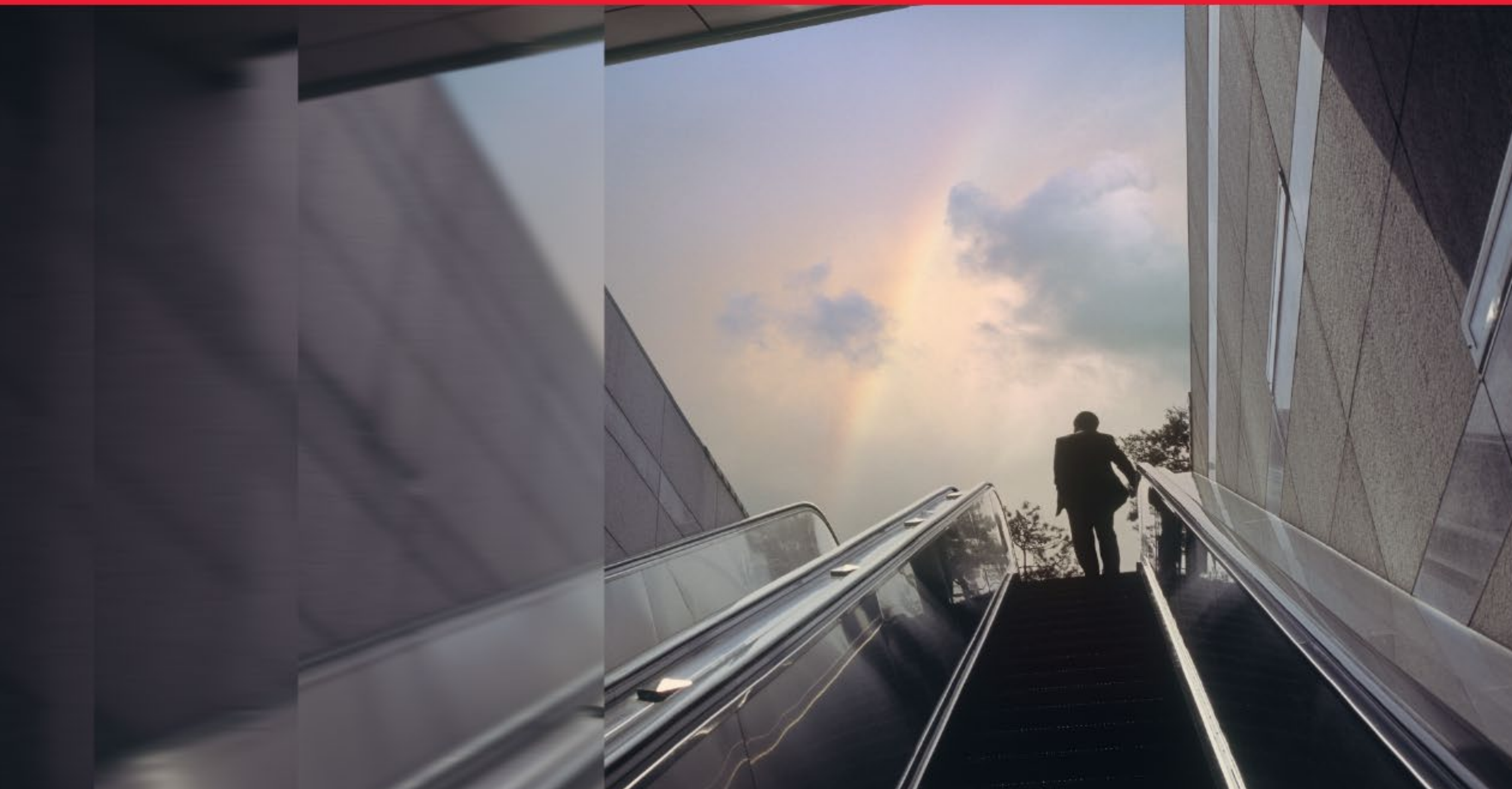
Ultimate Guide to the Reinsurance Renewal

Strengthen Relationships for Collective Success

Reinsurance Renewal Season 2023
Making Better Decisions



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About the Report

Aon's Ultimate Guide to the Reinsurance Renewal provides a comprehensive assessment of key market dynamics looking ahead to the January 2024 renewals period. Commentary on global reinsurer capital, alternative capital and rating agency perspectives on the macroeconomic environment offer insights on the potential direction of the global (re)insurance industry and future renewals.

Reinsurance Renewal Season Virtual Platform

Aon kicks off the reinsurance renewal season with a virtual platform to help you stay up to date with all our events. From our panels to thought leadership, our virtual platform provides re/insurers with all the latest updates from Aon's reinsurance renewal season. Register for the virtual series for more insights.

AON

Executive Summary: Strengthen Relationships for Collective Success

In the absence of a significant catastrophe event, the January 2024 renewals are expected to be more orderly than the prior year, with supply and demand largely in balance.

Following the reset in property catastrophe pricing and retention levels in January 2023, subsequent renewals in April, June and July were more predictable, as reinsurers re-established their risk appetite and insurers successfully navigated the changing market dynamics.

Capacity has grown steadily this year, with capital entering the market via third party investors aligned with traditional reinsurers, as well as through insurance-linked securities (ILS). The rebound in the ILS market provides a key supply-side driver in the property catastrophe space, while the delta in pricing sends a clear signal to the traditional sector.

Aon estimates that global reinsurer capital has increased by 10.7 percent, or $60 billion, to $620 billion since the third quarter of 2022, principally driven by retained earnings, recovering asset values and new inflows to the catastrophe bond market. While the trend is encouraging, there is some way to go before previous levels are attained.

Market reset triggers increased reinsurer appetite

The reinsurance market is now in a more sustainable position ahead of the January 1 renewal, with rate adequacy for property catastrophe and strong investment returns already driving better results in the first half, despite above average industry natural catastrophe losses. The average annualized return on common equity for reinsurers that Aon tracks was 17.7 percent, up from only 1.2 percent in the prior year period, albeit on a diminished capital base.

Two quarters of higher returns, however, are unlikely to be sufficient to satisfy investors, and we would expect reinsurers to remain disciplined for the foreseeable future. While capacity is sufficient to meet current demand, it is also worth noting that industry sub-sectors are at different stages of the market cycle. Some loss-affected markets could face capacity constraints at January 1, although portfolio dynamics have dictated different results, especially for diversifying regions, in the past.

That said, reinsurers are now demonstrating increased appetite for property catastrophe business, particularly for middle to higher layers. There are still some challenges in placing lower layers, where insurers' needs are greatest, but there are also significant opportunities for reinsurers to be viewed as long-term strategic partners at these attachment points.

The casualty reinsurance market also remains attractive to reinsurers, underpinned by underlying rate and improved investment returns. Casualty capacity is buoyant, yet reinsurers remain disciplined in the face of economic and social inflation, and prior year loss development.

Natural catastrophe frequency remains a challenge

High frequency weather-related catastrophe activity continued in the first half of 2023, in particular from modeled secondary perils. Insurers incurred, and largely retained, $56 billion in losses, some 54 percent above the 21st Century average of $36 billion, according to Aon's Catastrophe Insight.

The dominant factor was severe convective storms in the U.S., which caused an estimated $38 billion[1] in insured losses. The principal reinsured events were the earthquakes in Turkey and Syria and two back-to-back billion-dollar flooding events in New Zealand.

The trend continued into the second half, with the devastating wildfires in Hawaii in August, which destroyed over 2,200 buildings with preliminary insured loss estimates ranging from $2.5 to $3.0 billion of damage according to Aon. In the same month, California was hit concurrently by an M5.1 earthquake and the first tropical storm since 1997, which brought record-breaking rainfall and flooding.

Reinsurers' results in the first half of 2023 provide early evidence that the market has successfully distanced itself from frequency catastrophe losses and secondary perils. Ceded losses have significantly reduced as a result of the retention increases and shift away from providing aggregate catastrophe protection. In addition, given current rating levels and industry returns, the magnitude of loss the reinsurance sector can absorb while continuing to make adequate returns has increased on last year.

Reward constructive partners

The return to a more orderly and profitable market is an opportunity for reinsurers to focus on providing value to insurers, and for insurers to reward reinsurers that are pragmatic, flexible and creative.

Reinsurers should reconsider how they can best support insurers, in particular those with high net retained losses, including revisiting aggregate products, and using data and analytics to find the optimum point at which reinsurance is accretive to insurers, yet provides adequate returns.

In addition, we see an opportunity for reinsurers to focus on certainty, working with insurers to better align cover across a program and provide more consistent terms and conditions at renewal.

Top tips for a successful renewal

As market stability brings optimism, our focus this renewal season is on optimizing capital strategies by building stronger reinsurer partnerships, accessing diversified capital sources and driving differentiation for our clients.

01 Understand your true cost of capital and rethink your risk transfer metrics

02 Differentiate your portfolio with a custom view of risk

03 Transfer reserve risk to free up capital for growth

04 Consider alternative capital for optimal placement results

05 Revisit holistic and executable strategic solutions to refine risk appetite and optimize capital

[1] Loss figures differ from published report due to loss development updates.

Turn attention to growth

With the market now on a stronger footing, re/insurers can begin to turn their attention to innovation and growth. There is historically high demand for legacy reinsurance, as insurers seek to augment their capital base to supplement additional retained property losses. Parts of the mortgage reinsurance segment have seen capacity constraints and meaningful price increases from record U.S. mortgage originations in 2021 and 2022. This is expanding the opportunity for new re/insurers to participate in this segment, which has generated an estimated $10 billion of ceded ultimate profit since 2012.

An orderly and profitable reinsurance market is a pre-requisite to address some of the big challenges facing the insurance industry. According to Aon's 2023 Weather Climate Catastrophe Insight, only 43 percent of the $340 billion[2] in damage from natural disasters in 2022 was covered by insurance. Of the $92 billion of economic loss from the earthquakes in the first half of 2023, just $6 billion was insured. The industry has a tremendous opportunity to help close this protection gap, and by doing so, support vulnerable communities and strengthen local economies.

