Openly - Chief Executive Officer & Founder at Pyrrhic Re

Interview conducted on November 07, 2022

Topics

Reinsurance Market, Capital Sources, Catastrophic Losses, Cyber Insurance, Personal Lines, Rate Increases, Brokers and Agents

Summary

A Tegus Client interested in the reinsurance market spoke with the Chief Executive Officer & Founder at Pyrrhic Re, who explained that the market is broken due to a $90 billion capital shortfall. The sales and renewal cycle typically begins with three conferences between September and October, and the submission arrives to the reinsurers in early November to late November. The CEO predicts that insurers will not have enough reinsurance coverage purchased, and they need to cut back on the amount of premium that they write. The CEO also discussed the typical source of capital for reinsurers and how their balance sheet is funded, as well as the state of the reinsurance market, negotiations for 2023 contracts, and product exposure. The CEO listed tail risk exposure, trade credit reinsurance, surety reinsurance, event cancellation reinsurance, political violence cover, aviation and marine war cover, and cyber as areas of concern.

Expert Details

Chief Executive Officer & Founder at Pyrrhic Re, a hybrid reinsurance company. Expert can speak to the reinsurance space in great detail.

Expert is currently Chief Executive Officer & Founder at Pyrrhic Re, a hybrid reinsurance firm. Expert is responsible for the day-to-day runnings of the business and doing whatever it takes to help the business to grow.

Expert was previously CEO & Active Underwriter at Verto Syndicate 2689, leaving in May 2019. The expert was a founding partner and responsible for the Underwriting and Operational Performance of start up Lloyd's syndicate Verto 2689.

Q: 11/3: can you speak to the general market pricing going forward, focused on personal lines (homeowners specifically)?

A: Nat Cat business has been on a 6 year losing run. It has resulted in many reinsurers firms either reducing or exiting or reducing cat capacity. The ILS market is in complete disarray. Many ILS markets will be offering cat bonds only participation. Several ILS firms will cease to operate. The largest ILS fund (Nephila) has had a reduction of AUM of over 50% of their highest AUM. All of this on the back of increasing demand for catastrophe coverage. I expect capacity to be scarce, terms and conditions to be restricted and pricing to spike upwards dramatically.

Q: 11/3: can you speak to the underwriting process and returns hurdles for reinsurers?
A: Pre-Ian return hurdles for reinsurers would have likely been low teens. These return expectations have been not been met for the last 6 years by most reinsurers. Post-Ian return expectations have to be reaching levels in excess of 20%. Reinsurers must reinvent themselves and their process to meet their investors expectations. The underwriting process must be far more stringent. Terms and conditions must be far more restrictive. Aggregate and risk management must improve.

Q: 11/3: can you speak to the attitudes towards working with large incumbents, insurtechs, single vs. multi product carriers, MGAs vs captive carriers, etc.

A: Large incumbents such as Munich Re, Swiss Re, Berkshire, Hannover Re & Scor are likely to increase terms and conditions and command private deals to secure their capacity. Those insurtechs (e.g. Lemonade) who underwrite catastrophe business will find that their reinsurance costs are considerably more expensive.

Single product carriers (e.g., Property or Cyber) are focused on top line and hitting their benchmarks. I am concerned about the vulnerability of being a one trick pony. Multi product carriers have the best opportunity to succeed as they have diversity in their portfolio and will take advantage of rate increases across all classes of insurance.

Tegus Client

Hi, thanks for taking the time. I’m researching the insurtech space, specifically on the carrier side in the P&C space. And one of the areas that we're paying particular attention to right now is the reinsurance market given everyone's cost of capital has gone up, things are getting tight and you look like someone that had a great background for us to pick the brain on the topic.

So we're really excited to this call today. So hoping to learn a little bit more about for the sales cycle, the renewal cycle as well as sort of key negotiated terms and kind of your temperature on where that market is today for sort of high growth primarily quota share, MGAs and full set carriers. So if that makes sense to you, maybe we can get into your background and how you got where you are today.

Chief Executive Officer & Founder at Pyrrhic Re

Okay. Well, my background, I'm CEO and Founder of a firm that's called Pyrrhic Re, soon to be rebranded Cadence Re, which is a reinsurance hybrid business, both ILS fund and MGA. Prior to that, 36 years with seven firms. I've been a member of the Executive Management Committee for underwriting and claims and risk for three publicly traded firms.

