howden

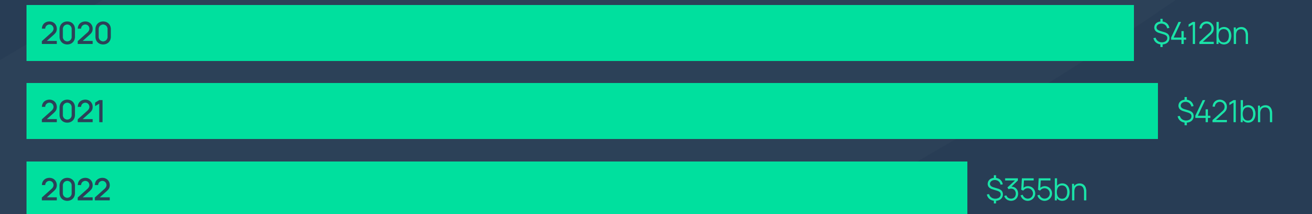
THE GREAT REALIGNMENT

Key takeaways

Macroeconomic and geopolitical realignments, alongside persistent outsized natural catastrophes, have introduced significant uncertainty and volatility into the (re)insurance market

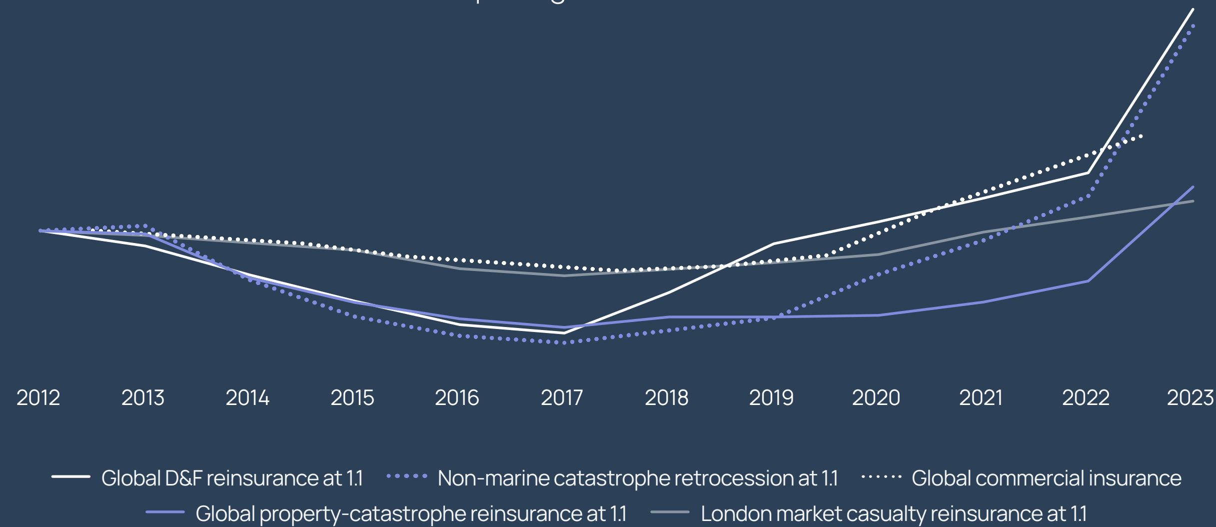
Biggest reinsurance capital squeeze since 2008

$66bn of capital erosion at YE22 vs YE21



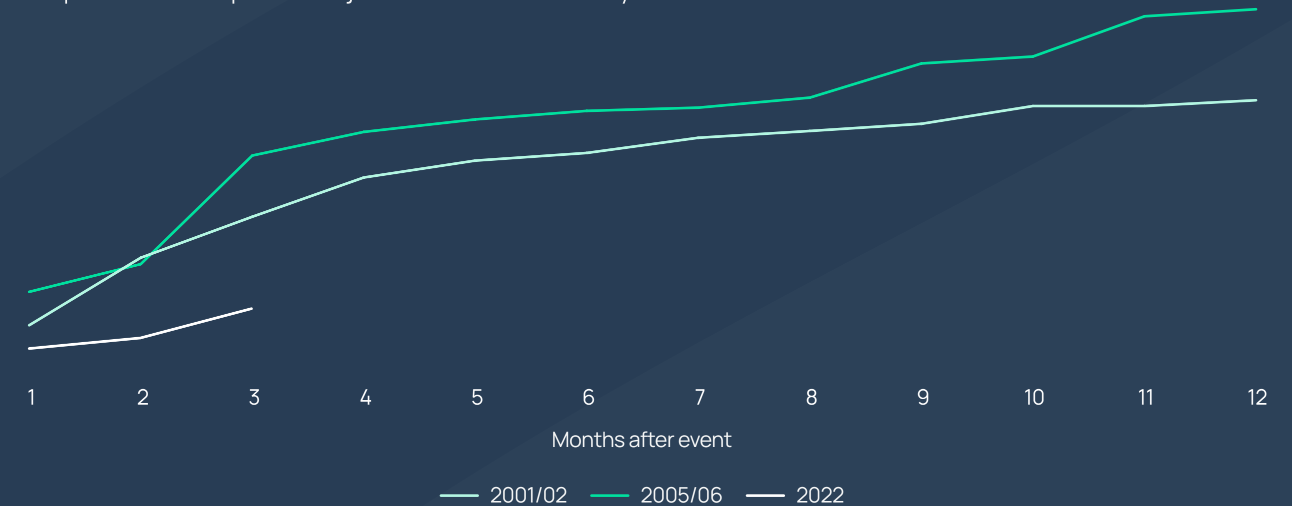
Differing rate momentum reflects individual, mini-cycles with varying levels of sensitivity to losses and broader macro risks

Global insurance and reinsurance pricing index from 2012



New capacity could soon be enticed back into the market, given modest inflows in 2022 and higher returns on offer in 2023

Capital inflows post-major event this century



1 January 2023 reinsurance renewals

+37%
Global property-catastrophe

Biggest year-on-year increase at 1.1 since 1992

+50%
Retrocession

Cumulative increase of 165% since 2017

+45%
Global direct and facultative

Cumulative increase of 160% since 2017

Unlocking capital in order to find solutions for the risks of today (and tomorrow) will be crucial to maintaining relevance and offering clients coverage that meets their rapidly changing needs

01

The great realignment

The world has become a riskier place. Any hope of a return to normality in the wake of COVID-19 has been shattered by a succession of geopolitical and macroeconomic shocks that brought war back to Europe, triggered an energy crisis and ended the era of cheap money and low prices.

The effects of COVID – huge fiscal and monetary stimulus, supply constraints and high debt burdens – have collided with the devastating fallout from Russia's invasion of Ukraine to bring about a great realignment, characterised by structurally higher inflation, rising interest rates, heightened security threats and accelerated deglobalisation. Throw into the mix increased recessionary risk, turbulent financial markets, climate change, one of the most expensive natural disasters (Hurricane Ian), a challenged, if relenting, cyber market, and the operating environment is acute.

The corollary for risk managers and underwriters is a complex and nuanced (re)insurance market, driven by line specific, mini-cycles with varying levels of sensitivity to losses and broader macro risks. The big renewal story of the last 12 months has been the reversion of pricing cycles in the commercial insurance and reinsurance sectors, marked by price increase moderation overall for the former, albeit with strengthening in challenged areas, and rapid acceleration for the latter.

HEADWINDS

- Multi-decade high inflation
- Rising loss costs
- Capital impairments
- Economic downturn
- Higher reinsurance / retrocession costs
- Climate change
- Catastrophe losses of ~$600bn since 2017
- Highly dynamic cyber risk landscape

TAILWINDS

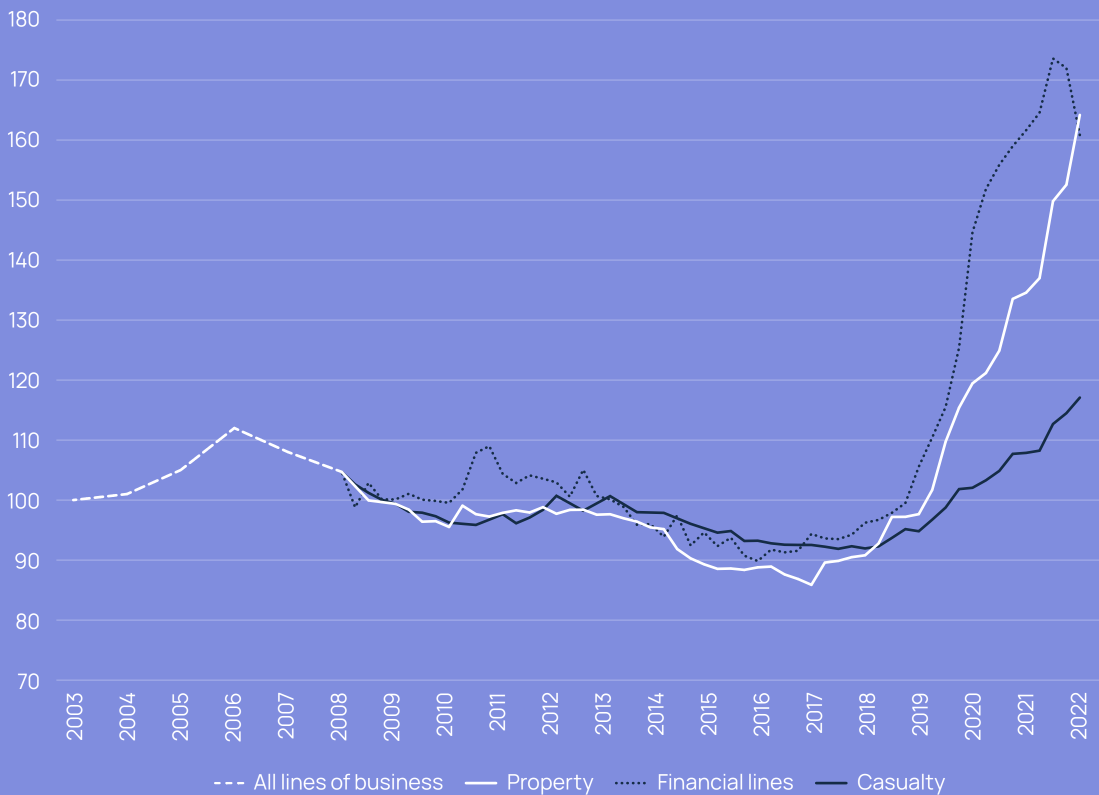
- Compounding pricing increases
- Tighter terms and conditions
- Anti-cyclical characteristics
- Risk awareness
- Growing demand for (re)insurance
- Higher interest rates / investment returns
- Premium growth (volume and pricing)
- Growth opportunities

Commercial insurance market

Prices across most commercial insurance lines continued to rise in 2022, the fifth year of a hardening market cycle. Buyers' hopes for a return to softer conditions have been complicated by multi-decadal inflation highs and sizeable losses from Hurricane Ian.

The commercial pricing cycle began in 2018 with diminished underwriting appetite, itself a reaction to weak results and earnings volatility. Returns have improved significantly since despite exceptional market losses so far this decade, and impairments to sector capital in 2022.

Figure 1: Global commercial insurance pricing index – 2003 to 2022 (Source: NOVA)



THE DELTA BETWEEN PRICE AND LOSS COSTS ACROSS COMMERCIAL PORTFOLIOS **REMAINS IN INSURERS' FAVOUR.**

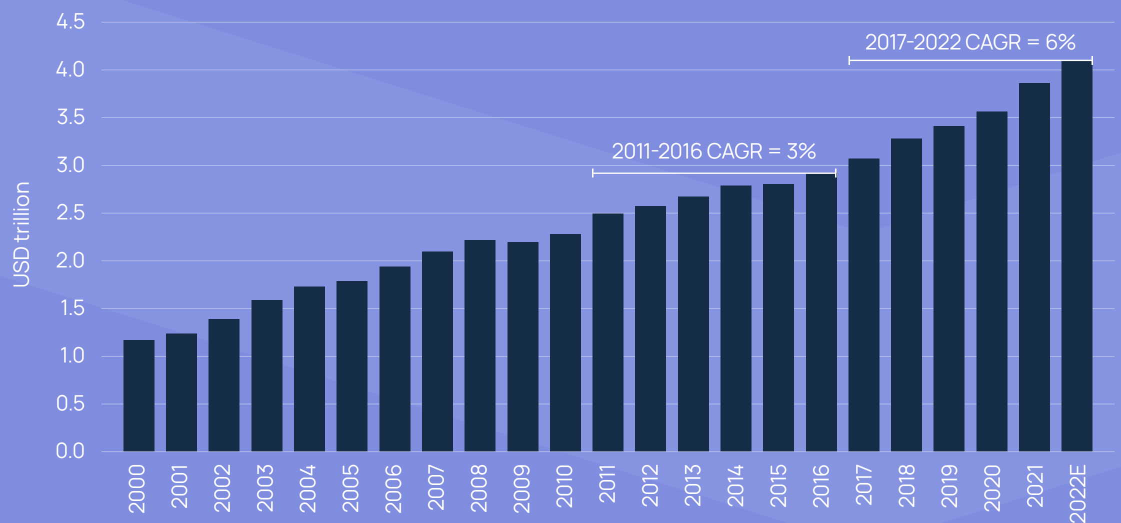
Although pricing continues to rise on an indexed basis overall, annual increases have begun to diminish. Commercial insurance rate rises averaged 9.8% year-on-year during the first three quarters of 2022, a deceleration from the 12.5% recorded for full-year 2021.

Most areas continued to achieve rate-on-rate gains in 2022, with some lines even bucking the tapering trend to record accelerated increases. Strong competition in financial lines on the other hand saw pricing moderate initially and then decrease towards the end of the year. Classes with the highest price rises included cyber and catastrophe-exposed property whilst premiums for worker's compensation and directors and officers (D&O) were subject to less pressure and registered decreases in certain regions.

Buyers can expect similarly bifurcated dynamics in 2023, with pockets of stress in areas such as property and other markets affected by adverse loss experience and rising claims inflation contrasting with capacity abundance elsewhere as insurers look to grow in lines where performance is strong. The hard reinsurance market and higher financing costs, not to mention an unbroken six-year run of above-average catastrophe losses, mean insurers' costs of capital are increasing.

The commercial market is well placed to navigate this environment. The underwriting uplift from 20 consecutive quarters of price increases is substantial and the delta between price and loss costs across commercial portfolios remains in insurers' favour. Demand for protection continues to be robust (see Figure 2), and crucially, higher investment returns will boost earnings as interest rates normalise.

Figure 2: Global non-life insurance premium – 2000 to 2022 (Source: Howden, Swiss Re)



The viability of additional hardening must be weighed against the danger of businesses buying less protection and retaining more risk following four years of compounded rate increases and additional cost pressures elsewhere, not least energy.

The intricacies of the current marketplace require the highest level of broking experience and expertise to unlock supply. For all the challenges confronting commercial insurance buyers, capacity is available as more carriers pivot from remediation to growth. These are disciplined plays designed to leverage the firming rate environment, and competition creates opportunity.

As the risk landscape undergoes structural change, and inflation requires careful adjustments to limits to address higher insured values, differentiated advice and creative risk management solutions can make all the difference.

Reinsurance market

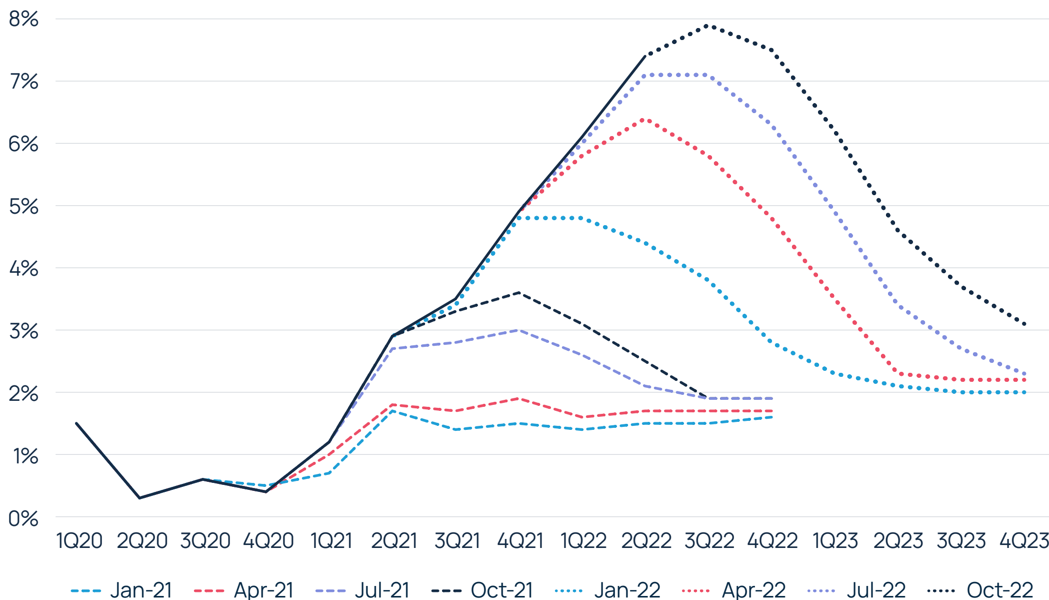
Having initially experienced lower pricing increases compared to those recorded in the commercial insurance market, the reinsurance sector reached its tipping point during mid-year renewals last year (as outlined in Howden's recent report).[1]

Macroeconomic and geopolitical realignments, alongside persistent outsized natural catastrophes, reset supply and demand dynamics in several areas, with buyers seeking to secure additional top-end cover in response to rising insured values and more premium entering the market. Demand-side pressures coincided with a severe capacity crunch, as capital providers (both rated carriers and ILS) pulled back whilst others were only willing to maintain allocations. The mismatch between supply and demand was already estimated to be in the tens of billions of dollars when Hurricane Ian hit Florida as a category 4 storm to reinforce one of the hardest reinsurance markets in living memory.

Asset-driven declines in dedicated reinsurance capital exacerbated capacity constraints at 1 January 2023. Whilst the sector's strong gearing to investment-grade fixed income securities bolstered its capital position through the era of ultra-loose monetary policy, it is now navigating adverse impacts in response to rapidly changing inflation expectations and sharp decreases in the value of fixed income investments – especially at the short end of the curve where shorter-tail carriers tend to invest.

Figure 3 shows how headline inflation forecasts for advanced economies provided by the International Monetary Fund have trended over the last 24 months. The misses in 2021 and 2022 are stark, averaging around 2.5 percentage points compared to a near-zero average for 2020 and all of the preceding decade. As a result, markets have lost faith in the consensus, leading to significantly higher forward interest rate assumptions.

