REINSURANCE MARKET PROSPECTIVE
WEATHERING THE STORM
At JLT Re, our trusted team combines market-leading expertise and proprietary analytical tools with the freedom to challenge conventions. We create new insights and explore innovative capital solutions tailored to meet client needs.
EXECUTIVE SUMMARY

After five consecutive years of falling rates, global property-catastrophe reinsurance experienced upward pricing pressure at 1 January 2018, with significant variance across regions. This result was driven in large part by higher loss experience as the sector suffered its most expensive catastrophe loss year on record in 2017 after hurricanes Harvey, Irma and Maria (HIM) delivered a devastating triple blow to coastal regions of the United States and the Caribbean. The spate of fierce wildfires in California towards the end of the year added to loss burdens and, when combined with other significant events, pushed insured catastrophe losses marginally above USD 140 billion for the first time ever in real terms. With the vast majority of large losses occurring in the United States, a substantial proportion were borne by collateralised vehicles and insurance-linked securities (ILS) markets.

Nevertheless, as JLT Re predicted in October¹, carriers’ strong capitalisation, as well as the nature of the losses in 2017, prevented the type of market reaction that had followed other large loss years. The sector’s existing capital base, as well as new capital inflows in Q4 2017, capped risk-adjusted pricing increases at 1 January 2018 to levels that were below early market expectations. That said, a pricing floor was seemingly reached as reinsurance prices were flat or up for the vast majority of geographies and business lines.

RENEWAL OUTCOMES

Property-catastrophe rate increases were most pronounced in regions impacted by loss activity, while low single-digit rises or flat outcomes were more typical for programmes without significant losses. Although reinsurers sought to stem margin compression with more substantial rate rises at 1 January 2018, many ceded ground to clients as the date neared, particularly in non-loss affected areas.

Figure 1: JLT Re’s Risk-Adjusted Global Property-Catastrophe Reinsurance ROL Index – 1992 to 2018² (Source: JLT Re)

² JLT Re’s ROL index is risk-adjusted, meaning changes to exposures, as well as premiums, are incorporated.
Figure 1 on page 3 shows that JLT Re’s Risk-Adjusted Global Property-Catastrophe Reinsurance Rate-on-Line (ROL) Index rose by 4.8% at 1 January 2018, with levels still below those seen in 2016. The highest increases were recorded in the US, with rates renewing flat to up 5% for loss-free programmes and up 10% to 20% for loss-affected business. Flat to moderately up renewals were typical for international property-catastrophe business, reflecting more benign loss activity in Europe and Asia. Even with these increases, the cost of property protection remains competitive with global property-catastrophe pricing approximately 30% below 2013 levels.

Global market property programmes, such as retrocession and direct and facultative (D&F), typically saw higher rate increases at 1 January 2018, although these also fell below early market expectations. Despite initial indications that markets would push for more, rates for retrocession catastrophe programmes were generally up by between 10% and 20% on a risk-adjusted basis, with event-based programmes falling towards the lower end of this range. Lloyd’s and global D&F catastrophe business was typically more loss-affected, and this translated into programme risk-adjusted rate increases of 15% to 25%, sometimes more for badly hit layers.

Impacts spread beyond property lines as higher catastrophe and attritional losses influenced renewals for specialty and casualty lines. This coincided with a growing recognition that rates in some of these areas had fallen to levels that tested technical profitability after successive years of declines.

As a result, aviation programmes typically renewed as expiring whilst rate reductions moderated for most terrorism accounts. Marine and energy programmes saw rates rise on average due to HIM and back-year loss deterioration.

Negotiations for casualty renewals, meanwhile, were balanced by profitability pressures on original business and reinsurers’ desire for higher rates due to the build-up of claims. Loss-free casualty programmes therefore typically renewed close to expiring levels whilst accounts that experienced losses saw moderate increases. These outcomes were often accompanied by lower ceding commissions.

Healthcare classes were mostly flat.

CAPITAL MATTERS

The supply of reinsurance capital continued to drive the market during the 1 January 2018 renewal. 2017 was the first year since 2008 in which dedicated reinsurance capital declined (see Figure 2). The sector’s excess position nevertheless remains high at USD 45 billion, or about 17% above gross premiums, having fallen by roughly USD 15 billion during the second half of the year.

As a result, capacity levels continued to be plentiful across most classes of business at 1 January 2018. Whilst supply and demand dynamics initially tightened in business lines with heavy losses, pressures were offset by post-HIM capital deployments through channels such as new collateralised vehicles, post-event funds, new catastrophe bond issuances and increased stamp capacity and pre-emptions. Investors responded to opportunities in both the reinsurance and retrocession markets, resulting in the replenishment of a significant portion of lost capacity in time for renewals.
2018 REINSURANCE RENEWALS

PROPERTY & CASUALTY (P&C)

Figure 3: Risk-Adjusted Rate Movements for P&C Programmes Renewing at 1 January 2018\(^3\) (Source: JLT Re)

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<td>Global Facultative**</td>
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Average rate change % (loss-free)

* Very few programmes were loss-free for global D&F and retrocession, so the ranges shown reflect loss-affected rate changes.

** Rate changes for global facultative apply to full year 2017 (light blue) and early 2018 (dark blue). Individual programme outcomes varied within the ranges shown for each class of business.

US PROPERTY-CATASTROPHE

- After five years of below-average insured catastrophe losses, the US experienced one of the most destructive hurricane seasons on record after hurricanes Harvey, Irma and Maria (HIM) made landfall in quick succession. The spate of fierce wildfires in California towards the end of the year added to carriers’ loss burdens. These events inevitably dominated negotiations during 1 January 2018 renewals for US property-catastrophe programmes.

