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Reinsurance Market Dynamics

January 1, 2023

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About this report

Aon's Reinsurance Market Dynamics provides a comprehensive assessment of key market dynamics looking back at the January 2023 renewals period. Commentary on global reinsurer capital, alternative capital and rating agency perspectives on the macroeconomic environment offer insights on the potential direction of the global (re)insurance industry and future renewals.

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Executive Summary: Fundamental Shifts and Enduring Truths

The January 2023 renewal marks a turning point for the reinsurance market, signaling a new reality for buyers. It was the most challenging January 1 renewal in a generation as the reinsurance market underwent a fundamental shift in pricing and risk appetite, especially for property catastrophe risk. Following six years of underwhelming returns and above average catastrophe losses (capped by Hurricane Ian in late September of 2022), the market had started to experience firming in 2022. Different from prior market cycles, there were a number of exogenous factors including forty-year record inflation, unrealized investment losses driven by a precipitous rise in interest rates, dramatic foreign exchange moves, climate change driving evolving investor sentiment, and a war in Europe, the reinsurance market took action to put itself back on an even keel.

Pricing for U.S. property catastrophe and global property retrocessional business hit multi-decade highs at January 1. Reinsurers moved away from frequency layers and sought to redraw the scope of property catastrophe protection with narrower coverage definitions and more excluded perils. Insurers were challenged in navigating these changes, especially those that have not ceded losses and were not in peak zones, concerned that reinsurers were treating all buyers in the same way.

Pragmatic Outcome to a Turbulent Renewal

The January 1 renewal process was strained with quoting delays (driven at least in part by dislocation in the property retro market) and a broad divergence in terms and conditions requested by reinsurers. Despite headwinds, however, clients were able to purchase the reinsurance protection they need, securing core coverages albeit at significantly higher rates and retentions. While capacity was constrained, fears of a major capacity crunch in the wake of Hurricane Ian were not realized. Insurers responded to market dynamics by adjusting increased retentions and scaled back demand for additional limit, while improved pricing helped free up additional reinsurance capacity as the renewal progressed.

Reinsurers that communicated their position early in the renewal process, provided collaborative and workable solutions and maintained midyear capacity commitments were the most successful at January 1 and are now better positioned to capitalize on growth opportunities going forward.

Lessons of a Hard Market and Future Capital Flows

'Hard markets' are fundamentally characterized by the inability to purchase desired levels of capacity. Successfully navigating such a market requires preparation and high-quality data. At January 1, insurers that went to the market early with a well informed and proactive strategy were best positioned to secure capacity. Portfolio differentiation and client advocacy were also critical in a market where challenging reinsurers' broad assumptions can make a big difference to client outcomes. Clients that were able to leverage strong relationships and clearly demonstrate how they have mitigated the impact of inflation on exposures were able to access more favorable terms and capacity.

Meaningful new capital did not enter the market in advance of January 1. In late December, we saw encouraging signs that reinsurers were looking to take advantage of improved conditions, although the capacity entering the market at January 1 fell well short of withdrawals earlier in the year. New capital may flow into the reinsurance market in the first quarter attracted by the certainty of returns and improved underwriting conditions that were established at the renewal.

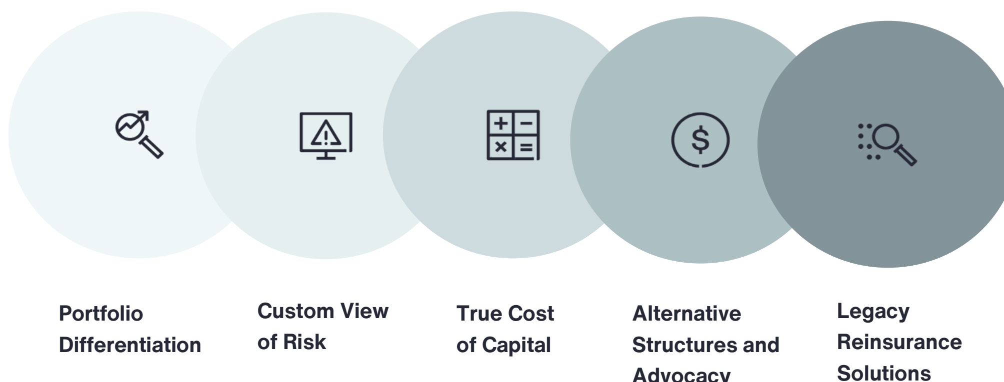
Capital entering the reinsurance market in 2023 will be rewarded by strong demand and attractive terms. We believe many clients will reevaluate their retained volatility in the first quarter and several may consider additional reinsurance purchases.

Capital Optimization is More Important than Ever

Reinsurance remains an accretive source of capital for insurers when compared with debt and equity. However, the re-setting of the reinsurance market at January 1 has important implications for insurers' capital management and balance sheet protection. As the reinsurance market puts itself on more of a sustainable footing, traditional reinsurance is returning to its core role of protecting capital, which will potentially increase earnings volatility for insurers.

Clients have many tools at their disposal to optimize capital efficiency and retained volatility. In 2022, Aon published a list of key considerations for a successful renewal upon which we have expanded below given lessons learned at January 1, 2023:

- Consider alternative capital for optimal placement results
- Discuss integrated placements across property and casualty leveraging a diversified portfolio
- Access a new facultative facility for capacity for terrorism exclusions from property cat covers
- Leverage strategic consulting and data analytics to refine risk appetite, adjust investment and underwriting strategies, or review business lines, as well as differentiate your portfolio at renewals
- Explore structured reinsurance covers and legacy reinsurance solutions to manage volatility and free up capital to absorb higher retention levels and/or support growth opportunities
- Articulate clearly how you underwrite for inflation and its impacts on your risk profile
- Develop a custom view of risk to de-risk and reduce exposure concentrations, as well as to improve understanding of secondary perils and emerging risks
- Understand your true cost of capital, including volatility of returns, which is critical to optimizing the long-term return on capital
- Partner with a true client advocate that can provide advice and analytics to ensure your portfolio is best positioned across capital providers to achieve your capital optimization goals



Enduring Truths

The industry faces a moment of truth. The January 2023 renewal season was buffeted by a confluence of events many of which are macroeconomic and geopolitical, existing outside of the loss experience that typically drives changes in reinsurance market terms and conditions. Many of these variables remain and will be part of our industry's landscape for the foreseeable future. This tumult comes on the heels of a global pandemic and war in Europe. Risk premiums have increased across asset classes globally. Uncertainty seems to be the order of the day.

Insurance in its various forms has existed for thousands of years to provide stability amid unpredictable outcomes. Reinsurance has remained an important pillar of the insurance industry's capital structure for hundreds of years, providing a flexible source of capital and risk transfer that can be easily adapted to support individual client needs.

We are hopeful that the turbulence of the January renewals is a meaningful step forward to a stable structural and pricing environment.

While this was an extremely challenging and, in many instances, stressful renewal, the marketplace functioned. Though deals were negotiated and finalized prior to year-end, there is collective work to be done. Watch Andy Marcell's interview last December in the midst of renewals, calling on the industry to come together to provide insurers with a resilient, stable and relevant reinsurance product.

Aon is working hard to rebuild investor confidence, create additional capacity and ensure that reinsurers have access to the highest quality data and analysis to enable them to maximize their support of clients.

Joe Monaghan
Global Growth Leader
Reinsurance Solutions, Aon

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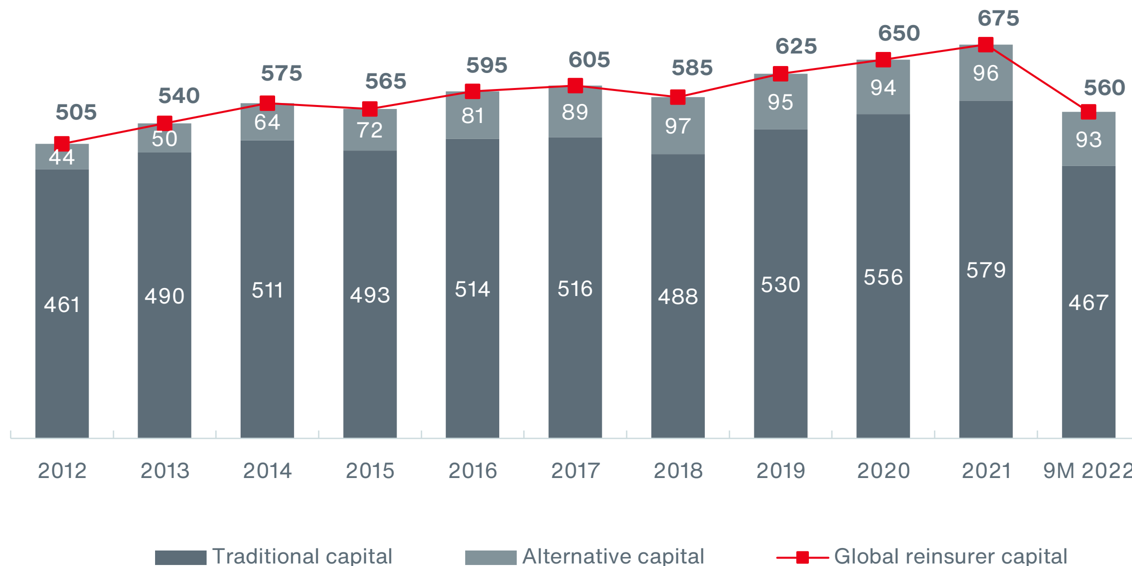
Global Reinsurer Capital: Reduced Asset Prices Erode Reported Book Values

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

Aon estimates that global reinsurer capital declined by 17 percent, or $115 billion, to $560 billion over the nine months to September 30, 2022. The reduction was principally driven by substantial unrealized losses on investment portfolios.