There are also significant opportunities to address new and emerging risks associated with a broad range of powerful, transformative trends that are shaping the future risk landscape. Aon's Transformative Trends analysis identified over $80 billion in premium growth opportunities for insurers from just three megatrends, the Metaverse, Shared Mobility and Intellectual Property. Prescriptive analytics, powered by artificial intelligence, could generate some $100 billion in additional premiums.

Conclusion

Losses in the second half of 2023 may yet influence the January 1 renewal, but clearly the market is now more orderly and predictable. We believe the market should now turn its attention to the pursuit of constructive collaboration and increased client centricity. Reinsurance remains a valuable tool for insurers, but there is much the market can do to strengthen its current value proposition and deploy its resources to drive innovation and meet the growing needs of insurers.

Joe Monaghan

Joe Monaghan
Global Growth Leader
Reinsurance Solutions, Aon

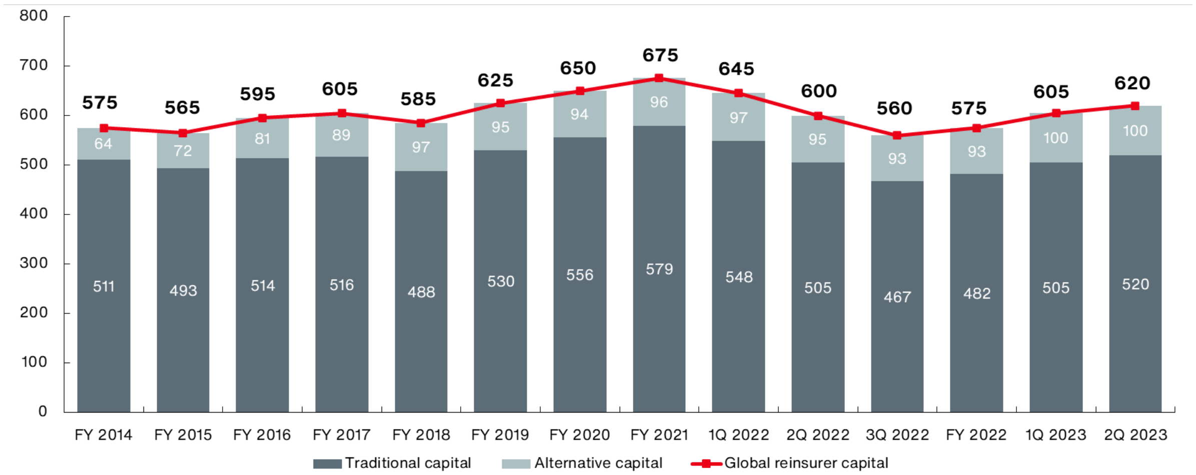
[2] Loss figures differ from published report due to loss development updates.

Global Reinsurer Capital: Recovery in Progress

Mike Van Slooten, Head of Business Intelligence
Richard Pennay, CEO of Insurance-Linked Securities

Aon estimates that global reinsurer capital rose by $60 billion to $620 billion over the nine months to June 30, 2023. The increase was principally driven by retained earnings, recovering asset values and new inflows to the catastrophe bond market.

Exhibit 1: Global Reinsurer Capital ($ billions)



Sources: Company financial statements / Aon's Reinsurance Solutions / Aon Securities Inc.

Traditional capital: Strong earnings drive rebuild

Traditional reinsurers generally performed well in the first half of 2023, despite elevated losses from natural catastrophe events, offering further evidence that the recent reset in pricing, retentions and other terms and conditions has created a path to more sustainable earnings. In addition, higher interest rates are boosting investment returns, with new money yields generally now placed at around 5 percent.

Overall, Aon estimates that shareholders' equity reported by global reinsurers totaled $520 billion at June 30, 2023, an increase of 11 percent, or $53 billion, from the low point of $467 billion seen at the end of September 2022.

The sector is viewed as well capitalized, relative to the risk currently being assumed, as confirmed by strong regulatory and rating agency capital adequacy ratios. However, much more capital will be required if current unmet needs are to be addressed over time.

Reinsurer results for the first half of 2023

Introduction of IFRS 17

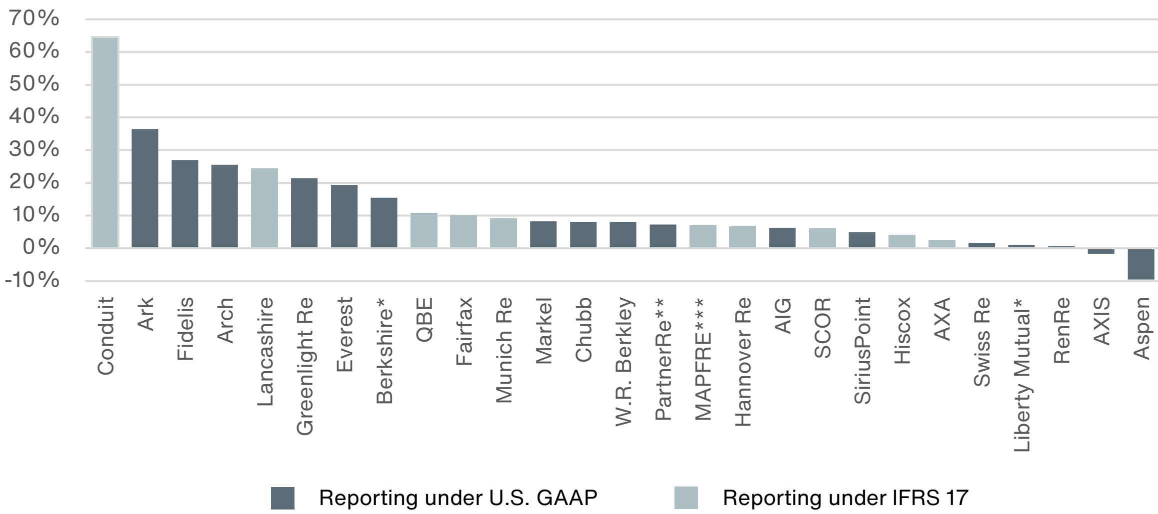
Analysis of the global reinsurance sector has been complicated by the implementation of IFRS 17 in some areas of the world from January 1, 2023. The new regime diverges significantly from U.S. GAAP, meaning, for example, that it is now more difficult to directly compare the operating performance of European reinsurers with their counterparts based in the United States and Bermuda.

Even within the cohort of reinsurers now reporting under IFRS 17, significant variance in financial disclosure can be observed at the outset of the new regime. It is hoped these inconsistencies will be addressed over time.

Premiums/insurance revenues

The chart below shows the reported growth/contraction of the property and casualty (P&C) insurance and reinsurance business written by selected companies in the first half of 2023. The average movement was an increase of 12.0 percent, driven by higher renewal pricing in most lines and new opportunities in a challenging risk environment. Only two companies showed overall reductions.

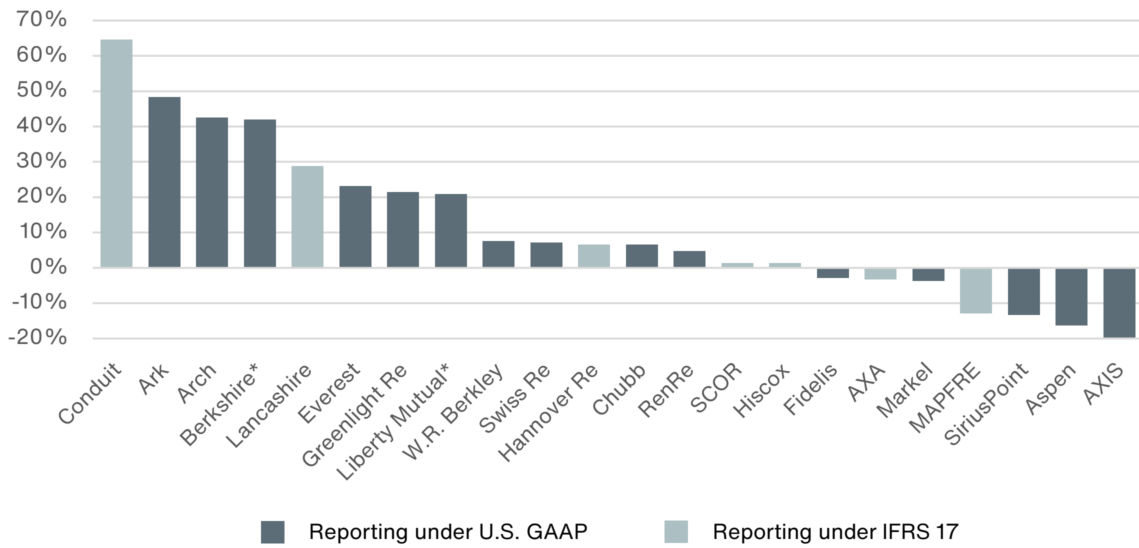
Exhibit 2: H1 2023 Changes in Total P&C Gross Premiums Written / Gross Insurance Revenues



Notes: *Change in P&C NPW **Change in total GPW ***Change in total insurance revenue
Source: Company financial statements

Growth/contraction of P&C reinsurance portfolios, where disclosed, is shown in Exhibit 3. The average movement was an increase of 11.6 percent. Eight companies reported growth of more than 20 percent in the first half of 2023, driven by higher renewal pricing. Seven showed reductions, due to changing risk appetites. A shift in business mix from proportional to non-proportional covers was a headwind to premium/revenue volumes in most cases.