- Yet, despite the US market suffering one of its most expensive years ever in 2017, capacity remained plentiful, even in peak zones. In fact, more capacity was available at 1 January 2018 than at the corresponding renewal in 2017 as new players entered the market looking for opportunities to deploy capital at more attractive rates of return. Existing carriers also maintained (or increased) participations, including alternative markets after most were able to reload any trapped capital in time for the renewal. Markets were more cautious in providing aggregate covers after a number of programmes were exhausted in 2017.

- The abundance of capacity helped offset any significant upward pricing pressure at 1 January 2018 and early proclamations (by some) of substantial rate increases did not materialise.

\(^3\) Please note that the figures provided in Figure 3 are averages and significant variability exists in individual programmes.
Indeed, loss-free layers saw only moderate price increases, with a range of flat to up 5% fairly typical when adjusted for exposure changes. Whilst risk-adjusted rate increases were higher for loss-affected layers, they fell within a range of 10% to 20%. Most reinsurers gave way on price in the last weeks of December.

These concessions reflected a standoff that initially saw markets sit on firm order terms in the hope of precipitating price increases. But as it became clear that supply was widely available, and the risk of churn was real as new markets offered competitively priced capacity to steal market share from incumbents, placements were completed fairly rapidly.

Stronger performing cedents continued to benefit from favourable terms as markets looked to nurture relationships and secure placements.

Terms and conditions were generally stable, with cedents mostly focused on securing the best possible outcome on price.

**WESTERN EUROPE P&C**

Despite attempts by some leading markets to increase rates following costly catastrophe losses in North America last year, the Western European reinsurance market experienced little change across most lines of business at 1 January 2018. Capacity levels were stable, and remained plentiful.

Pricing for loss-free property-catastrophe programmes was predominantly risk-adjusted flat, with some moderate increases. Catastrophe activity in the region was relatively benign in 2017.

Renewals for other lines, including property risk, motor and general third-party liability, were very much dependent on historical performance. Renewals were typically flat (with some adjustments according to experience) for these lines of business at 1 January 2018.

For proportional business, ceding commissions were generally stable. Again, historical performance was the key driver here.

**CHINA PROPERTY-CATASTROPHE**

Risk-adjusted pricing for loss-free excess of loss (XoL) property-catastrophe programmes in China typically renewed flat at 1 January 2018.

China suffered some catastrophe losses in 2017, with Typhoon Hato especially leaving its mark after it battered Macau. Hong Kong and other southern parts of the country were also impacted, albeit to a lesser extent. As a result, loss-affected XoL programmes typically saw risk-adjusted rates rise by between 5% and 15%, although even more significant increases were recorded for severely impacted accounts.

The build-up of losses also impacted proportional business at 1 January 2018, with ceding commissions often determined by programme performance. Accounts that held up well renewed flat, whilst programmes that suffered losses saw ceding commissions fall, with declines of between 1% and 3% commonplace.

Nevertheless, for cedents willing to pay market price, capacity remained sufficient at renewal and there was little evidence of tightening due to elevated global catastrophe activity in 2017. As a result, firm order terms often settled below initial quotes.

Buying behaviours remained generally unchanged at 1 January 2018.
ASIA PACIFIC PROPERTY-CATASTROPHE (EXCLUDING CHINA AND JAPAN)

- Property-catastrophe pricing in the wider Asia Pacific region remained competitive at 1 January 2018. After the double-digit declines of 2016 and 2017, risk-adjusted pricing on average fell less sharply at the 2018 renewal, with loss-free property-catastrophe XoL programmes typically renewing flat to down 5%. Nevertheless, some strongly performing cedents were able to negotiate significantly higher discounts, although these were the exception rather than the rule.

- Loss activity (outside of Australia) was relatively benign in 2017. Few programmes therefore suffered major losses but, for those that did, rates mostly renewed as expiring, or with manageable 5% increases.

- Loss-affected programmes in Australia, nevertheless, saw rate increases of up to 20%. This was due in large part to Tropical Cyclone Debbie’s landfall in Queensland.

- Ceding commissions for proportional business renewing at 1 January 2018 were broadly flat in most Asia Pacific markets, although increases of up to 2.5% were also recorded.

- Capacity levels remain plentiful as reinsurers look to strengthen their presence in the Asia Pacific region. The excess supply in the market was exacerbated by low losses in 2017. Some large cedents also ceded significantly less premium at 1 January 2018.

- These factors ensured that the Asia Pacific property-catastrophe market continued to experience some modest softening at 1 January 2018. Whilst some global reinsurers, particularly those impacted by elevated catastrophe losses in North America in 2017, attempted to withstand cedents’ attempts to negotiate price discounts, placements were over-subscribed and other international markets took up or absorbed their shares by giving way on price and agreeing to risk-adjusted rate reductions.

“After the double-digit declines of 2016 and 2017, risk-adjusted pricing for Asia Pacific property-catastrophe business fell less sharply at the 1 January 2018 renewal, with loss-free XoL programmes typically renewing flat to down 5%.”
MIDDLE EAST AFRICA P&C

- After four consecutive years of double-digit rate reductions in the Middle East P&C market, a changing environment emerged at the 1 January 2018 renewal as margin compression and regional loss activity led to relative rate stabilisation in several lines of business.

- The global catastrophe losses of 2017 had only a moderate influence on renewals in the Middle East. Regional losses had more impact, with large risk losses, as well as mounting attritional claims, preventing any further rate reductions.

- As a result, pro rata bouquet treaties (that include property, engineering, general accident and marine risks) renewed on an as-expiring basis, or with slightly improved terms for reinsurers, in line with last year.

