THE INSURER
Insurance Insight Intelligence

Published: Mon 3 Jun 2024

Non-traditional reinsurance among remedial measures for US carriers as frequency perils bite

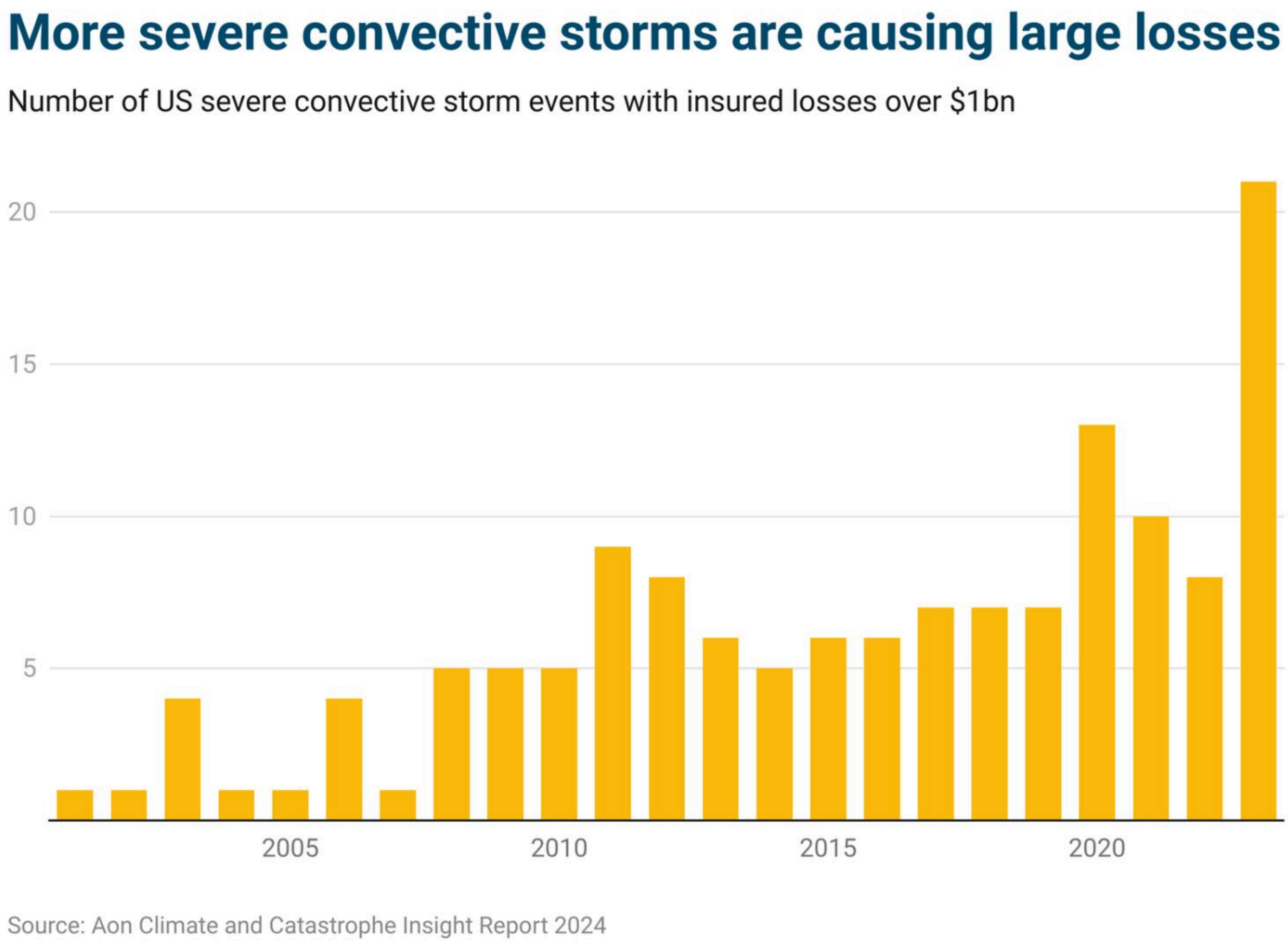
Weather, inflation, regulation and challenges in the reinsurance market are leaving many US carriers highly exposed to attritional losses. For some, the actions needed to get loss ratios back on track could include purchasing new forms of reinsurance.