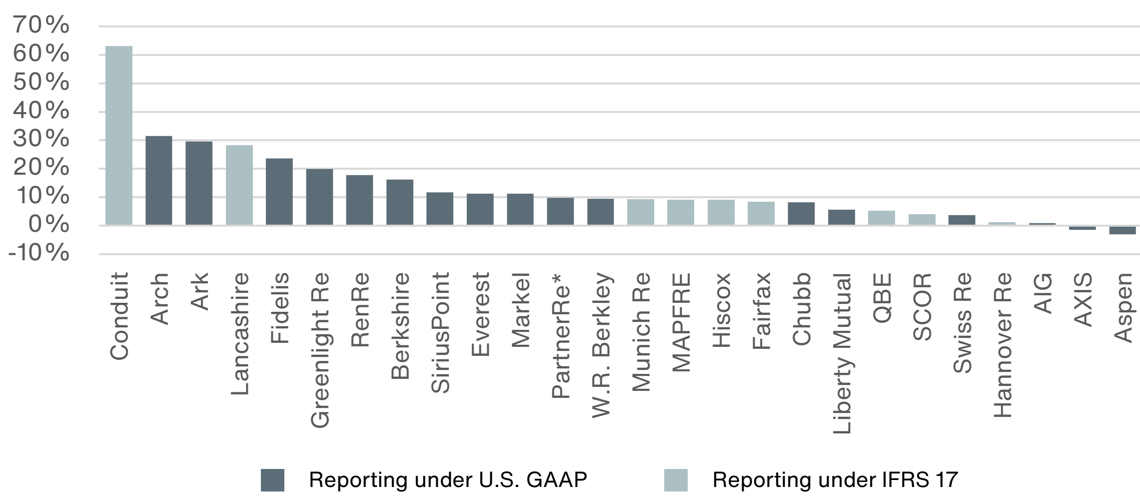
Exhibit 3: H1 2023 Changes in P&C Reinsurance Gross Premiums Written / Gross Insurance Revenues



Notes: *Change in P&C Re NPW; Source: Company financial statements

The chart below shows reported changes in total P&C net premiums earned / net insurance revenue in the first half of 2023. The average movement was an increase of 13.7 percent, providing strong support to reported underwriting results.

Exhibit 4: H1 2023 Changes in Total P&C Net Premiums Earned / Net Insurance Revenue



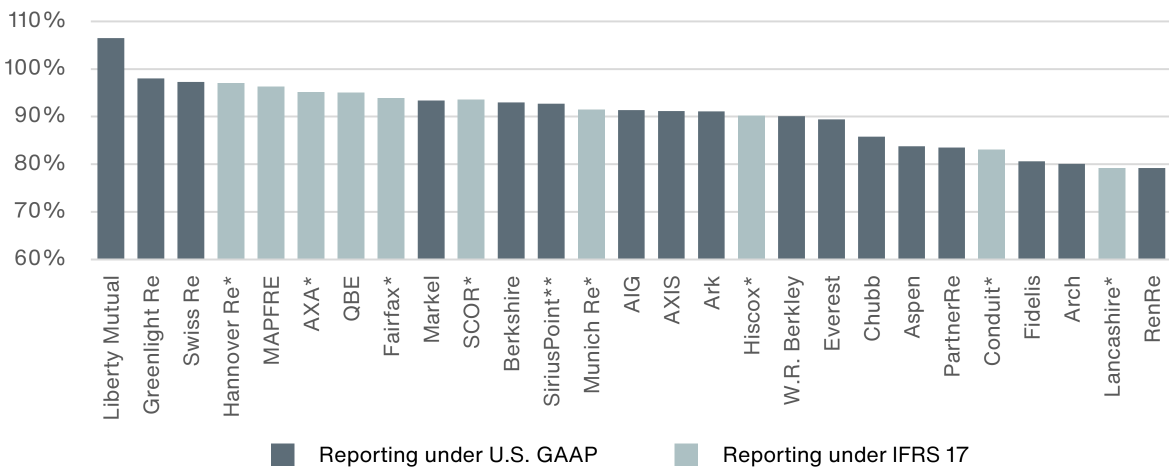
Notes: *Includes life business; Source: Company financial statements

P&C underwriting results

Insured losses from natural catastrophe events were well above long-term averages in the first half of 2023, driven by relentless severe convective storm activity in the United States. The period also featured numerous high-profile flooding, drought and wildfire events around the world, as well as a major earthquake in Turkey and Syria.

Nevertheless, most reinsurers posted positive underwriting results, reflecting the benefits of the shift in pricing and coverage seen in recent years. The average net combined ratio across the companies shown in Exhibit 5 stands at 90.4 percent, down from 91.7 percent in the first half of 2022.

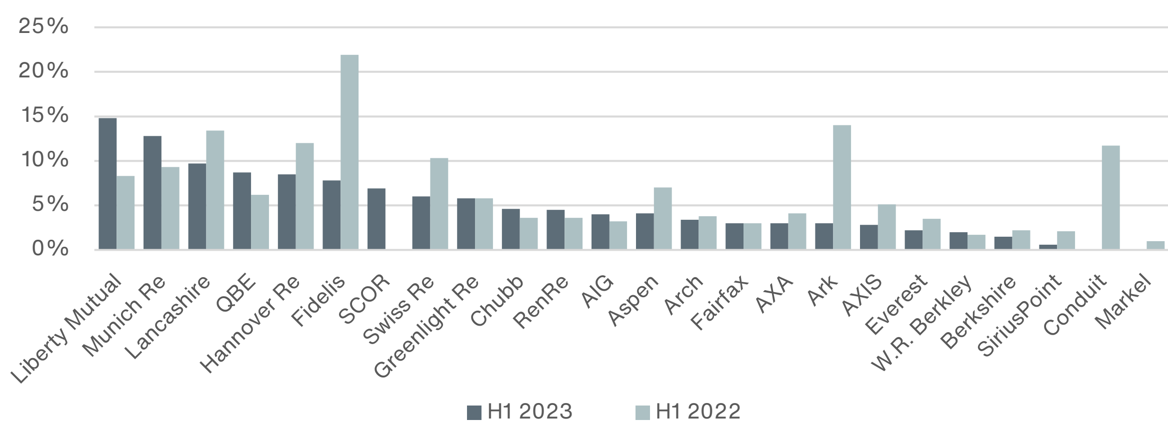
Exhibit 5: H1 2023 Net Combined Ratios



Notes: *Undiscounted **Core business, excluding impact of loss portfolio transfer
Source: Company financial statements

Disclosed major losses from natural catastrophes and man-made events, net of reinsurance and reinstatement premiums, are converted to combined ratio points in Exhibit 6, noting that reporting thresholds vary across the industry. The average reduced to 5.0 percent in the first half of 2023, the prior year period having been impacted by reserves for potential losses arising from the Ukraine conflict.

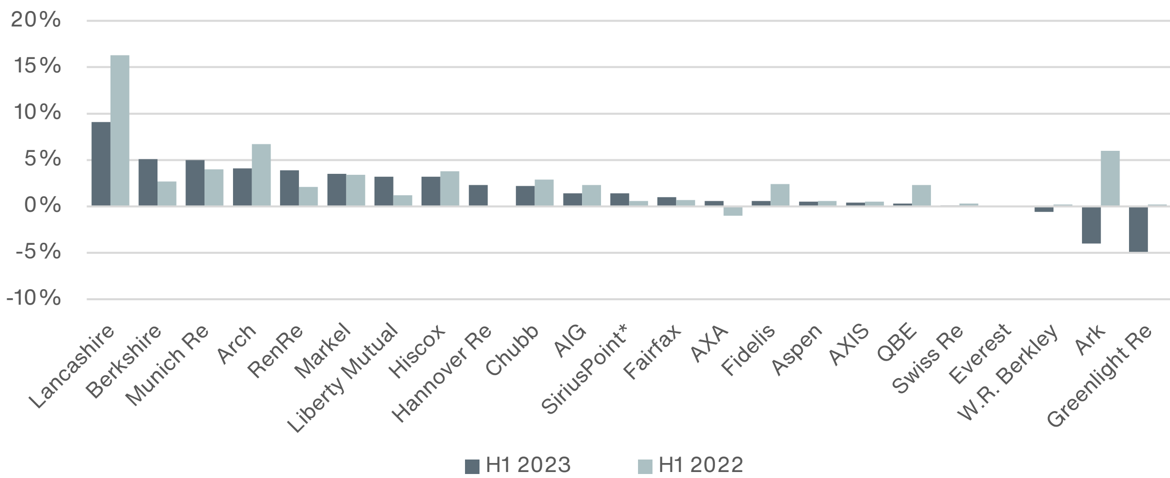
Exhibit 6: Reported Net Major Loss Ratios



Source: Company financial statements

Disclosed movements in prior year reserves are converted to combined ratio points in Exhibit 7. Most outcomes are still positive, but the average benefit declined to 1.7 percent, from 2.6 percent previously. Generally, short-tail reserves are continuing to run-off favorably, whereas general liability reserves for the 2015-2019 accident years are proving problematic.

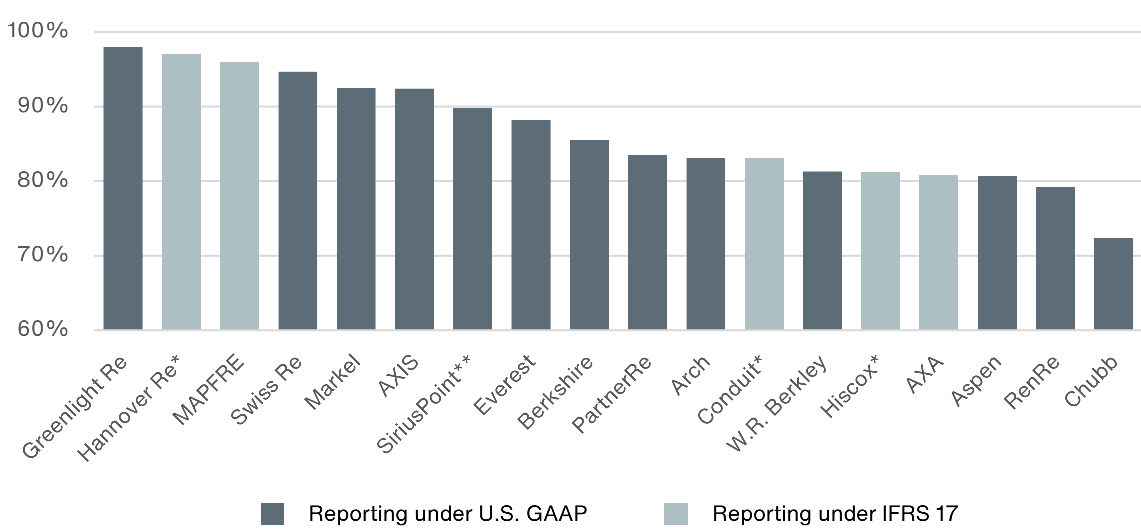
Exhibit 7: Prior Year Reserve Development



Notes: *Excluding impact of loss portfolio transfer in H1 2023
Source: Company financial statements

Reinsurance net combined ratios in the first half of 2023, where disclosed, are captured in Exhibit 8. The average outcome across the companies shown is 86.6 percent, an improvement from 92.3 percent in the prior year period.