I have founded two firms that included the Lloyd's of London syndicate and this firm that I've just mentioned. I've worked in every major insurance and reinsurance hub worldwide Bermuda, New York, London, Zurich, all classes of non-life P&C insurance, reinsurance, a lot of experience, a lot of background, now most of them are players in the marketplace. So hopefully that could give you a good sort of growth spectrum about the marketplace.

Tegus Client

Awesome. You have much deeper experience than we could ever hope to in this space. You mentioned your hybrid insurance company. Just the level of claims. Can you just help me understand how that's different from your RenaissanceRe or your Everest or Munich in the market?

Chief Executive Officer & Founder at Pyrrhic Re

Okay. Hybrid business is basically a business that built based on fee income as well as underwriting income and manages itself according to the market cycle about whether or not it chooses to focus more on underwriting income or focusing more on fee income. In reality, RenaissanceRe is little different.

RenRe is a business that relies heavily on fee income and is very successful at that in terms of passing on risk that it underwrites to a high level on to the investment community by sidecars, reinsurance quota shares or alternative sort of investment arrangements.

So but the hybrid side of it is basically, the way I would describe it is that, I guess, let's go back a little bit further and talk about what has always been the plan with reinsurance, and reinsurance always, something bad happens in the world. Typically, what we have things known as the class of, and the class of is a group of reinsurers typically formed in Bermuda to deal with the world, post-9/11; post-Andrew, Hurricane Andrew; post-Hurricane Katrina.

And the formula is always the same. It's basically stake $1 billion in Bermuda, get a name on its rating and start writing business at attractive rates and pricing. The problem with that plan has been that the investment community hasn't been overly satisfied with the returns and hasn't been very satisfied with the exit strategies.

So what the hybrid side of it basically means, or creating a hybrid business, basically means that you effectively borrow somebody else's balance sheet to affect in the underwrite business on your behalf. You underwrite business on their balance sheet for your profitability. You pay them fees, but you're also earning fees in the process. And what you're doing is gradually, over time, building out an asset base for which eventually, which you choose or not choose do, form a rated vehicle.

Tegus Client

Okay. Got it. That's helpful as a starting point. And maybe one place to start is sort of around the sales and renewal cycle. So there's a few of these every year. I understand the primary renewal date is 1/1.

Maybe what would be the typical time line as a company is marketing their book to a group of insurance companies or reinsurance companies through a broker, the various steps in the process, and when approximately in the process, there's sort of certainty around the terms of the next year's reinsurance review?

Chief Executive Officer & Founder at Pyrrhic Re

Okay. The process normally begins with one, there's three conferences actually that occurred between September and October in Europe and in the U.S., and that's basically where you get together with your clients, reinsurers get together with their insurers to lead, have a general discussion. The submission, as we would call it, typically arrives to the reinsurers in sort of early November to late November.

If the brokers have their way, the firm order terms, in terms of what they think the binding terms and conditions should be, should be arriving first, second week of December, and the business should be bound between Christmas and New Year's.

Now that's the way the world normally works. Mostly for excess of wealth business, sometimes quota share business goes into the new year. Now what we're looking at this year since we're dealing with what is estimated to be a $90 billion capital shortfall in reinsurance is that this January 1 business could very well be, not finally come to completion until the end of Q1.

Tegus Client

Interesting. If I repeat that back to you, that's all driven by that capital shortfall you were discussing earlier in the rising rate environment, cost of capital has increased materially. So you think that there's potential that, that will continue well in Q1.

Chief Executive Officer & Founder at Pyrrhic Re

That's correct. I wouldn't even be using on a cost of capital basis. I would simply say to you that there is no capital for parties to trade with. And if I talk you through the sort of touch points, obviously, insurers buying group policyholders, reinsurers bind with insurers to provide treaty reinsurance and facultative reinsurance.

And retrocessionaires bind with reinsurers to provide protection for the reinsurers. To start off with the retrocession market, which is reinsurers reinsuring reinsurance, forgive me, that sounds as good of an oxymoron saying that, but that's what is mainly coming from the ILS funds. That market is completely broken at the moment.

The large carriers, the large ILS funds, such as Nephila and others, have a significant shortfall in their capacity from the prior year. Nephila, as a perfect example, is roughly down 50% of available capital or assets under management year-on-year. So there's no retrocession for reinsurers to have protection. So reinsurers are equally saying that we have most protection.