Exhibit 1: Global Reinsurer Capital ($ billions)



Sources: Company financial statements / Aon's Reinsurance Solutions / Aon Securities, LLC

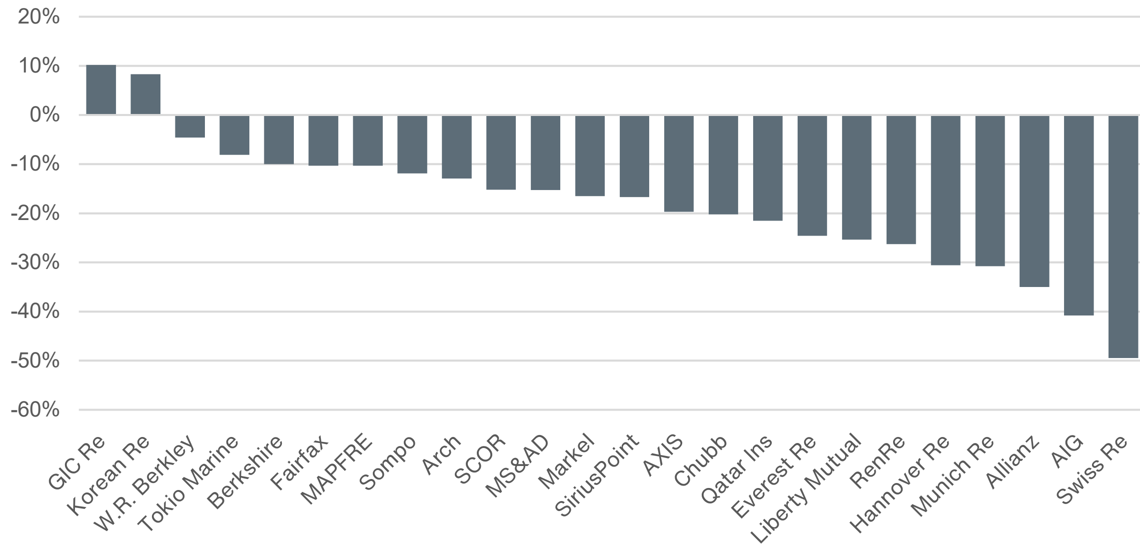
Traditional Capital: Accounting Mismatches Drive Volatility

Reported equity levels were down across the industry in the first nine months of 2022, with some of the world's largest insurance and reinsurance groups showing the most significant declines.

Underwriting results were generally resilient in the period, despite the impact of Hurricane Ian, but investment portfolios were impacted by material unrealized losses, driven by rising bond yields, widening credit spreads and declining equity markets. These effects undermined overall earnings and eroded reported book values.

Reinsurer management teams pointed to mismatches in the major accounting regimes that were driving volatility in reported equity. Mark-to-market losses are being immediately recognized on the asset side, while there is little to no offset on the liability side to reflect the long-term benefits of higher interest rates. In addition, bonds are generally held to maturity and recover value as that date approaches.

Exhibit 2: 9M 2022 Changes in Total Equity (Original Reporting Currencies)



Sources: Company financial statements / Aon's Reinsurance Solutions

Risk-based regulatory and rating agency capital models tend to take a more economic view, which explains why regulatory solvency ratios and financial strength ratings have so far been resilient, despite the reductions in reported equity. That said, sensitivities to major losses and recessionary risks are likely to have increased, while debt leverage tolerances are being tested in some cases.

New capital formation is currently limited, reflecting significant uncertainties in what has become a very challenging risk environment. Investors are particularly concerned about the impact of climate change and inflation, but there are expectations that the prospect of higher returns will drive new allocations going forward, particularly as the benefit of higher pricing and interest rates becomes visible in earnings.

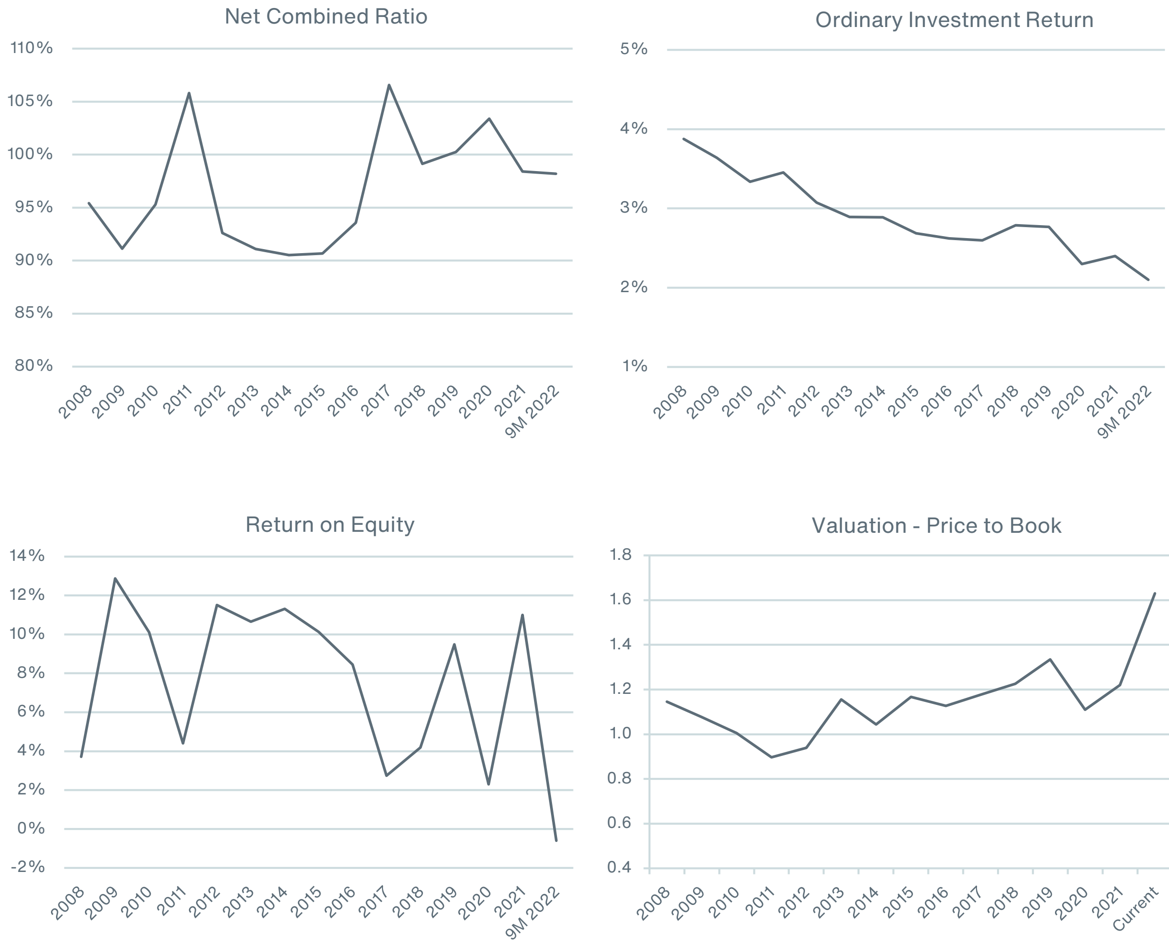
Reinsurer Results

Most reinsurers continued to report strong property and casualty (P&C) premium growth in the first nine months of 2022. Underwriting results are benefiting from compounding rate increases and the move to more restrictive coverage terms seen in recent years. However, major loss activity is continuing at elevated levels, the most notable event in the period being Hurricane Ian at the end of September. The net combined ratio across the 17 ARA companies that reported was 98.2 percent.

The ordinary investment yield was down again in 2022. Higher interest rates will be very positive for future earnings, but existing bonds typically need to mature before higher yielding instruments can be purchased, creating a lag in reported results. Total investment returns were heavily impacted by market volatility and, as a result, the aggregate return on equity was -0.6 percent for the ARA companies.