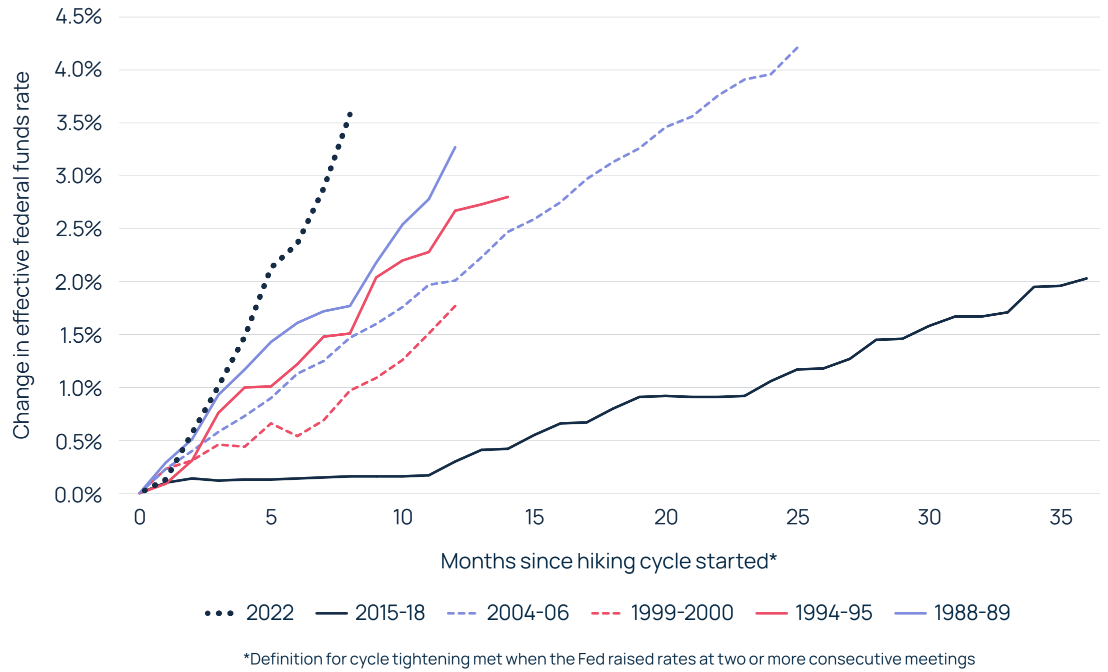
Figure 3: Headline inflation forecasts in advanced economies – 1Q20 to 4Q23
(Source: Howden, International Monetary Fund)



The result has been the most front-loaded cycle of monetary tightening in recent history. Figure 4 plots the increase in the U.S. effective federal funds rate last year, surpassing anything seen in the last 40 years. Other central banks have had to undertake similar, albeit more moderated increases, not least to protect the value of their currencies.

[1] Howden, *A Tipping Point*, September 2022.

Figure 4: U.S. monetary tightening cycles – 2022 vs historical (Source: Howden, Federal Reserve)



*Definition for cycle tightening met when the Fed raised rates at two or more consecutive meetings

This has had a significant impact on reinsurers' balance sheets. During the first nine months of 2022, unrealised losses for a composite of reinsurance companies accounted for nearly all of the capital decline shown in Figure 5, as other items more or less offset one another.

Given the sector's outsized exposure to shock catastrophe events and the accompanying risk of early asset liquidation to pay claims, the impact of unrealised losses is likely to influence capital allocations in the near-term, even if they reverse over time.

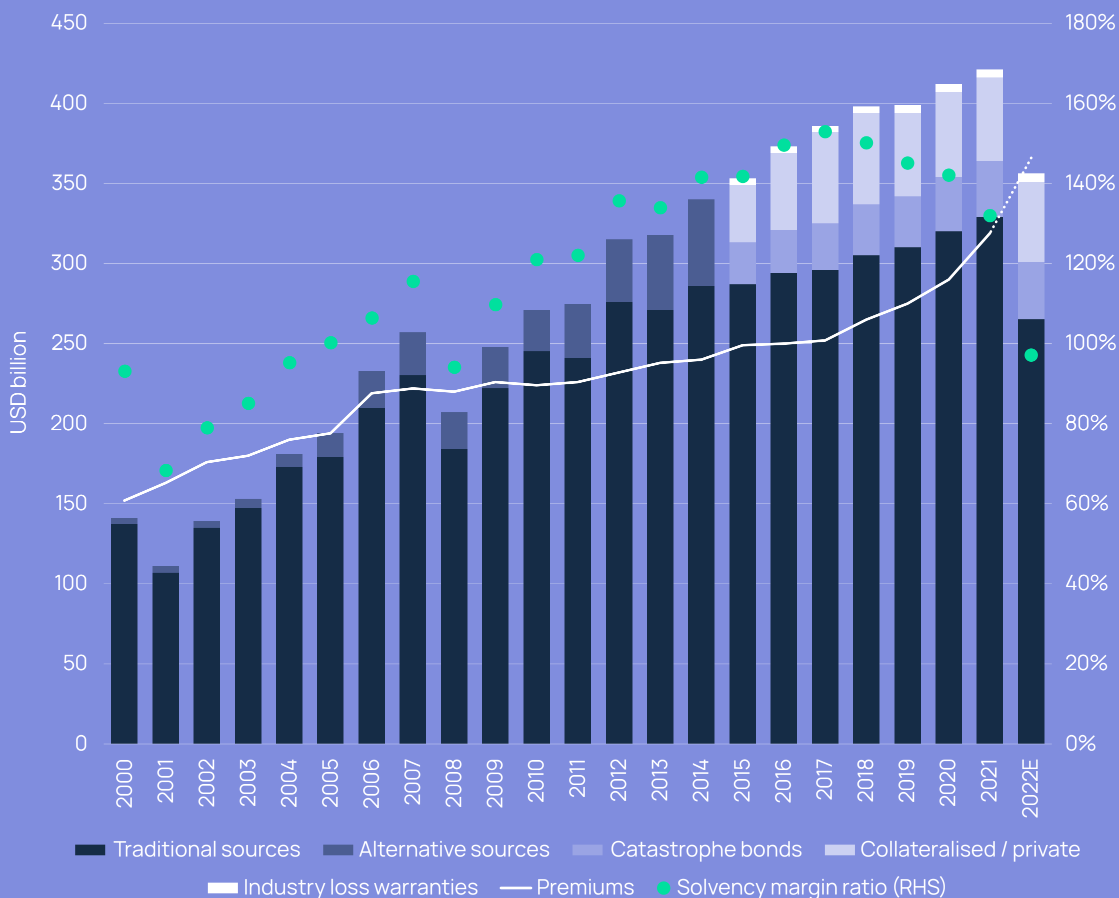
Figure 5: Components of capital decline for Howden's reinsurance composite – YE21 to 3Q22 (Source: NOVA)

Capital raises from incumbent carriers in 2022 were restricted amidst heightened market uncertainty and higher financing costs. Nor was there any meaningful reload from third-party capital investors, who were inclined to assess 1 January renewal outcomes before weighing potential deployment opportunities in 2023.

Capital inflows of USD 3.3 billion plus post-Hurricane Ian were stunted compared to the USD 14 billion and USD 18 billion that entered in 2001 and 2005 during similar timeframes. Trapped capital compounded the dearth of supply. Future allocations into the reinsurance market will be weighed against the changing risk landscape, along with potential opportunities in other asset classes as 'risk-free' yields rise, especially at shorter durations.

Bringing all this together, Figure 6 shows how Howden's estimate of total dedicated reinsurance capital has trended relative to gross reinsurance premiums written since the turn of the century. Capital erosion of close to 15% to USD 355 billion at YE22, the first full-year decline since 2008, together with significantly higher premiums, sent the sector's solvency margin ratio (capital divided by premiums) down below 100, a level last recorded during the global financial crisis. It also left certain reinsurers more exposed to liquidity and credit risks at a time of heightened claims uncertainty.

Figure 6: Dedicated reinsurance capital and global gross reinsurance premiums (all lines) – 2000 to 2022 (Source: NOVA)



Reinsurance renewals

All of which converged to create highly challenged and complex reinsurance renewals at 1 January 2023. Structures and coverage terms were at the forefront of property-catastrophe negotiations this year, amidst recognition from all parties that prices would rise significantly. Reissued firm order terms, non-concurrent terms and diversification plays leveraging demand for catastrophe capacity as a way to improve access and margins for non-property business reflected shifting market conditions.

Persistent and elevated catastrophe losses, along with the attendant issue of catastrophe model efficacy, continued to drive sentiment in property lines amidst concerns that changing weather patterns are increasing both the frequency and severity of climate-sensitive perils. Higher retentions, tighter terms and reduced frequency coverage (i.e. aggregates, lower excess-of-loss layers, quota shares) reflected reinsurers' resolve to focus more on capital protection after six consecutive years of above-average catastrophe losses.

Navigating more restricted retrocession coverage terms, and having been hit by surprise losses in recent years, reinsurers looked to enhance coverage certainty by adding exclusions to all-risks cover or moving to named perils. Terrorism and strikes, riots and civil commotion (SRCC) in particular came under scrutiny, with a number of reinsurers willing to maintain all-perils coverage as long as robust exclusions were in place for these risks. Others pursued more restrictive solutions, with coverage offered on a specific named peril basis only. Some cedents agreed to narrower, peak peril protection for higher layers in order to close deals and entice capacity.

Several lines in specialty reinsurance likewise underwent a correction at 1 January 2023 in response to sizeable losses from the Ukraine war. Casualty renewals were more orderly in comparison, although market conditions also tightened here. Concerns about loss costs in a high inflationary environment, along with moderated rate increases on original casualty business, counterbalanced favourable supply dynamics to yield firming renewals overall.

STRUCTURES AND TERMS WERE AT THE FOREFRONT OF PROPERTY-CATASTROPHE NEGOTIATIONS, AMIDST RECOGNITION FROM ALL PARTIES THAT PRICES WOULD RISE SIGNIFICANTLY.

Global direct and facultative

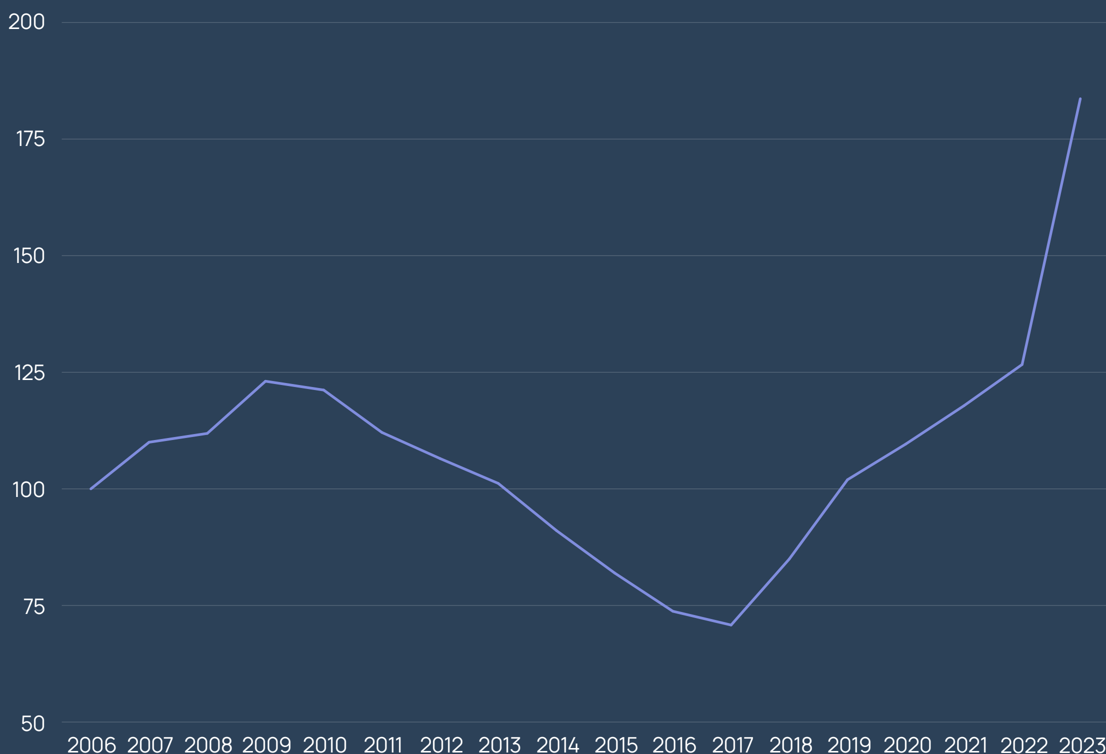
Even in this highly challenged environment, the direct and facultative (D&F) market recorded strong growth in 2022 and continued to support clients renewing programmes at 1 January 2023. Increased demand for D&F catastrophe cover – driven by an inflation-induced rise in insured valuations on original business, attendant requirements for increased reinsurance limits and reduced retrocession capacity – added to pre-existing supply and pricing pressures.

Figure 7 shows how six successive years of significant reinsurance rate rises, with a marked acceleration of 45% in 2023, has yielded a cumulative increase of 160% plus since 2017 to take pricing levels above those recorded in the aftermath of Hurricane Katrina in 2006. The underlying market has benefitted from even more substantial pricing tailwinds during this time.

Changes to programmes' structures and terms were substantial at 1 January 2023, making any comparison to prior years difficult given that the degree of change in coverage provided. Retentions were up significantly, coverage terms moved towards named perils and terms and conditions tightened. Price movements varied significantly depending on loss experience and performance.

Capacity nevertheless continued to be available at the right price and level at 1 January 2023. Late activity in the retrocession market yielded more favourable outcomes than expected for some carriers, which relented D&F supply constraints in late December. This saw most deals over the line and enabled certain cedents to push back successfully on attempts by markets to limit coverage. Named natural catastrophe perils prevailed in most cases, meaning any remnants of non-natural catastrophe coverage ceased at 1 January 2023, unless caused by natural catastrophes.

Figure 7: Global D&F reinsurance pricing index – 2006 to 2023 (Source: Howden)



EVEN IN SUCH A HIGHLY CHALLENGED ENVIRONMENT, THE D&F MARKET CONTINUED TO SUPPORT CLIENTS RENEWING PROGRAMMES AT 1 JANUARY 2023.

Favourable pricing trends on original business, along with changes to terms and conditions and improved risk selection, has seen D&F underwriting outperform in recent years. Improved underlying deductibles have reduced attritional losses whilst exclusions around communicable disease, cyber terrorism and SRCC have limited unpriced losses. Efforts to de-risk in other areas have also paid off, as carriers have improved retention levels and reduced PMLs whilst maintaining income levels.

All of which has supported D&F reinsurance profitability during a period of heightened loss activity. Whereas carriers operating in the regional, nationwide and retrocession spaces in the past six years suffered several losses that breached programmes (e.g. U.S. hurricanes, Japanese typhoons, U.S. wildfires, floods and convective storms), D&F reinsurers have been less exposed and escaped with low layer losses for peak perils and ran largely clean for secondary perils. D&F losses from Hurricane Ian also appear to be developing favourably compared to other markets.

From an underwriting perspective, D&F business continues to provide significant opportunity, with rate increases sufficient to justify material portfolio expansion. From a purchasing perspective, the attractiveness of D&F excess-of-loss pricing and capacity availability, and the continued reduction of combined D&F and retrocession programmes, is fuelling demand.

This increase in demand is being absorbed mostly by rated carriers that operate in the D&F market, compared to the more ILS-centric retrocession market, although some ILS providers have stepped up. Whilst investor aversion and trapped capital led to reduced retrocession supply at 1 January 2023 renewals, capacity in the D&F market was more resilient, with global markets specifically stepping up. In this challenged environment, the London D&F market is once again differentiating itself by finding capacity for increased business flow whilst displaying underwriting skill and delivering strong results.

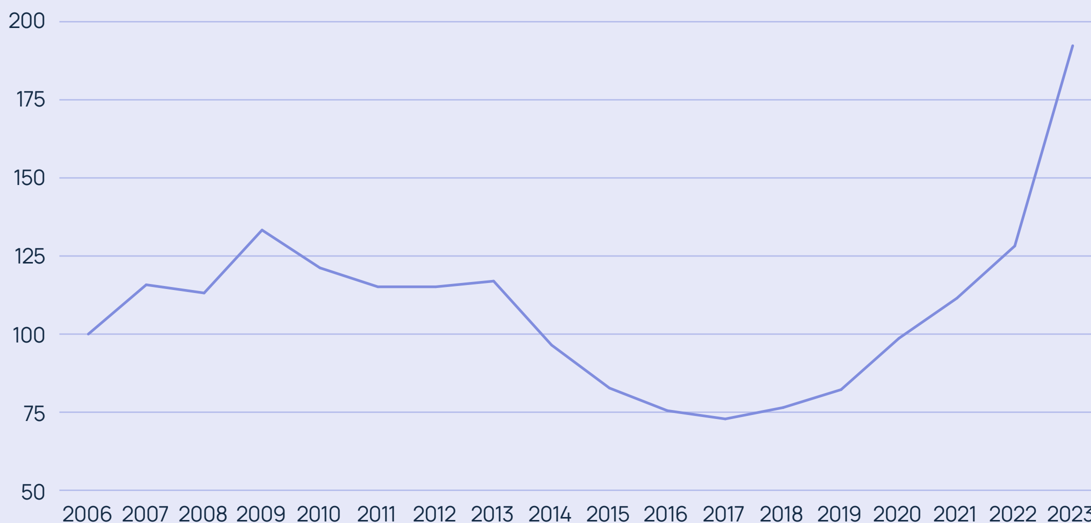
Retrocession

Hurricane Ian's impact on an already dislocated retrocession market meant a sizeable portion of collateralised retrocession capital was trapped going into 1 January 2023 renewals. The second most expensive real-terms loss on record added to challenges that included significant prior year losses, investor fatigue and withdrawals from traditional carriers following several years of lacklustre performance. The timing of Hurricane Ian also meant that many retrocession buyers were forced to reassess their underwriting plans for 2023, causing a temporary slowdown in the market.

The corollary was more limited and more expensive retrocession capacity in 2023, although supply dynamics varied as capital providers prioritised performance and long-standing partners. When capacity was secured, higher attachment levels and another round of pricing increases were required to mitigate rising inflation and other loss amplifiers, including claims from Hurricane Ian and a succession of expensive secondary peril events.

The majority of UNL placements were occurrence based, with limited aggregate structures purchased and many markets pulled back from retrocession quota shares. Named-peril contracts, already widely used in the retrocession market, became more prevalent as several buyers agreed to narrower coverage. Cedents nevertheless pushed back on attempts to tighten buffer loss factors and increase exclusions for non-core coverages.