- Risk-adjusted pricing for loss-free XoL property-catastrophe programmes was typically up by approximately 5% at 1 January 2018. Regional property retrocession loss-free programmes, meanwhile, renewed flat to up 5% on a risk-adjusted basis. Although rate reductions abated, the outlook for the Middle East property market remains challenging, with loss ratios in the high 90s.

- There were several risk losses in 2017, with one major event in the Middle East Africa region (the Abu Dhabi National Oil Company (ADNOC) refinery fire) affecting most regional reinsurers. Several impacted risk XoL programmes suffered rate rises of between 5% and 15% at 1 January 2018. And increases could continue through 2018 as other affected programmes renew up to and including 1 July.

- Loss-free energy programmes typically renewed flat on a risk-adjusted basis, although there was significant variability depending on risk exposures. Loss-affected energy programmes saw rates rise by up to 10% after the ADNOC loss, and other significant events that included a refinery fire in Ivory Coast and the Sohar aluminium plant loss in Oman.

- In an effort to address poor technical results for motor business, regulators in Saudi Arabia and United Arab Emirates imposed minimum deductibles and rates in both countries. Increased regulatory action continues to spread across the region, with new standards being imposed in the motor and medical arenas in particular. This manifested during the 1 January 2018 renewal as pricing for motor XoL programmes increased by 5% on average. Carriers are increasingly adopting cautious approaches in order to follow various regulatory requirements.

- Capacity remains plentiful and was relatively stable at 1 January 2018. That said, regulators are closely scrutinising underwriting standards: as a result, some well-rated reinsurers are looking to move into new product lines such as cyber, aviation, credit and agriculture in order to unlock new growth opportunities. But skill shortages in the underwriting field are currently impeding these initiatives.

“A changing environment emerged for the Middle East Africa P&C market at the 1 January renewal as margin compression and regional loss activity led to relative price stabilisation, replacing double-digit rate reductions.”
GLOBAL DIRECT AND FACULTATIVE

- Renewal outcomes in the global D&F market varied significantly at 1 January 2018 and were very much unique to each cedent, with loss experiences and risk exposures key discerning factors. Additionally, long-term relationships played an important role in differentiating cedents during renewal negotiations.

- Generalisations about D&F property renewals at 1 January 2018 are therefore difficult to make as every programme offered its own set of circumstances that needed to be evaluated individually. For example, cedents with higher attachment points that hit only lower layers typically saw more favourable pricing outcomes, whilst those that saw losses impact higher layers often translated into more substantial price increases.

- Uncertainty around the total insured cost of Hurricane Maria added to complexities during the renewal process, and these were compounded further by the fact a number of cedents had reduced exposure levels through 2017 in response to the prolonged soft market environment.

- All this notwithstanding, global D&F catastrophe programmes broadly saw rates rise by between 15% and 25% on a risk-adjusted, like-for-like basis at 1 January 2018. There were, nevertheless, significant variances around this range, with badly hit layers seeing higher increases. Firm order terms typically settled below initial quotes as markets ceded ground during the renewal process.

- Capacity remained plentiful at 1 January 2018 as alternative markets successfully reloaded and traditional markets responded by looking to write more. Cedents mostly stuck with existing panels. Budget spend was a key driver in most cedents’ buying appetite.

- D&F risk excess renewals, meanwhile, were dependent on portfolio mix and loss experience. With many programmes excluding losses emanating from critical catastrophe zones, hurricanes Harvey and Irma had less impact. However, Caribbean (for those that had cover), Mexican earthquake and California wildfire losses did affect some programmes.

- General market appetite for higher rates led to even loss-free renewals seeing minor price rises, although these were generally less than 10% and small in monetary terms.
RETROCESSION

- Although insured catastrophe losses reached record levels in 2017, retrocession renewal prices at 1 January 2018 fell below reinsurers’ early expectations. The mid-sized nature of the catastrophes mitigated losses for occurrence covers, with only Hurricane Irma having any sort of impact. Even then, generally only lower layers sustained losses. The succession of catastrophes in 2017 did, however, hit aggregate covers more significantly.

- Supply and demand forces played a key role in preventing more substantial pricing corrections at 1 January 2018. Despite the issue of trapped capacity being used by some to talk up rates during early negotiations, virtually all alternative markets were able to replenish lost or locked capital. New collateralised vehicles were also launched in time for the renewal.

- Competition was exacerbated by traditional reinsurers looking to increase their retrocession participations in an attempt to exploit the firming pricing environment. Whilst their objective was not ultimately met (as pricing did not spike to anticipated levels), it all culminated in retrocession capacity levels being higher in 2018 than at the corresponding renewal in 2017.

- These dynamics meant that rates for retrocession catastrophe programmes were generally up by between 10% and 20% on a risk-adjusted, like-for-like basis at 1 January 2018, with event-based programmes falling towards the lower end of this range.

- Ceding commissions for pro-rata treaty placements remained flat at 1 January 2018, but aggregate/occurrence caps were moved to reflect expected growth on certain accounts.

INDUSTRY LOSS WARRANTIES

- The industry loss warranty (ILW) market experienced significant losses in 2017, and rate increases ensued at 1 January 2018.

- Risk-adjusted pricing for loss-free US nationwide covers rose by between 5% and 12.5% whilst regional coverage saw more moderate increases of between 5% and 7.5%.

- Loss-affected ILW covers saw significant rate increases, ranging from 20% to 30% plus, although very few renewed at 1 January 2018 due to these more stringent terms. Most loss-affected ILWs were low-level frequency covers (such as second-event USD 10 billion US wind or third-event USD 5 billion US all natural perils).