Reinsurer valuations were under pressure in the first half of 2022 but moved sharply higher in the final quarter of the year. The prospect of better returns has benefitted share prices since Hurricane Ian and these increases are being set against some significant reductions in book value.

Exhibit 3: Reinsurance Sector* Performance



*All data based on Aon's Reinsurance Aggregate
Sources: Company financial statements / Aon's Reinsurance Solutions

Reinsurers have generally performed poorly since 2017. Over the six-year period to the end of 2022, the ARA has reported an average combined ratio of around 101 percent and an average return on equity of just under 5 percent. This is one of the driving forces behind current underwriting discipline.

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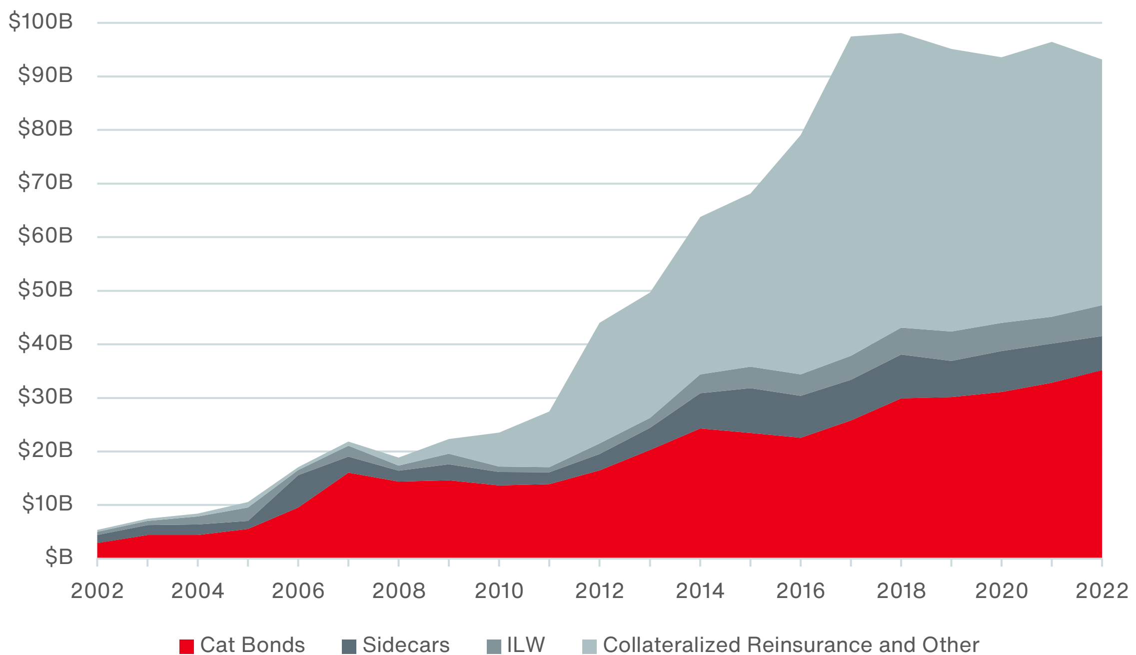
Alternative Capital: Poised for Strong Market Growth from Attractive Returns and Asset Class Diversification

2022 Recap

The 2022 property catastrophe bond (cat bond) market was supported by new and repeat insurance and reinsurance sponsors and maintained an orderly manner despite the macroeconomic headwinds facing the market, Hurricane Ian, the war in Ukraine, inflationary concerns and rising interest rates. The market grew year-over-year (as measured by limit outstanding); issuances outpaced maturities by $2.2 billion, or roughly 7 percent, consistent with the growth seen in 2021. We observed a supply-demand imbalance for cat bond capacity, as more insurers and reinsurers sought to tap the cat bond market to mitigate challenging traditional reinsurance and retrocession renewal seasons. This, along with increased catastrophe activity over the past five years, has pushed the bond market into a higher total return environment, with material increases in overall pricing, accompanied by higher collateral returns. We anticipate Insurance-Linked Securities (ILS) investors to take advantage of attractive returns and diversification opportunities presented by the ILS market in 2023, driving further growth and delivering valuable capacity for re/insurers.

Gross committed assets in ILS declined by an estimated 3 percent in 2022; the combination of Hurricane Ian and redemptions throughout the year put a strain on existing investor capital, while inflows were constrained partly due to macroeconomic factors and concerns around the severity of Hurricane Ian in the fourth quarter. The estimated allocation across various product types is shown below.

Exhibit 4: Alternative Capital Deployment (Limit in $ billions)



Source: Aon Securities, LLC

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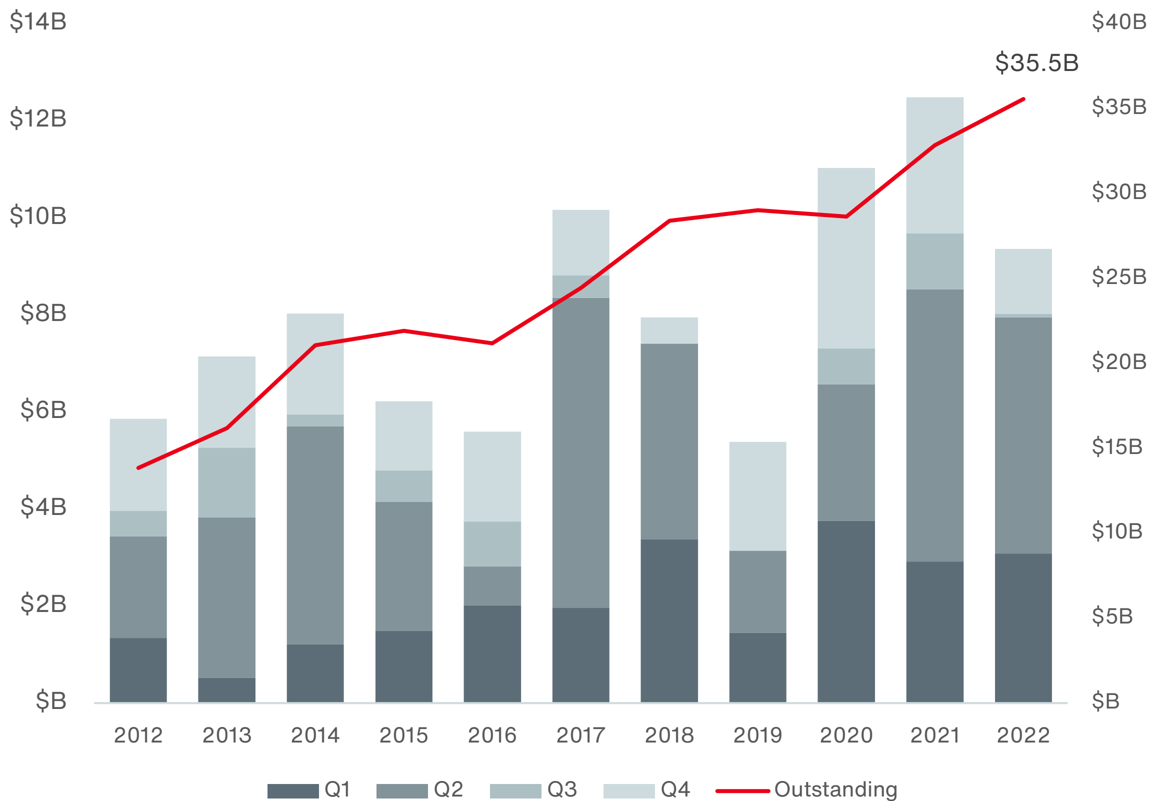
Resiliency of the Market

Relative to collateralized reinsurance, ILWs and sidecars, we observed investor preference for cat bonds, as the liquidity and structure of the instrument continues to be favored, resulting in an increase in capital allocated to the cat bond market, overall.

Cat bond issuance during the first half of 2022 was robust with 8 percent growth in overall bonds outstanding. However, Hurricane Ian, which occurred in late September, slowed down the issuance of further deals and those that came to market typically received smaller overall sizing. Post-Ian, average transaction sizes roughly halved from $232 million to $116 million as investors, which had limited capacity, looked to maintain relationships and reward repeat sponsors that came to market. That said, the amount of cat bonds outstanding gained slightly throughout the fourth quarter and the first week of January as investors managed to reallocate maturities into new issuances.

Exhibit 5: Property Catastrophe Bonds Issued and Outstanding



Source: Aon Securities, LLC

The sidecar market continued to be constrained by several factors, notably, concerns around coverage written, portfolio composition and general global loss experience. While reserves for COVID-19 losses have largely settled across the industry, uncertainty remained for unmodeled losses in (re)insurance portfolios. As a result, investors have become more stringent in their selection of ceded sidecar risk; investors prioritized structures and portfolios with profitable track records, regular and transparent reporting and more favorable terms and conditions, e.g., ceding and profit commissions.