Figure 8: Howden Risk-Adjusted Non-marine Retrocession Catastrophe Rate-on-Line Index – 1992 to 2023 (Source: NOVA)



Risk-adjusted retrocession catastrophe excess-of-loss rates-on-line rose by 50% on average at 1 January 2023 (see Figure 8), with a range of up 20% to up 90%. Following significant remediation to aggregate covers and low-attaching occurrence layers at previous renewals, double-digit increases were also recorded for layers further up occurrence programmes at 1 January 2023, indicative of the acute supply constraints across the market.

Rated carriers continued to de-risk or withdraw whilst difficult fundraising conditions, marked by a volatile macro environment, added to investor caution for a market that has underperformed in recent years. Diversification benefits, so important to ILS investors, are now being weighed against evidence that loss frequency and severity are being impacted by climate change and other factors, including potential catastrophe model limitations.

[2] This is a point estimate within ranges depending on loss experience, exposure, territory and other client-specific conditions, and masks pockets of significant challenge for certain risks.

Some capital providers looked for allocation opportunities in the run-up to renewal, but not at a level or commitment sufficient to ease supply gaps. Trapped capital from Hurricane Ian, alongside downsized allocation limits due to poor performance in equity and bond markets, led to reduced capital inflows into the catastrophe bond market. As a result, new issuances fell, spreads widened significantly, transaction sizes shrunk and terms tightened in 4Q22. Pricing widened throughout the curve, up approximately 50% versus the first half of 2022 and between 70% and 120% compared to 2021 levels.

The catastrophe bond market nevertheless continues to be the preferred ILS product due to the liquidity provided to investors, as evidenced by eleven transactions in Q4, raising approximately USD 1.5 billion in capital markets-based risk transfer capacity. Activity in the insurance loss warranty (ILW) market increased as cedents looked to secure capacity despite historically high pricing (up 70% on average in December for U.S. wind and earthquake) and higher attachment triggers (most trades were above USD 60 billion). Pockets of capital were available for lower attaching occurrence layers, but many of these excluded Florida.

Confronted by this backdrop, buyers were forced to restructure programmes, exclude risks, explore alternative solutions (including index products) or buy less protection. All of which had implications for property-catastrophe reinsurance supply.

Property-catastrophe reinsurance

Late or incomplete retrocession placements meant that property-catastrophe reinsurers had less clarity than usual around their net positions when offering renewal lines at 1 January 2023. Given capacity constraints, several reinsurers prioritised existing renewals despite significant submission inflows. This, along with gaps in some programmes, is likely to see continued purchasing activity leading up to this year's North Atlantic hurricane season.

Figure 9: Howden Global Risk-Adjusted Property-Catastrophe Rate-on-Line Index – 1992 to 2023 (Source: NOVA)

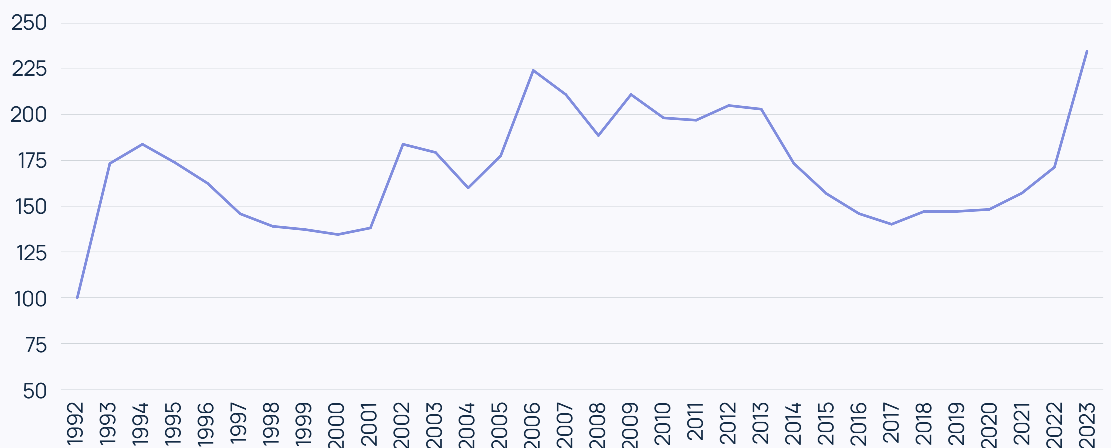
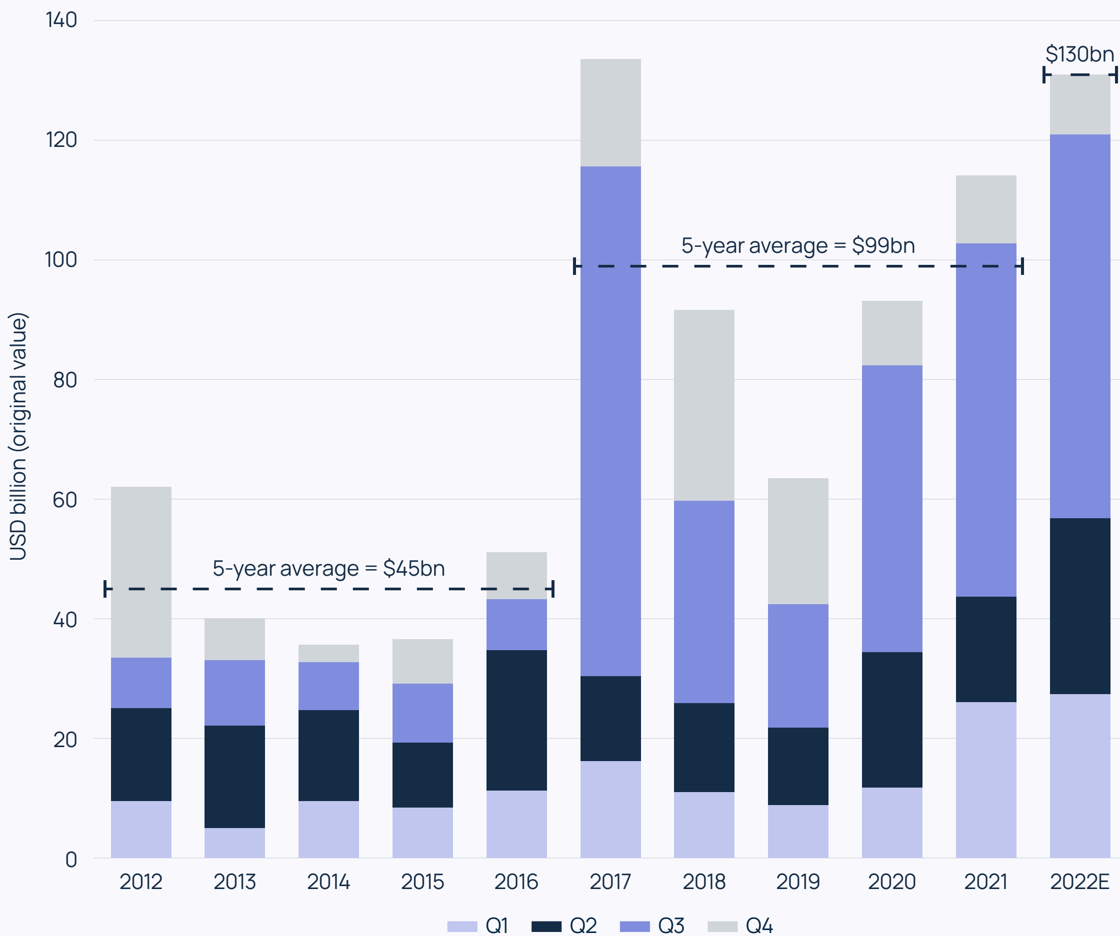


Figure 9 shows that Howden's Global Risk-Adjusted Property-Catastrophe Rate-on-Line Index rose by an average of 37% at 1 January 2023.[2] This was considerably higher than the 9% recorded last year, and marks the biggest year-on-year increase since 1992.

The result reflected a seismic shift in supply and demand dynamics. Retention levels, which in several cases have been stable for much of the last decade, rose significantly (in the U.S. especially) to reduce reinsurers' frequency exposures and meet demand from cedents for top-end cover following inflation-induced increases to insured valuations. And with no let-up in loss experience – the USD 100 billion threshold was breached once again in 2022 whilst cumulative insured losses over the last six years are now in excess of USD 600 billion (see Figure 10) – reinsurers were determined to achieve outcomes commensurate with the levels of risk absorbed.

Figure 10: Global insured catastrophe losses by quarter – 2012 to 2022 (Source: NOVA)



From a pricing perspective, this typically translated into mid double-digit increases depending on performance and loss experience. Equally consequential changes were made to terms and conditions, event definitions and scope of coverage as reinsurers looked to reduce earnings volatility following the unusual mix of major losses. Where reinsurers' demands were not met, participations were often reduced and some layers went unfilled.

ELEVATED CATASTROPHE LOSSES AND INFLATION WERE KEY INFLATING FACTORS FOR PROPERTY RENEWALS IN 2023.

Europe

Programmes up for renewal at 1 January are weighted towards European exposures, and loss experience and inflation in the region were key inflating factors in 2023. Following on from storm Bernd in 2021, the European market suffered further damaging losses in 2022, including costly EU windstorms early in the year and historic hail events in France during the summer, which have developed adversely.

Following a prolonged period of relatively benign loss activity, the string of losses in Europe in the last two years tested reinsurers' assumptions around frequency and severity. Strong demand for additional limits to counter inflation, combined with some retrenchment from incumbent reinsurers, created a challenging environment for buyers that often resulted in higher attachment points, more stringent terms, paid reinstatements and substantial rate increases – up 30% on average, but significantly higher for loss-affected programmes. Capacity was nevertheless sufficient to see most deals over the line, particularly for cedents able to demonstrate strong performance and / or leverage long-standing relationships.

United States

U.S. renewals were even more challenged overall, with an average rate-on-line increase of 50% reflecting a highly stressed marketplace that became even more critical after Hurricane Ian's historic loss. Increased demand coincided with supply constraints to create the most difficult U.S. renewal in decades. Some buyers failed to fill their programmes and named-peril coverage was more prevalent. Some insurers resorted to shortfall covers, as a result.

Outcomes were a culmination of building pressures in the U.S. market, which, in addition to rising insured values and reconstruction costs, has absorbed losses from seven major landfilling hurricanes in six years, as well as several high profile secondary peril losses, including wildfires, convective storms and winter storms. Hurricane Ian exacerbated underlying capacity and pricing tensions as losses breached reinsurance towers.

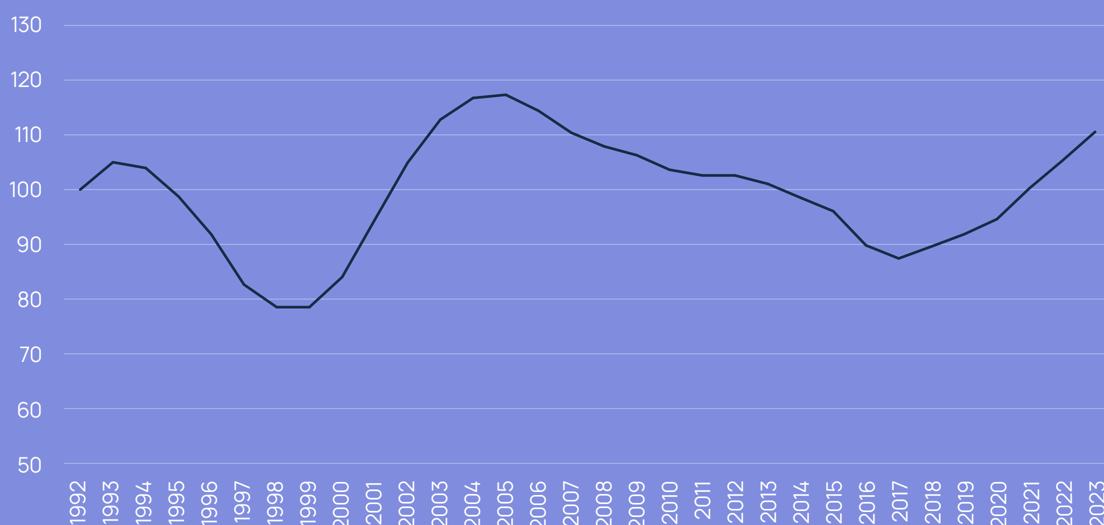
The result was the biggest change in rates-on-line since 2006. The lack of capacity for lower layers meant cedents were forced to retain more. Demand from some larger cedents for more top-end coverage to counter high inflation dissipated somewhat as escalating pricing and tightening terms challenged the economics of additional limits.

Casualty reinsurance

Casualty reinsurance supply dynamics, facilitated by reinsurers' diversification strategies, remained stable throughout 2022 and into the 1 January 2023 renewal. Despite deteriorating macro fundamentals in 2022, reinsurers have benefitted from a prolonged period of compounded price increases on original business, even if these moderated last year. Investment portfolios will also soon yield improved returns as interest rates rise.

Casualty renewals nevertheless tightened at 1 January 2023. Concerns about inflation and reserve adequacy for prior (soft market) years, along with tapering casualty insurance rates and a desire for market tightening to mirror conditions in the primary market, prevailed to shape outcomes. Isolated instances of loss deterioration reported by certain cedents last year for financial lines exposures reinforced the cautious outlook.

Figure 11: Howden London Market Casualty Risk-Adjusted Reinsurance Rate Index – 1992 to 2023 (Source: NOVA)



As a result, London market casualty reinsurance excess-of-loss rates, including adjustments for exposure changes and inflationary impacts, rose by 5%[2] on average at 1 January 2023 (see Figure 11). Reinsurers cited rising inflation and the prospect of higher claims severity for the increases. Outcomes were similar to those recorded last year (where the corresponding data point was also + 5%), as strong demand and discerning supply told.

Upward pressure on ceding commissions seen in recent years abated. A select number of improved or outperforming accounts were able to achieve flat commissions, with reinsurers still keen to tap into attractive economics derived from underlying remediation. Most other accounts saw decreases of one to two percentage points, with steeper reductions for those that have not performed so well or where underlying pricing deteriorated. U.S. D&O commissions in particular came under pressure as original rates saw significant reductions and unfavourable reserve development was reported.

Reinsurers' attempts to achieve improved pricing and terms for casualty business in exchange for access to constrained catastrophe capacity were counterbalanced by cedents' willingness to increase retentions if demands were deemed excessive.

A volatile world

Volatility has been a rare constant through three years of relentless change. Economic shocks and geopolitical realignments during this time have ended the era of low inflation and cheap capital and introduced variables like commodity crises, stagflation and interest rate risks.

Risks are escalating as the world lurches from one crisis to another. With unexpected losses from Russia's invasion of Ukraine coming fast on the heels of COVID-19, and coinciding with other systemic threats (e.g. cyber and climate change), risk aversion is prevalent.

The current environment presents a huge opportunity for the (re)insurance market to reinforce its value. (Re)insurers have long played a crucial role in shoring up economic resilience by paying claims, and are in a strong position to secure their role as trusted partners by continuing to offer affordable capacity and coverage during one of the most important periods of change in living memory.

Conditions are undoubtedly challenging – financial market volatility and stress in the world economy look set to extend deep into 2023 whilst structural changes to the loss environment continue to cause considerable underwriting uncertainty – but it is incumbent on carriers and brokers alike to apply their intellectual and financial capital to find creative solutions for the risks of today. This is the route to long-term relevance, and untapped opportunities.

Howden is at the forefront of these efforts. We have a deep understanding of market dynamics and are renowned for delivering pioneering solutions that meet clients' needs. With macro shocks and geopolitical tensions fuelling uncertainty, and the risk landscape changing like never before, insurance and reinsurance buyers require detailed insights and analysis into key market drivers. Howden is leading the charge by providing cutting edge thought leadership and risk transfer advice to support clients in managing market change and maximising their potential.

ECONOMIC AND GEOPOLITICAL SHOCKS HAVE ENDED THE ERA OF LOW INFLATION AND CHEAP CAPITAL **AND INTRODUCED VARIABLES LIKE STAGFLATION AND INTEREST RATE RISKS.**

2022: a multi-crisis environment

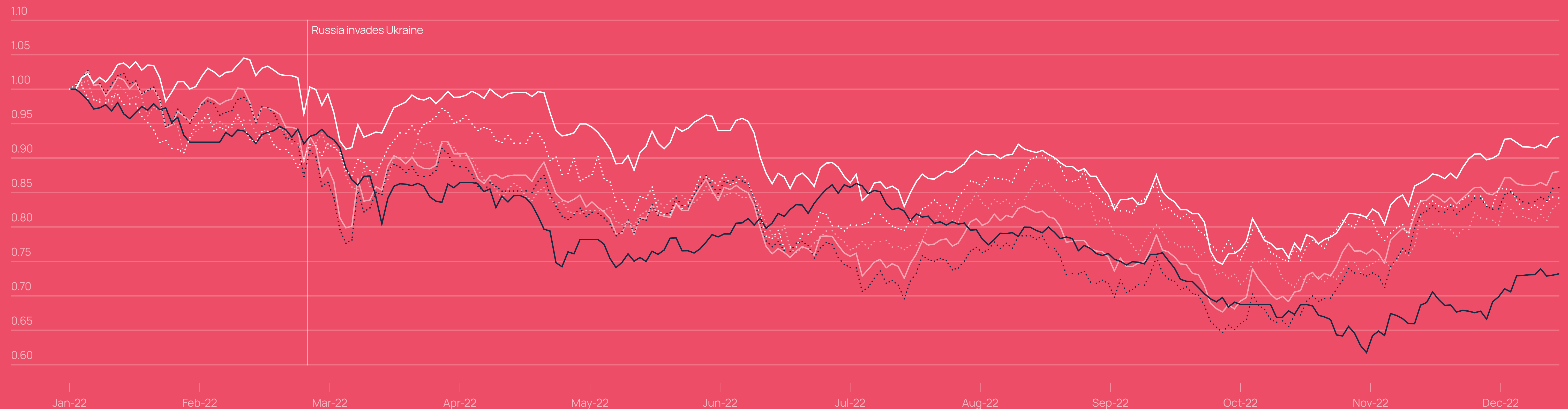
After the long shadow cast by COVID-19, 2022 held out promise for more stable times. It will go down in history as the year that never was in that regard, as Russia's invasion of Ukraine, together with legacy issues from the pandemic, led to financial market volatility, fractured energy markets and reset macro-fundamentals.

A year that started with high hopes for 'team transitory' ended with near double-digit inflation and the fastest cycle of monetary policy tightening in recent memory. Energy was the main inflationary force, but rising core inflation in several advanced economies revealed persistent pressures. Little surprise then that bonds and shares fell in tandem for the first time since the early 1980s.

