- Massive market hardening shapes January renewal
- SI Re sustainably strengthens the quality of its book of business

STEPS 1/23

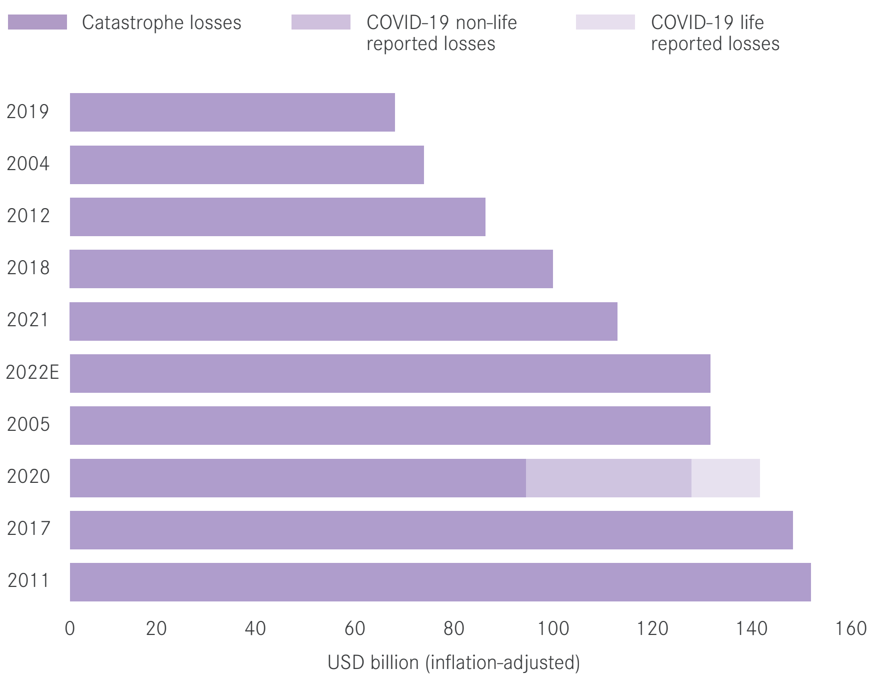
Massive market hardening shapes January renewal

The 2023 renewals represent a paradigm shift for the insurance sector. Longstanding reinsurers admit to not having experienced such a heated year-end renewal before. Although the sector had anticipated further market hardening on the heels of some hardening action observed in previous renewals, hardly anyone expected the extent of the broad and abrupt contraction in capacity available at 1.1.2023. In previous years, reinsurers had also demanded that the price for providing reinsurance capital had to rise and were able to enact price increases to specific lines of business. However, given the persistent low interest rate regime, fresh capital used to keep flowing into the market, distorting price discipline. This time was different: contract conditions, retentions and prices tightened massively. Cover and layers were discontinued, so that programmes had to be comprehensively restructured.

The cause of this market hardening lies in the combination of economic and geopolitical crises, exacerbated by the effects of climate change. On the one hand the sector had to deal with high natural catastrophe losses from previous years, and on the other hand it still had to digest the impact from the pandemic. In addition, Russia's invasion of Ukraine made wars of conquest a reality again, with the block mentality of the post-2nd world war years having its re-entry. The rising tensions in the Far East are also quite concerning as frictions between the US, its local allies and China impact the global economy.

High demand following the reopening of markets after the pandemic,

TOP 10 LARGEST LOSS YEARS ON RECORD



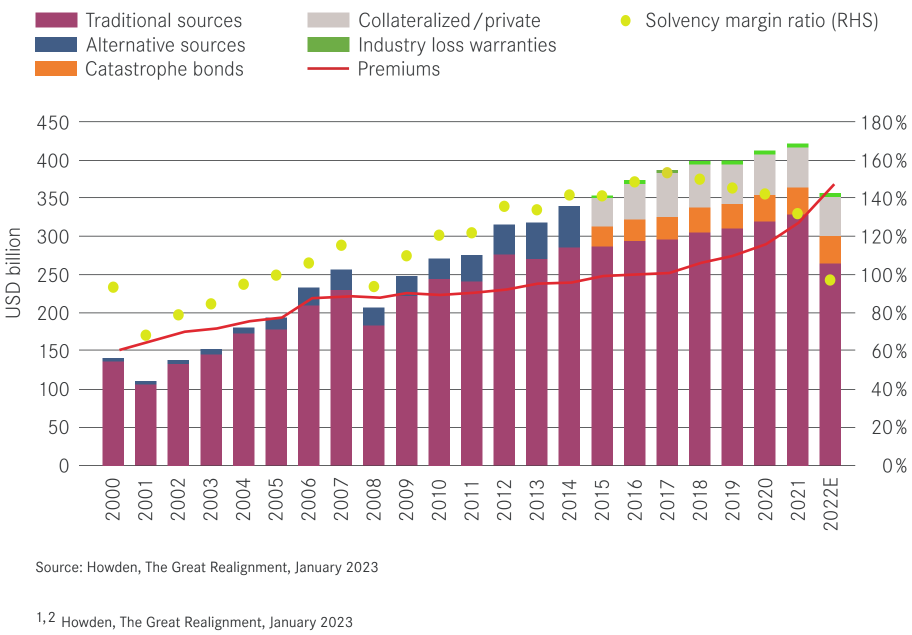
Source: Howden, The Great Realignment, January 2023 distorted supply chains and higher energy prices given the end of cheap Russian gas supply to Europe, caused inflation to reach levels not seen for decades, rising to around ten percent in Europe and the US. Initially slow to respond, the central banks drastically increased rates at a pace never seen before. On top of that, there was Hurricane Ian making landfall in Florida in 2022, causing the second most expensive natural catastrophe event in insurance history with insured losses of about USD 60 billion.