Hurricane Ian

Following Hurricane Ian, ILS investors paused to understand their exposures to - and valuations of - their portfolios, resulting in a number of deals being subsequently delayed. As one of the largest loss events to hit the (re)insurance industry in the 25-year history of the cat bond market, Hurricane Ian is expected to result in roughly $400 million of losses for cat bond investors (assuming overall loss reserves and the industry estimates increase during 2023). While a manageable loss for the $36 billion market, Hurricane Ian put a significant dent in the earnings of ILS funds in 2022. It is likely that much of the losses can be attributed to mark-to-market movements as opposed to principal reductions. Such losses are likely to be recouped as bonds ultimately revert to par at maturity (assuming no further losses or significant adverse development of Hurricane Ian reserves).

The hurricane, the fourth most powerful storm to hit Florida since records began in 1851, positively affected ILS funds' ability to raise capital to meet increased demand, appreciate the immediate price widening and take advantage of the opportunities presented by challenging conditions in the traditional reinsurance market. Investors' concerns for climate change, catastrophe risk modeling and loss development have impacted the risk-return profile of ILS (i.e., increased margins), particularly when considering the challenging investment environment experienced in 2022 with respect to inflation, higher interest rates and considerable movements in foreign currencies.

As time has passed since Hurricane Ian made landfall and investors have gained a better understanding of their losses and capital positions, we have observed a return to larger issuance sizes, relative to the immediate aftermath of the event.

Risk Spreads and Capital

Margins in ILS have increased significantly during 2022. Some of the increased margins observed in 2022 are directly attributable to Hurricane Ian and the material rise in collateral yields. Conversely, global equity, fixed income and credit markets struggled during 2022 and investors benefited from the lack of correlation between ILS and other asset classes.

From an ILS sponsors' perspective, the increasing prices seen in traditional reinsurance and retrocession markets is increasing the demand for ILS capacity. We are now in a market where demand for ILS capacity exceeds supply, and while this has resulted in higher overall pricing and tighter terms and conditions, regular sponsors of cat bonds and other ILS products have been appreciative for this alternative source of capital, having developed stronger relationships with ILS investors.

Market Outlook

ILS capital has become an essential source of capacity for insurers, and an important component of reinsurance purchasing strategy. We expect demand for all forms of alternative capital to remain elevated throughout 2023 as insurers and reinsurers look to mitigate both macro-economic and reinsurance market challenges.

Historically, higher margins and the diversification of the asset class, relative to the broader financial markets, has resulted in meaningful market growth and could be a net positive for new and existing sponsors. This is likely to occur once the markets better understand Ian loss development, inflationary trends, interest rates and the overall geopolitical uncertainties that have pervaded the broader financial markets in 2022. The overall theme remains that diversification is playing out well compared to prior 'bull run' of the broader financial markets. The investment case for ILS remains strong, and will be further bolstered by reinsurance and retrocessional rate increases sustained at year-end 2022.

Macro Conditions: Extreme Volatility

2022 was an unusual year. Inflation hit multi-decade highs, sparking concerns about both prospective claims and reserves. Interest rates were hiked at an almost unprecedented pace, impacting bond values and eroding capital positions. Equities had their worst year since 2008, while the euro hit parity with the dollar for the first time in 20 years.

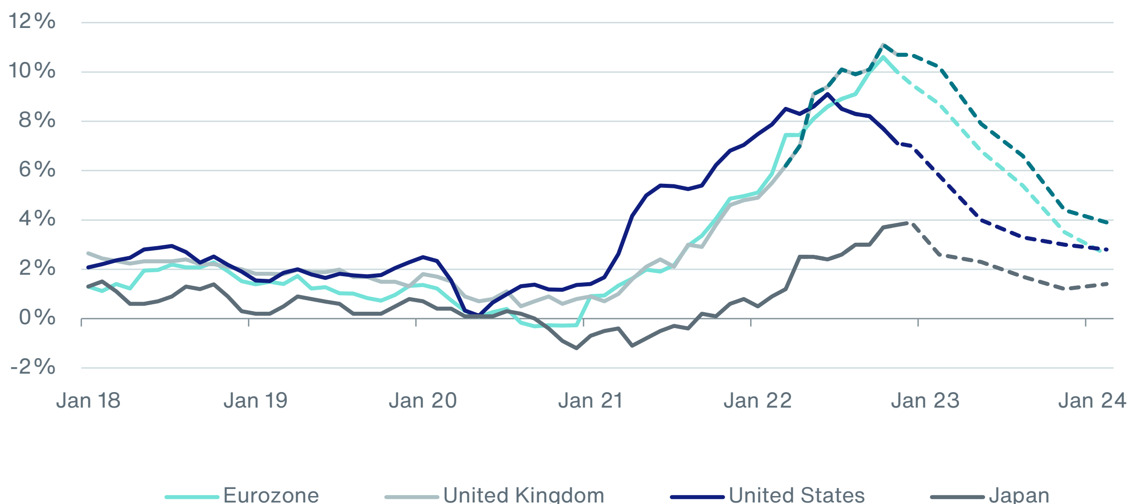
All these factors contributed to making what was always likely to be a complex renewal season even more challenging.

Short tail lines, including property and motor damage, bore the brunt of claims inflation, as rebuilding costs and used car prices shot up. Casualty lines fared better, because they are typically more geared to wage and medical cost inflation. For the moment, these are generally running below consumer price inflation (CPI). Nevertheless, several major reinsurers strengthened reserves during the year on the back of inflationary pressures.

Economists are hopeful that we are now past the peak. In the U.S., inflation has fallen 2 percent since a summer high of 9 percent. Economists polled by Bloomberg forecast a steady decline to below 3 percent by the first quarter of 2024, as shown in Exhibit 6.

Inflation has proved more persistent in Europe, where energy is a larger component of the headline rate. However, in recent weeks there are some encouraging early signs that European inflation is also starting to fall.

Exhibit 6: Historical and Forecast CPI/HICP

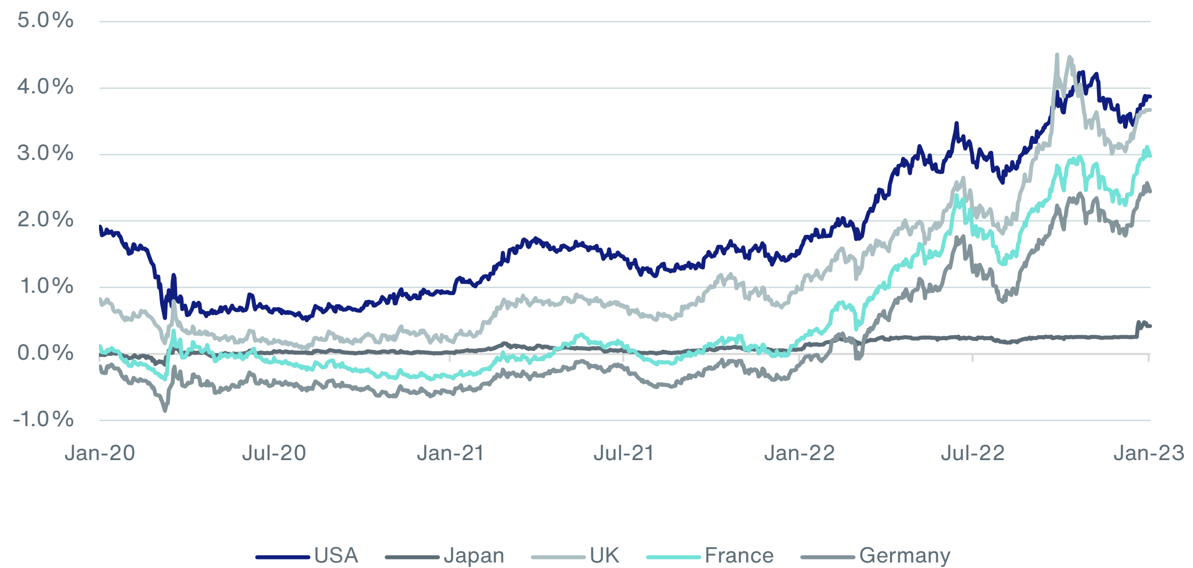


Source: St Louis Fed, Bloomberg consensus forecasts as of January 3, 2023

To tame inflation, central banks have been raising interest rates. The US Fed raised its benchmark policy rate on seven occasions in 2022, ending the year at 4.25-4.5 percent, the highest level in 15 years. The European Central Bank hiked its main lending rate from 0 percent to 2.5 percent, in the second half of the year, and expects to raise rates again this year.

Higher central bank rates are feeding through to higher interest rates on longer term government bonds, as shown in Exhibit 7. The 2.4 percent rise in the US 10-year rate in 2022 was the largest yearly increase in over 60 years.