- **High-frequency, low-severity weather and catastrophe events are causing severe stress for some US carriers**
- **Increased climate activity is just part of the problem, with economic and social inflation driving up losses**
- **Carriers are retaining more losses than they would like as reinsurers' appetite for lower attachment points and aggregate covers remains limited**
- **Alongside corrective actions on their portfolios, some are turning to non-traditional reinsurance solutions designed to meet carriers' needs on terms capacity can support**
- **Branch Insurance is among the carriers that adopted a new risk transfer solution at 1.1 2024, in an SCS reinsurance transaction structured by Demex and brokered by Gallagher Re**

Carriers under pressure

Insured losses from higher-frequency, lower-severity weather events, particularly severe convective storms (SCS) and tropical storms, have risen in the US in recent years.

Six of the top 10 natural disasters by insured loss in 2023 globally were US SCS events, according to Aon. This trend shows no sign of slowing, with two US SCS outbreaks in Q1 2024 being the costliest insured loss events of the quarter.



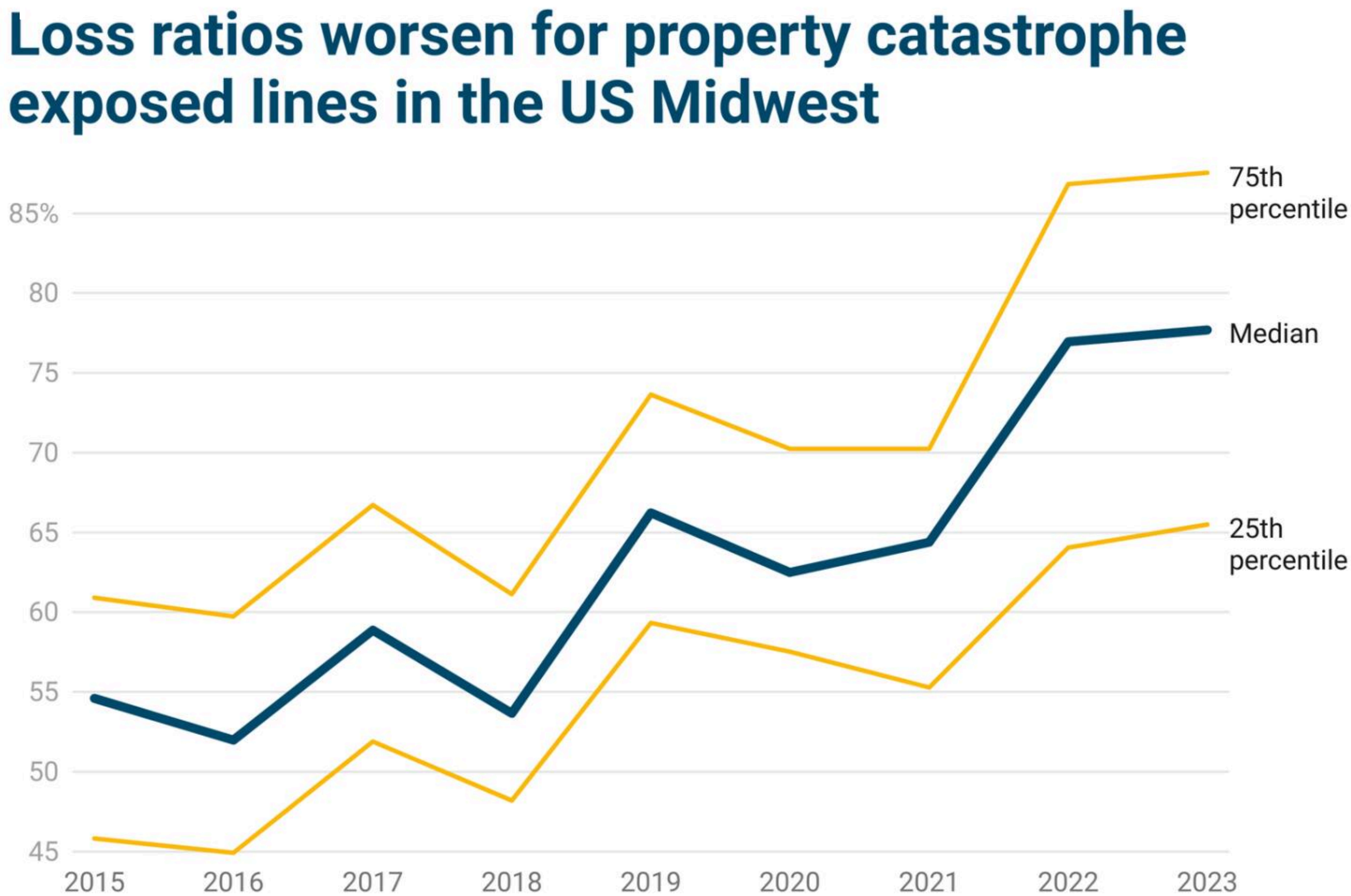
Much of these losses are retained by carriers, rather than ceded to reinsurers. They have been severe enough to drive some into insolvency. MutualAid eXchange, United Home Insurance and Cameron Mutual, all with portfolios concentrated in central states, were liquidated in 2023. State regulators cited challenges with weather-related losses as a key factor in their demise.