- Capacity levels were sufficient at 1 January 2018. Although markets were initially cautious, possibly reflecting uncertainty over the amount of trapped capital, this eased gradually as claims from Hurricane Irma seemed to develop favourably. (Estimates for the Californian wildfires, on the other hand, have increased.) Nevertheless, reinsurers took a different and more sceptical view of second and third event pricing by either narrowing the breadth of cover (named storms only instead of wind or all natural perils) or retreating to higher levels. There was also resistance to attempts to broaden the scope of cover to include US territories and possessions.

- But reduced demand was the key driver during ILW renewals. The ILW market is often linked to shortages of capacity in other areas, the ultimate net loss (UNL) retrocession market especially. Catastrophe bond capacity is also increasing. Given that supply here remained plentiful at 1 January 2018, a number of cedents looked to mitigate ILW price increases by switching to UNL.
US PUBLIC ENTITY

- Elevated losses in 2017 impacted the US public entity market at 1 January 2018, with a number of cedents seeing moderate price increases to their reinsurance programmes overall.
- Loss-free XoL programmes for property saw risk-adjusted price increases of 4% on average at 1 January 2018. Liability and workers’ compensation business mostly renewed flat.
- Loss-affected programmes saw more significant upward pricing pressure in reaction to losses, with property up by an average of 10% on a risk-adjusted basis. Loss-affected liability and workers’ compensation programmes also recorded rate rises, albeit at a more moderate pace of 5% and 4%, respectively.
- Ceding commissions for proportional business reflected this slight tightening, being flat to marginally down at 1 January 2018.
- Capacity levels were largely stable, although 2017 catastrophe losses did cause some tightening for property business. Capacity levels for liability and workers’ compensation placements were sufficient.
- Whilst tightening for property business was anticipated, building liability losses also manifested at renewal, leading to some pricing pressure in this space.

US WORKERS’ COMPENSATION

- Renewal outcomes for workers’ compensation (WC) business were bifurcated at 1 January 2018. Whilst risk-adjusted XoL pricing for WC catastrophe layers typically ranged from flat to down 5%, per person layers renewed flat to up 10%.
- Capacity for WC programmes was generally sufficient at 1 January 2018. But here again there were some important differences between catastrophe and per person layers. Whilst the record-breaking catastrophe losses of 2017 had no discernible impact on WC renewals, the build-up of large individual losses over the last year or so did manifest. As a result, some markets reduced their line sizes for per person layers over concerns about pricing levels. Whilst there was still enough capacity to get placements subscribed, some per person layers had to be re-firm ordered.

“Renewal outcomes for workers’ compensation business were bifurcated at 1 January as risk-adjusted pricing for catastrophe layers ranged from flat to down 5% whilst per person layers renewed flat to up 10%.”
- Despite this, firm order terms generally settled at the lower end of quoting ranges for the WC market overall, with programmes often being bound at the lowest or second lowest quote.
- Reinsurers exhibited more willingness to provide broader coverage rather than lower pricing. For example, Maximum Any One Life (MAOL) provisions continued to increase, with up to USD 20 million being offered in some cases.
- More favourable terms encouraged changes in buying behaviours, with more cedents exploring reserve development mitigation strategies, including adverse development covers and aggregate stop loss covers.
LONDON MARKET CASUALTY

• 1 January 2018 renewals for London Market casualty business were completed late. This reflected uncertainty surrounding business plans and the UK discount (Ogden) rate. Cedents also held back to gauge the direction of property-catastrophe pricing before committing to orders and structures on long-tail business.

• As a result, expectations between cedents and markets were narrower than in the recent past. Whilst reinsurance rates for London Market casualty business did not harden significantly at 1 January 2018, market conditions may continue to firm through 2018, partly to demonstrate technical rate increases.

• Risk-adjusted pricing for loss-free XoL programmes was typically flat at 1 January 2018, although outcomes varied significantly depending on programme size and placement longevity. Tweaks to structures and conditions on occasion facilitated technical rate increases for markets.

• Loss-affected programmes saw modest rate increases, in the order of 3%. Experience was again the main driver at 1 January 2018. Of course, Ogden changes significantly impacted UK business that was likely to incur bodily injury claims. There was considerable uncertainty in the market over how to treat the most recent revision to the Ogden rate, but pricing for bodily injury business generally settled at between up 10% and up 25%.

• Capacity levels remained abundant during the renewal. In fact, slightly more capacity was available in 2018. This enabled cedents to be aggressive during negotiations, a strategy that often proved to be successful as firm order terms fell below reinsurers’ expectations. That said, markets were willing to reduce lines if they felt required margins were not being achieved.

• Reinsurers also attempted to reduce commission levels for proportional business at 1 January 2018, but with limited success. Cedents stood firm and ceding commissions were generally aligned to experience and reinsurers’ margins. Whilst there was no uniform market reaction for pro-rata renewals, commission levels on new proportional treaties were not as favourable to cedents as they had been in prior years.

GLOBAL FACULTATIVE

• The global facultative market continued to soften for much of 2017, although a general trend towards rate stabilisation emerged during the second half of the year for certain lines of business. Pockets of rate increases were recorded in Asia Pacific (Australia and New Zealand especially).

• Rates varied significantly across classes in 2017. Loss-free property and terrorism business saw price reductions moderate through the course of the year. Whereas rates for both lines fell by as much as 20% to 25% in most territories during the first half of 2017, they ended the year down up to 10% for terrorism and flat to down 5% for property. Due to low premium levels for casualty business, pricing for loss-free programmes typically renewed within a range of flat to down 5%, with outcomes in Asia Pacific trending towards the higher end of this range.