Exhibit 7: Interest Rates on 10 Year Government Bonds



Source: Bloomberg

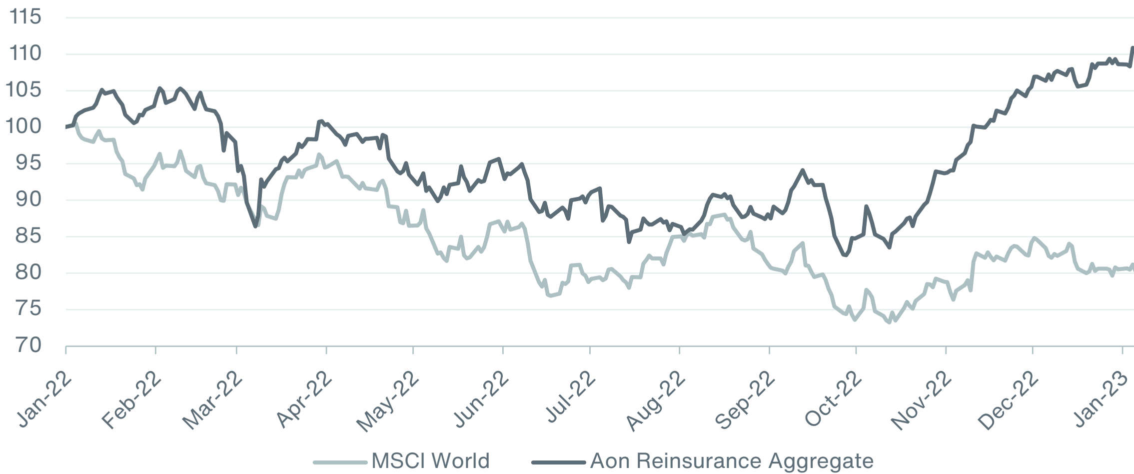
Higher rates should meaningfully enhance the long-run profitability of the reinsurance industry. Reinsurers primarily invest in bonds and make significantly more money from investment returns than they do from P&C underwriting.

However, it will take time for the full benefit to emerge in earnings, as maturing investments are reinvested in higher yielding assets. As discussed in the capital section of this report, the resulting fall in bond prices has hit reinsurers' book values.

Another contributor to the large fall in reinsurers' capital positions we saw over 2022 was equity markets. 2022 was the worst year for world stock markets since 2008. This environment made it significantly more difficult for both existing players and potential new entrants to the reinsurance market to raise capital, despite rapidly hardening price conditions.

As shown in Exhibit 8 reinsurance stock prices significantly outperformed the wider stock market over the last two months of the year, which may change this dynamic in 2023.

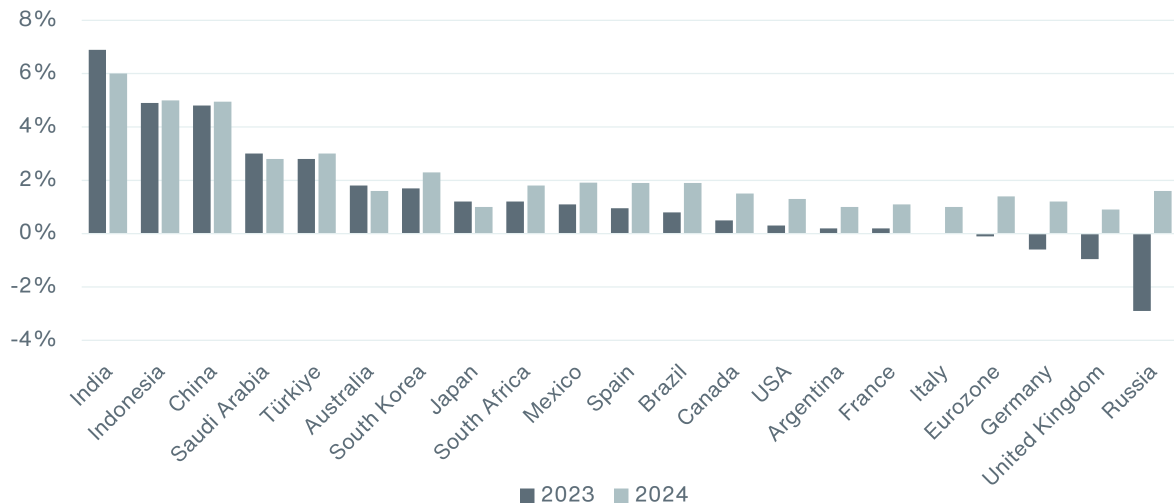
Exhibit 8: Global Stock Market and Reinsurance Industry Stock Performance (Indexed)



Source: S&P Capital IQ Pro

Higher interest rates often precede recessions. Most economists are now forecasting a global economic downturn in 2023. A Bloomberg survey puts the average expected growth at just 1 percent in the U.S. and -0.1 percent in the eurozone. P&C (re)insurance often fares better than other sectors in economic downturns because insurance is not a discretionary product and claims, apart from certain lines such as D&O and credit, are generally uncorrelated with economic growth. However, further increases in credit spreads or falls in equity markets could put additional pressure on reinsurer balance sheets.

Exhibit 9: Forecasted Real GDP Growth for the G20



Source: Bloomberg consensus forecasts as of January 3, 2023

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Demand-Supply Dynamics: Opportunity for Integrated Placement Strategy

By: Tracy Hatlestad, Head of Global Property and Paul Anderson, U.S. Property Growth Leader
Nigel Light, Head of Global Casualty and Amanda Lyons, Head of U.S. Casualty
Chris Coe, Global Agriculture Leader and Dave Ott, U.S. Agriculture Leader
Mark Skilton, Global Head of Specialty and Aviation; Luke Foord-Kelcey, Global Head of Cyber
James Fogarty, Richard Miller, Matt Price, Marine, Energy and Composite
Ben Walker, Andreas Koutris, Doug Espenson, U.S. Mortgage
Nick Ayres, Rupert Evans, Ewa Rose, Trade Credit, Structured Credit and Political Risk, and Surety

Property: Reset to Promote a Sustainable Market

Property catastrophe reinsurance, which typically accounts for the lion's share of reinsurance spend among property casualty insurers, was the most challenging segment of the market during the January 1 renewal, with the largest rate increases and significant changes to program structure.

Mid-year renewals signaled potential changes were in store for the reinsurance market at January 1, as reinsurers responded to the perfect storm of inflation, rising interest rates and a prolonged period of heightened natural catastrophe losses. When Hurricane Ian made landfall in Florida in September, it only fortified reinsurers' resolve and accelerated required changes in the market.

Despite an at times -frustrating renewal process, insurers were able to place programs in what is probably the most difficult property catastrophe reinsurance market in 30 years. Insurers that were well prepared and took a pragmatic approach saw the best results at January 1.

Insurers will ultimately benefit from the resetting of rates and coverage at January 1 to create a more sustainable market. We expect to see new capacity enter the property catastrophe space in 2023, while existing reinsurers are likely to review their portfolios in light of changing market dynamics. Reinsurers that chose to value insurer partnerships will ultimately fair better as the market evolves.

Topic	Commentary
Adapted to market conditions	Property catastrophe capacity for reinsurance was constrained at the January 1 renewal, outstripping demand. However, insurers adapted to market conditions with retention increases and consideration of top end limit, easing some pressure on capacity at the renewal. As a result, insurers were able to place desired limits on programs at January 1, albeit with little or no surplus capacity available for additional limit.
Advocacy and broad market relationships find common ground	Client advocacy was critical during the January 1, 2023 renewal process. Insurers benefited from broader market knowledge and touchpoints with several levels at a reinsurer's organizational structure to find common ground on rate, retention levels and coverage terms that still represented their unique portfolio needs. Strong market relationships played an important role at the renewal, where new