Exhibit 8: H1 2023 Reinsurance Net Combined Ratios

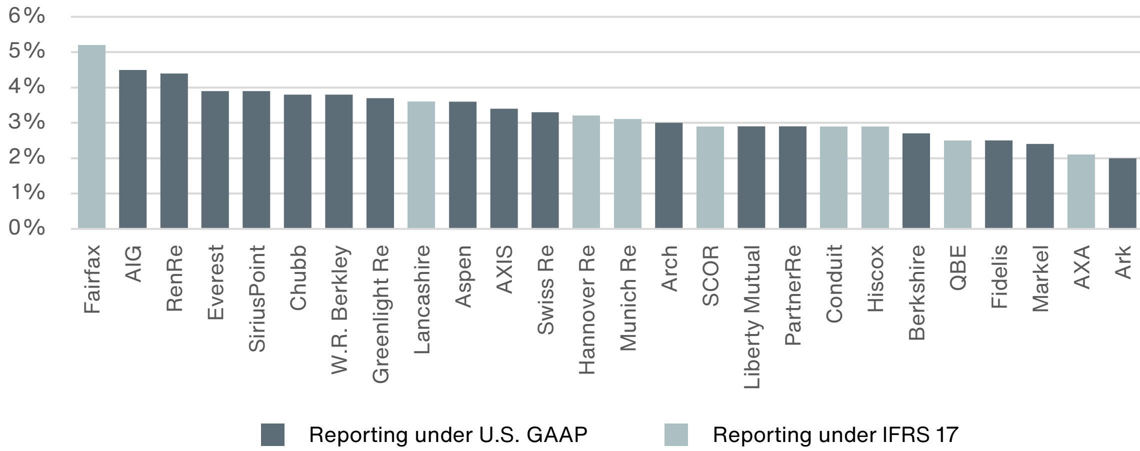


Notes: *Undiscounted **Core business, excluding impact of loss portfolio transfer
Source: Company financial statements

Investment returns

Reported investment results are benefiting from higher interest rates and resilient stock markets. The average ordinary net yield across the companies shown in Exhibit 9 rose to 3.3 percent in the first half of 2023, up from 2.1 percent in the prior year period, with further improvement expected going forward.

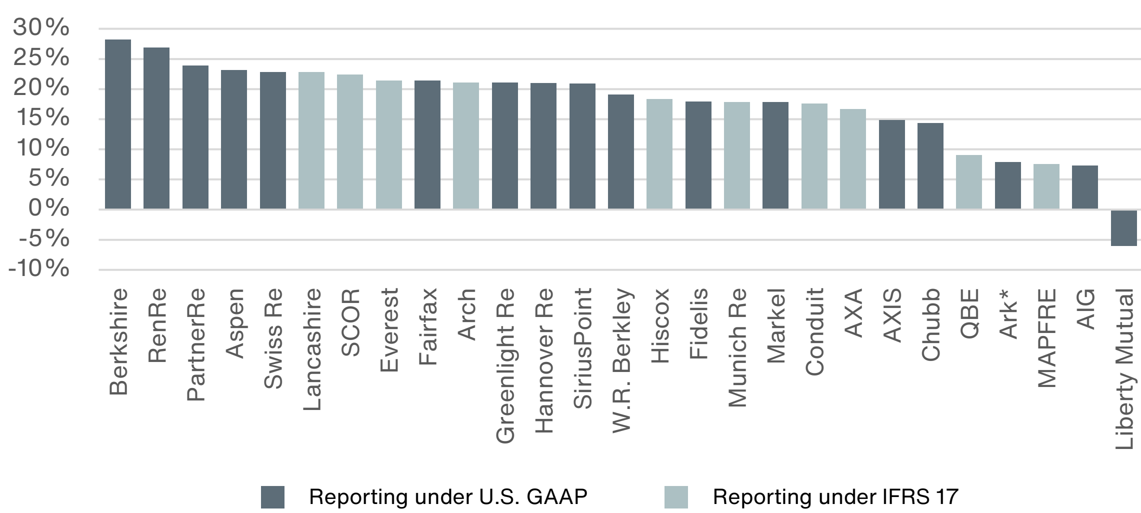
Exhibit 9: H1 2023 Ordinary Investment Income Net Yields



Source: Company financial statements

Strong underwriting results and improving investment yields combined to deliver robust earnings for most reinsurers in the first half of 2023. The average annualized return on common equity across the companies shown in Exhibit 10 was 17.7 percent, up from only 1.2 percent in the prior year period. It should be noted that the denominator has reduced, due to the unrealized losses seen in 2022.

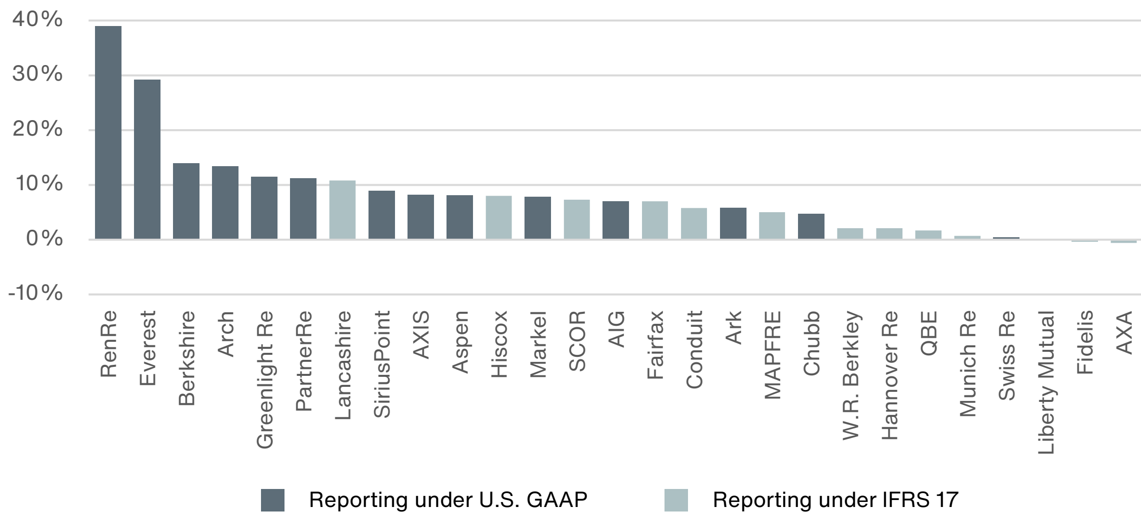
Exhibit 10: H1 2023 Annualized Post-Tax Return on Common Equity



Notes: *Pre-tax
Source: Company financial statements

Strong earnings and partial reversal of the unrealized investment losses seen in 2022 have bolstered reported equity positions over the first half of 2023. The average increase across the companies shown in Exhibit 11 was 8.1 percent, with RenRe and Everest leading the way, following issuances of new equity in the second quarter. European equity growth was dampened by the payment of annual dividends.

Exhibit 11: H1 2023 Changes in Total Equity



Source: Company financial statements

Outlook

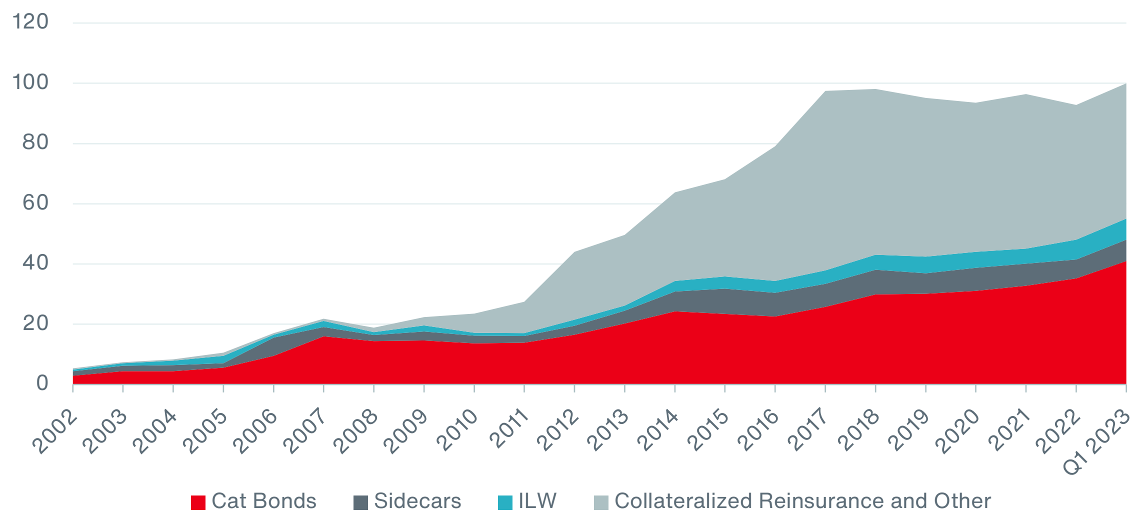
Absent a very large loss in the remainder of the year, most reinsurers will perform strongly in 2023, building capital among the incumbents and potentially encouraging new company formations in 2024.

Assuming no disruption to the retrocession market, some easing of current capacity constraints can be expected at upcoming renewals, but concerns around the impact of secondary perils will likely maintain discipline at the lower end of programs for the foreseeable future.