Figure 12 shows all major equity markets were down in 2022, with a number of indices in bear market territory for much of the year before a rally late in the year erased some of the losses. The bond market recorded its worst performance in decades.

Heading into 2023, the threat of systemic risks in global financial markets from high inflation and interest rates, alongside heightened geopolitical tensions, will continue to be pre-eminent concerns. Energy security risks, as well as elevated losses from extreme weather events, also reinforce the need for climate change and the net-zero transition to be kept at the forefront of policymaking and (re)insurance innovation.

Figure 12: Performance of major equity markets in 2022 (Source: Howden, Bloomberg)



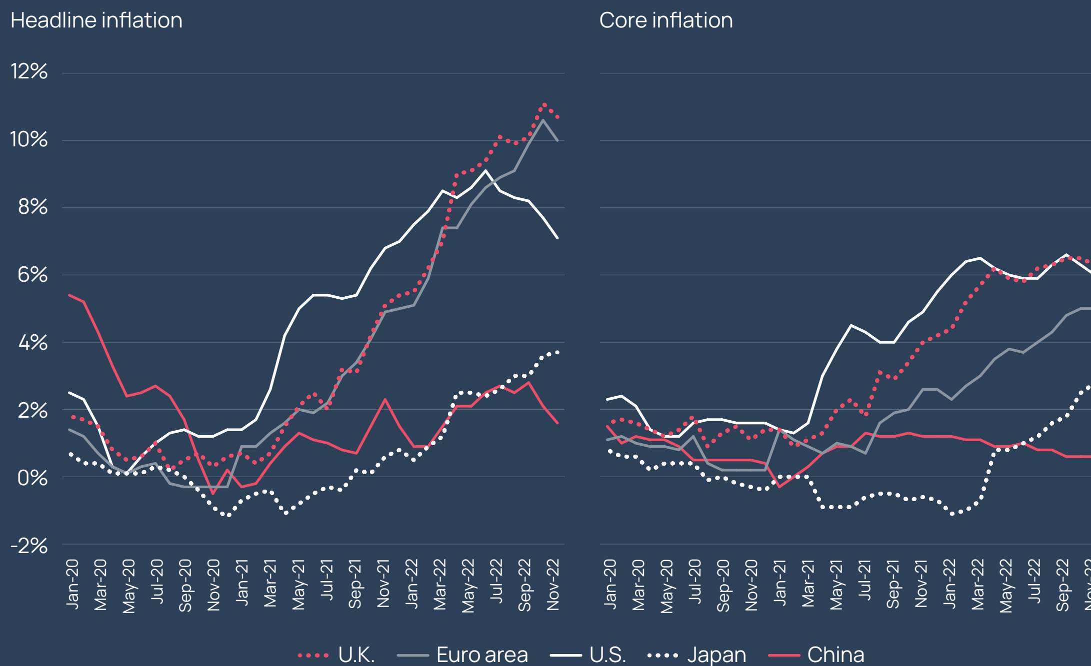
Inflation uncaged

Inflation has been the big macroeconomic story of the last 12 months. Figure 13 shows that price pressures are most acute in Western economies, with disinflation in China providing a source of relief given the country's influence over global energy consumption levels and exports of goods.

The significant overshoot of inflation targets in 2022 reflected a myriad of developments; the effects of the war in Ukraine most prominently, which caused food and energy prices to spiral, but also legacy-COVID impacts, where pent-up demand, stocked by fiscal and monetary stimulus, collided with supply issues to push up prices.

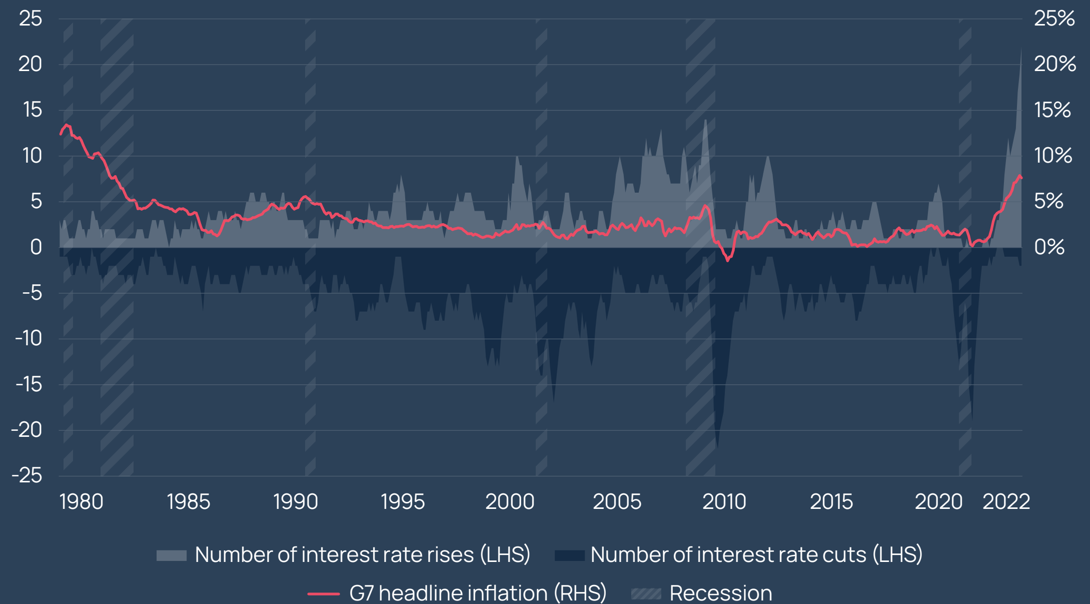
Core inflation, which strips out energy and food costs, is highest in the United Kingdom, Europe and United States, regions where labour markets are tight as wages rise above recent norms and certain segments of the population have left the workforce.

Figure 13: Headline and core inflation for select advanced economies – 1Q20 to 4Q22
(Source: Howden, Bloomberg, OECD)



The monetary response that followed was one of the most rapid and synchronised episodes of tightening on record (see Figure 14). Inflation has remained stubbornly high, however, and is likely to continue to force the hand of policymakers in 2023, even if headline pressures are expected to ease overall. Commitments by central banks to do what is necessary to return inflation to target have ominous growth implications. Indeed, decades have passed since prices fell from these levels without some sort of recessionary impact.

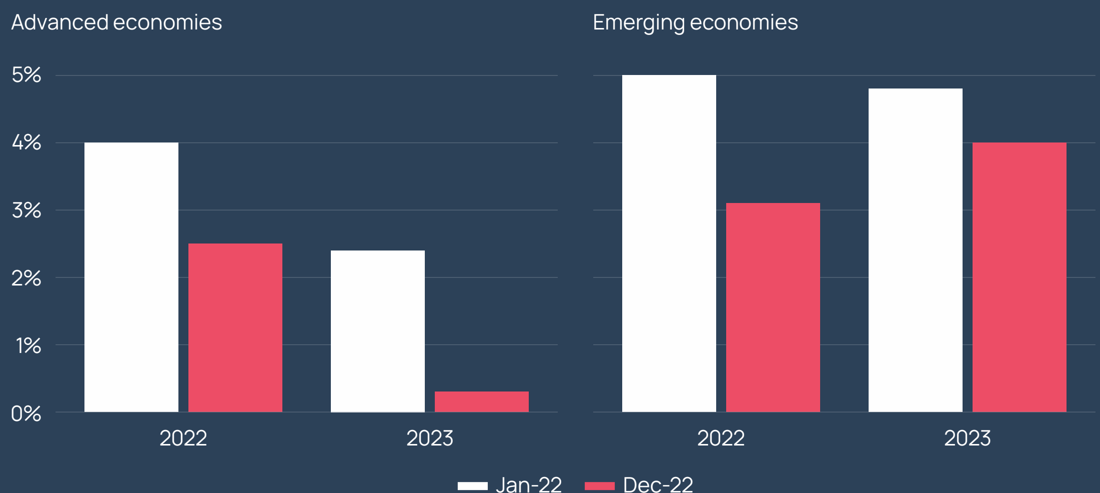
Figure 14: Global interest rate rises and cuts vs G7 headline inflation – 1980 to 2022[3] (Source: Howden, World Bank, Bank for International Settlements)



The challenges policymakers face in navigating the narrow path of stemming inflation and limiting economic damage will remain acute this year. Interest rate increases work with lags – economists estimate that rate rises can take months or even years before negating inflation – and there is growing concern that aggressive monetary policy tightening could bring larger than intended impacts and exacerbate the economic slowdown.

Growth forecasts for 2022 and 2023 have been reduced significantly, as a result. Downgrades are particularly large for advanced nations, where consensus growth forecasts have been cut by 1.5% for 2022 and are just above zero for 2023 (see Figure 15). Indeed, baseline scenarios for a few major economies (e.g. United Kingdom, Germany) are now projecting recessions, with mounting concerns for others. All of which points to more volatility and uncertainty in the year ahead.

Figure 15: Consensus growth forecasts for 2022 and 2023 (Source: Howden, Bloomberg)



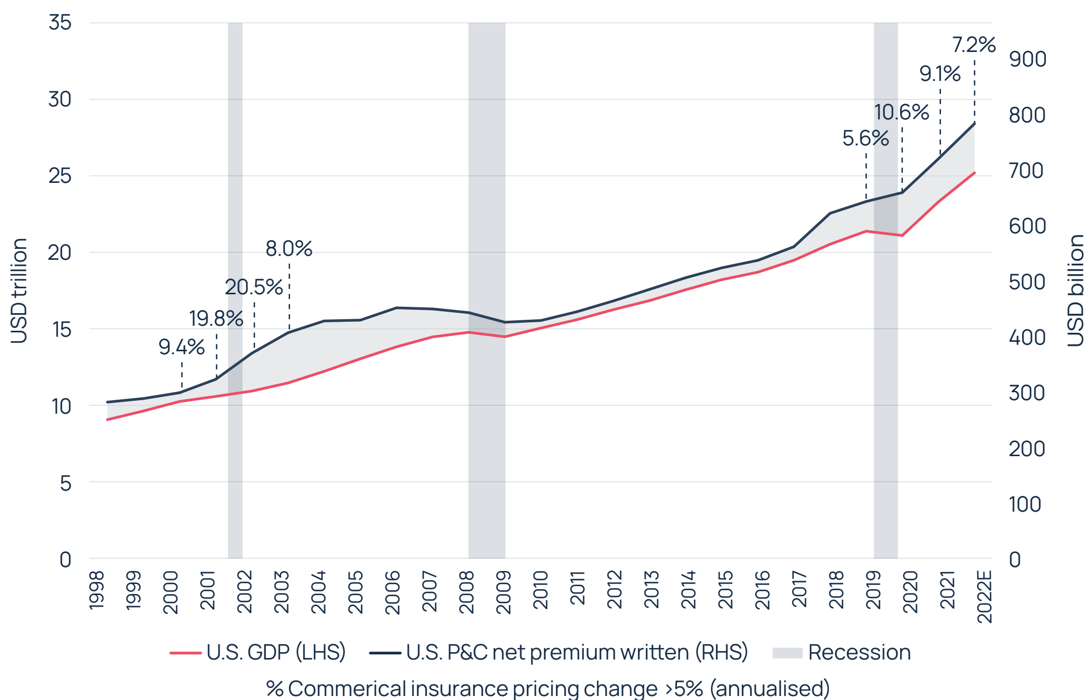
[3] Three-month average of the number of policy rate rises and cuts over each month for 38 countries, including euro area.

Top line tailwinds

This macroeconomic backdrop – weak economic growth, 40-year high inflation and rapidly rising interest rates – has important implications for the (re)insurance market. Despite deteriorating macro-fundamentals, the sector continues to benefit from strong premium growth overall.

Cyclical and structural factors on the demand side, including the changing risk landscape and inflation (i.e. higher asset / premium values), supported by sustained price increases, saw nominal U.S. P&C premiums keep up with healthy GDP growth last year (see Figure 16). This follows a prolonged period of above-trend premium growth that started in 2018.

Figure 16: U.S. GDP vs P&C insurance premiums – 1998 to 2022
(Source: Howden, U.S. Bureau of Economic Analysis, S&P Global Intelligence, CIAB)



Premium data in Figure 16 includes both commercial and personal lines, thereby understating the top line tailwinds experienced by the former given the relative soft pricing of the latter. Limits and exposures in commercial lines correlate closely to insureds' sales, fixed assets and payrolls, items that registered inflation-induced growth in 2022 and helped sustain sizeable premium increases, augmented further by rate rises.

Headwinds are building, however. Some businesses are now looking to restructure programmes and increase retentions in order to contain premium increases and secure the additional limits required by higher inflation. The risk of monetary policy overshoot and recession cannot yet be discounted either, given the speed and magnitude of interest rate increases.

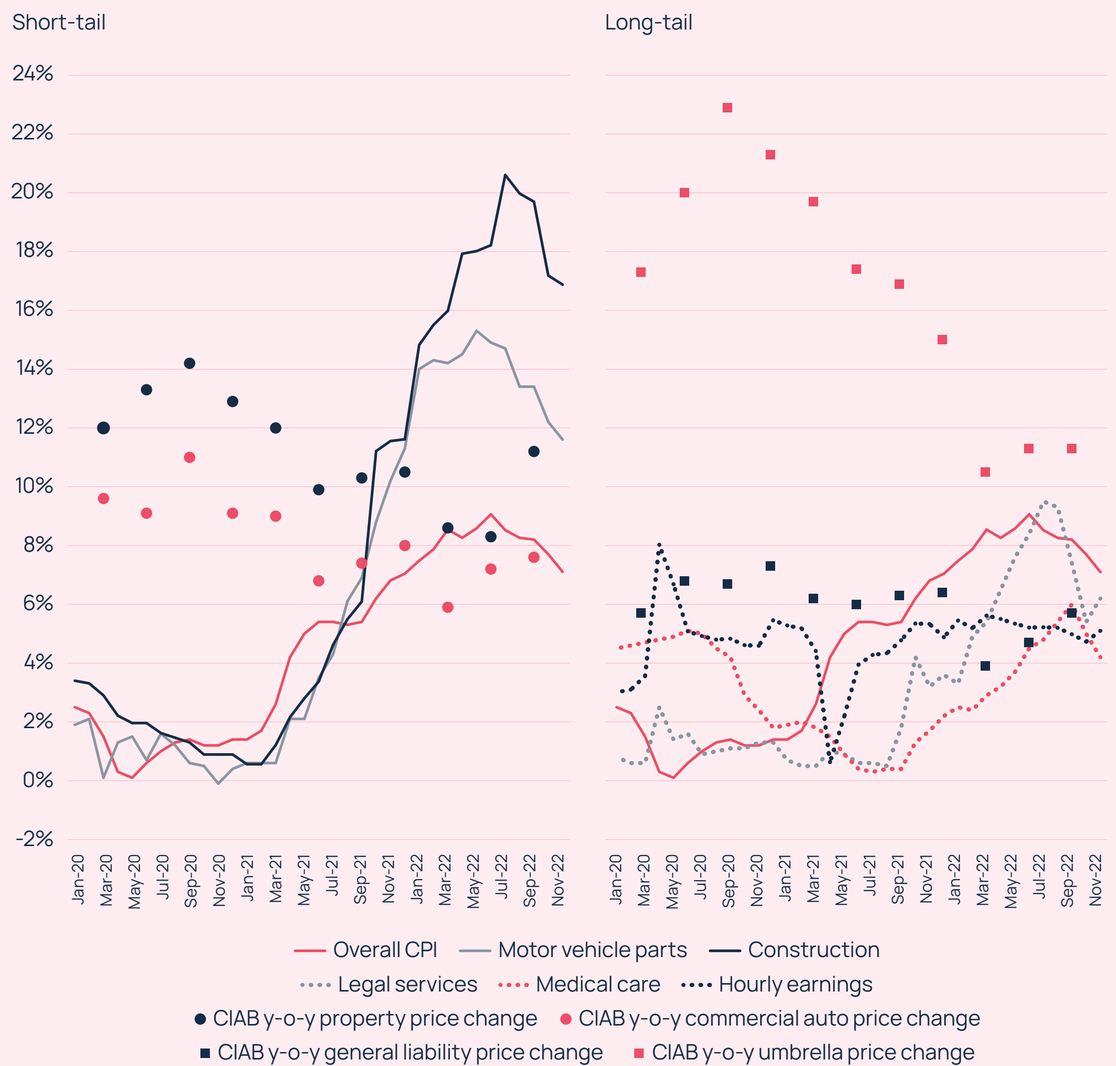
Market hardening during recessionary periods, especially when risk aversion is high, is an important reason why insurance can be counter-cyclical to the rest of the economy. But any severe or protracted downturn that increases company bankruptcies, cuts payrolls and reduces asset values would likely constrain top line growth, particularly if it coincided with receding pricing tailwinds.

Inflation headwinds

Macroeconomics are changing the claims and investment environment too. Alongside rising economic inflation, and its implications on claims costs and reserve adequacy, considerable offsets from higher investment income are likely to materialise over the medium term as interest rates normalise. There are also legacy-pandemic impacts to consider, which continue to shape supply chains, driving patterns, claims behaviours and loss experiences.

Short-tail lines such as property and motor have been most impacted by surging inflation so far, as elevated costs (materials and labour) and replacement values, in addition to supply chain issues and longer repair times, add significantly to claims severity. Liability lines are more exposed to subsets of wage, medical and legal costs, areas that have generally lagged overall CPI up to now in most advanced economies.

Figure 17: U.S. CPI for categories relevant to short-tail and liability lines vs year-on-year price changes – 1Q20 to 4Q22 (Source: Howden, BLS, CIAB)



The left hand chart in Figure 17 shows U.S. construction costs rose substantially last year, significantly ahead of overall CPI. Although building costs now look to have peaked, they are expected to stay elevated in 2023. The motor market likewise experienced sharp price pressures from high vehicle values and rising costs for labour and parts. Long-tail lines were more modestly impacted by broadening inflation, with mid single-digit increases for relevant CPI categories in 2022 (see Figure 17, right).

Even with (re)insurers adopting more conservative loss cost assumptions in response to rising inflation, carriers reported last year that pricing increases in commercial lines were sufficient to cover rising claims costs in most areas. Pressures in the property market, exacerbated significantly by Hurricane Ian, triggered a pricing response towards the end of last year, and strong underwriting conditions elsewhere sustained or even improved margins overall.

Reserve development was mostly favourable during the first nine months of 2022. For carriers that moved to strengthen reserves in response to rising inflation and higher litigated claims, actions were concentrated around short-tail lines most exposed to pressures. Conservative loss picks, along with higher pricing, reduced limits and higher attachment points, put commercial writers in a strong position to navigate potential adverse loss experience. The spectre of elevated inflation becoming entrenched has nevertheless increased reserving risks for long-tail lines.