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	capacity was hard to come by, and proved critical for filling gaps in programs left by reinsurers exiting the property catastrophe space. Aon's clients benefited from insights drawn from real-time data at scale and the most thorough market network that ultimately enabled better business decisions.
Retention and attachment levels rise	Retention levels broadly increased at January 1, reflecting the effects of inflation and the increased relevance of secondary peril losses in recent years, which have increasingly impacted reinsurance layers. In many cases, retentions rose to levels at or above cumulative inflation over the last decade and above recent years' secondary loss history. More specifically, the US Regional client segment meaningfully increased property catastrophe retentions at 1/1 following multiple years of relatively flat retention level adjustments. This result should be well received by reinsurers.
Well-articulated inflation management paid off	Inflation was an important driver for increased reinsurance demand and retention levels at January 1, and a key focus for early renewal discussions. Insurers that articulated the effect of inflation on their portfolios and how they actively managed risk assessment were able to avoid reinsurers' overly conservative inflation assumptions in analyzing insurer portfolios.
Demand for additional limit in 2023	Early estimates for additional limit showed significant increases fueled by inflation-driven growth in exposure, in particular in the U.S. and Europe. However, bound limit was effectively flat for peak zone U.S. risk at January 1, 2023 and less than 10 percent up in non-peak regions that are favorable for reinsurer diversification, as clients adapted their reinsurance purchasing to market conditions and raised retention and/or co-participation levels. Some insurers will consider buying additional limit for second and subsequent events or top layer protection, should market conditions allow throughout 2023. In addition, insurers should be looking to build and fortify relationships with reinsurers as the market evolves in 2023. While inflation has abated to a degree, certain regions are capacity-constrained and 2023 results will be key to maintaining balance in supply and demand.
Rate change magnitude driven by regional experience	The January 1 renewal resulted in significant rate increases and structural changes to programs in almost all markets. Risk-adjusted rate-on-line increased substantially in both North America and Europe, with U.S. property catastrophe prices now exceeding 2007 highs, which followed active hurricane seasons in 2004 and 2005. Markets in Asia and Latin America were not immune from market dynamics, although price increases and changes to program structure and terms were often less pronounced.
Push back on coverage terms	Terms and conditions came under considerable pressure at January 1, as reinsurers sought to delineate and clarify coverage. Some reinsurers focused capacity on well-modeled natural catastrophe risks, with a desire by some to move to named peril coverage. A limited number of reinsurers sought to rein-in hours clauses. There was also a push by some markets to exclude or limit non-natural hazard risks from property catastrophe covers, in particular terrorism, riot and civil commotion. Broadly speaking, the market lacked consensus and clients were able to resist some changes where exposures were minimal. Where coverage

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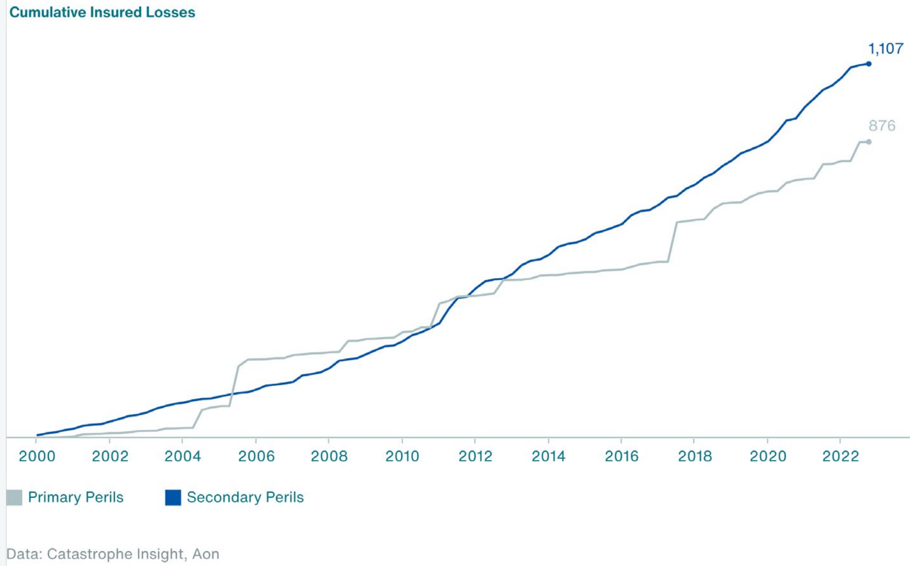
	concessions were made, insurers protection was secured with fewer non-concurrencies than some might have anticipated throughout the renewal season.
Integrated placement strategy between property and casualty	In the current market, broader trading relationships have become more valuable as insurers take a more strategic view of their total reinsurance spend, including the interplay between property and casualty lines of business and net retentions. At January 1, a number of insurers explored options to build cross-program support for casualty portfolios in order to achieve the property catastrophe placements, resulting in a win/win for reinsurers' looking to find diversified growth opportunities.
Preparation pays in difficult renewal	In challenging market conditions, well informed insurers commenced renewals early and took a pragmatic approach, exploring a wide range of program options and structures, as well as protection solutions and capacity providers. Despite a challenging market, insurers that were earlier to market and more advanced in delivering firm orders were in a better position to address gaps in capacity.
Hurricane Ian's impact	Hurricane Ian, which made landfall in Florida on September 28 as a high-end Category 4 storm, added further ambiguity for the property reinsurance sector. With an estimated insured loss of $50 billion to $55 billion according to Impact Forecasting, Ian is the second largest hurricane loss on record, making 2022 the sixth year in a row for above average insured catastrophe losses and the fifth costliest year for insurers on record. Although the size and ceded loss nature of Hurricane Ian may be less than initially predicted, the industry was further strained by having another year of loss versus profitability that could have mitigated rate increases. Ian also contributed to a more strained renewal process, as reinsurers and ILS funds reviewed business plans and risk appetite mid-way through the renewal, causing delays and uncertainty for insurers. Data: Catastrophe Insight, Aon
Secondary perils	The increased relevance of secondary perils to reinsurance layers was a significant driver behind pressure on retention levels and reinsurers move to focus coverage on well-modeled natural perils. Losses from secondary perils, such as wildfires, convective storms, floods and hail, have been an important contributor to the erosion of reinsurer returns, with cumulative losses from secondary perils outpacing those paid out from hurricanes since 2000, according to Impact Forecasting. Anticipated developments in models for secondary perils, however,

will help clients and reinsurers better understand secondary peril exposures in coming years, and help drive reinsurance solutions. In EMEA alone, winter storm losses from Dudley and Eunice and severe storm losses in France earlier this year as well as the impact of Bernd in the summer of 2021 impacted renewals. In the U.S., the same was true for Midwest convective storm and hail activity, which resulted in adjusted January 1 renewal strategies for a number of regional clients.



Quota share capacity constrained

Despite substantial underlying rate increases, capacity for property quota share protection that included catastrophe exposure continued to be constrained as reinsurers favored property catastrophe excess of loss reinsurance protection at the January renewal. Ceding commissions for catastrophe-exposed quota share programs came under pressure in a number of markets, although clients resisted in the face of retention increases. However, as primary rates continue to increase at a meaningful pace, reinsurers are likely to reconsider opportunities presented by quota share covers with catastrophe exposures at future renewals.

Retro market retrenched

Property catastrophe retro capacity retrenched at January 1, with material changes to pricing, structure and seller appetite. With more than 80 percent of excess of loss retro business renewing, demand was high. Sufficient supply became available across the product range albeit at higher prices and levels. In what was a challenging and late renewal, retro pricing increased significantly and coverage narrowed, with limited appetite in the retro market for non-natural and secondary perils. The majority of retro programs were therefore restricted to peak modeled territories and perils only. The late retro renewal added further delays and uncertainty for property and specialty reinsurance renewals, which ran concurrently.

With the growth in alternative capital over the past decade, ILS funds and other alternative capital investors are a critical provider of retro capacity, accounting for the majority of the property retro market. However, the alternative capital market has suffered the same demand-supply mismatch as traditional property catastrophe reinsurance markets, with investors demanding higher returns and

	better clarity of coverage. Hurricane Ian also disrupted the supply of retro, as markets paused to review business plans, and with significant ILS capital potentially trapped in collateralized retro arrangements. New capital is being attracted to the retro market by higher rates and improved terms, but capital inflow has not kept pace with outflow and increased demand to cede more risk to third parties.
Market differentiation	Reinsurers that communicated quotes and authorizations early in the renewal process, provided collaborative and workable solutions on contract language and maintained the capacity levels they committed to midyear will be viewed as strategic, long-term partners. In some scenarios, reinsurers that took an overly aggressive and inflexible approach to coverage or price were signed down or off programs. As a result, there were changes to reinsurer panels.

Casualty: A Rational Interest in Diversification

The casualty market remains generally stable relative to other reinsurance markets, although renewals in January were complicated by the demand-supply mismatch in property catastrophe. The quotation process was delayed and more involved than recent renewals, as reinsurers and insurers explored options to leverage casualty business in property renewals.

In contrast to property, capacity in the casualty reinsurance market was plentiful, as reinsurers demonstrated an increased appetite for the class. While some reinsurers pushed for improved terms at January 1, the balance of power remained with buyers. Following a period of underlying rate increases, reduced limit deployment and initial indications of 2020 and 2021 being benign years, casualty insurers entered renewals in a position of relative strength. Reinsurers that were in-tune with these market realities proved more pragmatic and continued to support existing insurers as well as expand on market opportunities. Others retracted as they expected the casualty market to follow the momentum of the property market and were unwilling to pivot even though this scenario did not materialize. This was not the case in the Professional Liability segment where primary rates are on the decline with many clients falling short of their rate projections and experiencing adverse development.

U.S. Casualty

Within the general casualty space there was continued divergence between pro rata and excess of loss reinsurance. Conjecture leading up to January 1 that ceding commissions had to come down substantially largely waned. The vast majority of our pro rata book renewed with flat ceding commissions; a few clients saw slight decreases. For excess of loss covers, discussion around social and economic inflation and the post COVID-19 environment continued. Excess of loss risk-adjusted rate increases were on average in the low single digits, however, based on individual portfolio characteristics and experience outcomes ranged from risk-adjusted rate reductions to high single digit increases.