Selected US insurance insolvencies in 2023

Company	Geographic coverage	Note
MAX Insurance the Way It Should Be! Fair • Faithful • Socially Responsible	Midwest and Mid-Atlantic	MAX was found to be insolvent in August 2023 and was liquidated by the Kansas Insurance Department. Insurance commissioner Vicki Schmidt said, "Unfortunately, this company fell victim to a very tough reinsurance market and catastrophic storms throughout the nation"
UNITED HOME INSURANCE CO.	Midwest and South	United Home Insurance was placed into receivership to rehabilitate the business in September 2023. It was liquidated in November. The Arkansas Insurance Department said the company's financial condition had declined "due to substantial weather-related losses"
CAMERON MUTUAL	Midwest and South	Cameron Mutual was placed into rehabilitation in August 2023 and liquidated in December. The Missouri Department of Insurance said Cameron Mutual was "geographically concentrated in areas impacted repeatedly by severe storms, resulting in major losses this year [2023]"

Source: *The Insurer*

The problem is not limited to a small number of companies. Across property catastrophe-exposed lines in the US Midwest – an area particularly affected by SCS in recent years – loss ratios have worsened significantly.



Loss ratios for lines of business exposed to property catastrophe risk in the Midwestern US by the top 100 insurers of the same in 2023.

Source: The Insurer based on S&P Capital IQ Pro

The worst losses cause surplus erosion and a weakened overall financial position. “Insurance companies are retaining more risk,” said Bill Clark, CEO of Demex Group.

“It’s so big that it eats up a substantial part of their annual earnings, or maybe all their annual earnings, and then they have to tap their surplus. Once they tap their surplus, they are almost on a death spiral. The only question is at what pace.”

AM Best announced 54 credit rating downgrades for US personal and commercial lines insurers in 2023, up from 29 in 2022. Many such downgrades have been driven by weather-related losses, including some in the first half of 2024.

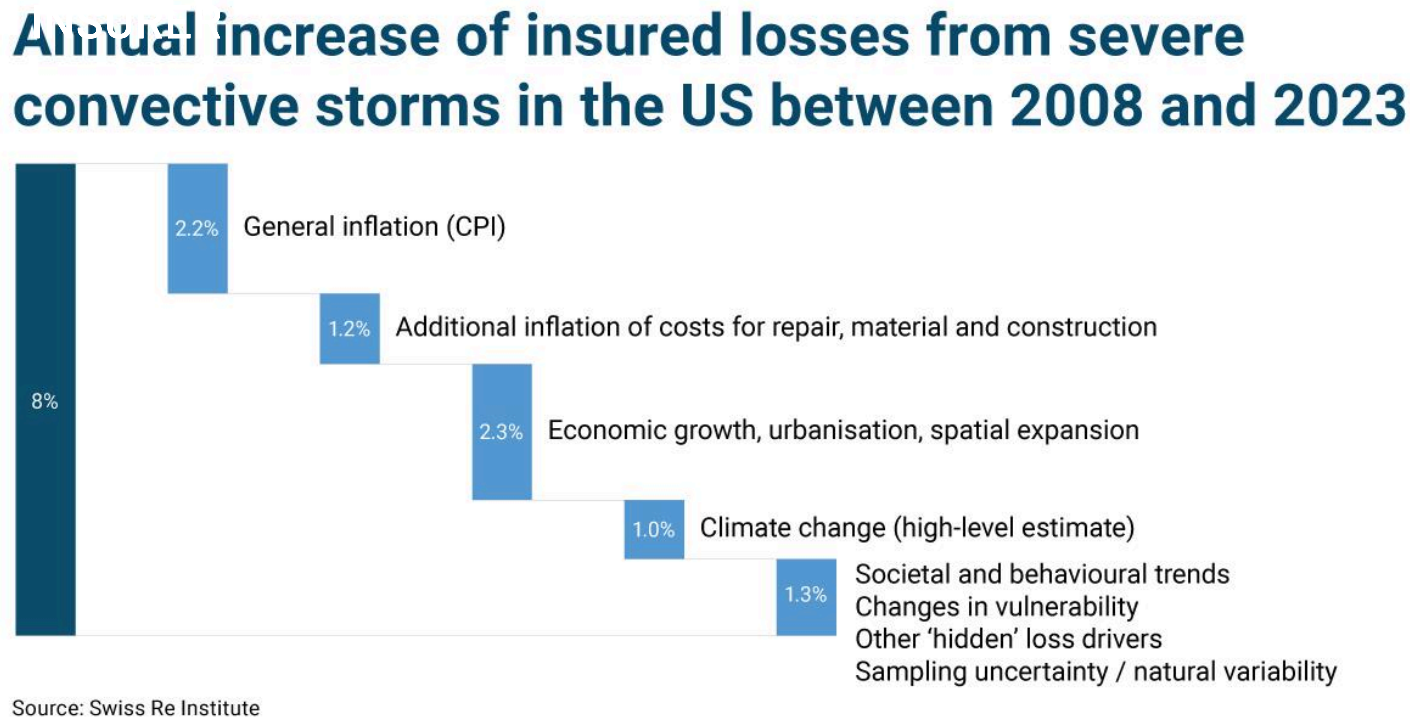
Selected AM Best downgrades in 2023 and 2024