• Pricing for loss-affected facultative business was mostly up in 2017, although the magnitude of the increases varied depending on the size of the loss. Property accounts renewed flat to up 10% on average, with more significant increases in Asia Pacific. Casualty business saw similar outcomes.

• Construction, meanwhile, was down 10% to flat as an overall market (recognising that construction all risks (CAR) projects are, of course, not renewals). However, significant rate increases of up to 20% were seen for wood frame CAR projects due to losses in the area and reductions in capacity, particularly in the US.
• Capacity overall remained plentiful in 2017 despite market withdrawals (such as Novae Syndicate, Navigators Syndicate, Brit Syndicate and Axis) as these were more than offset by new entrants. These included Kemah Capital (writing on behalf of Berkshire), Rokstone Re backed by Best Meridian International, One Underwriting backed by Standard Syndicate and Geo Specialty backed by Lloyd’s syndicates.

• The record insured catastrophe losses of 2017 had little impact on supply. In fact, a number of existing markets, Lloyd’s syndicates especially, increased capacity subsequent to these events, some with immediate effect. Capacity therefore continued to be bullish during the last quarter of 2017.

• Overall, surplus capacity in the market proved to be a double-edged sword. Whilst innovative facultative solutions were available for upfront carriers to use to protect or arbitrage, placements on the retail side were often oversubscribed, leading to carriers being left off risks or having reduced shares, and therefore reduced facultative orders.

• Demand for facultative cover was stable to moderately up in 2017. Whilst major global carriers bought more facultative protection to reduce net retentions, others pursued more centralised buying strategies that resulted in reduced facultative placements.

• Supply is likely to grow in 2018. In addition to the new capacity that entered the market at the turn of the year, other start-ups could launch in the coming months. Global reinsurers are also looking to grow their facultative incomes in 2018.

• The overall trend of price stabilisation is likely to continue for the first half of 2018, although the direction of travel will be influenced by losses during this period. Should claims continue to spiral upwards, some capacity may start to withdraw from loss-making regions or classes, which, in turn, could see more significant upward pricing pressure.

STRUCTURED REINSURANCE

The structured reinsurance market is split into two main types of transactions: prospective cover (protection for future underwriting) and retroactive cover (protection for existing reserves).

PROSPECTIVE MARKET

• Pricing in the prospective market continued to experience downward pressure for much of 2017. Supply remained plentiful as a growing number of markets offered new capacity. The distinction between structured and traditional reinsurance continued to be blurred.

• The impact of HIM and other elevated catastrophe losses in 2017 has yet to play out in the prospective market, although more demand could materialise in Q1 2018 after cedents’ traditional reinsurance placements are completed in January. Nevertheless, growth in new markets could slow if traditional covers see significant rate increases.

RETROACTIVE MARKET

• Supply and demand in the retroactive market increased in 2017, as a growing number of markets were prepared to offer cover in reaction to cedent requirements.

• Changing fiscal and regulatory environments continue to impact the retroactive market. For example, federal tax changes in the US are likely to affect the structure of covers as they will no longer be able to run through affiliated companies without being subject to 10% tax on premium.

• Nevertheless, the retroactive market remained vibrant during 2017. And continued growth is expected in 2018 amidst strong competition from markets and sustained demand from cedents seeking solutions that offer both capital relief and finality.
SPECIALTY

Figure 4: Risk-Adjusted Rate Movements for Specialty Programmes Renewing at 1 January 2018* (Source: JLT Re)

AVIATION

- XoL aviation programmes typically renewed flat on a risk-adjusted basis at the 1 January 2018 renewal. This compared to declines of up to 10% at the corresponding renewal in 2017.
- The outcome in 2018 was balanced by abundant capacity and low loss experiences on the one hand (there were no major airline fatalities in 2017) and reinsurer resistance to further decreases on the other.
- This market resolve stemmed more from a growing recognition that aviation reinsurance rates had started to test levels of technical profitability rather than any wider impact from the elevated catastrophe losses of 2017. In fact, changing market approaches to aviation placements were first observed in July, before HIM had made landfall.
- Insurance carriers benefitted from increased premiums in late 2017 due to underlying exposure growth in fleet values and passenger numbers.
- Capacity levels were stable but remained plentiful. There were no significant changes to terms and conditions.

MARINE & ENERGY

- Despite marine programmes being materially impacted by cargo and yacht losses as a result of HIM, loss ratios generally remained below 100% in 2017 and many reinsurers achieved satisfactory returns from the sector.
- Risk-adjusted pricing trends for marine & energy programmes at 1 January 2018 moved from negative to positive territory for the first time in four years. The impetus for this reversal came primarily from increased reinsurer resolve to deny risk-adjusted rate reductions. This stemmed in large part from HIM’s impact and a reminder of how little current pricing levels account for natural catastrophe risks given the sector’s exposures. Changes to trapped exposure, as well as back-year deterioration (due to losses such as Siri, SBM and Tullow), also had an impact.
- As a result, risk-adjusted pricing for marine & energy programmes rose by an average of 4.9% at 1 January 2018. There were, nevertheless, significant variances around this figure, with outcomes ranging from down 4% to up 12%. This compared to a range of down 17% to down 8% at the corresponding renewal in 2017.
- Despite initial reinsurer resistance, ceding commissions remained unchanged for proportional business. There was increased demand from marine buyers for pro rata programmes at 1 January 2018 whilst energy quota share placements reduced for the second consecutive year.
- Capacity levels remained plentiful, with new market entrants struggling to access established programmes and there was limited new business for the market to write. Once firm order terms had been granted, following markets provided at least the same level of support as 2017.