Alternative capital: Resiliency and growth

The ILS market has experienced significant growth over the past twelve months, despite headwinds in the form of heightened catastrophic activity and persistent macroeconomic uncertainty. As illustrated below, the ILS market has grown to over $100 billion in outstanding limit, including $38.6 billion in catastrophe bonds as of June 2023. Heightened spreads in H2 2022—driven by the impacts from Hurricane Ian and broader macroeconomic forces—created an ideal environment for investors to raise capital. Investors have been successful in those efforts, with a $5 billion increase in AUM since year-end 2022. Growth in AUM—resulting from both investors' success in raising fresh capital and reinvested premium earned on outstanding issuance—is poised to result in record-breaking cat bond issuance volume for 2023.

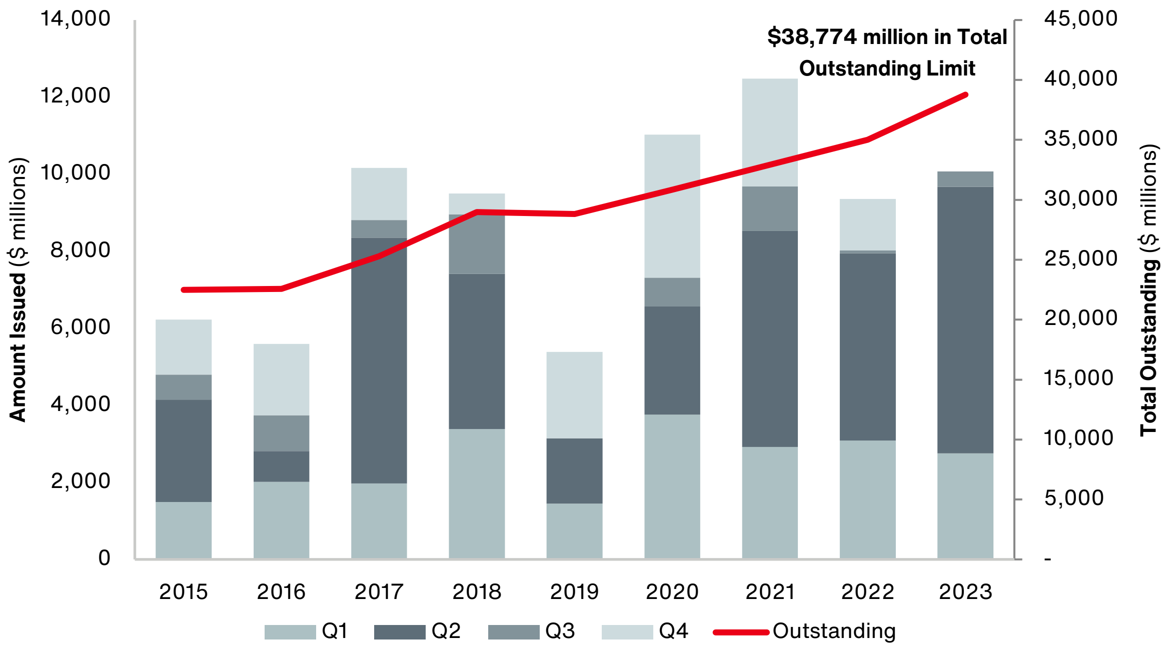
Exhibit 12: Alternative Capital Deployment (Limit in $ billions)



Source: SEC form ADVs, asset manager marketing materials and websites, company quarterly reports, Artemis and Trading Risk / Aon Securities, LLC

Despite a slow start to the year, Q2 2023 turned into the largest quarter for issuance volume the cat bond market has ever seen; increased volume was paired with larger issuance sizes compared to those seen in the first quarter. The total limit issued in April reached over $2 billion—a record for that month—and despite the growth in number of sponsors seeking coverage, spreads tightened from levels seen earlier in the year, largely as a result of investors' expanded pools of capital and improved sentiment regarding the impact from Hurricane Ian on the market. Exhibit 13 shows total issuance volume to date in 2023 exceeds $10 billion, resulting in over $3.7 billion of growth in total cat bond limit, an over 10 percent increase from year-end 2022.

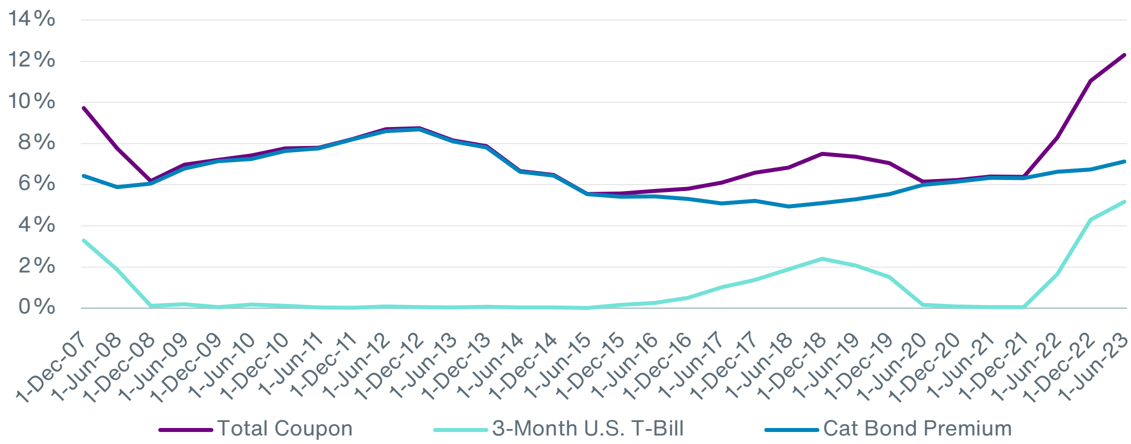
Exhibit 13: Total Outstanding Catastrophe Bond Issuance



Source: Aon Securities, LLC

The market is poised for further growth in the second half of 2023, particularly given anticipated returns for the year. Exhibit 14 shows the combination of higher interest rates (in this case, represented by the average return on 3-month U.S. T-Bills) and growth in weighted average premium earned across all outstanding cat bonds[3] results in all-time high total coupons earned on cat bonds over the past twelve months, despite headwinds felt across the broader economy.

Exhibit 14: Total Coupon Earned on Outstanding Catastrophe Bond Issuance—Risk Interest Spread plus 3-month U.S. T-Bills[4]



Source: Aon Securities, LLC and Federal Reserve Bank of St. Louis.

The catastrophe bond market's growth in 2023 has been welcomed by insurers, reinsurers and governments who have sought to complement their risk transfer program with ILS. With the ILS market now in its third decade, its ability to bounce back and grow during a time of economic uncertainty and increasing natural catastrophe frequency, is a true testament to its resiliency and overall value proposition to all stakeholders.

[3] Weighted premium calculated for each half year by taking the initial risk interest spread for each transaction and multiplying by the respective original principal amount, and normalizing to the total issuance amount for the respective half year.

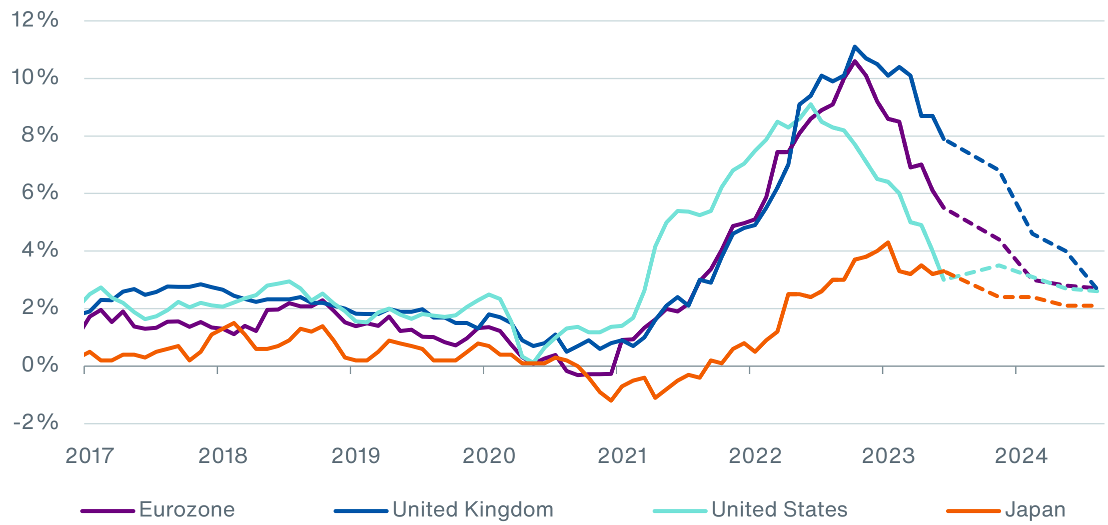
[4] Cat bond premium calculated for each half year by taking the initial risk interest spread for each transaction and multiplying by the respective original principal amount, and normalizing to the total issuance amount for the respective half year; 3-Month U.S. T-Bill rates were pulled from the Federal Reserve Bank of St. Louis.

Macro conditions: Pressure eases, risks remain

The volatile macroeconomic backdrop has introduced more complexity for cedents and reinsurers over the last twelve months. Are we through the worst, or will the next twelve months bring added difficulty?

The number one macroeconomic 'headache' for the industry has been inflation. Consumer price indices (CPI) in most major markets peaked in late 2022, at levels not seen in decades. Since then, inflation has steadily declined, albeit at a slower pace in Europe than in the US, where CPI recently fell to 3.2 percent for the 10 months to July. Current consensus expectations point to a CPI normalization towards 2 to 3 percent in Europe by mid-to-late 2024.