Company	Date	Note
Germania Insurance	August 2023	Germania Farm Mutual's policyholder surplus was significantly eroded following "sizable underwriting losses in the second quarter of 2023 due to sharply higher-than-normal catastrophe activity, as well as inflation-driven increases in loss costs," according to AM Best
AMIC – Insuring The Future Of Local Government	August 2023	AM Best said, "Volatility in overall operating performance has primarily been impacted by an increase in property losses, from both inflation and weather events, coupled with continued challenges within the law enforcement liability segment"
Dover Bay	September 2023	The company's underwriting losses since 2021 are caused by "numerous weather-related losses affecting the states in which most of its underwriting exposures are based", said AM Best
Wolverine Mutual Insurance Company	September 2023	Wolverine Mutual's policyholder surplus declined by 20%, "driven by increased weather-related losses and ongoing inflationary pressures", said AM Best
Badger Mutual Insurance	October 2023	"Weather-rated losses and inflationary pressures" contributed to capital erosion, according to AM Best, with the downgrade reflecting future "susceptibility to weather losses"
Brotherhood Mutual	April 2024	AM Best said, "The company's underwriting performance has been challenged by elevated weather-related losses, particularly multiple low level catastrophe losses impacting its property insurance book"
Texas Farm Bureau	April 2024	The company's underwriting losses "were driven by the extraordinary weather-related events in 2023", said AM Best. It experienced "13 catastrophe losses, as classified by the group, four of which exceeded its occurrence catastrophe retention level."
MFM	April 2024	"Volatility in Midwest Family's underwriting results was impacted by continued reserve strengthening, elevated storm activity, increased reinsurance costs, which affected margins, and increased loss severity amid economic inflation that has been compounded by delays in litigated claims from court backlogs," said AM Best

Source: AM Best

The weather was not solely responsible for these losses, as noted in several of the AM Best downgrades. Each severe storm is causing more damage because, on average, the affected area will have more and costlier properties, with expensive litigation also hurting insurers' loss ratios.

Swiss Re Institute calculates that the increase in SCS losses over the last 15 years is mostly attributable to general inflation, additional rises in the costs of building materials, construction and repairs, and other macroeconomic factors such as urbanisation.



Traditional reinsurance is not an option

Reinsurers have pulled back from underwriting frequency protection for many of the same reasons that carriers are struggling with such losses. This leaves carriers retaining more weather-related losses than they would like.

The 1 January 2023 reinsurance renewals were a key point of adjustment, as reinsurers increased attachment points and appetite for underwriting aggregate covers dried up.

These changes remained in place through 1 January 2024. Howden's 1.1 report described the renewal as "challenged" for several Midwest mutual insurers that suffered substantial losses from SCS events in 2023.

Lack of suitable reinsurance compounds carriers' problems with frequency losses. "Carriers' increased retention was not by choice," said Hong Guo, EVP and chairman of (re)insurance at Arbol. "For some, their financial condition means this is not a problem. For others, increased retention poses additional risk to their capital."