The insurance industry is facing many challenges

With insured natural catastrophe losses of about USD 130 billion, 2022 is the fourth costliest year in insurance history. Worse still, seven of the ten biggest natural catastrophe claims years occurred in the past decade.[1] One of the main drivers for this is climate change and the industry slowly but truly admits that this must be reflected in insurance prices. As this does not just apply to primary risks, such as tropical windstorms, also perils that have long been considered as secondary risks are in the spotlight. The claims activity in Europe was not driven by major pan-European winter storms in recent years but by a high frequency of more isolated events. For example, there was storm depression «Bernd» flooding the Ahr valley in 2021 with insured losses exceeding EUR 10 billion, or the heatwave, forest fires and countless hailstorms that especially afflicted France last year.

So, while technical results came under pressure during 2022, the market value of investments also fell due to rising interest rates. This caused an accumulation of unrealised losses in insurers' balance sheets and a sharp fall in solvency ratios.

DEDICATED REINSURANCE CAPITAL AND GLOBAL GROSS REINSURANCE PREMIUMS (ALL LINES) 2000 TO 2022



Source: Howden, The Great Realignment, January 2023

[1,2] Howden, The Great Realignment, January 2023

A situation thus arose in 2022 that the insurance sector had not experienced since the financial crisis: its risk-bearing capacity contracted. Risk capital fell by more than USD 50 billion to about USD 350 billion and the industry's solvency margin dropped from 130 % to below 100 %.[2]

Another issue was the massive accentuation of the dislocation of the retrocession market, meaning the retrocession market disengaged further from the reinsurance market, is providing it with still less access to risk capacity – a development that SI Re warned about since some years ago, as we believed reinsurers were becoming too dependent on the retrocession market. And that is exactly what happened.

Given numerous natural catastrophe losses – especially in the US – in prior years, followed by Hurricane Ian last year, capital committed to Insurance Linked Securities (ILS) products to cover reinsurance risks remains trapped and is thus unavailable to investors to reinvest. This not only binds capital, it also unsettles investors. In essence: this capital source, the main resource for retrocessions in previous years, dried up. In this renewal round, major retrocessionaires withdrew their support or stopped quoting. Capacity also contracted due to the downgrading of the financial strength rating of prominent reinsurers.

Inflation had a big impact on the capitalisation in the sector. On the one hand, inflation increases the values to be insured and thus the insurance premiums, and on the other hand, it drives up the costs for existing liabilities that have to be paid in the future, especially for long-tail risks. This inherent loss of value needs to be reflected in reserves and premium calculations today.

In summary, it is reasonable to assume that the claims burden and its frequency will not only increase for natural catastrophes, but also – due to Russia's war in Ukraine– in such lines of business as aviation, marine or cyber insurance. We also expect social inflation to lead to more legal disputes and higher compensation sums awarded by the courts in affecting liability insurance.

Impact on renewals
In the 2023 renewals, coverage was thin for programmes offering no opportunity to recuperate past losses. There was no alternative to what were in some instances significant price increases and there is no prospect of a market softening in the foreseeable future.

Prices for programmes unaffected by claims were up 30 %–40 %, rising to above 50 % for programmes that incurred losses. Retentions also doubled in some cases. In property insurance, cover was often only available for loss events with a frequency of less than once every five years. At the same time, ceding commissions fell markedly and loss participations increased. There was no more reinsurance for aggregate covers available, as reinsurers insisted on per event covers. Moreover, hours clauses and definitions for loss events were also tightened.

As some primary insurers had neither expected, nor, more importantly, budgeted for such price increases, they had no option but to rethink their retention policy. We therefore assume the discipline that defined the relationship between reinsurance and primary insurance in these renewals will filter through to contract negotiations between primary insurers and their clients.

SI Re sustainably strengthens the quality of its book of business

SI Re completed a highly pleasing 1.1 reinsurance renewal. We used the pronounced market hardening to strengthen our profitability, increase premium volume and expand the business portfolio. New client relationships and portfolio adjustments enabled a greater diversification. We pursued the targeted expansion of our engagement in the regions and business lines where market conditions developed favourably. In markets that fell short of our expectations, we prudently reduced exposure. Overall, we are convinced to have improved the quality and resilience of our book of business sustainably.