* Very few programmes were loss-free for Marine & Energy, so the ranges shown reflect loss-affected rate changes.

Please note that the figures provided in Figure 4 are averages and significant variability exists in individual programmes.
• The Joint Excess of Loss Committee proposal to update market standard wordings was applauded widely by the market (particularly in aligning contracts with the Insurance and Enterprise Acts). However, when confronted by a challenging renewal season, many buyers preferred closer references to expiring wordings.

• The marine & energy sector has been a source of underwriting profit for reinsurers over the last two years, and margins look set to improve as pricing has swung from down 17% to up 5% during this period. The same cannot necessarily be said for their insurance counterparts and the probability of maintaining pricing momentum will rely heavily on insurers’ ability to sell rate through the year.

TERRORISM & POLITICAL VIOLENCE

• Despite a number of tragic, terrorist attacks in 2017 in advanced and developing countries, insured losses were modest and virtually none triggered reinsurance payouts.

• This reflects the changing nature of the terrorist threat, where motivations for attacks are now more focused on causing mass casualties (often creating non-damage business interruption) rather than triggering catastrophic property damage. The threat of large-scale terrorist attacks that cause significant property damage remains, however.

• The insurance market is looking to address the ‘non-damage’ issue by closing current protection gaps and offering cover that includes non-damage business interruption, active shooter, loss of attraction and cyber terrorism. The latter is now more widely included in terror policies, although aggregations are being closely monitored.

• Both commercial and certain terror pools are adapting their products to include different types of non-damage cover and provide customers (for example, regional small and medium-sized enterprises that previously did not buy terrorism insurance) with much-needed resilience against these new threats.

• Underlying exposures increased in 2017 against a largely flat income base. This impacted XoL renewal pricing at 1 January 2018 and, in general, programmes renewed with flat ROLs, against average reductions of 10% last year. When adjusted for exposure changes, 2018 flat renewals equated roughly to a 10% reduction on a risk-adjusted basis, although there was significant variance to this depending on the composition of the cedent’s portfolio.

• Pro rata treaties mostly renewed with as expiry terms and conditions.

• In terms of results, the class remains highly profitable, although the addition of increased underlying exposures and broadening coverages has, and will, further increase attrition.

• Capacity was largely stable at 1 January 2018, with a limited number of new entrants joining the market.

• Reinsurance buying patterns remained similar to prior years, although more cedents purchased aggregate layers to allow more flexible recoveries and better manage claims erosion.

CYBER

• The cyber (re)insurance market continues to grow strongly as the frequency, scale and sophistication of cyber attacks fuels demand.

• There were several high-profile cyber attacks in 2017. In addition to individual data breaches (involving companies such as Deloitte, Equifax and Uber), some incidents transcended sectors and geographies, with the WannaCry and NotPetya ransomware attacks in particular grabbing headlines given their global impacts. Despite this, losses to the cyber (re)insurance market were moderate, although the issue of ‘silent’ cyber risk manifested during the course of the year.

• Most cyber insurers continued to see large (double-digit) increases in income in 2017 as new business generated significant exposure growth. Whilst XoL loss-free programmes typically renewed with moderate ROL increases at 1 January 2018, this represented a favourable outcome for cedents on a risk-adjusted basis. Firm order terms were typically agreed within 10% of original quotes.

• Most quota share cyber programmes performed well in 2017, prompting some cedents to apply pressure to increase ceding commissions at 1 January 2018. This was mostly resisted by reinsurers, and ceding commissions typically renewed at expiring levels.

• Capacity levels were generally sufficient at renewal, with additional capacity from a limited number of new participants increasing competition.
HEALTHCARE

Figure 5: Risk-Adjusted Rate Movements for Healthcare Programmes Renewing at 1 January 2018\(^5\) *(Source: JLT Re)*

<table>
<thead>
<tr>
<th>Accident &amp; Health Catastrophe</th>
<th>Medical Benefits Per Person</th>
<th>North America Med Mal (Treaty)</th>
</tr>
</thead>
<tbody>
<tr>
<td>-25%</td>
<td>-20%</td>
<td>-15%</td>
</tr>
<tr>
<td>-10%</td>
<td>-5%</td>
<td>0%</td>
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<tr>
<td>5%</td>
<td>10%</td>
<td>15%</td>
</tr>
<tr>
<td>20%</td>
<td>25%</td>
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</tr>
</tbody>
</table>

Average rate change % (loss-free)

2018 2017

ACCIDENT & HEALTH

- Three key factors influenced accident & health (A&H) placements at 1 January 2018: major US catastrophe losses in Q3 and Q4 2017, accident and disability loss activity from late 2016 into 2017 and continued capacity abundance.

- Whilst the impact of 2017 global catastrophe losses (HIM and the California wildfires especially) was probably more muted in this market than others, it was nevertheless a factor. Some markets were adamant that capacity would be reallocated to other sectors if they were unable to generate targeted returns.

- Three subsectors came under heightened scrutiny following losses: US professional sports (loss of value contracts especially), Australian income protection and contract protection indemnity – the coverage type bought by Disney which paid a claim of approximately USD 50 million following the death of actress Carrie Fisher in late 2016.

- An abundance of capacity acted as a counterweight to price increases. 2017 saw a number of new London market entrants (including China Re, Barbican and Noa) whilst Starstone also expanded its A&H reinsurance platform. In the face of any reluctance to support terms from existing panels of reinsurers, brokers were able to turn to any/all of the above.

- These interacting drivers generally saw loss-free XoL programmes renew at expiring rates at 1 January 2018. There were some exceptions – rate reductions were recorded when cedents’ premium bases had increased substantially. Loss-affected programmes, meanwhile, typically renewed within a range of up 5% to up 10%.