We do not have this protection, we need to reduce our line size and they're passing that on to the insurers. And the insurers are negotiating with policyholders recognizing that they may or may not have the reinsurance they need in order to continue to function in accordance with rating agencies, regulators and all of the above. I've never seen a more broken market than I've seen right now.

Tegus Client

One question on your timing point around potentially binding with insurers towards the end of Q1. I guess first question on that is, what are the points that are being negotiated sort of between now and the end of Q1?

Or the change in sort of the capital position of reinsurers that's expected in order to be able to find those policies. And the second question is, in Q1, then do insurance carriers who write new policies simply not have reinsurance? Do they avoid writing new policies? How does that work in practice?

Chief Executive Officer & Founder at Pyrrhic Re

Okay. So basically, what happens is, I mean, let's use this very simple example, State Farm. State Farm puts out a reinsurance known as a firm order terms for their renewal. And that renewal effectively says that the premium should be $10 million or $100 million, whatever the number is and that the terms and conditions are this.

They put it out to the marketplace. The brokers try to place the business and the broker discover that they cannot place more than 20% of the necessary risk in order to fill the program. So what happens from there is the brokers go back to the market again, improve the terms and conditions to the benefit of the reinsurer. The reinsurers then respond again.

And then there's typically, let's say, an increase in the uptake, but nowhere near the sort of level, this is what I'm predicting is going to happen. Nowhere near the level. And then eventually, what happens, we reach a point where the inception date of the coverage is surpassed. We've gone past that 1st of January.

Now for State Farm or somebody like that, they're not too worried about it. They're mainly buying protection for hurricanes and earthquakes. They're buying protection from the East Coast. Obviously, it's hurricanes, and they're not too worried about hurricanes in January, at least not lately anyway. So it gets pushed down the line.

Typically, what happens then is there's the introduction of something known as a shortfall cover. And the shortfall cover is a coverage that's placed at better terms and conditions than what was previously offered to individual reinsurers, Berkshire Hathaway, Munich Re, Swiss Re, people like that. And at that stage, typically, you manage to get the program in place.

But again, from my personal experience, what I see right now, I'm literally expecting that insurers will not have enough reinsurance coverage purchased. And if that happens, they need to cut back on the amount of premium that they write. They need to cut back on the amount of premium that they write in certain areas, and they need to, perhaps, even change the original policy terms and conditions they're offering policyholders. All this is going to happen.

Tegus Client

Got it. That's super helpful explanation. Follow-up question there. Do you see this dynamic and sort of the broken market and just lack of reinsurance capital out there to cover the number of carriers looking for reinsurance? Do you see that affecting folks that are differentially affecting folks that are writing premiums in Florida or have historically worse loss ratios versus folks that have performed better and maybe have a more selective geographic underwriting strategy? Or is the market just sufficiently tight and broken that all carriers will suffer so to speak?

Chief Executive Officer & Founder at Pyrrhic Re

All carriers will suffer. Maybe not the same extent as somebody in Florida. There's definitely variability. So if you're looking at a European cat renewal or a European D&O renewal, if you're speaking about a line that's not catastrophe focused, their terms will be different, but they're still going to be quite P&L.

Tegus Client

Got it. Got it. One kind of elementary question actually, quickly on the reinsurance side as well. What is the typical source of capital for most reinsurers? How is the balance sheet actually funded? Or is it very different?

Chief Executive Officer & Founder at Pyrrhic Re

Their balance sheet is mainly centered around an AM Best rating. The AM Best rating is based on something known as a BCAR score, which is the end of it is basically your catastrophe stress score. For reinsurer to successfully trade on a rated basis, they need to have a rating of A- and probably a surplus of, let's say, USD 0.5 billion. Reinsurance because it's licensed. It's admitted, but unauthorized in most countries.

You're capable of conducting the reinsurance business globally with that sort of balance sheet, whereas if you were an insurance company, you would need far more capital necessary to trade. It's pretty much based around the AM Best rating. All the other rating agencies are practically irrelevant from the perspective of how it's judged.

So most counterparties will look at the reinsurer and say, is it rated? Are they rated? Yes, no? Is it above A-? Is it above a policyholder surplus of x, let's say, $0.5 billion? Yes or no? And then if they're not rated, then it's a question of whether or not the risk that they're reinsuring is really collateralized.