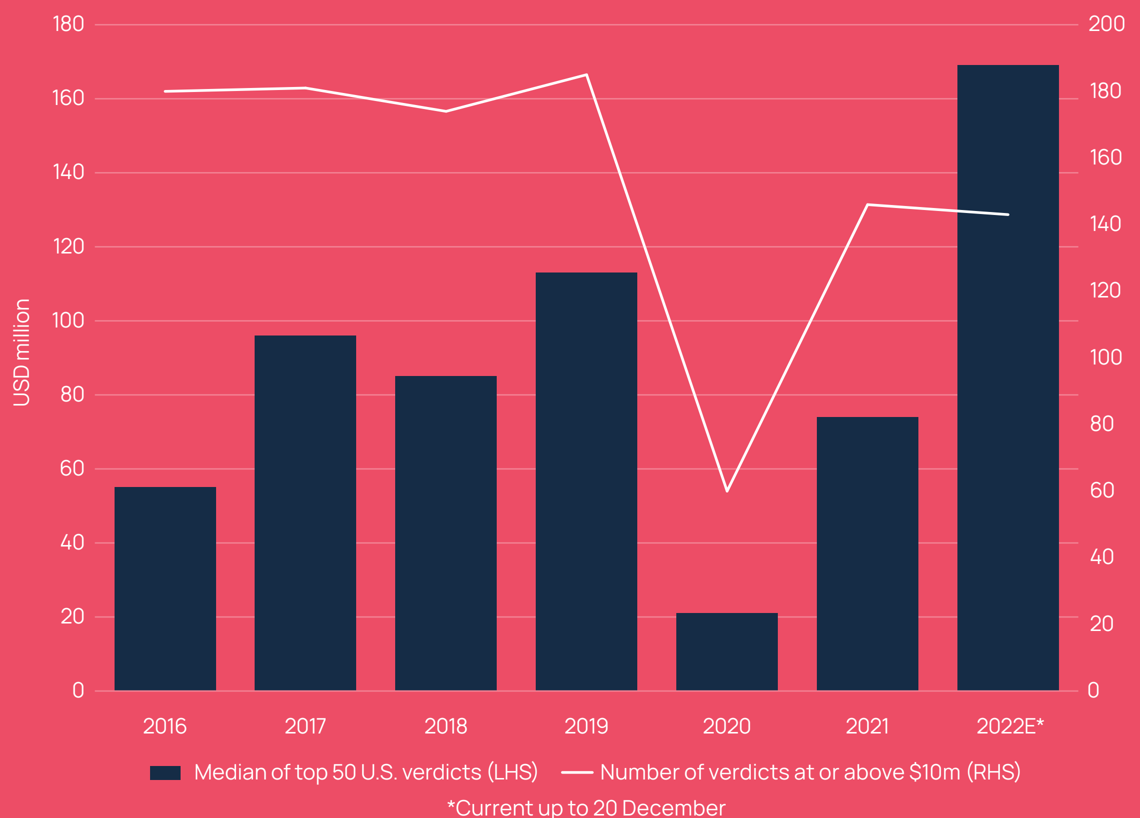
THE SPECTRE OF ELEVATED INFLATION BECOMING ENTRENCHED **HAS INCREASED RESERVING RISKS FOR LONG-TAIL LINES.**

Sting in the long-tail?

As economic inflation dominates the headlines, social inflation also continues to cause unease for (re)insurers. COVID initially held back loss costs due to court closures and case backlogs, but these transitory distortions now appear to be giving way to more normalised experience as litigation resumes.

Figure 18 shows how the frequency and severity of 'nuclear' verdicts in the United States have trended in recent years. According to data from Verdict Search, the number of cases with USD 10 million plus verdicts plummeted during the height of COVID, reflecting court closures, before recovering partially in 2021 and 2022. The equally stark drop in the median of the top 50 verdicts also reflected closures in 2020 and intermittent hearings in 2021, but more normal proceedings last year took the quantum above pre-pandemic levels as courts reopened and awards resumed their upward trend.

Figure 18: Nuclear verdict data in United States – 2016 to 2022 (Source: Verdict Search)

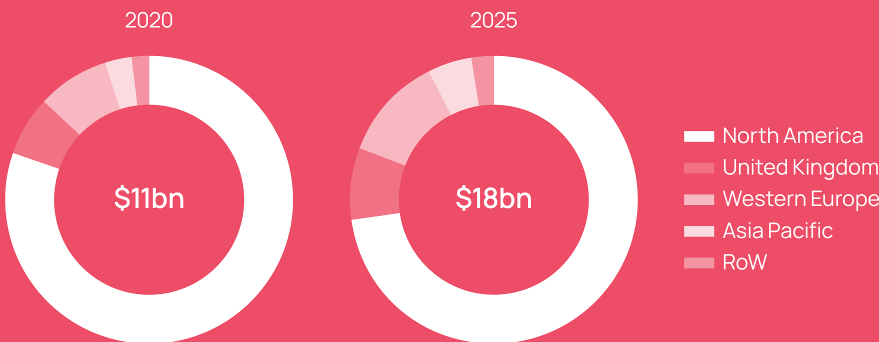


*Current up to 20 December

Whilst recognising the lack of precedent, as well as the myriad of additional inputs that influence claims settlements, the data provides an indication of frequency and severity trends in the post-COVID environment. Further high-severity settlements are likely in the months and years ahead as more cases are heard.

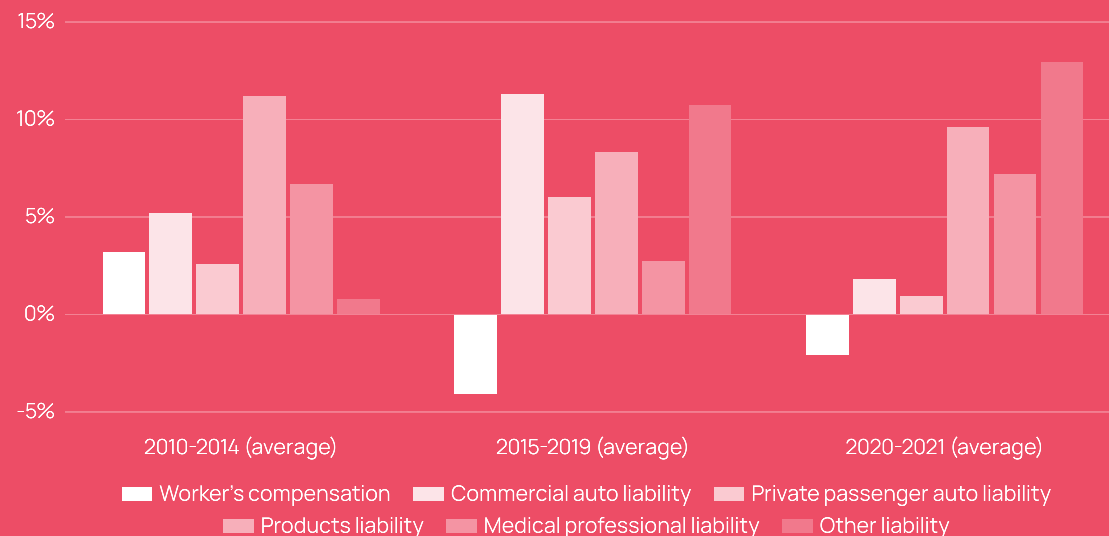
As a result, social inflation is likely to remain a hot topic for some time to come for both corporates and (re)insurers, and not just in the United States. The underlying socioeconomic and litigation trends that underpin the issue – an aggressive and active plaintiffs' bar, higher litigation costs, increased attorney involvement in the claims process, anti-corporate sentiment, the growth potential of third-party litigation funding globally (see Figure 19) – have endured through the pandemic and there is evidence that similar trends are manifesting in other countries.

Figure 19: Estimated investment potential for litigation funding by region – 2020 vs 2025
(Source: Deminor)



This is indicative of more normalised claims frequency and severity across a number of long-tail lines. Figure 20 shows how annualised changes to incurred losses for select U.S. liability lines have trended since 2010, with significant increases recorded for much of the last decade as the market navigated an increasingly adverse liability loss environment.

Figure 20: Annualised change to incurred losses for select U.S. long-tail lines – 2010 to 2021
(Source: Howden, National Association of Insurance Commissioners)



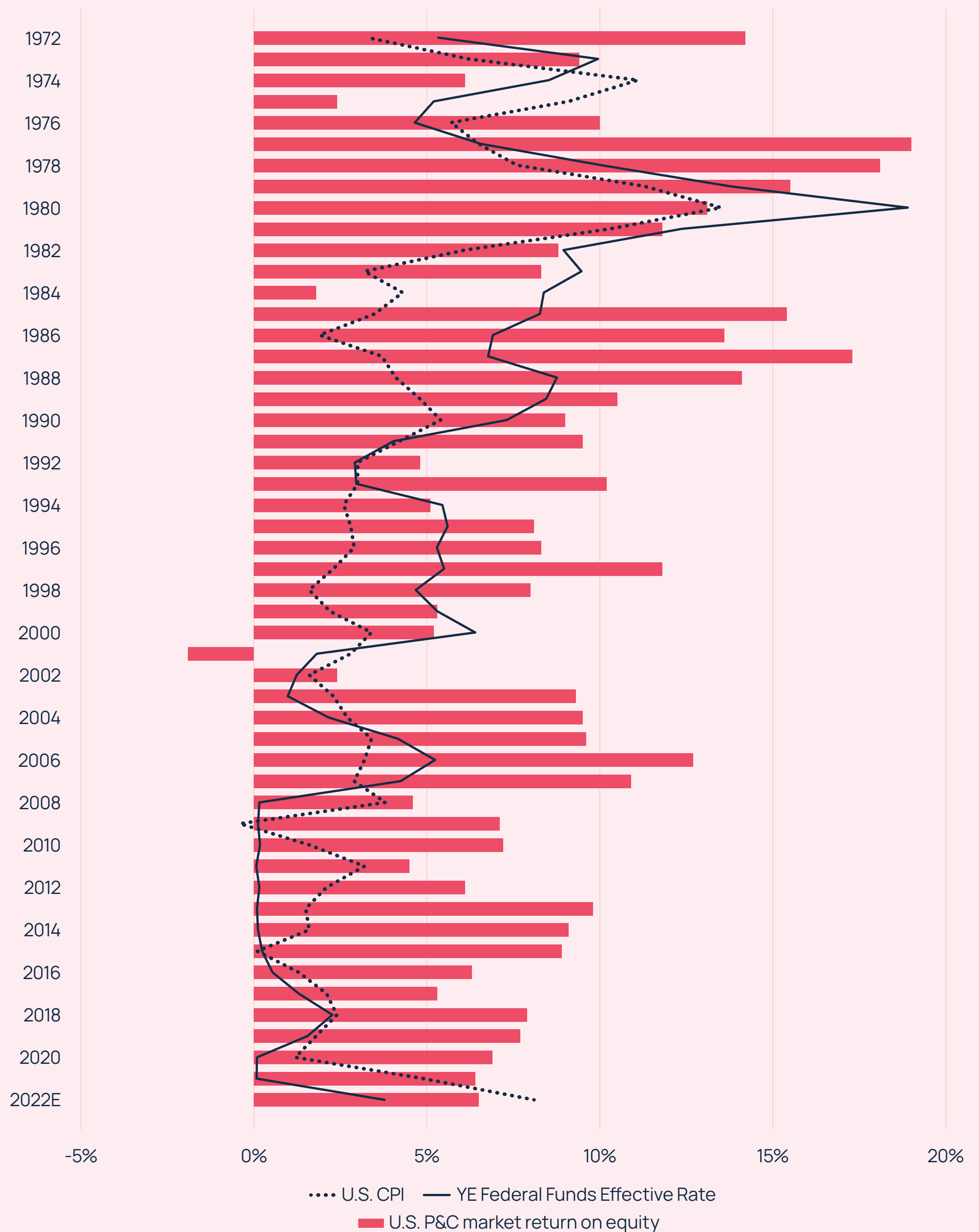
2020 saw a sharp reduction in long-tail claims frequency because of COVID, with significant falls in incurred losses across the board,[4] only for a near-full reversal last year to leave 2020-21 averages closer to pre-pandemic levels (as shown in Figure 20). Results for worker's compensation continue to be positive, assisted by favourable claims experience and changing workers patterns.

[4] Howden, *Times are a-changin'*, January 2022.

Investment income

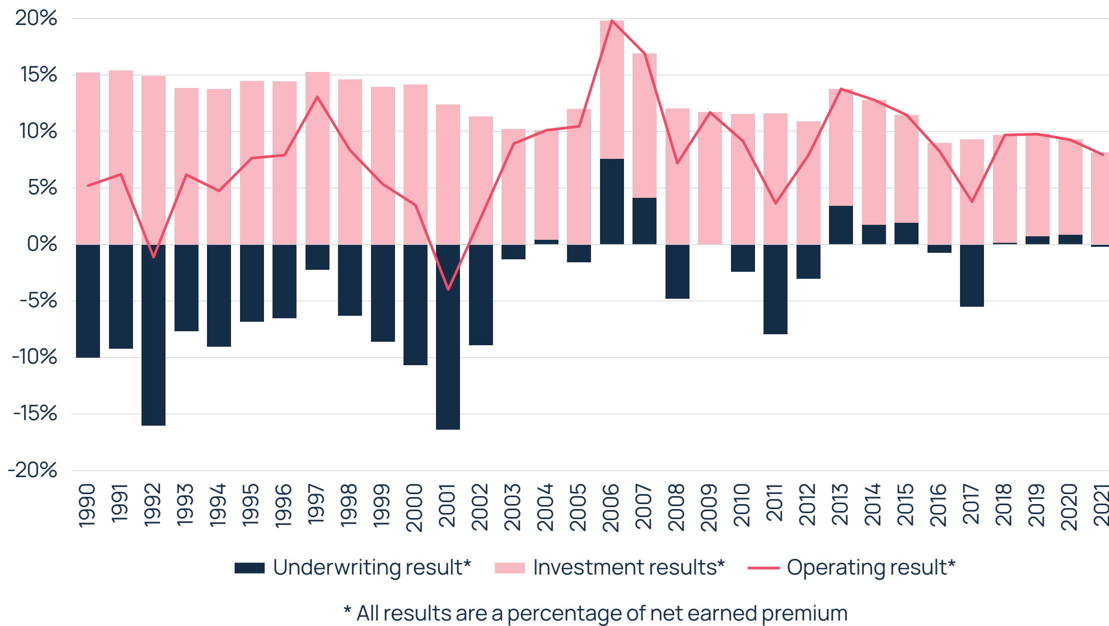
The market confronts rising loss costs from a position of strength, not only off the back of several years of rate increases but also higher reinvestment yields driven by the close historical relationship between interest rates and CPI. Indeed, Figure 21 shows that the U.S. P&C insurance market has on balance performed better during periods of high yields and inflation over the last 50 years, as evidenced by stronger returns on equity in the 1970s and 1980s.

Figure 21: U.S. P&C sector return on equity vs U.S. consumer price inflation and interest rates – 1972 to 2022E (Source: Howden, Bloomberg, Insurance Information Institute)



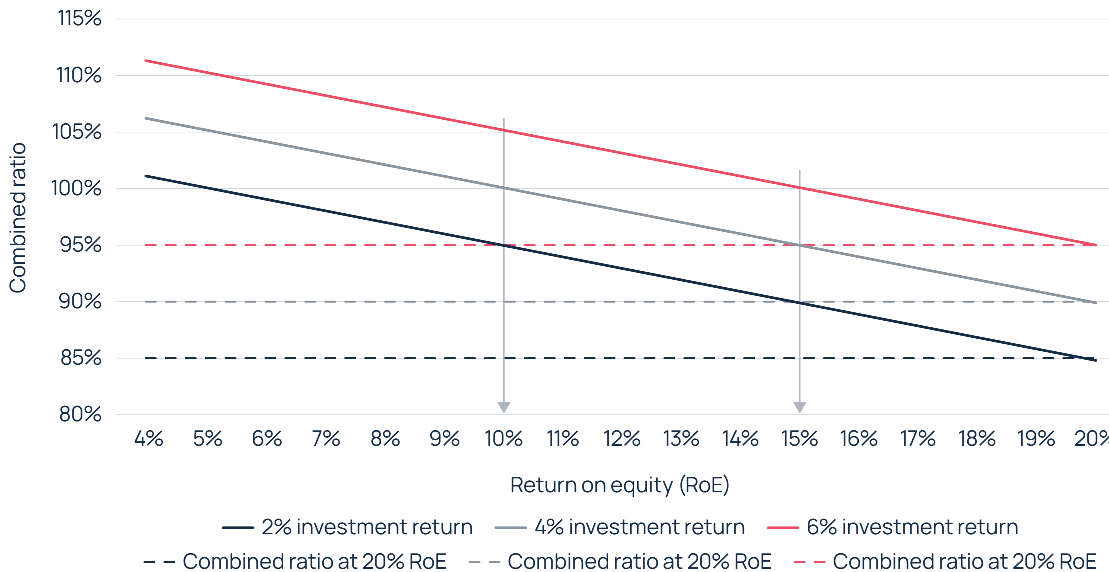
Figures 22 and 23 underscore the importance of investment income to the (re)insurance sector, with the former showing that investment returns have been by far the biggest contributor to U.S. sector performance in the last 30 years, even through the recent period of loose monetary policy.