In July 2023, AM Best downgraded Southern Farm Bureau, saying: "As a result of the hardening reinsurance market and increased catastrophe retentions, the group's net probable maximum loss figures have grown considerably."

Meanwhile, Associated Mutual's aggregate excess of loss reinsurance program was adjusted at mid-year 2023 to introduce a $20mn top limit. With the company more exposed to severe events, this also prompted an AM Best downgrade.

So-called farm mutuals in Wisconsin, Illinois, Missouri and Iowa have been particularly challenged, with regulators requiring them to purchase sideways reinsurance cover for which capacity has dried up.

Although reinsurance pricing is stabilising, the adjustments to attachment points and reduced appetite for aggregate covers are not expected to change in the foreseeable future.

The tools at carriers' disposal

As a result, carriers concerned about attritional losses need to make changes. This starts with underwriting. The economic and social inflation and macroeconomic factors driving up losses necessitate premium increases, which in some cases will be substantial. But they are limited by state regulators.

“Insurance companies are able to increase premiums, but not fast enough to keep with losses; regulators typically will not let them,” said Demex’s Clark.

Clark explained that even carriers that have significantly increased their premiums are seeing continued surplus erosion. Several AM Best rating updates mention rate increases that were insufficient to prevent a downgrade.

Where carriers cannot underwrite profitably at the rates permitted by regulators, with other factors such as litigation playing a key role, they may pull out of certain states. ***The Insurer*** ***reported back in November 2023*** that long-established distribution relationships with high customer retention rates are now being reset as underwriters are forced to cull sections of their book.

But cutting back underwriting in certain areas and increasing rates both take time to earn into results, typically between 12 and 18 months.

Another problem is pricing the risk of severe weather losses accurately. Catastrophe models have been widely used for hurricanes and earthquakes for decades, with less of a focus on secondary perils.

Swiss Re’s Sigma 1/2024 report said that even in regions well covered by sophisticated SCS models, “industry estimation of peak-loss return periods remains challenging”.

“If relevant loss trend drivers are not fully quantified and understood, on account of flawed input data and assumptions about emerging and new vulnerabilities, even state-of-the-art models cannot deliver accurate risk views,” it added.

Where surpluses have already declined, carriers could consider raising new capital. But this is harder for mutuals, given their ownership structure, and generally challenging in the current tight monetary policy environment.

An alternative is for smaller carriers to merge, which could provide geographical diversification, reduced operating expenses and a larger budget to invest in pricing attritional losses more accurately.

Meanwhile, carriers are also looking to non-traditional reinsurance structures to ease pressure on capital. Gallagher Re’s 1 January 2024 renewals report noted that tight reinsurance capacity for frequency protections, either on an aggregate or low-level occurrence basis, was leading more buyers to use structured buy-downs to meet their needs.

Structured solutions can be designed to cover attritional losses through excess of loss or quota share transactions. These include certain incentives for the reinsurer, such as loss ratio caps and profit commissions. They are a compromise for carriers: they can be useful to manage volatility while making some portfolio changes but are not ideal for the long term.

New types of reinsurance

Carriers and their reinsurance brokers are also beginning to explore new reinsurance products which aim to transfer frequency risks in a different way.

Demex, originally a spin-out from Munich Re, launched its retained climate risk reinsurance product in 2023. It combines data about a carrier’s historical losses from weather events with climate data to build a customised model, loss index and reinsurance product.

The index models the expected losses a carrier would face from aggregate attritional weather events. “Our product works similarly to traditional UNL (ultimate net loss) covers or aggregate covers,” explained chief risk officer Matt Coleman. “The difference is that what we are tallying and accumulating is modelled loss, not actual indemnity loss.”

During its first six months in the market, Demex has transacted deals totalling $65mn in limit. One example is Branch Insurance, which transferred a portion of its SCS exposure through a transaction brokered by Gallagher Re and structured and modelled by Demex. Descartes Underwriting provided capacity.

Bermuda-based Arbol Re designs reinsurance covers for named storms in the Southeast and SCS risk in the Midwest US, backed by a combination of traditional and alternative capital.

"While traditional reinsurers have to face issues with claims inflation and litigation, our approach is to focus on the hazard itself," said Arbol's Guo.

Guo explained that Arbol's parametric reinsurance structures involve creating a loss index based on the cedant's portfolio. Storm parameters, such as wind speed, are taken into consideration at every location.