Tegus Client

Got it. So to your point around hybrid reinsurers, they are talking about collateralizing risk. You're talking about selling the premium cash flows into the open market, right?

Chief Executive Officer & Founder at Pyrrhic Re

Yes, a hybrid reinsurance business is effectively using investment sponsors to underwrite business, and to do so, but in a manner where if the investor is unhappy with the marketplace, they do not have to shut down an AM Best regulated entity, which will take five to 10 years. They simply have to run off the liabilities in the jurisdiction that they locate it, typically, Bermuda reinsurance, Bermuda currency offshore environment.

Tegus Client

And do you see these investment funds at all going direct to the primary insurers rather than through having that additional third party or the reinsurer or the hybrid reinsurer? Do you ever see them going direct to the carrier?

Chief Executive Officer & Founder at Pyrrhic Re

They're going, again, from my experience, they're going directly to what I would describe as capital-light sources of insurance and reinsurance investment. Those being MGAs, brokers, program carriers and even some IT software. That's probably about the closest they get from an investment perspective, like direct investment into a reinsurance company.

That's also done, but it's done via what's known as a reinsurance sidecar, or via an ILS fund, or via some sort of collateralized quota share agreement for which the investor comes in, they have the ability to underwrite the specific year, whether you think the rates are particularly attractive.

And they have the ability to exit without having to lay off 100 staff and have all sorts of expensive sort of infrastructure costs because their belief is that this is not something that we're going to build on, creating net asset value and in turn, sell it for 1.5 book value or 20x average to the income business.

Tegus Client

I'm wondering what type of investors are typically sort of the most active in the reinsurance market? Are there large categories that typically have appetite, maybe not this year, but historically for reinsurance products?

Chief Executive Officer & Founder at Pyrrhic Re

Pension plans have been very active in the ILS market, insurance-linked security market. And typically, there has been a handful of the usual suspects, private equity FIG sort of investors who have an understanding of the space, who cyclically come in, come out of space, KKR, Warburg, Apollo, et cetera, things like that.

Tegus Client
Got it. Okay. That makes sense. And then I guess back to your views on what the market will look like this year, maybe assuming a delay when longer term policies are actually found with reinsurers. But can you give us a sense for the magnitude of the delta in terms, maybe in terms of ceding commission or other negotiated pieces of contracts?

Chief Executive Officer & Founder at Pyrrhic Re
Okay. Just to start off, in 36 years in this business, I have never seen, let's call it, reinsurance rate. Reinsurance rates and interest rates rise together. They've always gone the opposite direction because of the general sort of fundamentals about insurance, reinsurance rates, insurance rates are down, interest rates are high, you make your money on the asset side of the balance sheet.

And when the interest rates are down, you raise your insurance rates, you make money on the liability side of the balance sheet. At the moment, we have the rates rising, interest rates and reinsurance rates rising at the same point. And may I also add that reinsurance rates are rising at a higher level than social inflation.

So we're beating inflation, we're ahead of the game. And if you say those two things, and then you speak about the fact that at the same time, we're offering more restricted terms and conditions to our policyholders. What you literally have is what I would describe as the perfect storm. So it isn't about as an attractive market that you could possibly imagine being in from the perspective of the global market.

And I said it's not just on cats, it's on non-catastrophe lines of businesses, it's on workers' compensation, it's on med mals, on D&O, transactional liability, cyber, everything. The rates are being pushed up. And may I also add that we have seen continuous rate increases on P&C classes of business worldwide since Q4 2019.

Those rate increases were necessary because we've had systematic underpricing a business for probably seven, eight years prior to that. But now we're at a point where the rate adequacy is there, and it's simply a matter of staying ahead of inflation, which I believe the industry is doing. Now I have to give you that big speech there, I actually forgot what your original question was.

Tegus Client
Yes. I guess my question was if you have a sense for the magnitude of the delta in reinsurance terms like the most negotiated pieces, ceding commission or other structures and endpoints of relevant that you expect to shake out in the 2023 contracts.

Chief Executive Officer & Founder at Pyrrhic Re
Okay. Catastrophe-exposed business, P&C business should be looking at 20% to 30% rate increases with the restriction and terms and conditions in terms of what covers are offered. Typically, reinsurers have offered what's known as all risk cover, which is quite literally all risk barring a few exceptions.