Exhibit 15: Historical and Forecast CPI/HICP



Source: St Louis Fed, Bloomberg consensus forecasts

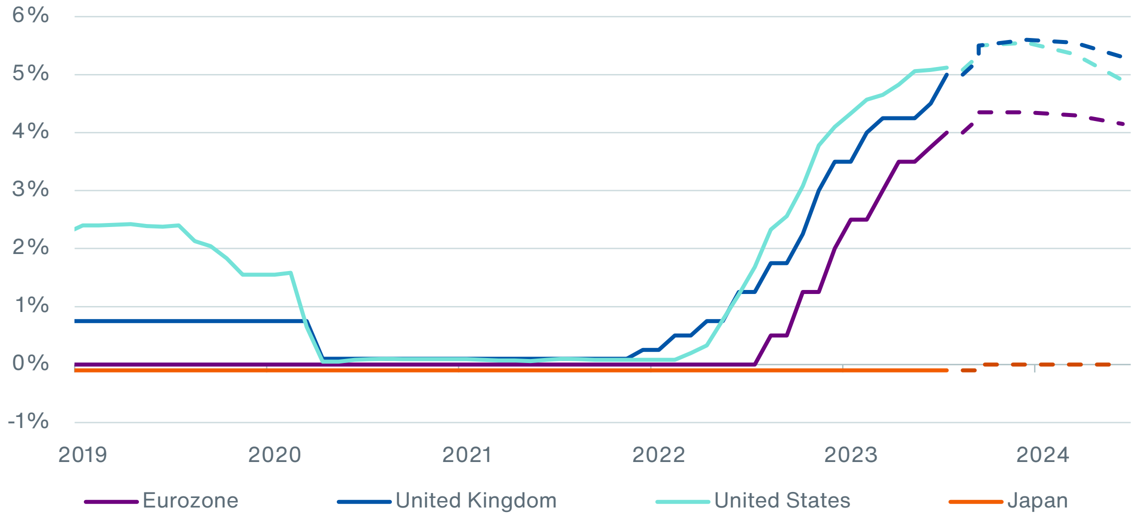
However, much of the decline in headline inflation this year was driven by volatile energy and food prices. 'Core inflation', which excludes these items, has so far proven hard for central banks to tame, most recently printing at 4.7 percent in the US and 5.5 percent in the eurozone (for the 12 months to July).

This backdrop has driven difficult discussions with reinsurers around past and future loss costs. Reinsurers have been seeking higher retentions and rate increases to insulate themselves against inflationary risks. Over recent renewals, cedents that have provided detailed data and demonstrated underwriting actions that mitigate inflation-driven uncertainty have generally received preferential treatment. We expect this to remain the case in 2024.

Increasingly, reinsurer attention is switching from short tail lines, such as motor and property, which experienced claims severity pressures in 2022, due to high repair and rebuild cost inflation, to longer tail lines, where other types of inflation such as social, wage and medical costs are key drivers of claims.

To curb inflation, central banks have aggressively hiked interest rates. The Fed's effective funds rate increased from just above 0.0 percent in early 2022, to over 5.0 percent today. The European Central Bank, after raising rates for the first time in 11 years in July 2022, increased the rate on its main refinancing operations benchmark to a 15-year high of 4.25 percent at its last meeting in July.

Exhibit 16: Historical and Forecast Central Bank Interest Rates

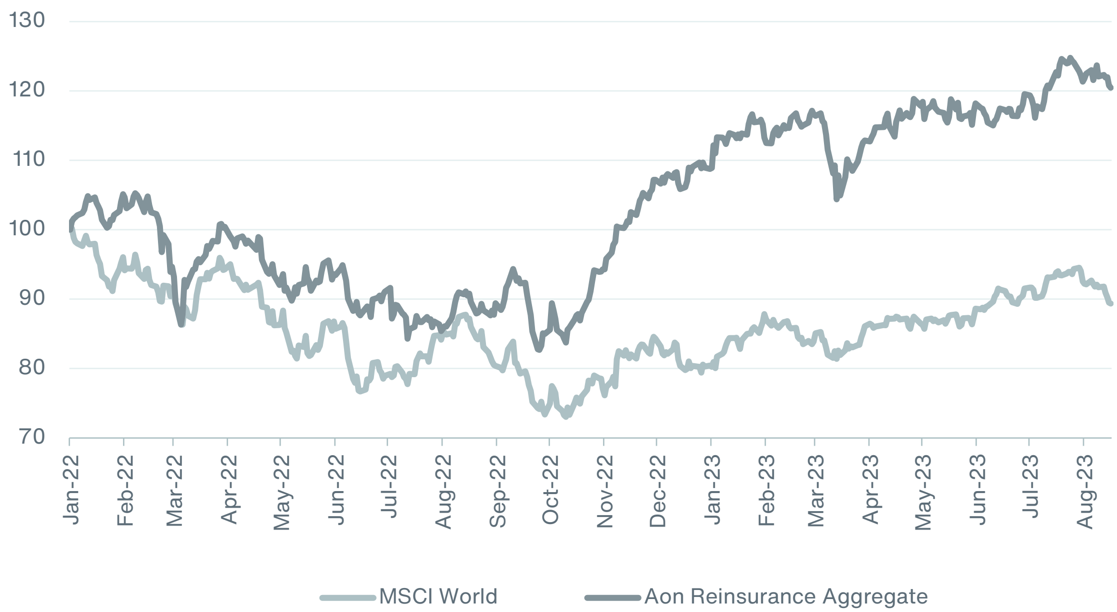


Source: St Louis Fed, Bloomberg consensus forecasts

Higher short term base rates are being reflected in higher interest rates on long-term government and corporate bonds. The upshot is that reinsurers are typically achieving reinvestment rates on new money invested at over 5 percent, whereas many were earning roughly 2 percent eighteen months ago. This has a huge impact on the expected profitability of long term (re)insurance contracts.

Following Hurricane Ian in late September 2022, public markets' investors began to price-in expectations of a hardening reinsurance market and potentially higher returns on capital for the industry. As shown in Exhibit 17, this led to material outperformance for the reinsurance sector versus the wider stock market. Higher share prices make it easier and more attractive for reinsurers to raise capital in the stock market. So far only a few companies have chosen this approach, notably Everest Re, Beazley and Ren Re (to fund its acquisition of Validus). Financial results for reinsurers are strong year-to-date, providing early evidence that market expectations are being met.

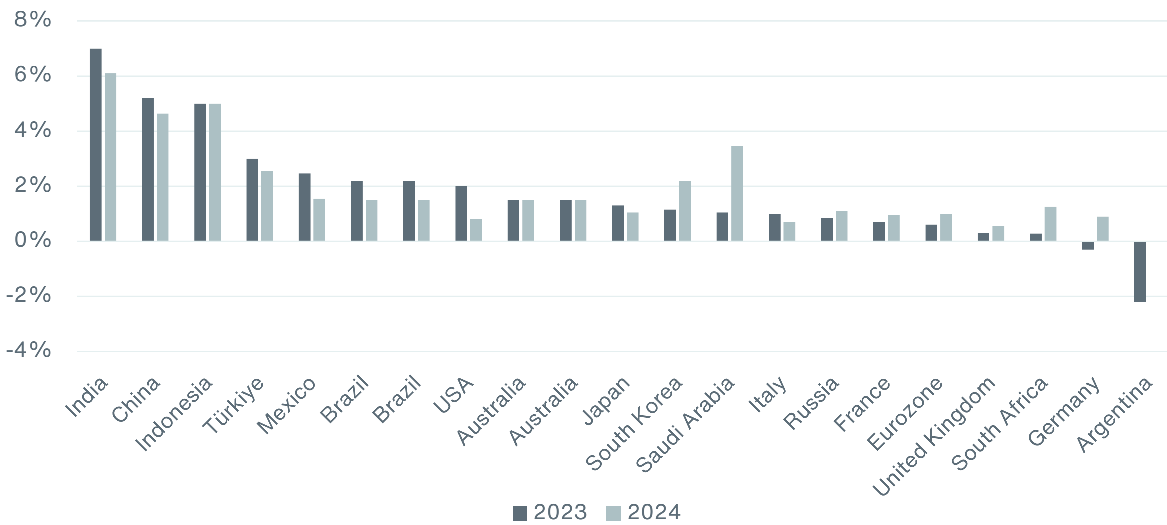
Exhibit 17: Global Stock Market and Reinsurance Industry Stock Performance (Indexed)



Source: S&P Capital IQ Pro

Growth forecasts for major developed market economies continue to be weak and recession in Europe or the US in 2024 remains a distinct possibility. Although P&C is generally considered a 'defensive' industry, which tends to perform better than other sectors in economic downturns, equity market falls and increases in credit spreads, for instance, would put strain on reinsurer capital positions, while recessions also tend to increase claims in lines like D&O.

Exhibit 18: Forecast Real GDP Growth for the G20



Source: Bloomberg consensus forecasts

After a rollercoaster 2022, the foreign exchange markets have been quieter in 2023, with the largest major currency movement year-to-date being a roughly 10 percent weakening in the Yen. If this situation remains unchanged, it may make it slightly easier for non-Japanese reinsurers to increase capacity deployed in the Japanese market at the next April renewal.

Rating Agencies: Insurer Results Under Pressure

Pat Matthews, Head of Americas Capital Advisory

Rating agencies are increasingly scrutinizing insurer performance, which has faced a series of headwinds in 2023. A turbulent renewal season at the start of the year led many insurers to increase their retentions. With insured losses during the first half of 2023 as the fourth highest on record (only behind 2011, 2022 and 2021, respectively), rating agencies have taken rating action, with downgrades so far significantly outpacing upgrades.

U.S. insurers impacted from multiple fronts

Entering 2023, insurers were already facing pressure from the financial market volatility that characterized the marketplace in 2022. Unrealized investment losses eroded the capital cushion—relative to rating agency, regulatory and economic capital requirements—that many in the industry had previously enjoyed. Rating agencies have generally taken the view that the strong liquidity resources of most insurers meant that insurers would be able to hold depressed assets to maturity, and positively adjusted available capital estimates accordingly. However, with increased reinsurance costs and market capacity constraints at the beginning of the year, many insurers were exposed to a larger share of the severe convective storm losses that have occurred in 2023. These losses further eroded capital and introduced increased volatility into underwriting results.