A value is assigned based on the wind speeds relative to each specific policy location across the portfolio, so the reinsurance can pay out based on the calculated portfolio loss. "We calibrate the structure based on the buyer's view of risk," said Guo.

"We are targeting exposures beneath the main program, or sideways for second and third events."

Arbol revealed in 2022 that it had paid a $10mn claim to cedant Centauri Insurance following Hurricane Ian. In April 2024, Arbol announced the upcoming acquisition of Centauri by its subsidiary Lilypad.

Another example is Footprint, a reinsurance product launched by investment advisor Resolute Global Partners, Gallagher Re and Karen Clark & Company (KCC) in 2023. It uses KCC's catastrophe models to calculate a cedant's loss after an event and settle a claim. The first Footprint transaction was focused on SCS risk.

All three products are parametric, in that they pay claims based on the value of an index, rather than an indemnity value. They are not conventional parametric products that pay out lump sums after catastrophe events that meet a given condition, instead they use a modelled loss figure that acts as a substitute for the true loss in familiar excess of loss or aggregate structures.

Because claims are settled based on weather and models rather than indemnity, these products can be a more appealing way for reinsurers to underwrite attritional losses. The uncertainty of factors like inflation, repair costs and litigation is removed.

Cole Mayer, Aon's head of parametric, said: "When designed appropriately, parametric covers can provide meaningful aggregate reinsurance protection for severe convective storm. Utilising parametric triggers can introduce new capital that would not otherwise be available for traditional reinsurance in certain areas of a tower."

No one measure is enough

There is no single cause of the challenges with underwriting frequency perils in the US, and there is no perfect solution. Carriers whose retained losses are hurting their balance sheets need to take various remedial measures, while they can no longer expect to transfer these risks through lower layers on their main reinsurance programs or aggregate covers.

But weather volatility may continue to erode surpluses and put financial stability at risk, even after corrective changes to underwriting. Branch, Centauri and the other early cedants of Demex, Arbol Re and Footprint could be the start of a trend of carriers adopting parametric reinsurance structures tailored to their portfolio for attritional weather risks.

Insurance Reinsurance Losses Property catastrophe Parametric US / Americas

Published: Mon 3 Jun 2024

Most read articles

NEWS CAPITAL RAISING

1 **Bowhead Specialty shares close up 40% following IPO**

NEWS RESULTS

2 **Board chair Becker: Axis has "recruited a new CEO who is very fit for purpose"**

INTERVIEW

3 **Wafer highlights importance of mentorship as Gallagher Re NA chair caps 45-year career**

ANALYSIS CYBER

4 **Insuring AI: the growing need to address silent exposures**

NEWS

5 **Correlation invests in fast-evolving Meridian Group**

NEWS PEOPLE MOVES

6 **Howden Re appoints former GC, Willis Re exec David Hearn chair of global clients strategy**

NEWS RESULTS

7 **Tizzio: Axis has been repositioned as an underwriting company and is "on the move"**

NEWS

8 **AIG offering early retirement option for staff amid $500mn cost-cutting programme**

INTERVIEW CONSTRUCTION

9 **Corry: Argo undertakes 10% rate cut for owners' interest business to be more commercial**

NEWS PEOPLE MOVES

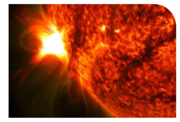
10 **Aon announces seven promotions within its Professional Services Practice**

Related articles:

ICA ups Jasper insured losses to A$354mn

Aon: European May SCS losses "at least" in the tens of millions of euros

Aon: Late May tornadoes generate "multiple hundreds of millions of dollars" in losses

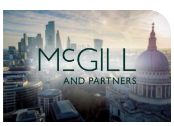


Solar storms have potential to cause industry loss bill higher than Katrina: Bloomberg

US SCS losses to top $20bn by end of May: Gallagher Re

Noto Peninsula earthquake payouts rise 14% to $540mn: GIAJ

Read more:

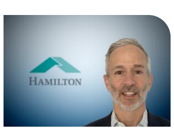


Former Vesttoo exec Kirwan resurfaces at McGill

CBIZ fires Bowman over alleged falsification of documents and suspends Cryan

PI MGA Kova expands with Newson and Patten hires

PI MGA Kova expands with Newson and Patten hires



Capital Z's Cooper returns to Hamilton Board

MS Transverse issuer credit rating upgraded on MSI support