- Firm order terms often settled below initial quotes for Asian accounts. For non-Asian business, firm order terms tended to be as quoted.

- Ceding commissions for proportional business were typically flat.

- Overall, A&H renewals reflected growing reinsurer resolve at 1 January 2018. But with firm order terms not meeting early renewal season expectations, markets often focused on maintaining core accounts and had no compunction in dismissing what they saw as inadequately priced, non-core business. This happened solely on programmes where final terms deviated significantly from what quoting reinsurers were targeting, although local markets were ready to pick up any slack. Also indicative of tensions during this renewal was the number of placements which had to be referred to underwriting committees or chief underwriting officers.

\(^5\) Please note that the figures provided in Figure 5 are averages and significant variability exists in individual programmes.
NORTH AMERICA MEDICAL MALPRACTICE (TREATY)

- The medical professional liability market at 1 January 2018 reflected profitability pressures on original business and reinsurers’ desire for increased pricing. Whilst several cedents are in a loss-free position with reinsurers, terms have eroded in recent years and margins are being squeezed. There was therefore a standoff at renewal as some reinsurers pushed for rate increases to offset pockets of deterioration in their books. Cedents resisted, citing strong reinsurer profits in this space over the last few years.

- As a result, loss-free XoL programmes or programmes where losses fell within the expected tolerance range typically renewed flat at 1 January 2018. With cedents’ subject premiums appearing to be stabilising, a flat rate likewise achieved flat dollars. But there were significant variations around this outcome. Some programmes recorded rate decreases in excess of 5%. In these instances, London markets reduced authorisations, although domestic reinsurers were often willing to absorb shortfalls. Additional or broadening coverages were priced for at 1 January 2018, whereas they generally had not incurred additional premium charges in prior years.

- Rate movements for loss-affected programmes were very much dependent on the overall level of loss. As a result, rate increases on loss-affected programmes generally fell within a wide range of 2% to 20%. But, even here, there was evidence of competition between London markets and domestic reinsurers, with the latter looking to steal market share by developing relationships and supporting the reinsurance of their own peer group as a potential avenue towards M&As and strategic partnerships. Strong competition between markets helped suppress price movements during the renewal.

- Firm order terms mostly settled at the lower end of quoting ranges, although this was not universally the case. In fact, there were some instances where firm order terms had to be reissued to secure reinsurer support. This predominantly was not price driven, but more a case of cedents wanting to secure backing from specific markets.

- Capacity levels remained relatively stable at 1 January 2018, but some markets have clearly become far more selective and price conscious. And whilst there have been a number of new market entrants into the medical malpractice space since 2014, they are increasingly adopting hard lines as they lack redundant reserves accrued from strong results in the early 2000s.

- Ceding commissions generally fell at 1 January 2018.
A PROSPECTIVE VIEW: WHAT TO WATCH IN 2018

Recent weeks and months have once again demonstrated the resilience of the reinsurance market and its ability to trade through trying times. During this time, carriers have paid out billions of dollars in claims without incurring significant capital impairments or any rating agency downgrades. The 1 January 2018 renewal was also conducted in an orderly manner. This is some achievement given that 2017 was the most expensive catastrophe loss year on record (see Figure 6). Following several years of below-average catastrophe losses, last year was a reminder that carriers must prepare for higher levels of catastrophe losses in future years. After all, insured catastrophe losses have now exceeded USD 100 billion three times in the last 15 or so years.

Figure 6: Global Insured Inflation-Adjusted Catastrophe Losses – 1970 to 2017E (Source: JLT Re, Swiss Re)

As the market bids farewell to a turbulent 2017 and enters 2018, JLT Re has identified 10 key factors that are likely to shape the reinsurance market over the next year, with potential implications for sector capital and pricing. These will be analysed in detail at the inaugural JLT Re market event on 25 January. Three areas of particular importance – catastrophe models, alternative capital and reserving – are briefly discussed here.

6 Includes National Flood Insurance Program (NFIP) claims.
1. CATASTROPHE MODELS

If some of the estimates put forward by the major commercial modelling companies are to be believed, the market could see significant revisions to losses through 2018. Whilst current market consensus suggests Q3 2017 catastrophe claims for the private market could reach USD 80 billion in total, the range offered by modelled industry losses was far greater. In fact, in the weeks after HIM made landfall, estimates varied from USD 65 billion at the bottom end to as high as USD 145 billion – a spread of USD 80 billion.

Figure 7 shows the high and low post-landfall estimates provided by different vendor modelling firms for HIM. Subsequent revisions made to estimates are also captured in the chart, with the patterned and filled (combined) entries of the same colour representing initial estimates and the filled entries showing most recent updates. The fact that three landfalling hurricanes in the world’s most comprehensively analysed peak risk region generated such enormous ranges in modelled estimates raises questions over whether modelling tools can be relied upon to produce credible information for real-time and post-event catastrophes.

Hurricane Maria in particular led to highly divergent views between the modelling companies. In fact, AIR Worldwide’s original top-end Maria estimate was nearly three times that of RMS and KCC. Strikingly, there was no overlap between AIR’s bottom estimate and its competitors’ highest. The gulf stemmed in large part from differences of opinion over Maria’s windfield size at landfall, ground-up exposures, repair costs, population migration and insurance coverages and terms (for business interruption especially) in Puerto Rico. Even after AIR issued a revised estimate for Maria several weeks after landfall, glaring differences remained. The same can also be said for existing estimates issued for Harvey and Irma.