And now the coverage is being far more restricted to individual perils and it goes on to something as we call named peril coverage. So pricing up, terms down. And then that's just purely on the catastrophe side. If we go to the non-catastrophe side, and we talk about casualty business or specialty business, a lot of that business mostly in the U.S., is conducted on a quarter share basis.

And I would expect to see a 10% to 20% reduction in the ceding commissions being offered. The brokers are probably the most difficult enough to crack in the whole food chain. Brokers are typically paid 10 points on excess of loss contracts, 10 points of the premium, 10%, I should say, and they're typically paid between 1% and 2.5% of the gross written premium on the quota share, the core ceded premium.

I would expect there the excess of loss commissions not to dip, expected to stay the same because there's such a strong foothold in the business. But I would expect their commissions on quota share business to drop to the region of sort of 1%, 1.5% from 2.5%. Doesn't sound like much, but again, from the perspective, if you think about it, they effectively cut their commissions at 40%. It's meaningful.

Tegus Client

And I guess that was probably more to your large cap or your average insurance carrier. But as you think about the insurtech market, and let's throw out Hippo and all those ones that run very, very high loss ratios.

I assume you have a high-growth insurance business that's moderate loss ratio of, call it, 65% to 70%, something straight down the fairway. Would you expect similar levels of ceding commission and catastrophe price increases? Or would you expect that to be more a higher magnitude than the broader market?

Chief Executive Officer & Founder at Pyrrhic Re
I would expect a higher magnitude to the market. I guess if you're an insurance company or a reinsurance company right now and you're not thinking about a loss ratio between 40% and 50%, something is wrong with the business.

And if you're not thinking about an operating ratio or acquisition costs plus expenses in the region of 25% to 30%, there's also something wrong with your business. This industry should be delivering, albeit, exceptionally large cat losses aside, we should be delivering a low 80s combined ratio based on terms of conditions.

Tegus Client
The low 80s buying ratio would be your expected return on a primary carrier?

Chief Executive Officer & Founder at Pyrrhic Re
I think the primary carrier should be delivering to its investors a 20-point return right now.

Tegus Client
Okay. And typically, that 5% to 10% market is probably 5% to 10% on average?

Chief Executive Officer & Founder at Pyrrhic Re
Yes.

Tegus Client
And then if you take the cohort of 10 Hippo, TypTap, the routes that just run at exorbitant loss ratios, while they are coming down but exorbitant loss ratios, do those get done in this market? I mean, how do you think about those?

Chief Executive Officer & Founder at Pyrrhic Re
They will get done. They're just going to get done at unfavorable terms to the insurtechs because the industry will largely use those insurtech, Lemonade, Hippo, et cetera.

Tegus Client
Do you have a different view on folks like openly branch potentially or others that have a slightly different acquisition distribution strategy? Do they have a different reputation in the industry or from reinsurers perspective relative to the Hippos and Lemonades in the insurtech space?

Chief Executive Officer & Founder at Pyrrhic Re
I think they have a better reputation. I think, again, I think the industry in general has been quite negative on Hippo and Lemonade particularly in terms of the representations, and obviously, the results have gone out and proven itself because one of the issues with our business, I always tell this, forgive me, if you just give me 30 seconds to describe the story.

1985 or '86 on Wall Street, walking down into a Charles Schwab office, buying my first shares of Westinghouse, probably not the best stock on that. And I remember that trade were coming in, filling out some paperwork, handing over the paperwork, and they gave the paperwork back.

I hate to say it, but in this market, and the way the industry still works, specifically amongst SME and larger business, everything is still bespoke and it's obviously less paper, but it's still a very unsophisticated tech-savvy market. Now of course, you can go on an app or a Hippo app and you could find your insurance policy through that.

That's a considerable improvement about things. But the thing that always shocks me about these firms is they refer to themselves as insurtechs and yet they still, in most cases, exclusively use insurance brokers to access business. And to me, a successful insurtech will recognize that the frictional costs associated with an insurance broker or an agent is the thing that we need to remove.

And that we need to make it so easy for our policyholders to buying business that they can do it online without any use of a broker. And once the industry does that, we've effectively disrupted that very old fashioned trading style that I described earlier, that is conducted on a daily basis, 12 miles away from me at the moment is Lloyd's of London.