Rating agencies like AM Best responded to this volatility with downgrades, which year-to-date approximately outweigh upgrades by a 2:1 ratio. Most frequently insurers have experienced negative rating pressure in their operating performance assessment, although for some insurers the volatility has also resulted in a weaker view of capital adequacy.

With credit ratings under increased scrutiny, demand for reinsurance protection may increase in the latter half of the year. Insurers continue to face an uncertain macroeconomic environment, along with persistent inflation that makes achieving rate adequacy another challenge. The increasing frequency of 'secondary' peril events, such as severe convective storm, may drive insurers to seek innovative solutions to the protection gaps that they experienced in the first half of 2023.

Revised draft of S&P's methodology may increase capacity

In May 2023, S&P Global Ratings issued an updated draft of changes to its methodology for assessing the risk-based capital adequacy of insurance and reinsurance companies. S&P estimated that the revised draft could lead to credit rating actions on approximately 10 percent of ratings. This version of the proposal seems more favorable to the market and may lead to increased reinsurance capacity over the intermediate term, given preliminary estimates of capital redundancy. At this time, S&P expects implementation of these updates in the fourth quarter of 2023.

Demand-Supply Dynamics

By: Tracy Hatlestad, Head of Global Property
Nigel Light, Head of Global Casualty, and Amanda Lyons, Head of US Casualty
Tom Murray and Richard Wheeler, co-CEOs of Global Specialty

Property: Foundations for a constructive renewal

The stage is set for a more orderly property catastrophe renewal at January 1 than a year ago, as key drivers of demand-supply uncertainty have subsided.

Despite costly natural catastrophe events this year, including the devastating earthquakes in Turkey and Syria, wildfires in Hawaii and a rare tropical storm in California, reinsurers look set to make strong returns in 2023, on the back of improved terms and conditions and higher investment results.

In addition, and in contrast to the end of last year, we see new capacity entering the property catastrophe market, predominantly in the form of insurance-linked securities and third-party capital aligned with traditional reinsurers.

Available supply is adequate to meet the needs of insurers at the top end of programs, and satisfy additional purchasing of limit. That said, different regions and segments are at different stages of the cycle and we expect reinsurers to maintain underwriting discipline.

However, greater stability paves the way for more constructive collaboration at 1/1. The return to a more orderly and profitable market is an opportunity for reinsurers to demonstrate their value in meeting the individual needs of insurers, and an opportunity for insurers to reward reinsurers that are pragmatic, flexible, and creative.

Topic	Commentary
Stable supply	All things being equal, the supply of capacity at January 1 will be broadly adequate to serve insurer demand. Additional third-party capital is flowing into the traditional reinsurance market, while a broader spectrum of reinsurers have expressed a desire to grow their portfolios in 2023. Multi-year capacity is also likely to be more readily available in 2024 than at the January 2023 renewal, providing an opportunity for insurers that have historically purchased on a multi-year basis to increase their share in 2024.
ILS price delta	The rebound in the ILS market in 2023 is a key supply-side driver in the property catastrophe space. The delta in ILS and traditional property cat reinsurance pricing sends a clear signal to the market, and provides further competition for peak risks. Also, the number of insurers that have accessed the ILS market in 2023 to date already surpasses the whole of 2022. Given the multi-year nature of catastrophe bonds, business written by the ILS market in 2024 will be lost to traditional reinsurers for future renewals.

Topic	Commentary
Retro market pressures ease	The late renewal of the property retro market in the wake of Hurricane Ian in 2022 added to capacity concerns in the run up to the January renewal. In 2023 the property retro market found a new equilibrium with stabilized supply-demand dynamics through post January 1 renewals. Subject to no major event occurring, property retro is set to play a constructive role in supporting property catastrophe renewals in 2024.
Strong demand for limit	Demand for property reinsurance at 1/1 is likely to be robust, reflecting inflation and additional purchasing. Aon forecasts mid-single digit growth globally.
Inflation miss-factor	Global headline inflation has reduced, but it remains an important driver for exposures and reinsurance limit. Insurers should reflect on the potential risk of under-valuation and the miss-factor in assumptions and coverage, given the inherent uncertainties of rebuild costs and the future economy on claims trends.
Status quo for retentions	Following significant increases in retention levels for property catastrophe reinsurance covers at January 1, 2023, retention levels are likely to be stable in 2024. In a more predictable and stable reinsurance market, some insurers may seek to adjust retention levels to reflect inflation and reinsurer appetite.
Realigning cover	The pressure on catastrophe terms and conditions seen at the January 2023 renewals is not expected to be repeated in 2024. With the return of more orderly renewals during 2023, we would expect the reinsurance market to constructively engage with insurers at 1/1 to provide more consistent cover and realign terms and conditions. Cover for Terrorism and Strikes Riot and Civil Commotion (SRCC), where capacity was constrained at the start of the year, is likely to be more widely available at 1/1, as reinsurers look to achieve growth ambitions.
EMEA	Against the backdrop of the earthquakes in Turkey and Syria and heightened secondary catastrophe loss activity in Europe – which have included flood and hailstorms in Italy, Slovenia and Croatia, riots and civil commotions in France, wildfires in Greece and heavy rainfall in the Nordics - reinsurers are likely to remain disciplined and potentially seek further improvements in terms and clarity in conditions for property catastrophe reinsurance which might vary country by country. However, we are not expecting major market shifts as those seen last year, unless driven by additional losses. Reinsurers' results have been positive, and we see no justification for the level of increases seen last year at 1/1.

Topic	Commentary
Fac in high demand	While market dynamics differ greatly between accounts, lines of business and markets globally, we see strong demand and stable supply for facultative reinsurance providing diversification to balance portfolio volatility. In 2023, insurers have become more flexible using facultative reinsurance and broadened their market choice selection by using the product to manage their catastrophe portfolios. We continue to see opportunities for insurers in the facultative market to build additional catastrophe and non-catastrophe capacity, reduce net exposures, fill gaps in programs supplementing treaty coverage and protect increasing concerns around climate change, valuation and terrorism.
Higher industry's loss threshold	Insured losses from natural catastrophes in the first half of 2023 were elevated at $56 billion[5], the fourth highest insured loss on record, according to Aon's Catastrophe Insight. However, the proportion of insured losses ceded has declined and the ability for reinsurers to absorb and continue to make adequate returns has increased on last year, owing to the change in rates in almost all global regions.
Secondary perils	Secondary perils continued to drive losses in the first half of 2023, with convective storms, wildfires, hailstorms and flooding in the US and Europe. Changes to retention levels at mid-year and January renewals have seen reinsurers move higher up programs and away from large frequency losses, including SCS and wildfires, which have seen reinsurers reporting fewer ceded losses in 2023. We expect reinsurers will now work with insurers and their advisors, using data and analytics, to innovate in this critical area going forward.
Diversity of reinsurer panels	With the return of reinsurer appetite and the prospect of a more orderly and settled renewal, insurers have an opportunity at 1/1 to further expand and diversify their panels. At January 1, 2023, constraints on property catastrophe capacity and withdrawals from the market resulted in fewer reinsurers on some insurers' panels.

[5] Loss figures differ from published report due to loss development updates.

Property spotlight: 80+% of SCS loss increases explained by exposure growth

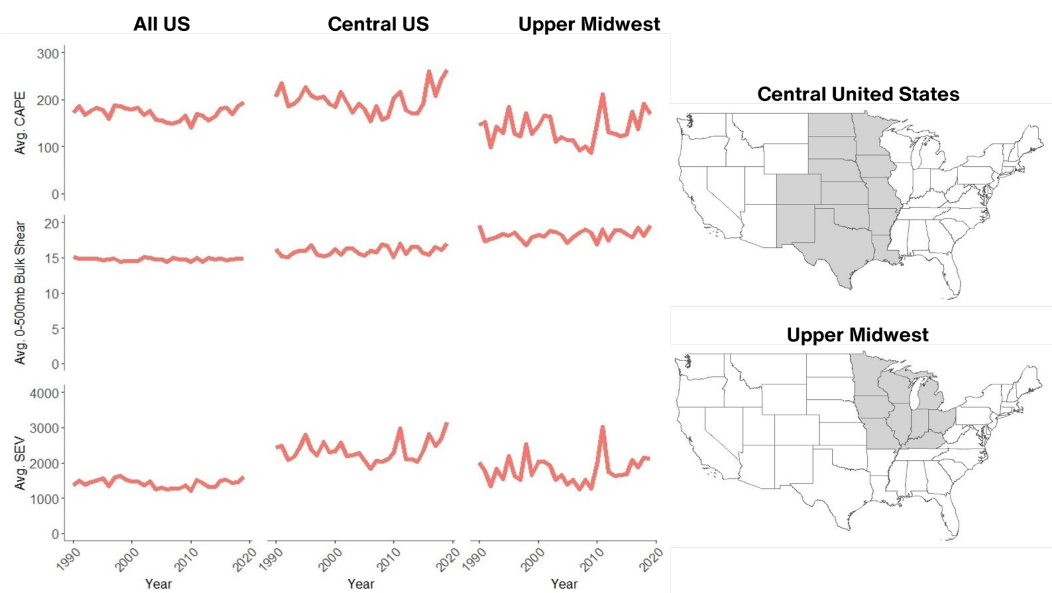
John Jacobi, Managing Director in Actuarial, Aon

Seventy percent of global insured losses were driven by severe convective storms (SCS) in recent years. In the US, SCS caused $38 billion of insured loss in the first half of 2023; breaking the 1H record of $33 billion, set in 2011. From 1990 to 2022, SCS insured losses increased at an annual rate of 8.9 percent.

As we enter January 1 renewals, it's pertinent to understand what is driving this trend of SCS loss volatility. Is it climate change, where a warming planet contributes to a shift in weather patterns, resulting in a new normal of elevated storm activity? Or can the increased loss trend simply be explained by underlying exposure growth and population distribution changes?