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International casualty

While the general insurance dynamic was the same as for U.S. casualty, treaty outcomes were slightly more favorable for buyers. Quota share commission renewed flat or slightly up, while excess of loss rates were broadly ranging from single-digit risk-adjusted rate change down to single-digit increase. Exceptions to these were poorly performing portfolios and/or non-standard reinsurance structures – consistent with other classes, reinsurers hit these with fierce terms or declined altogether.

Casualty Market Observations

Topic	Commentary
Demand stable	Demand for casualty reinsurance remained stable, with the majority of casualty insurers benefiting from strong balance sheets and positive rating levels. Given the underlying strength of casualty books, insurers were in a position at January 1 to reduce reinsurance purchasing through higher retentions if the economics of their reinsurance transaction were not at the right levels.
Ample supply	The supply of reinsurance capacity continued to grow at January 1, in what is an attractive market for reinsurers looking for growth and diversification opportunities outside property catastrophe. However, casualty reinsurers took divergent approaches at the renewal, with a number adopting a more opportunistic stance, demanding improved conditions. Others were willing to underwrite risks as expiring as they sought to maintain or increase line sizes. Market realities, however, won out and rate increases were modest at the renewal.
Net retentions	Insurers were generally amenable to increasing net retentions on many U.S. casualty lines due to underlying rate and limit reductions. The ability for insurers to take larger net positions, combined with an over-supply of proportional reinsurance capacity, has allowed U.S. casualty ceding commissions to remain relatively flat despite macroeconomic and reinsurance market headwinds.
Optimizing casualty placements	With casualty in demand, some reinsurance buyers were able to leverage their casualty business in order to optimize their overall reinsurance placement and access property catastrophe capacity. A number of reinsurers were keen to grow their casualty business and offered more favorable terms in return for increased access. Insurers that sought to leverage the value of their casualty portfolios to attract property catastrophe capacity, however, faced a more complex casualty renewal.
Attractive market for reinsurers	Improved underwriting results and the prospect of higher investment income have made the casualty market particularly attractive to reinsurers, especially as they look for opportunities to diversify away from property catastrophe. Recent years have seen positive rate movement for underlying casualty business at a time of reducing original policy limits. At the same time, higher interest rates will translate to improved investment income for casualty lines, which should be reflected in future reinsurance pricing.

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ILS interest grows	Much like traditional reinsurer capital, ILS investors are looking to diversify into insurance risk beyond property catastrophe, including casualty. While there has been some success attracting funds to write casualty business, it remains a niche market. Significant challenges remain for creating an ILS market for casualty, in particular long tail liabilities, yet casualty business provides an opportunity to invest in an uncorrelated and diversifying asset with attractive returns.
Unprecedented demand for ADCs / LPTs	There is an unprecedented level of demand for adverse development covers (ADCs) and loss portfolio transfers (LPTs). This heightened activity is driven by the desire to protect earnings and balance sheets from prior year loss activity while freeing up capital to write more business at today's attractive prices or grow their business in other ways. This demand has been supported by a better understanding of sustained capital benefit derived from these structures and the relative cost declining from increased capacity for legacy deals and a higher interest rate environment. We have seen dedicated capacity to the legacy market double over the last four years and expect demand for reserve transactions to continue to grow in 2023.
Financial lines	Financial lines, particularly D&O, was a different story than the general casualty market. Starting early in 2022, primary rates started dropping off and toward the end of the year we saw rate decreases for the first time in years. This was not forecasted by many reinsurers going into the 2022 renewals. The missed rate projections coupled with adverse development, particularly in U.S. Public D&O from the 2014-2018 accident years, had a negative impact on the originally forecasted 2022 loss ratios. As a result, we saw ceding commissions flat to down moderately (i.e., more than seen on general casualty) on January 1 renewals as reinsurers tried to regain some margin. However, international financial lines quota shares renewed flat or even slightly up on large, well-performing accounts; while global transactional liability was broadly flat.
Motor liability under pressure	One area of the casualty market that saw significant reinsurance price increases at the January 1 renewal was motor liability. Motor renewals in the UK and Europe were particularly challenging, with some markets facing double digit rate increases. Rate increases were driven by rising claims inflation and changes to legal and personal injury compensation regimes. U.S. auto also remains a challenging market, where insurance claims inflation continues to outpace both the consumer price index and premiums.

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Specialty: By Line of Business

Agriculture: Good Opportunities for Reinsurers

While the January 1 renewals are still ongoing, it has not been a uniform process, with historically profitable markets seeing only minor changes but territories with recent losses experiencing hardening terms. These changes have been driven by the outsized Brazil loss of 2021 (which developed and was quantifiable in 2022), the continued increase in commodity prices and the strengthening of the U.S. dollar. A shortage of capacity, along with the withdrawal of a major reinsurer and others having to reduce their agriculture portfolios, has also fueled the hardening terms. Pro-rata capacity has been in short supply, regardless of the significant tightening of reinsurance terms. This is occurring despite 2022 looking generally profitable for reinsurers and significant improvements to the original insurance business for 2023. This means that the outlook for agriculture business looks very promising for 2023, with enhanced opportunities for reinsurers to generate profits and improve historical margins.

Topic	Commentary
Capacity changes	Some reinsurers only offered pro-rata capacity in limited territories. Those continuing to support pro-rata were often able to improve terms and would only commit capacity if modeled margins showed a reasonable increase year-over-year. Despite these improvements, pro-rata treaties were difficult to fill out, and in certain territories, clients had to reduce their EPI to ensure full placement. The strong dollar has meant that 40 percent more capacity is required over last year for the U.S., the world's largest crop insurance market. This has materialized into some reinsurers reducing (and even refusing) 'buffers' on Stop Loss limits for 2023. This pressure on clients to accurately project their EPIs is also seen by the M&D percentages increasing.
Improvements in the underlying risk	Given pressure from reinsurers and poor results in past years, original rates have improved significantly. A tightening of terms and conditions, like increased standardized deductibles and the cutting of marginal products/coverages has also helped to improve the original business. The proposed introduction of new government catastrophe schemes (France and Italy) will help reduce volatility and improve results.
Growth opportunity for 2023	Many pro-rata treaties had loss ratio caps and loss participation clauses introduced for 2023, even if the margin was already improved by original underwriting measures. A consolidation of Stop Loss deductibles (increased) and uniformity in pricing (increased) has given reinsurers a more standard offering. More capacity was needed to cover the increased retentions, and at the right price, there should be enough capacity to complete all Stop Loss placements, allowing reinsurers to construct a more balanced and robust worldwide portfolio. The later renewal timing should also allow reinsurers to enhance these already improved portfolios. This has been evidenced by some specialist crop reinsurers seeking retro capacity to boost their program shares and take advantage of the hardening market terms.

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Aviation: Turbulence Ahead Despite Primary Stabilization

The aviation market experienced its most challenging renewal in over two decades at January 1, with significant rate increases and coverage restrictions. Looking ahead, insurers with reinsurance renewals in 2023 face an uncertain market, with potentially substantial Russia-Ukraine aviation losses still unresolved. Depending on how losses develop, aviation reinsurance capacity could come under pressure, while reinsurers are likely to seek higher retention levels from some clients at future renewals.

Topic	Commentary
Capacity sufficient albeit at a price	January 1 is a key renewal for the sector with a number of major aviation insurers securing their reinsurance protection. While reinsurance capacity remained sufficient to meet demand at January 1, it came at a price. Rate-on-line at January 1 increased significantly for aviation excess of loss reinsurance, while catastrophe layers experienced some of the highest rises. Increases were more pronounced for the largest accounts and limits, where all available capacity was required to complete programs.
Terms and conditions under pressure	In addition to rate, terms and conditions also came under pressure, as reinsurers moved to limited aviation grounding coverage and third-party war coverage in all-risk covers. Aviation reinsurers are now excluding war risks from aviation covers outside the specialist war market. However, aviation war reinsurance capacity was significantly constrained at the January renewal, with most insurers unable to buy desired levels of war reinsurance cover.
Loss development creeps	The renewal follows a period of unprecedented losses for the aviation market, namely a recent material reserve deterioration on a historic large aviation claim, as well as uncertainty surrounding potential claims arising from the Ukraine-Russia conflict. The historical loss - the largest ever single loss event for the aviation market – equates to over a decade of aviation reinsurance market income, with the majority borne by the reinsurance market. Prior to the reserve development in November, increases in rate-on-line were modest.
Primary rates stabilized	In contrast to reinsurance, aviation insurance rates stabilized in 2022 following several years of increases. Aviation insurers now face the prospect of passing on significantly higher reinsurance costs to policyholders, the bulk of which renew in the fourth quarter, or they might have to consider reducing line sizes, as it's expected that reinsurance rates will continue to increase and conditions will tighten. Aviation is a sector that is particularly dependent on reinsurance, with some carriers ceding as much as 80 percent of their business to reinsurers.
Retro in short supply	While available capacity mostly remained adequate at January 1, aviation reinsurers reduced their line sizes, in part due to limited availability of retro cover. With competition in aviation reinsurance somewhat dampened, Aon has been working to build new reinsurance capacity. New entrants, however, require retro reinsurance protection, which is in short supply, and subject to substantial rate increases.