Tegus Client

Interesting. That's an interesting perspective. I'm curious of how you think about, I believe, Lemonade made this announcement as well as potentially Hippo, starting D2C and then actually shifting into a hybrid strategy where they kind of reverted on some of the initial D2C evangelism and ended up having to do hybrid and bringing in the agents.

Chief Executive Officer & Founder at Pyrrhic Re

Yes, they did because I mean, somebody, Elon Musk or somebody like that will eventually take on the agents. But there's yet to be somebody from the industry with an insurtech sort of concept with the financial patients, why don't we just say, to effectively take on the brokers or take on the agents because their strength is if they're so embedded within sort of insurance and reinsurance business globally, it's very difficult to dislodge them.

I have consults with people ask me about are you worried about this broker and disintermediation? I certainly don't say in my lifetime that I don't expect them to be disintermediated because of the very idea that so much insurance business is bespoke. It's individual. It's not a sausage factory. You can't find Goldman Sachs D&O cover on an app. You wouldn't probably never buy Goldman Sachs' D&O cover on an app.

Tegus Client

Yes, yes. It depends on the product for sure.

Chief Executive Officer & Founder at Pyrrhic Re

Yes. Of course, yes. Your house, your car, perhaps. But again, you just heard that they're probably, within their whole original sort of statement, about what they were going to do. It was going to be disintermediated, the agents and the brokers, and it wasn't long before they realized that, that wasn't going to be possible and without it being to the detriment to the loss ratio.

Tegus Client

That makes a lot of sense. Given the state of the market as well, the reinsurance market, I'm curious if you have a view on how long this hard market in reinsurance will last. And when you expect some normalcy to return, if you expect that, sort of what's your multiyear view on terms and where things are going?

Chief Executive Officer & Founder at Pyrrhic Re

Okay. Well, if you invested in an ILS fund over the last six years, you've lost money consistently in the last six years. If you invested in the reinsurance sidecar over the last six years, most of the cases you have lost money. I think we have truly, as an industry, scared away investments or scared away investments from certainly people that went into the market or invested in the market at the wrong time, which would have been any time past 2017.

So we don't have any new capital coming into the space. So let's start off with 2023 where it's pretty much going to be a name-your-terms, name-your-price marketplace that will be for cat business and non-cat business, it will be not as strong as that. But again, forward rate movement in restrictions, in terms and conditions, I would expect this market to last between two and three years.

And then I would expect a gradual sort of step back in terms of concessions on terms and conditions. But that's largely dependent on Ukraine, on whether or not the aircraft that's kind of been impounded in Russia are returned, political violence coverage within Ukraine.

We have, incredibly, we have in November, this tropical depression off the coast of Florida. And it's all these sort of different sort of changing events predominantly around a very turbulent world, which insurance obviously participates in, and obviously, all the concerns in terms of global warming and the impact on global warming in terms of the frequency and disparity of catastrophe losses.

Tegus Client
Got it. And the investors in ILS funds who have lost money consistently in the last six years, is that just lenient pricing from a reinsurance binding to a carrier customer? Or what's sort of driving that dynamic? Is it the catastrophe? Or is it the pricing? Or both?

Chief Executive Officer & Founder at Pyrrhic Re
It's mostly a combination of the product and it's also a combination of the catastrophe. I'd say, probably pricing, less so. But basically, it's a one-trick pony sort of investment. Pension funds are attracted to it because perhaps, if you heard, natural catastrophe losses do not correlate with anything else within their investment portfolio.

They keep it within a certain sort of level within their assets under management, so that's not material. But what they discovered over the last six years is the losses that have come from this sort of diversified investment have become material.

And not only have they become material, they've also become problematic because they cannot get their investment back because their collateral is secured against reinsurance claims that could be argued that are loaded in terms of what the expected losses from the counterparties.

But the reinsurers are holding on to the capital, holding on to the collateral because if they give it back, they cannot get it back. So you can see, it's a fundamentally broad product. And until ILS diversifies into the classes of business and solve what is known as the collateral trapping issue.

Tegus Client
Yes. Interesting. And I'm curious with all of this said, where you are spending time at Pyrrhic and how you're thinking about the negotiations for 2023 contracts?

Chief Executive Officer & Founder at Pyrrhic Re
Okay. I'll just give a general description. Well, we have this unique sort of arrangement, a fronting arrangement, whereby we have a collateral calculation for the business that we underwrite on behalf that we used to underwrite about that is incredibly attractive versus a lot of technical ILS funds does. Now with all that in mind and with that collateral in hand, we're underwriting business like the sky is falling.