We answer this question by first looking at the weather 'ingredients' that are most favorable for severe thunderstorm development. The first is Convective Available Potential Energy, or CAPE, which is a measure of atmospheric instability and considered as a proxy for fuel available to a developing thunderstorm. The second variable is wind shear, a measure of wind speed and directional differences with height above the Earth's surface. The product of these two measures is known as the Severe Index (SEV) and is commonly used to diagnose severe weather potential.

Exhibit 19: Severe weather ingredients from 1990-2019



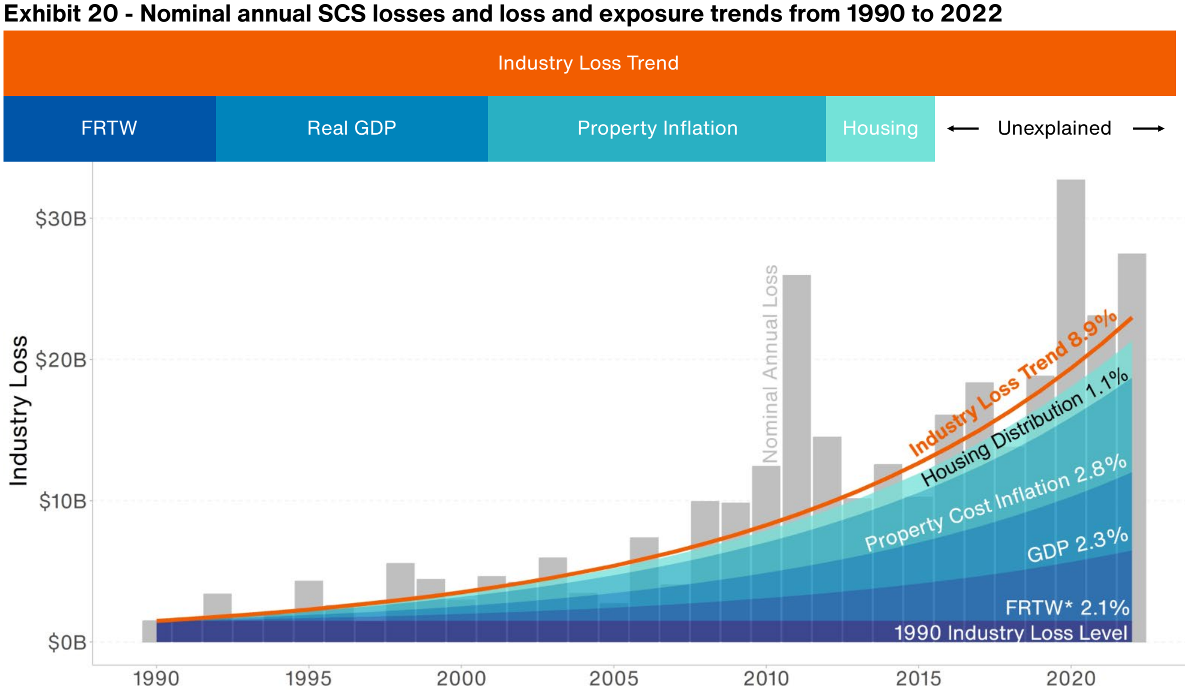
Source: Aon Analytics and NOAA

The chart above shows annual averages for key SCS ingredients from 1990-2019. NOAA's ERA5 reanalysis data, which is reported every 6 hours, was averaged through each year to determine the annual number. Other than some long term, decadal variation in CAPE observations in the Central US, there are no discernible trends in atmospheric ingredients that are most suitable for sever weather formation.

With the absence of physical drivers increasing severe convective storms, we can then assume that much of the SCS loss trend is due to underlying exposure changes. To prove this, we identified four main drivers of exposure change and quantified how much of the overall SCS loss trend they explained.

1. Real GDP accounts for how much 'stuff' there is in the economy and grew at an annual rate of 2.3 percent.
2. Fixed reproducible tangible wealth (FRTW) accounts for how much the 'stuff' is worth and grew at an annual rate of 2.1 percent.
3. Property cost inflation, measured by the producer price index for all construction, provides a good estimate of how construction costs change over time, which grew the fastest at a 2.8 percent rate.
4. Population distribution, measured by the housing distribution index, is based on changes over time in housing units in high hazard states like Texas and other Sun Belt states, with a 1.1% growth rate.

Exhibit 20 - Nominal annual SCS losses and loss and exposure trends from 1990 to 2022



Source: Aon Analytics

Note: Nominal losses were subject to a $100 million (in 2006 dollars) threshold before being aggregated by year.

Overall, exposures have grown at a combined rate of 8.6 percent per year. Compared to the loss trend of 8.9 percent, and allowing for analysis uncertainty, this means that over 80 percent of SCS loss growth can be explained by exposure changes. The remaining 20 percent is unexplained by these metrics, but could be due to small climate changes that are not discernible in the Severe Index, other exposure factors, or random chance.

While climate change has been shown to be a driving force behind evolving trends for other perils, there is little evidence that climate change is impacting key variables that influence SCS. (Re)insurers instead must deal with growing exposures in high hazard areas, which can be managed through traditional risk management techniques, such as accumulation management, effective claims handling and appropriate deductible, limit and premium levels. Going forward, the industry's emphasis for the SCS peril should be less on a changing climate and more on traditional risk management.

Casualty: Stable, yet disciplined market

Casualty reinsurance markets remain stable ahead of the January 1, 2024 renewal, with sufficient capacity across almost all major lines of business. Although D&O rate reductions are headlining the news, the reality remains that underlying casualty rates are broadly very healthy.

Long-tail lines continue to attract the support of reinsurers, with inflation concerns and the moderation in underlying rate increases, relative to a year ago, all combining to underpin discipline. Key topics to address during casualty reinsurance renewals will be inflation, investment income, rate change and prior-year loss development especially on years 2015-2019.

In this market, reinsurers will favor traditional reinsurance structures, and will seek to maintain or improve the current margins on excess of loss business, while further change in quota share commissions (up or down) will be related to 2022/2023 risk-adjusted rate change achievements and prior-year results.

Topic	Commentary
Buoyant supply	Capacity remains buoyant in the casualty market, although pockets of the market remain challenging. Large international towers with limits of $100 million or greater, for example, are under more pressure, reflecting reinsurer concern about the embedded US exposures and accompanying volatility of large losses. Overall, casualty insurers should find ample capacity for their current needs, with many reinsurers still keen to grow their casualty portfolios.
Improved investment returns	The impact of higher interest rates in major casualty markets are a big positive for ongoing supply. Compared with property lines, casualty (re)insurance benefits significantly from higher interest rates, which generate higher investment returns earned on long tail business. Improvements in investment returns should also strengthen insurer negotiations with reinsurers and support retention levels.
Eye on inflation	Casualty insurers continue to face elevated severity from economic inflation compared to historical levels but the impact is much less compared to last year's renewal. Social inflation continues to impact the line as nuclear verdicts continue to rise. However, liability insurers are proactively addressing the impact of inflation on portfolios in their presentations to reinsurers, as well as in underlying pricing. This is an area that will remain closely watched by reinsurers.
D&O at inflection point	Ceding commissions and capacity in the professional liability market came under increased pressure at mid-year renewals, especially in the Directors & Officers (D&O) market, where rates have been steadily falling from their first quarter 2022 peak. According to Aon's Quarterly D&O Pricing Index, D&O pricing was down in Q2 by 26.8% year on year – its fifth consecutive quarter of reductions. The D&O segment appears to be approaching an inflection point for original pricing and the reinsurance market.

Legacy / reserve risk opportunities	Demand for adverse development and other legacy products continues to grow and provide both insurers and reinsurers with attractive opportunities in the challenging property catastrophe reinsurance environment. Capital for legacy reinsurers has more than tripled over the past six years, from $6 billion to $20 billion. This increased capital supply and rising interest rates make the pricing on legacy deals more attractive than ever. Legacy markets are robust, with many insurers already taking advantage, enabling a redeployment of their capital into the well-priced current casualty markets. Insurers that do not investigate legacy transactions risk prior-year loss emergence that can damage future results and might cause them to be outliers relative to peers.

Specialty: Loss development to shape renewal

The specialty market should have a more orderly renewal at January 1 compared to last year with the supply of capacity adequate for most risks. However, there is still uncertainty surrounding Russia-Ukraine related loss development. Reinsurers looking to diversify their portfolios from natural catastrophe risk should support the supply of capacity for the specialty market. Insurers will need to engage early, leveraging existing reinsurer relationships, and tell a good story across a number of themes, including loss development, claims experience and changing exposures.

Topic	Commentary
Trade Credit & Political Risk	Amid ongoing global economic and political uncertainty, the trade credit and political risk market remains relatively stable. Loss ratios have begun to move upwards, with higher business insolvency rates and as claims notification related to the Russia-Ukraine conflict turn into tangible losses. However, the supply of capacity continues to be adequate for most risks, and the approach of reinsurers was more consistent at mid-year renewals. While some insurers feel the results in 2021 and 2022 may justify improved terms and conditions, at this point in the economic and reinsurance market cycle, reinsurers are likely to be circumspect. Buyers that are clear and realistic in their requirements for 2024 should achieve full placements.
Marine, Energy and Political Violence	The marine, energy and political violence terror market should expect a more orderly renewal than a year ago. The marine and energy reinsurance market is stable, with adequate capacity, experiencing a relatively benign and more traditional claims experience in 2023. Capacity constraints and coverage discussions in political violence and terrorism, evident at the January 2023 renewal due to the Russia-Ukraine conflict, are ongoing. Losses from the war remain uncertain and many are far from resolution. Insurers that engage early with the market will achieve optimum flexibility around cover.
Aviation exposures impacted by retro market	Aviation reinsurance renewals continue to be affected by conditions in the retro market, claims deterioration on prior years, and uncertainty around losses related to the Russia-Ukraine conflict. Retro capacity has contracted substantially, driven by market exits. Reinsurers may seek to mitigate the premium increases and coverage restrictions on their outwards retro, paying close attention to coverage and pricing for excess of loss covers. The ability of the direct market to achieve increases will be key to securing quota share capacity at renewal.

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