Some of this can perhaps be explained by the various assumptions each modelling company makes in calculating industry loss estimates. Whereas previous years saw recorded losses far exceed modelled losses, the opposite seems to have been true in 2017. Indeed, some modelling companies may have overreacted to the demand surge component after three category 4 hurricanes made landfall in the US (including Puerto Rico), along with additional category 3-5 damage in other parts of the Caribbean. Conversely, the models may have underestimated how well newer buildings performed during the hurricane onslaughts due to more stringent building codes in the US and Caribbean. This is especially relevant given the amount of new construction that has taken place in Florida alone in the past 10 to 15 years.

Catastrophe models are, of course, built to provide probabilistic outcomes for tail scenarios rather than predict the monetary cost of any single event. But given the unusually large divergences of loss estimates, their performance is likely to come under close scrutiny this year, particularly if they result in significant model revisions (as they did in 2005 and 2008 following hurricanes Katrina and Ike, respectively).

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7 Excludes NFIP loss estimates.
In addition, there is still considerable scepticism around RMS’s medium-term rate (MTR) view of hurricane risk, particularly over whether Atlantic Ocean temperatures are cooling and the proposed link to a reduced landfall frequency of hurricanes. With RMS in 2017 cutting its five-year hurricane landfall projections below the long-term average for Texas, the Gulf Coast, Florida and the Southeast, important questions are raised over whether this forward-looking view is useful to the (re)insurance sector. This is particularly pertinent after two category 4 hurricanes hit Texas and Florida last year, and it comes just a few years after RMS was recommending a view of risk that called for above normal-landfall between 2006 and 2012, which never materialised. Such regular changes can be disruptive to the sector as they have significant implications for risk perceptions and calculated loss amounts.

2. ALTERNATIVE CAPITAL

Although 2017 will no doubt be remembered for the succession of costly catastrophe strikes in North America, just as important to both reinsurance buyers and sellers was the performance of the ILS market.

How alternative capital providers would respond to major losses had been a growing source of speculation in the reinsurance market. Some questioned their long-term commitment to reinsurance whilst others predicted a spike in legal action over disputes during the claims settlement process. These voices grew louder following HIM, with certain market participants warning that the sizeable losses sustained by collateralised markets and ILWs in particular would lead to widespread double-digit rate increase at the 1 January 2018 renewal. Trapped capital became new buzzwords amidst predictions that alternative capacity would freeze until incurred losses were quantified.

Just a few months on, these concerns can be put to rest. As Figure 8 shows, a significant chunk of lost capital in the alternative market was replenished in time for the renewal, with substantial capital raising taking place for sidecar vehicles, in addition to significant new (i.e. not renewal) catastrophe bonds issuance. And claims for the most part have been paid speedily and efficiently.

The fact that much of this capacity was deployed at a lower rate of return than many predicted immediately after HIM made landfall played a crucial role in capping rate increases seen at 1 January 2018. It also reflects investors’ growing confidence in the reinsurance asset class. Investors undertook extensive due diligence before committing funds to the sector and were well prepared for these losses. In fact, given that claims mostly fell within risk tolerance ranges, allocations could increase further through 2018. There was certainly no let-up in catastrophe bond activity during Q4 (as Figure 9 shows), where issuance was above the 10-year average.

Cedents can therefore reasonably expect this source of reinsurance capacity to persist for the long-term. The implications for traditional reinsurers are more ominous, however, as it seems they can no longer rely on post-event price hikes to boost profitability, regardless of the magnitude of the loss.

Figure 8: Announced New Reinsurance Capital – Q4 2017 (Source: JLT Re)
3. RESERVING CYCLE

The implications of reserving for the (re)insurance sector are difficult to overstate. Loss reserves are typically the largest single item on balance sheets, and significant reserve development can heavily impact profitability and capitalisation. In fact, it was the liability crisis of 2001-2005 which most recently came closest to pushing the sector over the brink.

The irony is that this bane of insurers’ existence became a boon for a number of years after the financial crisis. During this period, carriers released redundant reserves into earnings, thereby compensating for historically low investment yields, as well as elevated catastrophe losses.

However, after more than a decade of favourable development, the reserving cycle is back under the microscope amidst concerns that it has reached an inflection point.

Reserve adequacy is notoriously difficult to predict but JLT Re in 2016 conducted an exhaustive analysis of reserve trends which identified early evidence of isolated net calendar year reserve deficiencies. This research has been updated to show reported calendar year reserve movements by quarter for the top 30 global (re)insurance companies up to Q2 2017 (see Figure 10 on page 22). For comparison purposes, Figure 10 also includes accident year loss development for all lines of business (shown by the orange line).

The analysis implies that the sector continues to be in a danger phase in which carriers are continuing to release large amounts of reserves even as accident year experience indicates that redundancies are diminishing. But there are early signs this could now be changing – Q4 2016 was the first time in over eleven years that P&C carriers experienced net reserve strengthening. This could be a critical milestone if this trend becomes more sustained in 2018. Reserve deficiencies, after all, have historically sustained hardening markets.

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Figure 10: Calendar Year Reserve Development by Quarter for Top 30 Global P&C Carriers Versus Accident Year Reserve Experience – 1998 to Q2 2017 (Source: JLT Re)

FUTURE VISION

The reaction of traditional carriers and capital markets to future reserve development and loss experience will be important in shaping the reinsurance market in 2018 and beyond. With speculation already focused on key renewals dates in 2018, it is crucially important for reinsurance buyers to have detailed insights into key market drivers. JLT Re exists to provide market-leading analysis and best-in-class advice and risk transfer to support clients in managing market change. We look forward to doing just that in the weeks and months ahead.
WE SEE OPPORTUNITIES THAT OTHERS DON’T

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