en/home/perspectives_details?id=47

5 https://www.soa.org/resources/research-reports/2020/13th-emerging-risk-survey/

Top Five Emerging Risks, 2016-2019

Year	2016	2017	2018	2019
1	Cyber / Networks	Cyber / Networks	Cyber / Networks	Climate Change
2	Financial Volatility	Terrorism	Climate Change	Cyber / Networks
3	Terrorism	Disruptive Technology	Disruptive Technology	Disruptive Technology
4	Disruptive Technology	Regional Instability	Demographic Shift	Demographic Shift
5	Retrenchment From Globalization	Asset Price Collapse	Financial Volatility	Financial Volatility

Trust Re's approach to managing emerging risks includes the identification, assessment, monitoring and reporting of such risks for better preparedness[6]. The key is always to avoid surprises and (to the extent possible) pro-actively assess the Company's risk appetite and pricing of these risks. Trust Re's emerging risks analysis has identified the below risks that could have potential impacts on the Company in the medium to long term. Some of them also present opportunities for the Company to deploy its expertise to build resilience:

GCC Shale Production

A growing phenomenon estimated by British Petroleum (BP) to account for nearly half of the growth in global gas by 2035. The GCC is known to have adequate shale gas and shale / tight oil deposits across several regions, which the respective governments are investigating. Given that the Energy line of business represents a large portion of Trust Re's underwriting portfolio, the ambitions of some GCC countries to exploit their own shale reserves could be an opportunity that Trust Re can cater for. Trust Re is following developments in this arena closely.

Blockchain Technology

Blockchain, a continuously growing list of records, called blocks, which are linked and secured using cryptography. The potential opportunities of Blockchain technology in insurance are very broad and the material impact on the value chain is vast. The Blockchain Insurance Industry Initiative (B3i), a collaboration of insurers and reinsurers including Trust Re, was formed to explore the potential of Blockchain on the industry and its benefit for stakeholders across the insurance and reinsurance value chain.

Nanotechnology

A multidisciplinary field covering a vast and diverse array of devices derived from engineering, biology, physics and chemistry. Nanotechnology can impact multiple lines of business including Life and Health, Energy and Engineering (Trust Re underwrites each of these lines).

Artificial Intelligence

Finance and insurance sectors are prime candidates for the automation offered by intelligent learning systems, given their reliance on large amounts of data and figures. Recognising the emerging opportunity and competitive advantage that Artificial Intelligence can present, Trust Re has entered into an agreement with Bahrain FinTech Bay to promote InsurTech and emerging technologies through joint events, hackathons, thought leadership and research.

[6] "Emerging Risks Management" Actuarial & Risk Management Department Trust Re, September 2018
https://www.trustre.com/en/home/perspectivesdetails?id=41

Climate Change

Particularly serious with regard to its impact on changing weather patterns and triggering extreme weather events. The Company's widepread business portfolio can expose it to potential natural catastrophe threats due to climate change and global warming; in response to which various controls are implemented to manage current exposures.

Cyber Risks

Have consistently appeared at the top of the list of emerging risks for the past several years. The critical role of increasing interconnection and digitisation in the Energy sector represents a highly attractive target for cyber attacks.

Business Interruption

A growing trend over the last several years, with Energy, Alternative Energy, Property and Engineering sectors particularly exposed - these lines represent a significant portion of Trust Re's underwriting portfolio. The future implications of COVID-19 on business interruption coverage are discussed later on in this article.

Risk of Stranded Assets

Defined as *"assets that have suffered from unanticipated or premature write-downs, devaluation or conversion to liabilities"*[7]. Stranding of assets can have direct and indirect knock on effects on various segments of the economy and affect the (re)insurance industry too.

Shifting Perspectives

As we look to the future, it is clear that it is not only losses which will turn the market. Other factors will no doubt come into play as well including the manner in which risks are assessed, adjustments in risk appetite and other market conditions. Furthermore, financial, regulatory and technological developments such as IFRS 17, Solvency II and especially FinTech will continue to push the sector to evolve.

Product and service innovation as well as customer-centric business models will be key to remaining competitive in a transforming market.

[7] Stranded Assets: the transition to a low carbon economy. Overview for the insurance industry, Lloyd's, 2017.

COVID-19 Pandemic

Certainly, the insurance and reinsurance market is constantly evolving; it needs to evolve as our world evolves and exposure to risk changes. The COVID-19 pandemic is a timely example of an evolving story which has an impact on a wide range of areas including morbidity, asset management and operations.

It may also be a precursor to broader scope of coverage under certain policies. For example, business interruption policies are typically triggered by property damage resulting from an insured peril. Given that COVID-19 is a new virus, it does not currently feature clearly as one of a number of specific[8] infectious diseases which could also activate business interruption coverage, aside from possibly inflicting claims due to operational issues with clients trying to manage an unusual event.

The personal and social impact of COVID-19 has already been devastating with many lives lost. Estimating the economic impact of this unforeseen phenomenon is hugely challenging given the relatively unknown nature of the virus and lack of precedent in recent history. For us, as insurers and reinsurers, we must be dynamic and respond appropriately to this crisis to improve the resilience of economies and societies in the future.

One thing for sure is that after the COVID-19 global pandemic, the market composition, dynamics, modelling and unusual event risks will be different.

[8] https://www.axa.co.uk/coronavirus/business-insurance/

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