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Cyber: Event-based Solutions Grow

Cyber insurers entered the January 1 renewal in a much-improved position following significant underlying rate increases and underwriting actions taken to address a spike in ransomware losses.

New players continue to enter the cyber reinsurance market, but additional capacity, both from traditional and alternative capital sources, will be required to meet future demand for cyber reinsurance. A consequence of hardening in the cyber insurance market is increased demand. While most cyber insurers reduced their exposure in the past two years, many are now looking to resume growth, which will further increase demand for cyber reinsurance. The cyber market is projected to grow by some 15 percent to 25 percent year on year until 2030, with increased penetration.

Topic	Commentary
Event-based reinsurance structure demand	The renewal saw growing interest in event-based structures, such as non-attritional excess of loss covers, which provide reinsurance protection for systemic or catastrophe cyber events, a key concern for the cyber insurance market and a constraint on underlying market growth. Confidence in these products has grown, aided by the development of event definitions, including one that launched by Aon in 2020, which has gained good consensus in the market from both buyers and sellers. Demand for event-based reinsurance structures is strong and we expect further growth in this segment of the market over the course of 2023. In addition to providing an important form of protection for the cyber insurance market, event-based reinsurance structures are attractive to alternative capital providers, creating a new source of capacity for the cyber market and a source of diversified growth for ILS investors. Aon bound a number of event-based transactions in 2022 backed by ILS funds, with more deals in the pipeline.
Supply-demand conditions	Reflecting the positive change in market conditions, ceding commission on quota share reinsurance contracts at January 1 were mostly flat, having come under downwards pressure in previous renewals, while some clients were even able to negotiate higher commission in response to improved results. Risk-adjusted rates for cyber excess of loss reinsurance continued to increase at January 1, 2023, reflecting constrained capacity for aggregate covers.
Cyber war and exclusions	The issue of cyber war came to the fore at the January 1 renewal, following several years of discussion in the market and the introduction of various cyber war and critical infrastructure exclusions. Reinsurers required additional information at January 1 as they sought to understand insurers approach to cyber war and how they are applying exclusions across different territories.

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Marine & Energy: Loss Uncertainty Complicates Renewal

Against the backdrop of the conflict in Ukraine, marine reinsurance renewals were among the most complex and challenging of the past two decades. The pressure points of the renewal were pricing, Composite structures, nat cat and coverage for war, political violence and aviation war. Programs were ultimately completed with rate rises and restrictions in terms and conditions. Many of the coverage items are not fully resolved and will continue to form part of negotiations for future renewals.

Topic	Commentary
Russia-Ukraine potential losses yet to materialize	Composite or whole account marine reinsurances, are exposed to potential losses related to the Russia-Ukraine conflict, with possible claims arising from marine war, aviation war and war on land covers. Marine insurers face potential claims from vessels stuck in Ukrainian ports, while the aviation war market could see very large losses from leased aircraft trapped in Russia. However, many of these losses have yet to translate into insurance claims, while some are in litigation.
Tightening coverages on class sub-sectors	While the majority of losses have yet to materialize, the reinsurance market took steps to tighten the composite marine product and limit certain coverages at the January 1 renewal. Attachment points within composite programs increased and reinsurers pushed insurers to buy specific limits for certain lines of business, in particular for political violence, terrorism and aviation war. Reinsurers also required more granular information on class sub-sectors within marine composite covers as they sought to clarify insurers exposures, including war, cyber and contingent business interruption coverages.
Capacity changes by line	Overall, available capacity was flat, although reinsurers were more disciplined in its deployment and were inclined to apply restrictions. Capacity for political violence and aviation war, however, was constrained, in part a reflection of changes in the retro market. Price increases for marine and energy were significant by historical standards and retention levels came under more pressure than at recent renewals, although monoline programs enjoyed more favorable treatment than composite programs.
Terms and conditions under scrutiny	Unsurprisingly, war coverages came under particular scrutiny, however there was a lack of market consensus on exclusionary wordings. While reinsurance for war perils was still available beyond Russia-Ukraine, the market was extremely cautious. Sanctions were also more relevant at the renewal as Russian energy and shipping assets are subject to an evolving sanctions environment. Sanctions compliance, and the introduction of a price cap on exports of Russian oil in December, added further complexity to the renewal process.
ESG push to disclose fossil fuel risks	Environmental, social and governance (ESG) was another notable feature of renewals for marine and energy. Reinsurers, while yet to change underwriting strategies, are requesting more detailed information from insurers on their approach to fossil fuels risks. Renewable energy exposures continue to increase and are now a material component of insurers' portfolios.

Mortgage (U.S.): 2022 a Record Year for Reinsurance

U.S. mortgage reinsurance is a relatively new line of business having started in earnest in 2012 after the Great Financial Crisis. Since then it has grown consistently, providing capital relief for the government sponsored enterprises (GSEs) Fannie Mae and Freddie Mac as well as the six U.S. mortgage insurers (U.S. MIs) and creating diversification for the reinsurance industry. 2022 was an extremely active year with both GSEs and all U.S. MIs purchasing significant volumes of reinsurance protection.

Topic	Commentary
Drivers of demand	In late 2021, revisions to the capital rule for GSEs were finalized that restored favorable capital treatment for reinsurance. With record low interest rates in 2021 and into early 2022, there was significant volume of credit risk to be reinsured. The cost of reinsurance protection in the form of Insurance Linked Notes through capital markets became unattractive during the year. Reinsurance, which prices risk based on housing market fundamentals, became a larger share of the overall credit risk transfer space due to the capital markets dislocation.
Record year for both mortgage reinsurance limit and number of transactions	2022 was the first full year that both GSEs purchased reinsurance since before the onset of the COVID-19 pandemic. The GSEs purchased just under $15 billion of reinsurance limit in 2022 across more than 25 transactions. Additionally, the U.S. MIs purchased over $3 billion of reinsurance limit across both excess of loss and quota share structures.
Growth opportunity for 2023	Looking forward to 2023, lower mortgage volumes are expected to be originated. Macroeconomic uncertainty, affordability challenges, and The Federal Reserve's actions to raise interest rates have reduced mortgage originations significantly during 2022 and are expected to suppress originations in 2023. However, both the GSEs and the U.S. MIs have appreciated reinsurers' fundamental based approach to pricing mortgage credit risk. The U.S. MIs have increasingly utilized the benefit of forward reinsurance protection on their mortgage portfolios. It is for these reasons that reinsurance may continue to take share from the capital markets and reinsurers will find opportunity for growth in this class of business.

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Trade Credit, Structured Credit and Political Risk, and Surety: A Positive Storyline

The January 2023 renewals for trade credit, structured credit and political risk, and surety reinsurance treaties were completed with relatively little disruption to structures, terms and conditions and panel compositions. While the wider market challenges had an impact, the recent positive results of these classes in the 2020, 2021 and 2022 underwriting years helped mitigate the desire of reinsurers to price programs higher, and the growing geopolitical and economic uncertainty.

Topic	Commentary
Concern over potential losses yet few large claims	In addition to reinsurers' concerns over the deteriorating global economy, the continuing Russia-Ukraine conflict is causing concern over potential claims from existing exposure, and also driving the need to exclude risk in Russia, Ukraine and Belarus. The credit insurance market has seen losses from the war, involving confiscation, expropriation, currency convertibility and payment default coverage. To this point there have been relatively few large claims. In many instances there has been a willingness on the part of policyholders/banks and obligors to seek solutions to avoid non-payment claims, and therefore the impact on the reinsurance market has been limited, and the final outcome remains unclear.
Stable outcome at renewal	Overall, both demand for and the supply of capacity for all of the business lines were relatively stable at the January 1 renewal. There have been signs that greater capacity will be needed in some sectors, as the impact of inflation increases insured limits. Reinsurers supporting this business continue to see its long-term prospects in a positive way.
Positive underwriting results offset pricing pressure	The positive results of recent years helped offset the upwards pressure on reinsurance pricing seen in other lines of business. While reinsurers carefully assessed where to deploy capacity, pricing was largely unchanged for proportional reinsurance covers. Excess of loss reinsurance contracts saw price increases, but this was partly due to increased exposure levels (compared with January 2022), and in overall terms risk-adjusted rates increased by only low single digits. Going forward, the effects of inflation, rising interest rates and the energy crisis are likely to increase loss ratios in 2023. However, insurers remain confident that they can manage through the cycle given the portfolio management that was undertaken during the COVID-19 crisis.

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