As mentioned in our leading article, renewals for this year saw a massive market hardening, a feature that had been foreseeable with the development in the retrocession market for some years. The convergence of economic, geopolitical and climate uncertainty, which resulted in yet another high claims burden, led to major investment losses and weighed on insurers' underwriting performance. In parallel, the retrocession market dried up, having been the key risk capital resource over the past decade. Overall, the market was faced with a reduction in available reinsurance capital for the first time since the global financial crisis in 2008. At the same time, primary insurers' demand for reinsurance increased due to the inflation-adjusted growth in sums insured.

This led to unprecedented price rises, especially for catastrophe cover in property business. According to the Guy Carpenter «Property Catastrophe Rate-on-Line Index» there was a 30% increase in the RoL for property catastrophe reinsurance contracts in the US and European market. Factoring in the catastrophic flooding in Germany caused by storm depression «Bernd» in the Ahr valley in 2021, the cumulative increase is 67% compared to 2017.

However, it was not only prices that were up. Conditions and clauses also tightened, leading to higher retentions, restricted limits and scarce capacity for some contracts (especially stop loss (SL) and aggregate excess of loss (AXL)). To conclude a placement, some cedants had to accept changed conditions or retain some part of the programmes on their own account.

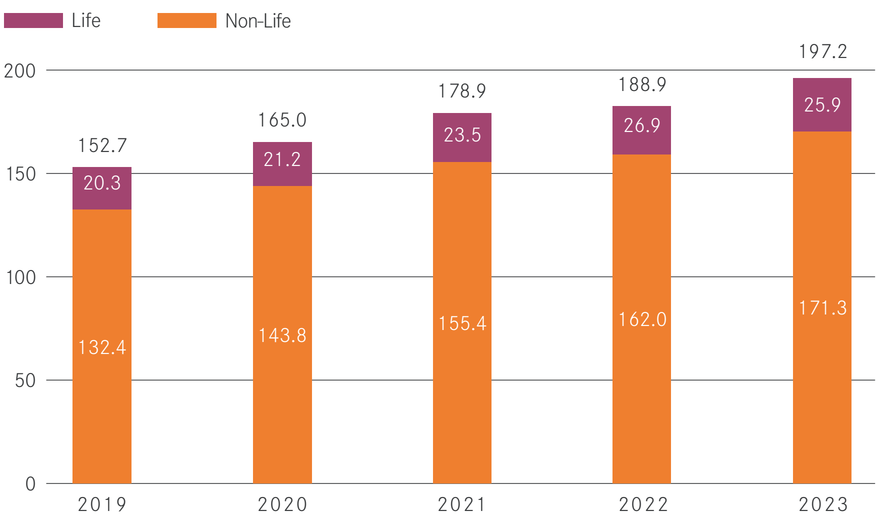
Profitability massively strengthened

Over 50% of SI Re's property business up for renewal was cancelled or restructured. This share was even more striking in the non-proportional book as over 66% was cancelled or reorganised.

The only way cedants could reconcile high rate increases with the rise in demand for cover, without massively expanding their reinsurance budgets, was through restructuring their programs.

In the property line, XL priorities in the working layer segment increased by an average of 47% and prices rose by 41%. In catastrophe covers, the average increase in priorities was as high as 70%, while prices rose by over 20%. By contrast, in unchanged catastrophe

PREMIUM VOLUME DEVELOPMENT FROM 2019 TO 2023 (EPI IN EUR MILLION)



covers, SI Re saw significantly higher price increases of 40%. In the overall property working layer segment, we saw double-digit price increases to the tune of over 21%, and in engineering by just over 17%. In all other P&C lines, prices increased between 5% and 7%.

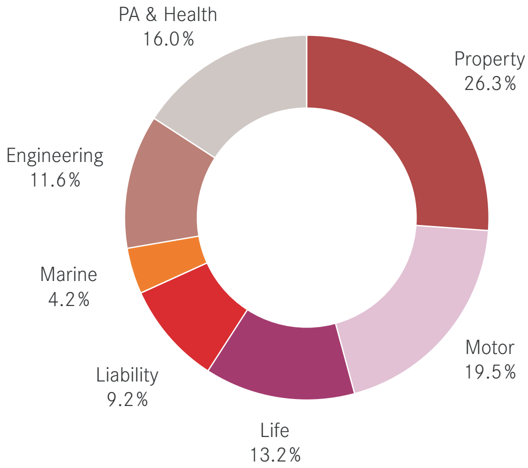
Set commissions in the claims-afflicted proportional property business have been reduced by up to 10 percentage points since 2021.

We are very pleased with expanding our client base again by 5% maintaining the positive trend of prior years. The line-mix remained stable. In total, premium volume was up 4.4% to about EUR 197 million for this year's renewals.

SI Re increased its capitalisation by EUR 25 million in December 2022, which enabled us to benefit from the business opportunities in the renewals and act as a stable and sustainable partner.

LINE SPLIT BY UNDERWRITING YEAR AS AT 1 JANUARY 2023

Estimated premium income (EPI) 2023 – EUR 197.2 million



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