Figure 22: Operating performance of U.S. P&C sector split by underwriting and investment results – 1990 to 2021 (Source: Howden, A.M. Best)



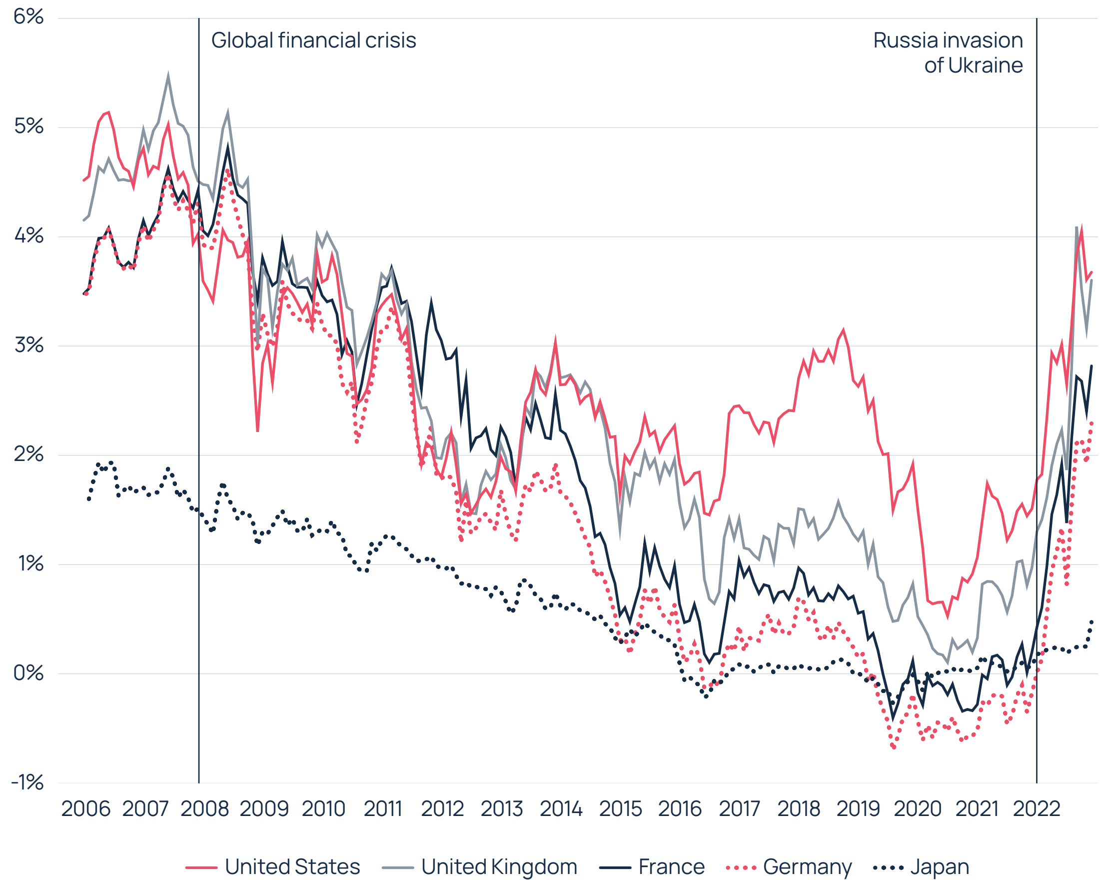
The boost to future sector earnings from recent interest rate hikes will be sizeable, a point reinforced by Figure 23, which shows that a 200bps increase in yields can generate a 500bps improvement to return on equity if underwriting performance is maintained.

Figure 23: Impact of investment returns on return on equity (Source: Howden)



And with government bond yields now approaching levels not seen since before the global financial crisis, this is a source of income that will help offset rising claims inflation and provide further momentum to carriers' earnings over the medium long-term.

Figure 24: 10-year government bond yields – 2006 to YE 2022 (Source: Howden, Bloomberg)



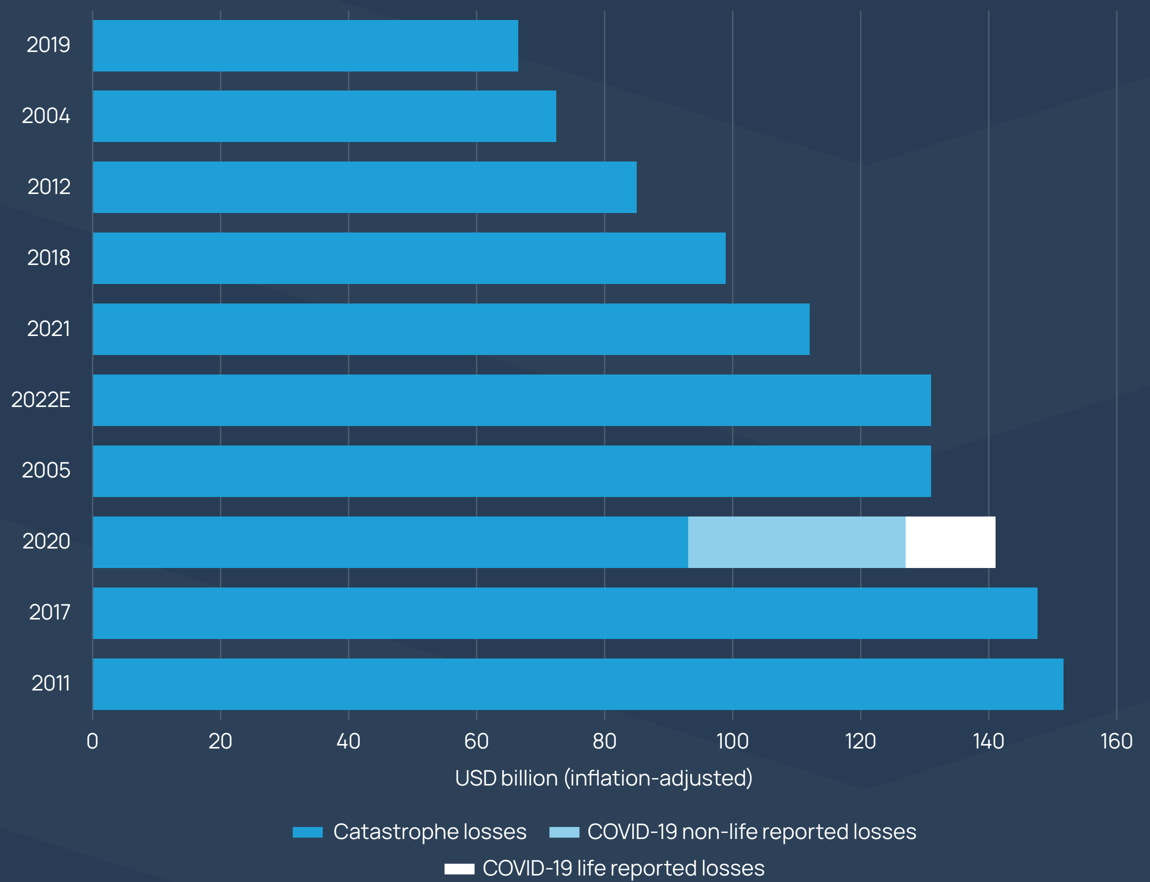
RISING INVESTMENT RETURNS WILL HELP OFFSET CLAIMS INFLATION AND PROVIDE FURTHER MOMENTUM TO CARRIERS' EARNINGS.

2022: a risk reset

2022 was not just about macroeconomics. Loss activity was equally fraught, as Russia's invasion of Ukraine delivered another shock industry loss (so soon after COVID) and highlighted the complexities of the cyber risk landscape as raised concerns about a transnational fallout coincided with reduced claims activity. 2022 was also the year of Hurricane Ian, the second most expensive catastrophe to hit the (re)insurance market ever.

Hurricane Ian and the war in Ukraine accounted for approximately 50% of insured losses last year. A quick analysis of the industry's ten largest loss years on record – as shown by Figure 25, with National Flood Insurance Program (NFIP) claims excluded – underscores the painful run sustained by insurers and reinsurers in recent times. Indeed, each of the last six years feature in the list.

Figure 25: Top 10 largest loss years on record[5]
(Source: NOVA, Swiss Re, Insurance Information Institute)



[5] Includes natural and man-made catastrophes, as well as COVID-19 losses for 2020, but excludes losses from the National Flood Insurance Program in the United States.

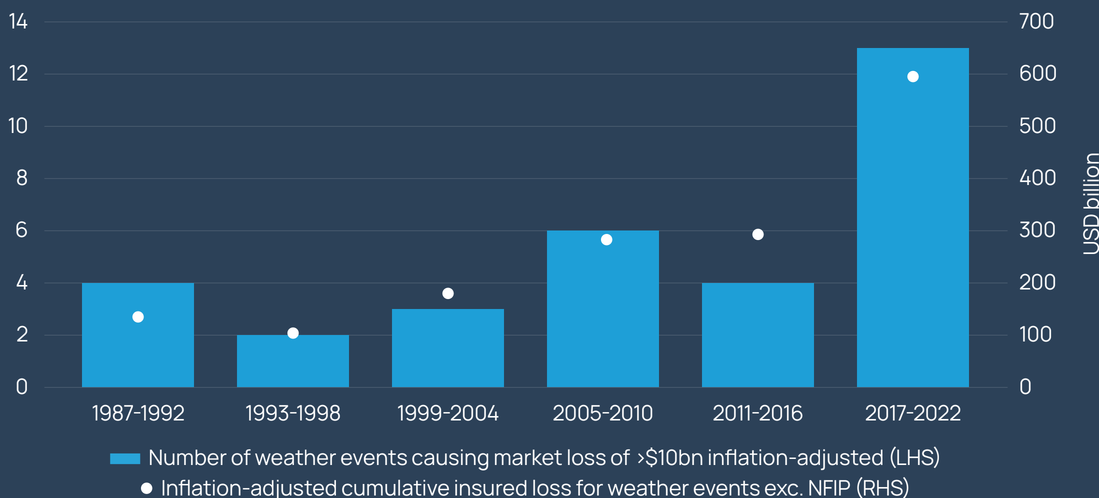
Climate risk: the new normal

Climate risk has once again been the catalyst for market change. Major losses caused by extreme weather events in recent years exceed historical precedent, driven by a myriad of factors from exposure growth and rising insured values to climate change, demographics and even some randomness.

Isolating the impact of each input is difficult, and all have played a role in the proliferation of mid-sized losses in the last six years (see Figure 26). Weather-related insured losses since 2017 are nearing USD 600 billion in aggregate, double anything seen on record.

With scientific research confirming that human-induced climate change is influencing weather and climate extremes around the world, and inflation adding substantially to insured values, especially in areas that have seen rapid exposure growth in recent years, any expectation that loss experience will revert to the old normal is unrealistic.

Figure 26: Number of weather-related insurance industry losses >$10bn in real terms and cumulative insured losses by six-year period – 1987 to 2022 (Source: NOVA, Swiss Re)

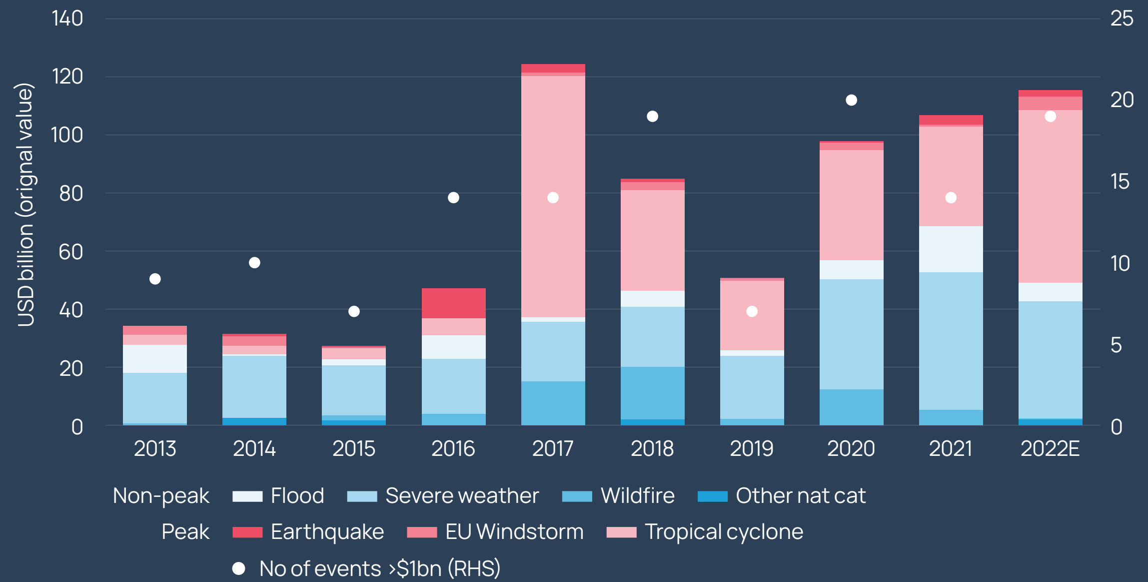


This period of elevated catastrophe losses has been notable not only for its quantum but also for the unusual mix of what were once considered to be high frequency, low severity events such as floods, wildfires, droughts and convective storms. These so-called secondary perils accounted for the lion's share of losses in eight of the last 10 years, with 2017 and 2022 being the two exceptions – see Figure 27 for distribution by peril.

Both these years have a major Florida landfilling hurricane in common – Irma in 2017 (category 3) and Ian in 2022 (category 4). Current estimates for Hurricane Ian are projecting losses in excess of USD 40 billion, within modelled expectations for a category 4 hurricane in Florida, but the ranges are wide and there is substantial uncertainty around the ultimate loss quantum, especially in such a high inflationary environment, and in a litigious state like Florida. According to the Florida Office of Insurance Regulation (FLOIR), the state accounted for 80% of U.S. homeowners' litigation in 2020 but only 9% of claims.

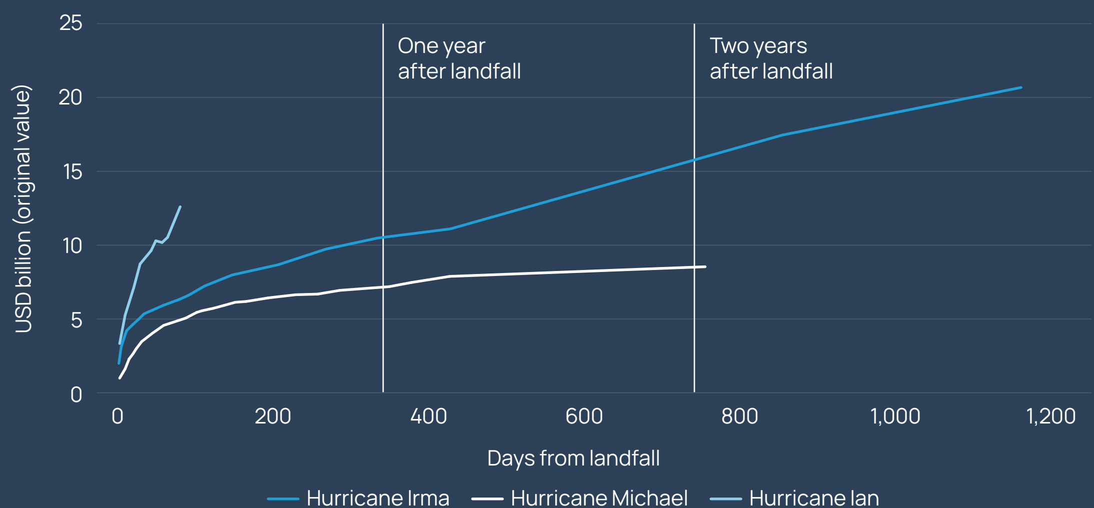
Figure 28 shows how estimated insured losses based on paid claims in Florida for hurricanes Irma and Michael (category 5, 2018) compare to early data for Ian. At similar post-landfall periods, Ian's estimated insured loss is close to double that of Irma.

Figure 27: Global insured natural catastrophe losses by peril – 2013 to 2022 (Source: NOVA)



Irma's development over time demonstrates tail risk for hurricane losses in Florida. Having initially conformed to the expected development pattern within the first year of gradual levelling off from an initial spike (as exhibited by Michael), claims for Irma subsequently experienced a rapid and sustained reacceleration, which reflected litigation risks in the state and led to substantial loss creep up to three years after landfall, the bulk of which fell to reinsurers.

Figure 28: Paid claims development in Florida for Hurricane Ian vs Irma and Michael[6]
(Source: Howden, Florida Office of Insurance Regulation)



The market will be watching closely to see if legislative changes brought in before and after Ian made landfall can prevent a rerun. Even if losses end up falling towards the lower end of expectations, pressures in the property market will be acute this year. Carriers' catastrophe budgets have failed to keep up with sustained losses from weather-sensitive perils, and, coupled with rising loss cost inflation, portfolio remediation and price adequacy are likely to be areas of considerable focus and action this year.

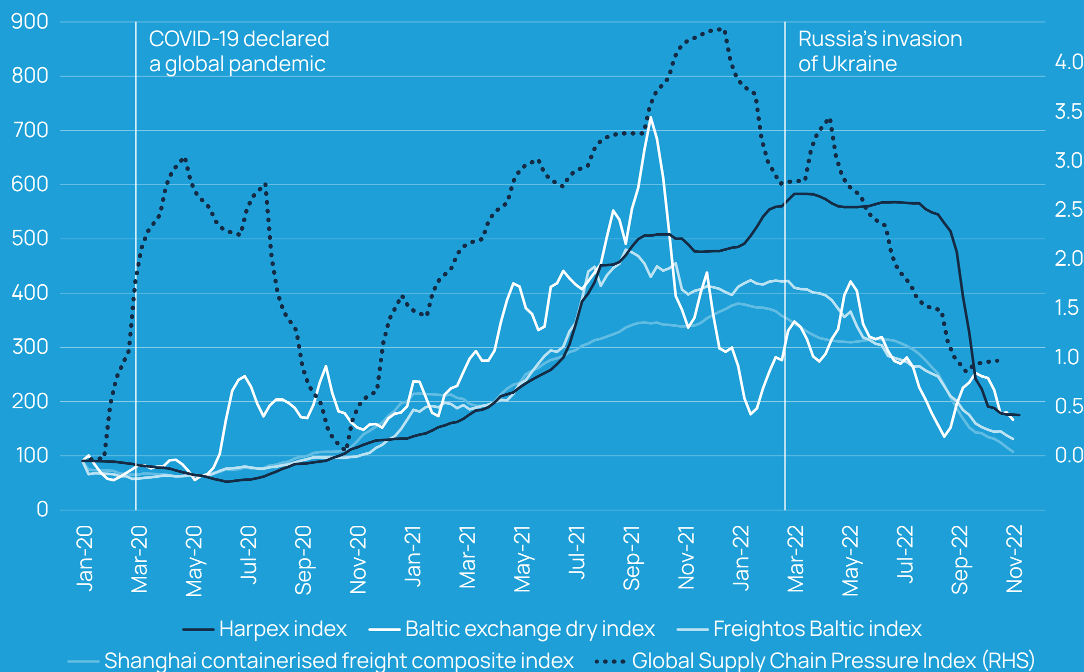
[6] Data in Figure 28 shows estimated insured losses released by the Florida Office of Insurance Regulation based on paid claims data filed by insurers to the regulator.

Ukraine losses: limited visibility

Geopolitics added to substantial loss volatility in 2022. The war in Ukraine has brought devastating humanitarian consequences first and foremost, but also unexpected losses and economic shocks.

The crisis early last year impaired already stressed supply chains, before shipping costs and overall pressures subsequently subsided through the course of the year (see Figure 29). Both the war and COVID underscore the need for companies to secure supply chains and reduce reliance on geopolitical hotspots.

Figure 29: Global supply chain pressures[7] – 1Q20 to 4Q22
(Source: Howden, OECD, Federal Reserve Bank of New York)



Heightened tensions in Ukraine and elsewhere, including the Taiwan Strait, along with the global economic downturn, potential COVID disruption in China, energy security concerns and climate change, will continue to pose a significant threat to global supply chains in 2023. Indeed, analysts are predicting semi-permanent disruption for the next decade.

