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ADDRESSING INDUSTRY CHALLENGES

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DECEMBER 14, 2023

AM BEST REVISES OUTLOOK ON HOMEOWNERS

September 19, 2023

“…three consecutive years of net underwriting losses in the U.S. homeowners insurance segment owing to:

- elevated natural catastrophes that have continued in the first half of 2023, combined with

- other ongoing market challenges,

AM Best has revised its outlook on the segment to negative from stable.”

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AM BEST REVISES OUTLOOK ON HOMEOWNERS

September 19, 2023

“Rising loss costs, inflation and supply chain disruptions are pressuring earnings, making it difficult to maintain rate adequacy.

“Consequently, some market leaders have curtailed new business in catastrophe-exposed areas.”

MANY THINGS HAPPENING SIMULTANEOUSLY

- Increased frequency and severity
- Construction cost inflation
- Interest rates – both real and nominal
- Social inflation
- Supply chain
- Multiple years with high frequency and severity of catastrophes

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BROKER REPORTS

Aon June/July Report 2023

- Global reinsurance capital dropped from $675B in 2021 to $575B in 2022. (14.8% decrease)

- Q1 2023: rebounded to $605B.

- Q3 2023: up to $630B.

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Regional Focus

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BROKER REPORTS

Aon June/July Report 2023 – U.S. Regionals

- “U.S. regional and mutual insurers are being uniquely affected by the speed and magnitude of changes in the property catastrophe reinsurance market.

- “The impact can be seen through a combination of increased reinsurance costs, higher program retention levels and the reduction of aggregate reinsurance protection from the market.

(emphasis added)

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BROKER REPORTS

Aon June/July Report 2023 – U.S. Regionals

- "Taken together, these changes have left U.S. regional insurers with **greater net retentions at a time of evolving natural catastrophe activity, and an overall increase in exposure for the industry** due to economic factors such as inflation.

(emphasis added)

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WEATHER – SWISS RE

- August 9, 2023

- “In the US, a series of severe thunderstorms prompted insured losses of USD 34 billion in the first half of 2023, the highest ever insured losses in a six-month period.

- “Ten events caused losses of USD 1 billion and above each, compared to an annual average of six events for the previous ten years.”

WEATHER – SWISS RE

- December 7, 2023

- “Economic losses from both nat cat and man-made events in 2023 is estimated at $269 billion by Swiss Re, which is around 9% lower than in 2022, but above the previous 10-year average of $235 billion.

- “Of this, the large majority, or $260 billion relates to nat cat events, with $9 billion coming from man-made events.”

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WEATHER – INSURANCE JOURNAL

- July 13, 2023
- “Seven states experienced at least $1 billion in total insured severe weather loss for the first half of 2023, according to an update from BMS Group.
- “Texas led all states with insured severe weather loss of $7.2 billion while Illinois, Kentucky, Colorado, Tennessee, Arkansas and Missouri also broke the $1 billion mark.”

WEATHER – INSURANCE JOURNAL

- December 8, 2023
- “U.S. property/casualty underwriting results deteriorated during the first nine months of 2023 to a loss of $32.2 billion.
- “The result, highlighted in short financial review from AM Best, is $7.6 billion worse than the same period a year ago.
- “The blame, which has been well documented lately, lies primary with the personal lines segment – specifically the homeowners lines of business and driven by a record amount of losses from convective storms.”

WHAT WE ARE HEARING

- Significant derecho activity over last three years
- Aging buildings – older structures less resilient than newer ones
- Larger companies are better able than smaller companies to balance book of business to reduce concentration risk

WHAT WE ARE HEARING

- Changes in geographical footprint
- Cedents need to make a business case for their existence without being over reliant on reinsurance.

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WHAT WE ARE HEARING

- Smaller insurers have long relied on low reinsurance costs as a key part of their business model – a model that was not sustainable over time or proved not to be sustainable

- Upticks in frequency and severity, coupled with the concentration risks inherent to small mutuals, make that business model even more challenging

Legislative/Regulatory Reponses

US Property Market Dynamics

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RESPONSES TO THESE CONDITIONS

- Catastrophe Funds
- Residual Markets

CATASTROPHE FUNDS

- Cat Fund: A government created/managed reinsurance facility
- Cat Fund creation becoming a more commonly discussed topic among some state legislatures and regulators.
- Some in Congress discussing the viability of a federal cat fund as well.
- Florida is currently the only state with a catastrophe fund. Other states should **not** follow Florida's lead.

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CATASTROPHE FUNDS - CHALLENGES

- The RAA is opposed to the creation of cat funds. Risk should be transferred into the private market, not government created entities.
- Private reinsurance takes risk out of a state and spreads it globally. A state cat fund concentrates risk in the state
- Sufficient funding for a cat fund may take years to build up and may never achieve sufficient capital.
- Feast or Famine
  - Self insurance is always cheaper than insurance, until you need the insurance

RESIDUAL MARKETS

- Citizens, TWIA, CEA, FAIR Plans
- "Do they transfer risk back into the private market?"
- Traditional reinsurance and cat bonds: two mechanisms to put the risk into the private market
- Colorado created a FAIR plan this year in response to market disruptions caused by wildfire risk – RAA successfully urged legislature to authorize risk transfer into reinsurance market

RESIDUAL MARKETS

RAA Guidance on Residual Market Creation

- First step: Identify the issue and cause; do no harm
- Is the problem a reduction of options? Or a lack of rate?
- Off the shelf platforms are easier to stand up than bespoke facilities

Suggested Policy Considerations

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POTENTIAL AVENUES

While there are no silver bullets here, regulators and legislators should consider taking steps to attract more capital into the marketplace without delay.

Potentially attract more capital with:

- significant rate and form freedom reforms
- removing any barriers to mergers between companies

BROKER REPORTS

Aon June/July Report 2023

- “a sense of order returned to renewals at the mid-year.”
- “Capacity was more readily available and some reinsurers showed a greater willingness to grow.”
- “Tort reform and state reinsurance support helped attract capacity to Florida, which showed encouraging signs of a return to stability at mid-year.”

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ESG and Insurance

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- RAA tracked 98 so far this year in 27 states

- Of interest to our members are bills that:
  - Bills that prohibit businesses (that do NOT include insurers by the bill's terms) from penalizing or preferring customers based upon the company's ESG policies

  - Bills that directly impact (re)insurers either by specific reference or by definition of the terms within the bill.

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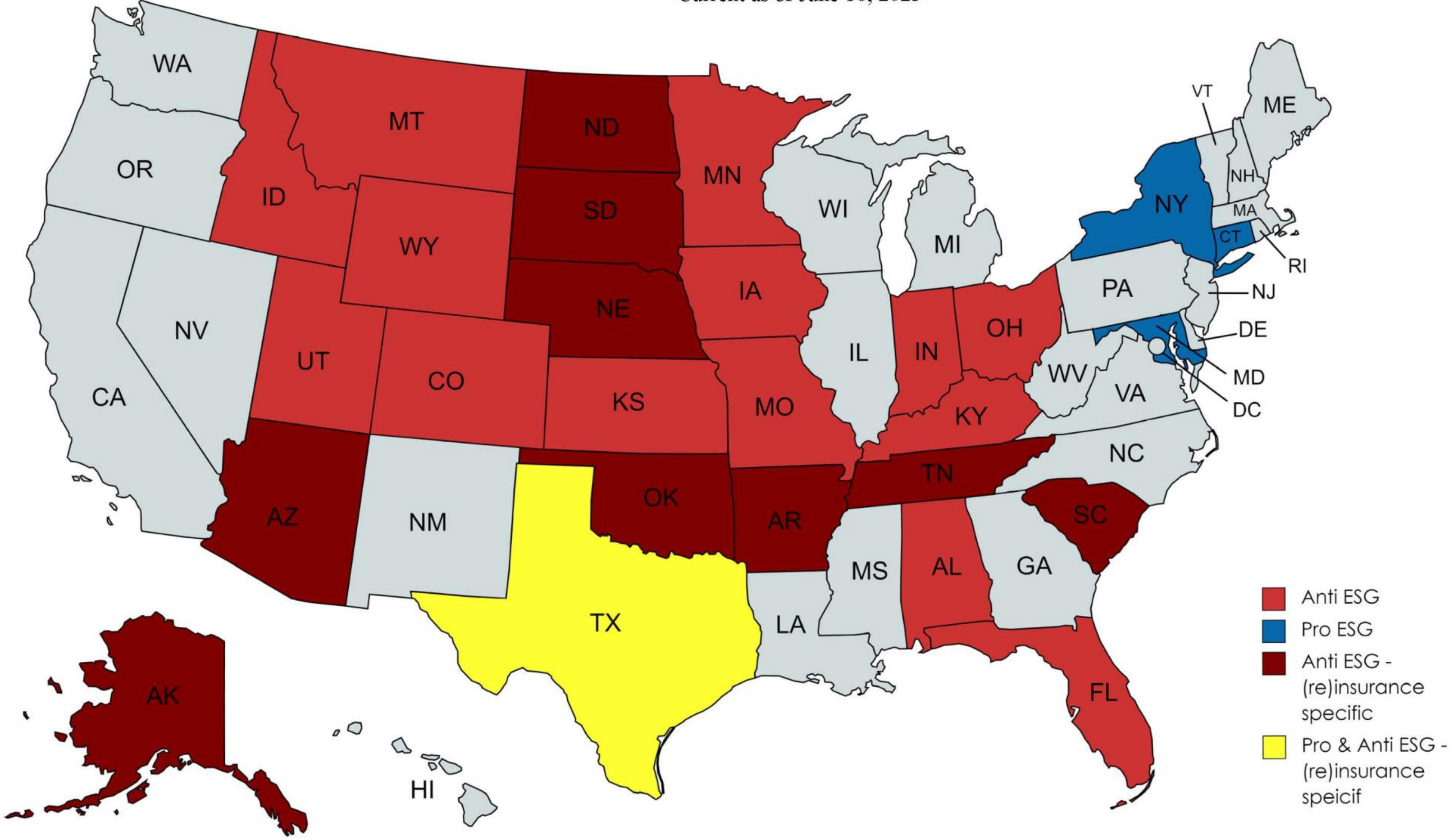
ESG Legislation Tracking Map