The challenges and inefficiencies that come from building greater supply chain resilience (e.g. near-shoring or friend-shoring) will only add to cost pressures confronting businesses around the world, especially at a time of heightened gas supply uncertainty in Europe and a global shortage of semiconductors.

[7] All shipping data in Figure 29 is indexed to 100. For the Global Supply Chain Pressure Index on the right-hand scale, zero represents the long-term average, going back to 1997. The index has reported unprecedented pressures for much of the last two years – https://www.newyorkfed.org/research/policy/gscpi.

Whilst claims from the Ukraine war are likely to be manageable overall for the (re)insurance sector, the concentration of losses amongst premium-light lines of business will lead to disproportionate pain. Specific segments of the speciality (re)insurance market, covering niche areas like aviation war, marine, political risk, political violence and trade credit, are undergoing varying degrees of corrections from the sizeable losses that have and will transpire, albeit over a prolonged period.

Figure 30 shows war-related losses reported by individual (re)insurers during the first nine months of 2022. After a series of announcements in the first half, with losses aggregating to around USD 2.5 billion, only a handful of carriers added to reserves in 3Q22. This was due in large part to ongoing hostilities (making access for loss adjustors difficult) and little additional visibility on how losses will develop.

Most carriers to report losses have yet to include aviation in their provisions. With several cases destined for court and verdicts potentially years away, this will act as an overhang for those exposed for some time to come.

Figure 30: Reported (re)insured losses for Ukraine war vs ultimate industry loss estimates (Source: Howden, company reports)

Reported losses have some way to travel before they get close to the expected ultimate industry loss of USD 10 billion to USD 20 billion. Amidst widespread acknowledgement that additional reserves will be booked in 2023 and potentially beyond, specialty reinsurance treaties underwent significant repricing at 1 January 2023, alongside tightened terms and stripped back composite covers.

With the Ukraine crisis coming fast on the heels of COVID-19, it demonstrates the vast loss potential associated with systemic perils. Both events have shown that losses emanating from what appear to be distinct perils like business interruption, cyber, supply chain failures or price shocks are often connected and can strike simultaneously. They straddle multiple classes of business and bring sizeable loss accumulation potential by flouting traditional controls around correlations, boundaries and duration.

The scale of such events has moved loss scenarios from the theoretical to the real world and, in doing so, caused a marked shift in risk perceptions.

THE UKRAINE WAR AND COVID-19 DEMONSTRATE THE **VAST LOSS POTENTIAL FROM SYSTEMIC PERILS.**

Cyber: ransomware and hybrid warfare

Russia's invasion of Ukraine added a big dose of complexity into an already complicated cyber risk environment, elevating the threat of large-scale attacks at a time when the market was still adjusting to rampant ransomware.

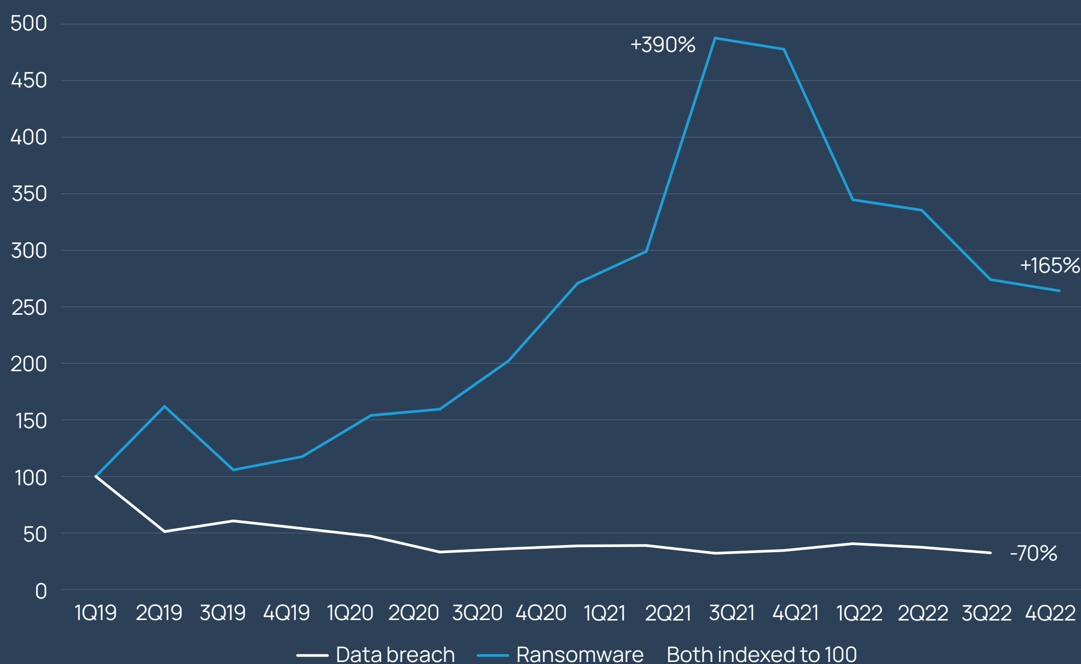
Cyber risk has undergone several episodes of change in its relatively short history, but escalating ransomware frequency and severity in 2020 and 2021 was unlike anything experienced previously. The accompanying retrenchment of insurance capacity, coupled with a wave of demand globally, caused a supply and demand imbalance of such extremity that the average cost of cover more than doubled.

2022 introduced further uncertainty into the market. Given the protagonists in the Ukraine war – Russia and Ukraine host some of the worst offending ransomware gangs – the prospect of cyber warfare and spillover to other states is real. The array of groups operating in the cyber battlefield also potentially complicates distinctions between state-sponsored attacks and those carried out by non-state actors.

The situation remains highly unpredictable, but most cyber activity linked to the conflict has so far been relatively contained, and the large-scale attacks widely predicted in the run up to invasion have not (yet) occurred. In fact, the immediate effect of the conflict appears to have contributed to a reduction in ransomware frequency, as both warring sides refocus their efforts and resources.

This is supported by data in Figure 31, which indexes the number of global ransomware and data breach incidents since 2019. The near four-fold increase in ransomware incidents through 2020 and the first half of 2021 abated in the second half before falling further last year. Ransomware activity nevertheless remains at elevated levels, especially when compared to data breach trends over the last four years.

Figure 31: Frequency index for global ransomware vs data breach incidents – 1Q19 to YTD22
(Source: Howden, SonicWall, Risk Based Security, Flashpoint)



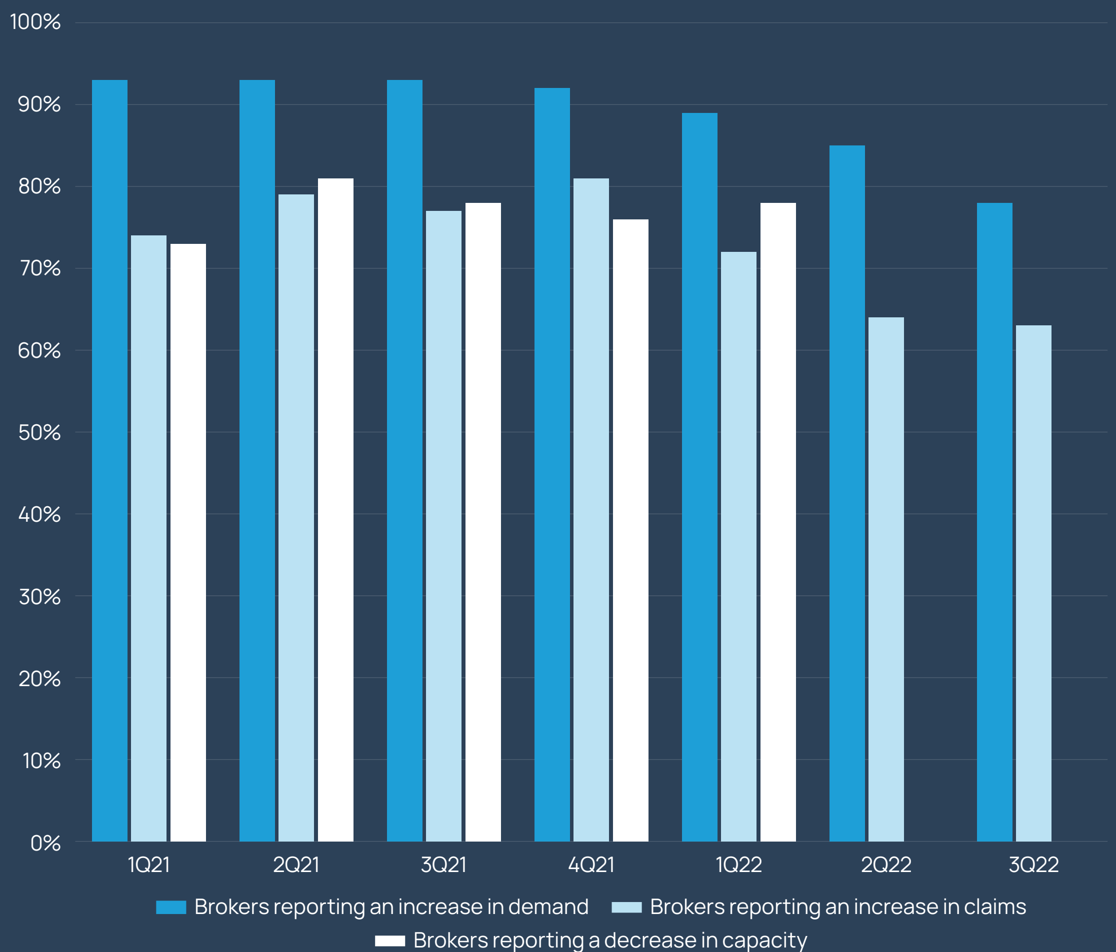
Perhaps an even more decisive factor in suppressing attack frequency (and severity) has been improved cyber hygiene. This is something that the insurance market has augmented by requiring companies to have minimum standards of cyber security in place in order to access capacity.

Insurers' deployment appetite is now correlated directly to the sophistication of security controls, and, as a result, companies are investing heavily to improve their risk posture. This has not only made them more resilient to conventional, financially motivated cyber attacks, but also to the considerable risks that exist in such a highly charged geopolitical climate.

The burdens on companies getting to this point have been considerable, but the cost of insurance cover is now more commensurate with attritional loss costs, and hardened cyber defences have left companies less vulnerable to prolonged disruption or outsized losses in the event of a breach.

Most buyers are looking to maintain existing levels of coverage overall in spite of the rising costs, but this has inevitably caused strain in an environment of restricted capacity and increased uptake – see Figure 32 for trends around supply, claims and demand in the United States.

Figure 32: Capacity, claims and demand trends in U.S. cyber market – 1Q20 to 3Q22
(Source: Howden, CIAB)



WITH INCREASED COMPETITION, THE INGREDIENTS FOR A MORE MATURE CYBER MARKET ARE NOW IN PLACE.

These difficulties notwithstanding, there are signs that conditions in the cyber insurance market are starting to moderate or even stabilise. Figure 33, which shows Howden's Global Cyber Insurance Pricing Index from 2014, along with year-on-year changes, attests to this. Within the last 12 months, average rate increases have fallen from 120% plus to low double-digits, yielding flattening pricing overall, albeit at historically high levels.

With existing carriers looking to increase capacity deployments, boosted further by a series of new entrants, the ingredients for a more mature cyber market are now in place. Insurance buyers will therefore be expecting a rational cyber market this year, with access to capacity that rewards improved risk profiles. The prospects for 2023 are looking up, but, as is always the case with cyber, much will depend on geopolitics.

Figure 33: Howden's Global Cyber Insurance Pricing Index – 2014 to 3Q22 (Source: NOVA)

Cyber insurance pricing index (LHS)
Year-on-year % change (RHS)
450 175%
400 150%
350 125%
300 100%
250 75%
200 50%
150 25%
100 0%
50 -25%
Jun-14 Sep-14 Dec-14 Mar-15 Jun-15 Sep-15 Dec-15 Mar-16 Jun-16 Sep-16 Dec-16 Mar-17 Jun-17 Sep-17 Dec-17 Mar-18 Jun-18 Sep-18 Dec-18 Mar-19 Jun-19 Sep-19 Dec-19 Mar-20 Jun-20 Sep-20 Dec-20 Mar-21 Jun-21 Sep-21 Dec-21 Mar-22 Jun-22 Sep-22

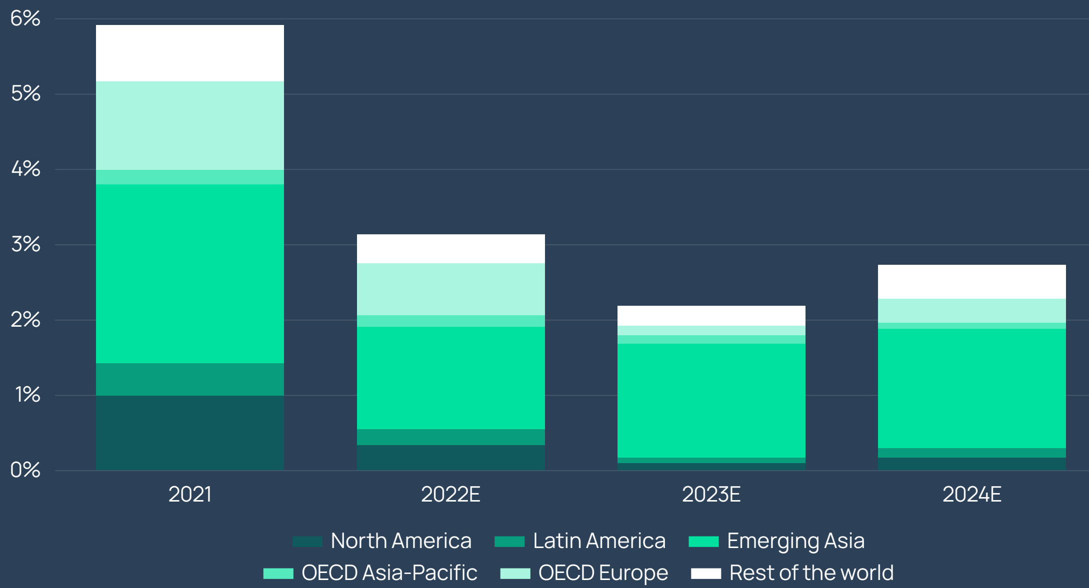
04

2023: charting the year ahead

The global economy is in a precarious position heading into 2023. The war in Ukraine has superseded COVID-19 as the dominant economic driver, even as China continues to grapple with fresh outbreaks. The combination of an energy shock, rapid inflation, rising interest rates and geopolitical tensions has seen economic growth lose momentum. Figure 34 (on page 44) shows the diminished contribution advanced economies are forecast to make to global growth in 2023 and 2024.

THE GLOBAL ECONOMY IS IN A PRECARIOUS POSITION HEADING INTO 2023. THE COMBINATION OF AN ENERGY SHOCK, RAPID INFLATION, RISING INTEREST RATES AND GEOPOLITICAL TENSIONS HAS SEEN GROWTH LOSE MOMENTUM.

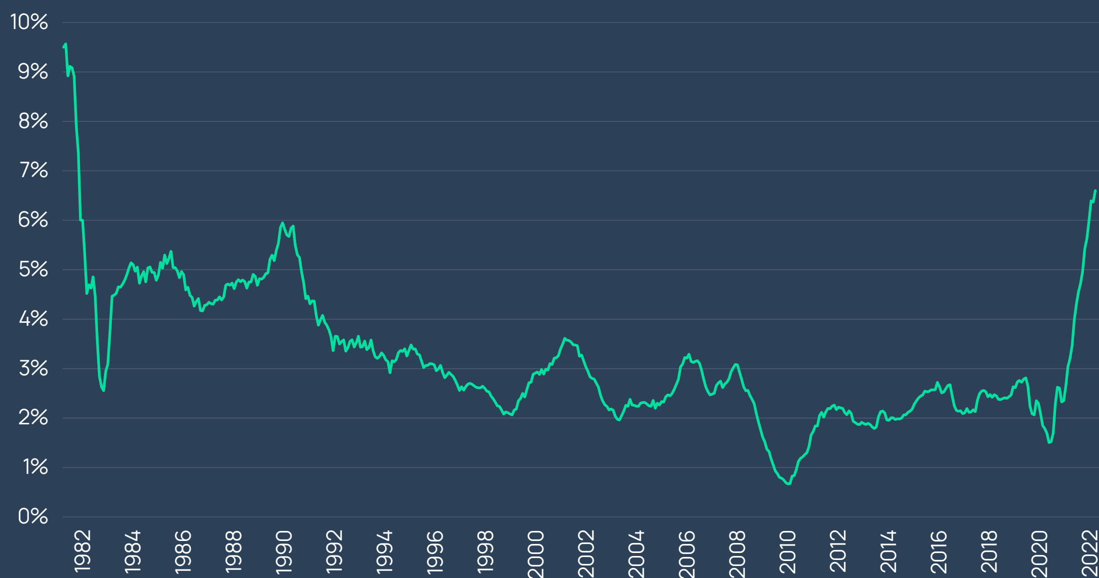
Figure 34: Projected contributions to global GDP growth – 2021 to 2024 (Source: Howden, OECD)



The uncertainty around these forecasts is high. Wholesale energy prices, which have fallen from recent highs, are tied closely to the Ukraine crisis and the outlook for inflation is complicated further by issues that link back to the pandemic, including workforce participation rates, wage pressures and supply chains. Labour markets remain tight, which is likely to prevent monetary policy loosening in most major economies.

Although headline inflation is likely to fall in 2023, pressures may be penetrating into stickier parts of economies. Figure 35 shows that the Sticky Consumer Price Index for the U.S., which is weighted towards more rigid service-based categories, was at a 40-year high at the end of 2022, suggesting inflation will remain elevated for some time to come.