Current as of June 16, 2023



Created with mapchart.net

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RAA
REINSURANCE ASSOCIATION OF AMERICA

The RAA believes insurers should retain the freedom to rate, underwrite and invest as they see fit, within their expertise and risk appetite.

We oppose both “anti-ESG” legislation and “pro-ESG” legislation seeking to restrict rating, underwriting and investing freedom.

Our members are keenly aware of the transition risk created by a shift towards renewable energy.

(Re)insurers need the freedom to adjust and invest to adapt to the transition to help ensure insurance capital is deployed in the most efficient way possible.

“ESG” is not defined

- In the absence of clear definitions, industry will have to "divine" the legislative intent.
  - How does industry go about selecting suitable definitions?
- Ultimately, what falls into ESG will be left to regulators and courts – frequently after the fact.

Good, Established Reasons for Using So-called “ESG Criteria”

- Certain risks – thermal fuel, gun manufacturers, miners present unique risks to insurer

- Solvency concerns may require insurers to not have excessive exposure to a certain category of risk

- The energy sector is always in transition; our industry needs flexibility to devote capital to both legacy energy risks and developing ones.

Climate related transition risk is (or should be) the risk that:

(a) investment values will rapidly fall due to: (i) a societal shift away from thermal fuels or (ii) weather or sea level related damage or risk of damage due to climate changes (human influenced and/or natural variability); or

(b) actual or expected insurance losses will increase markedly due to climate changes (human influenced and/or natural variability).

What does the transition risk look like?

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(Re)insurers are in the business of risk identification, risk measurement and risk taking in their underwriting and investment portfolios.

Investments -

- Investments have inherent market risks.
- What should insurers should be permitted to invest in?
- A transition from thermal fuels to non-carbon emitting energy sources is a societal issue – not an insurance one

Investments -

- A transition from thermal fuel to non-carbon emitting energy sources….but at what speed?

- There is "some" risk that a significant portion of the developed economies could outlaw sale or use of thermal fuels.

Developed societies need and use significant energy.

During the transition, both existing and green energy sources will be required.

There will be a role for insurers to play in insuring both necessary forms of energy.

- The RAA doesn’t comment on the specific actions of (re)insurers
- We read the same reports regulators do
- Reinsurers are not a monolithic group – they make decisions independently of each other and thus have different views of ESG.

- Broker Reports
- The underwriting review of cedents
- Carbon Capture and Storage (CCS)

On CCS:

- “Both offshore and onshore clients are starting to use CCS in markets across the globe and as an alternative to conventional decommissioning, and as a means of generating extra revenue and tax credits….Insurers are prepared to cover these exposures, and CCS is likely to become an accepted element within the upstream portfolio.”

Gallagher Global Energy Insurance Market Update, June 2022, pg. 6

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On Renewables:

- “It’s clear that many of the technologies expected to be the foundation of the energy transition are simply not ready.”
- “It would be no surprise to see a slew of [ ] bankruptcies in [renewable] technology companies who have spent too much money on prototypes and scale up efforts….”

WTW Energy Market Review, April 2023, pg. 12

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On Renewables:

- Brokers report on their concerns
- Impact on the cost per megawatt from renewables

- Headlines don’t tell the whole story. Neither does Twitter.

- Legislators would benefit from regulator resources to fully understand how the industry is working in the ESG space – however it is defined.

- This will be a multi year process.

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Headline: **“U.S. on track to see fewest wildfires in two decades”** (PropertyCasualty360, Dec. 12, 2023)

“Around one-third of the U.S. population now lives in a WUI, putting 46 million homes with an estimated value of $1.3 trillion at risk, according to Triple-I.

“This shift helps explain why insured losses from wildfires have grown, despite an overall decline in the number of wildfires.”

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“Oil and gas is going to make up a major part of the energy mix for many decades to come, according to the most sustainable of outlooks.”

-WTW Energy Market Review, April 2023, pg. 33

Final Thoughts

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- The Oklahoma Standard
- 5^{th} best in nation for economic outlook (ALEC)
- Role in energy, ag and transportation
- America needs Oklahoma firing on all cylinders