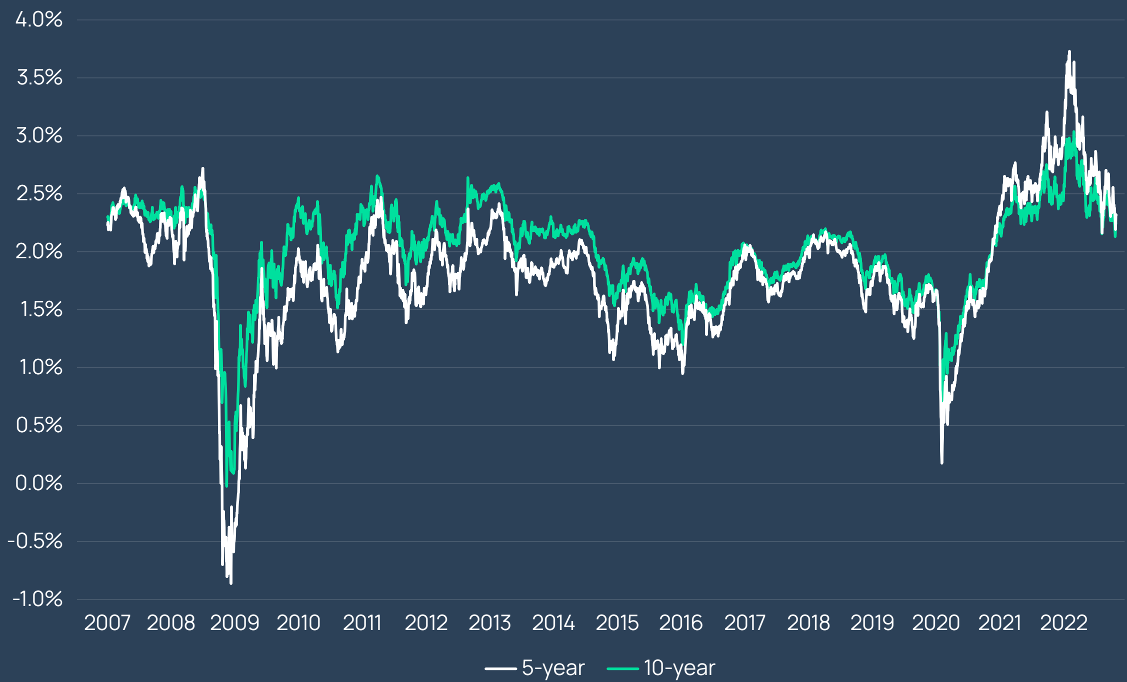
Figure 35: Sticky Consumer Price Index – 1982 to 2022 (Source: Howden, Atlanta Fed)



Bond market-based measures of forward inflation have long-term expectations relatively well anchored, however. Whilst 5-year and 10-year U.S. breakeven rates peaked at record highs in the immediate aftermath of Russia's invasion of Ukraine last year, they had fallen back to the top-end of more normalised ranges by year-end (see Figure 36).

How inflation develops over the next year or two will be a key input into (re)insurance demand, loss cost inflation and investment income.

Figure 36: U.S. breakeven rates for 5-year and 10-year inflation-linked Treasury securities – 2007 to 2022 (Source: Howden, Bloomberg)



HOW INFLATION DEVELOPS WILL BE A KEY INPUT INTO (RE)INSURANCE DEMAND, LOSS COST INFLATION AND INVESTMENT INCOME.

Resilience and innovation

The macroeconomic backdrop is just one of several factors that will shape the (re)insurance sector from here. Others, such as social inflation, climate change, the net-zero transition and war, are more difficult to quantify and predict, and (re)insurance is playing a crucial role in indemnifying clients when losses occur. There is also an opportunity for the sector to go beyond traditional risk transfer and move into the realms of mitigation and adaptation by offering risk reduction incentives to policyholders and rewarding positive measures.[8]

(Re)insurers are in a strong position to do just that. Even after the effects of multi-decade high inflation, another USD 100 billion plus loss year and substantial investment losses, the sector remained profitable in 2022 (see Figure 37).

Future prospects for the market look positive too. Investment income will benefit significantly from higher reinvestment yields whilst underwriting gains are likely to be sustained by the favourable pricing environment. This is especially true for reinsurance following the re-pricing and restructuring of programmes at 1 January 2023. These tailwinds are likely to be sufficient in offsetting higher claims inflation and more expensive reinsurance / retrocession.

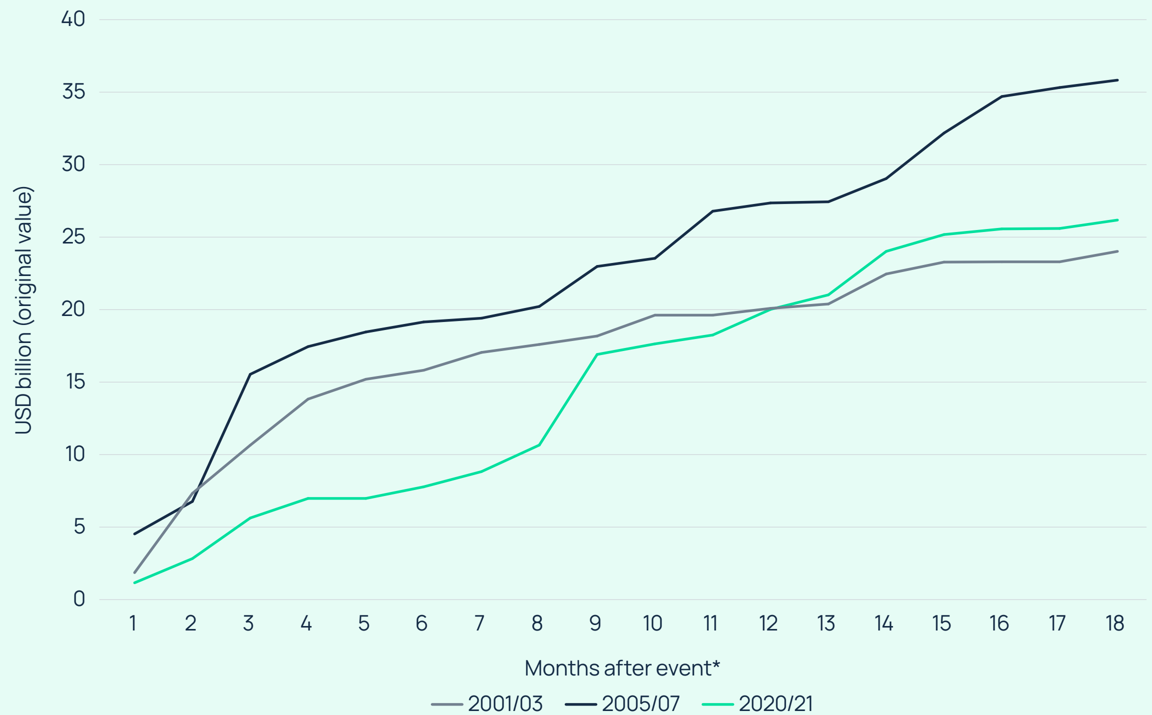
Figure 37: Drivers of (re)insurance sector net income – 9M20 to 9M22 (Source: NOVA)

[8] Howden's recent study with Fidelis established a correlation between ESG ratings and lower loss ratios, indicating that ESG credentials should be factored into underwriting and pricing decision-making.

Capital inflows

Capital will be crucial to servicing growing demand for (re)insurance protection. The sector has previously attracted substantial amounts of capital post-shock events to compensate for the loss of capacity and leverage the attendant pricing opportunities (see Figure 38).

Figure 38: Quantum and timeline of cumulative capital inflows following COVID, Katrina and 9.11[9] (Source: Howden, S&P, Artemis)



*Month 0 is September for 9.11, August for Katrina and March for COVID-19.

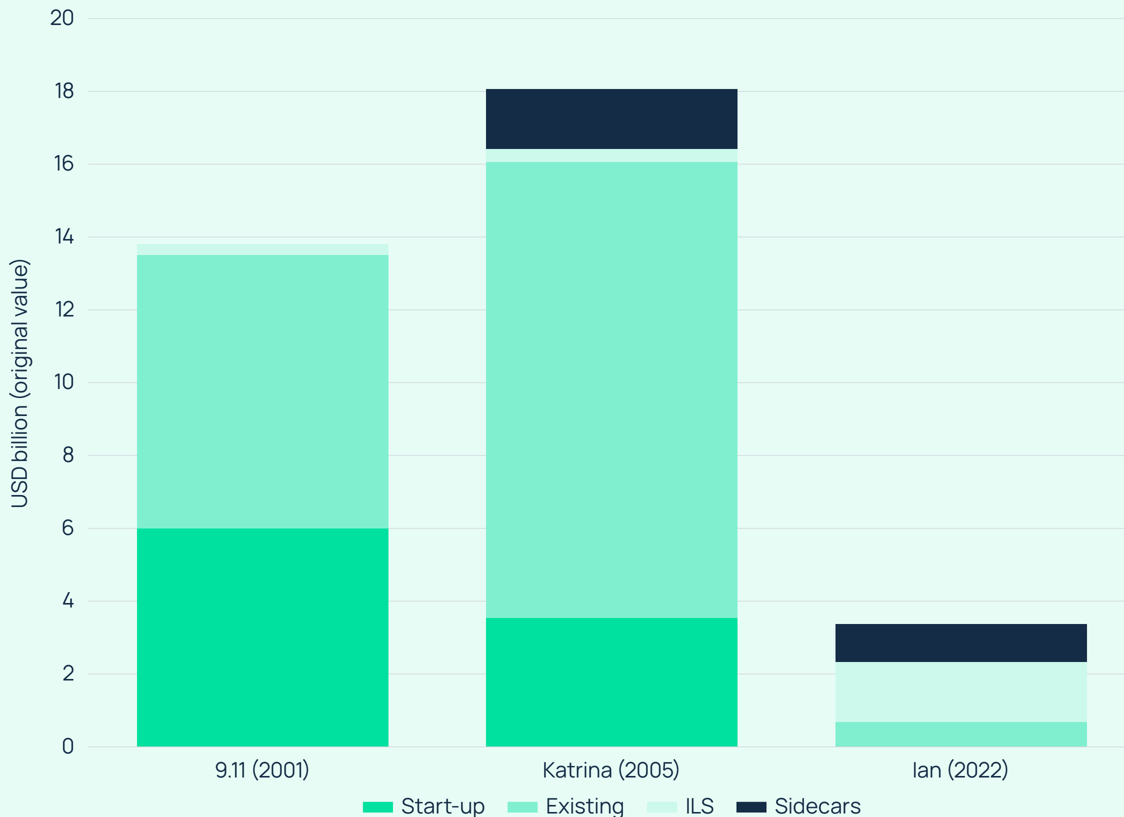
Following capital raises of more than USD 25 billion in 2020/21, comparable in quantum to what entered the market in the 18 months that followed 9.11, inflows slowed significantly last year. Having made commitments early in the cycle, investors with sector experience were more circumspect about where to allocate capital in 2022, particularly after recent losses tested risk tolerances and returns in other asset classes have become relatively more attractive.

Corrections in the equity and bond markets prompted some pension funds to manage down (re)insurance allocations and prevent ILS portfolios exceeding maximum target limits. Most reinsurers also prioritised improving risk-adjusted returns across existing catastrophe portfolios rather than raising additional capital to underwrite more exposures.

[9] Includes publicly available data on equity capital raises by new and incumbent carriers, as well as new capital allocated to catastrophe bonds and sidecars.

Figure 39 compares capital inflows in the months leading up to 1 January renewals following 9.11, Hurricane Katrina and Hurricane Ian. Timeframes to year-end are similar for all three events but capital generation post-Ian has been negligible compared to the amounts raised in the final months of 2001 and 2005. Investor caution hindered attempts to launch new initiatives in 2022 whilst ILS inflows, the main source of capital growth in 2020/21,[10] were also limited.

Figure 39: Announced capital inflows leading up to 1 January renewals – 2022 vs 2005 and 2001
(Source: Howden, S&P, Artemis)



HIGHER POTENTIAL RETURNS COULD SOON ENTICE CAPITAL BACK INTO THE MARKET.

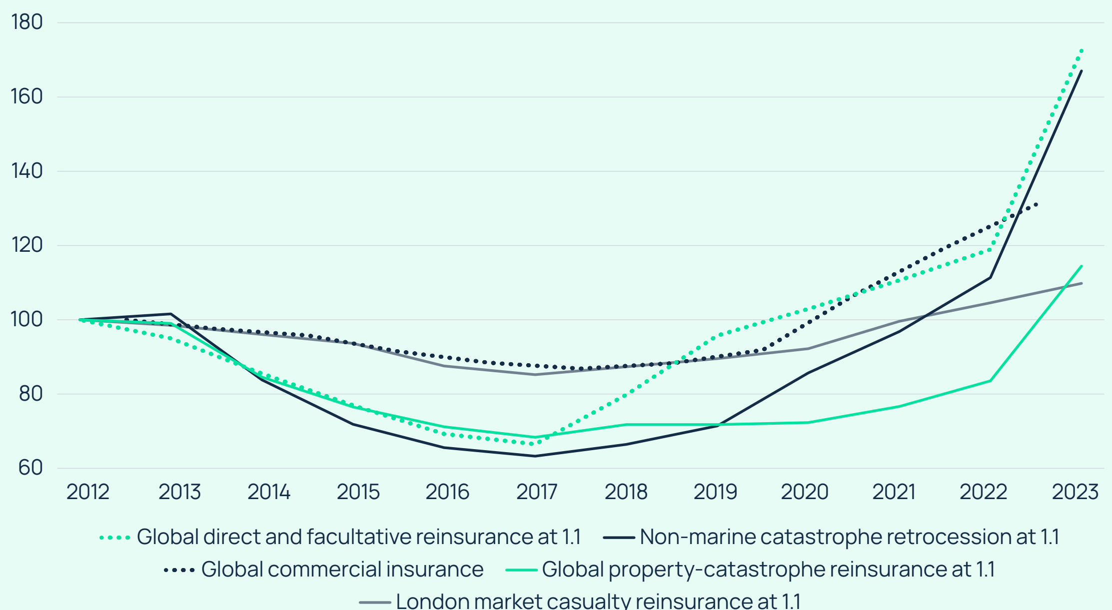
[10] Howden, *Times are a-changin'*, January 2022.

Risk and reward

Higher potential returns on offer following one of the hardest reinsurance renewals in living memory could soon entice capital back into the market, however. Several capital providers deferred deployment opportunities in late 2022 to assess a number of factors, including 1 January renewal outcomes, loss development for Hurricane Ian and broader macroeconomic conditions. Clarity around these issues will be crucial to lifting the capital squeeze.

Developments in early 2023 portend well for the year ahead. Figure 40 shows how differing rate momentum across commercial and reinsurance lines has already gone a long way to reversing the long-standing lag for reinsurance.

Figure 40: Howden pricing index for primary, reinsurance and retrocession markets – 2012 to 2023 (Source: NOVA)



The current pricing landscape reflects supply and demand dynamics and perceived levels of risks. Corrections for reinsurance at 1 January 2023, combined with equally important changes to structures, terms and scope of cover, are likely to yield stronger underwriting margins in spite of rising loss cost inflation, higher costs of capital and structural changes to the loss environment.

The ability to demonstrate profitability over the long-term will be crucial to capital providers. Given the backdrop of elevated catastrophe losses, climate change concerns and broader inflationary trends, not to mention opportunities for improved returns in other asset classes, investors will be looking for evidence of strong underwriting performance over a sustained period and across cycles.

Whilst this long-sighted view may prevent inflows akin to those synonymous with the Class of 2001 or the Class of 2005 in the near-term at least, investor appetite is likely to increase over the next year or two as margins improve and the macroeconomic environment stabilises. Securing access to capital will therefore be a key differentiator for (re)insurers, MGAs and ILS funds, which plays to the strategic investments Howden has made in this area in order to facilitate inflows, create capacity and find solutions for clients across the insurance value chain.

Current market conditions demand a new approach to broking that is cycle-savvy, innovative, aggressively entrepreneurial and home to the sector's strongest talent. Come and talk to us.

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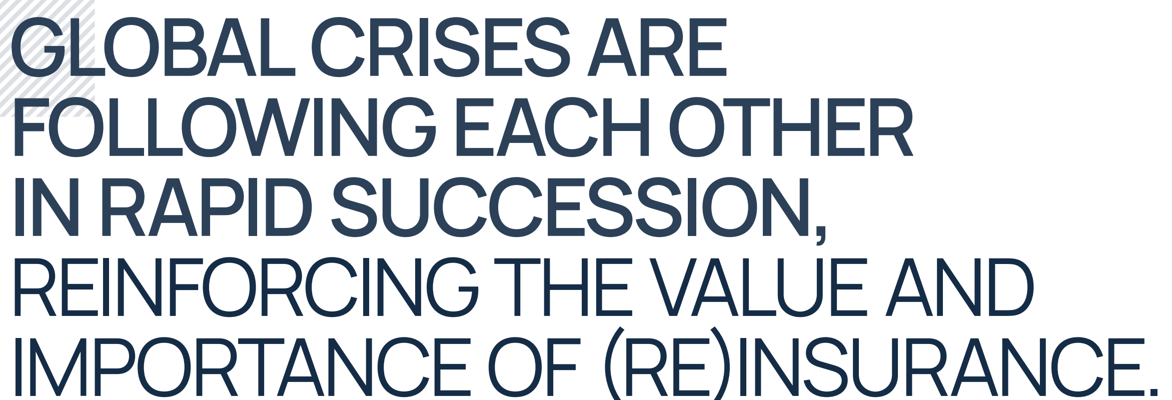
Expert advice in extraordinary times

A complicated new world order has emerged, heralding an era of higher inflation and interest rates, heightened geopolitical tensions, elevated catastrophe losses, supply chain vulnerability, cyber risks and potential loss aggregation. Global crises are following each other in rapid succession, and the value and importance of (re)insurance comes to the fore during such volatile times.

Unlocking capital in order to find solutions for rapidly changing risks will be crucial to maintaining relevance and offering clients coverage that meets their needs. The megatrends driving extraordinary change also reinforce the need for access to original insights and research.

As an intermediary, we are conscious of our position in the market and our responsibility to inform the discussion in the interests of clients. This paper attempts to do just that. By bringing important sector trends to the fore, Howden is leading the discussion, enabling us to facilitate the most innovative client solutions. We look forward to working closely with insurance and reinsurance companies in this endeavour, and supporting clients in managing change and securing the best coverage available in the marketplace.



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Contacts

Julian Alovisi
Head of Research
+44 (0)7593 576 024
julian.alovisi@howdengroup.com

Jose Manuel Gonzalez Perez
CEO, Howden Broking Group
jmgonzalez@howdengroup.com

Brad Maltese
CEO, Howden Re
+44 (0)7513 722 476
bradley.maltese@howdenre.com

David Flandro
Head of Analytics
+44 (0)7719 928 552
d.flandro@howdengroup.com

Michelle To
Head of Business Intelligence
+44 (0)7710 705 627
m.to@howdengroup.com

Elliot Richardson
Chairman, Howden Re
+44 (0)7967 292 457
elliot.richardson@howdenre.com

Howden

One Creechurch Place,
London, EC3A 5AF

T +44 (0)20 7623 3806
F +44 (0)20 7623 3807
E info@howdengroup.com

www.howdengroup.co.uk

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