There's no other way to describe it with being absolutely draconian in terms and conditions, in terms of pricing, and also in terms of the balance of the portfolio that we're trying to build. Unlike a typical ILS fund, a hybrid business, you want to call it, by its all classes of business.

And so if there is bad catastrophe losses, it has a portfolio of non-catastrophe losses to offset the lumpy bits that come from the catastrophe side. Same point, if you get a little bit of loss creep inflation. So if the inflation gets ahead of your rate increases on the non-cat side, you hopefully have the diversification of cat risk, which is obviously a class of business that is either volatile or it's loss free, generally speaking.

So simply speaking, from what I see out in the marketplace, you asked me what sort of negotiations I'm seeing so far? I'm seeing terms and conditions that are originally being suggested by the brokers as being completely dismissed. I'm seeing the large reinsurance companies, Munich Re, Swiss Re, basically acquiring draconian terms and conditions. And simply speaking, the brokers are, quite frankly, in their most weakened state with a perspective of their ability to drive terms and conditions.

And it's going to be an extremely rough and difficult reinsurance producing period between now and, let's call it, the 2nd of July, which is whether more or less all reinsurance is purchased for anyone who needs to buy reinsurance.

Tegus Client

Yes. Okay. Really helpful. And as a general rule, do most reinsurers purchase or work within the retrocession market and actually sort of syndicate out the majority of the risk, part of the risk? Do you have any sort of metrics around how much of that reinsurance risk is actually being re-reinsured?

Chief Executive Officer & Founder at Pyrrhic Re

Okay. Yes. Well, I would say to you, if I gave a description of just about the way my business operates, our maximum exposure is about 60% of net assets, okay? Let's say, a Hurricane Katrina-type event. Maximum net exposure is 14% of net assets. Typically, what you do in reinsurers' buying protection according to return periods.

These return periods could be 1 in 100 return period event, 1 in 250. And the general guideline that we see from the typical Bermuda reinsurer, it's called RenaissanceRe. Their 1 in 100 hit to their net asset is probably in the region of 12%, somewhere in that area. And that 1 in 250 hit to their net asset is probably between 20% and 30%.

Tegus Client

Okay. Good to know. Thank you. I think last question from me actually, and I think we've touched on it a little bit, but just to clarify before we let you go. On product exposure, are there any particular product categories that reinsurers are particularly skeptical or avoidant of in this market dynamic or any that are preferred?

Chief Executive Officer & Founder at Pyrrhic Re

Okay. Well, let's go through the list, what we call as tail risk exposure mainly earthquake risk. That's a concern. I would say a major concern at this moment is trade credit reinsurance or surety reinsurance, obviously, across the economic conditions due to, if you look at the history of COVID-19, event cancellation reinsurance is also a concern.

Ukraine has caused concerns for what we call as political violence cover, which is basically an attack on an asset in Ukraine, if you want to call, let's call it that. Aviation and marine war cover, obviously, for the same reason, would also be a concern.

And the area that we're all watching with interest and you'll ask 10 insurers, you'll probably get 10 different answers is cyber. Cyber is becoming a very large class of business. It is estimated to be, at the moment, about a $5 billion to $6 billion gross written premium class of business globally.

And they're estimating that, that premium will grow to between $20 billion and $25 billion over the next five years, and also the investment in what's referred to as cyber MGAs. And there's a lot of, frankly speaking, I think there's a lot of concern coming out of the cyber area for two reasons.

Reason one is ransomware, which obviously, you ransom, you take control of the hospital's IT system, and you demand a ransom in order to free that system. That's quite common. It caused some loss making of the business. The second thing which is happening right now, which is, I think, is a fundamental breakdown in terms of the policy form is cyber insurers and cyber reinsurers depend on an exclusion on their policy, which is called, basically, an act by a foreign state/war that caused the cybertech.

And let's call it what it is. We know that North Korea, we know that Russia, China, all of the above, regularly test U.S. European infrastructure and their companies for vulnerabilities in order to test to see if they can freeze the company or cause some form of harm. Insurers have been relying on some several large claims recently in that area on that exclusion. And the U.S. courts have kicked out an exclusion in all cases.

Yes, it's a concern, but if you go on the interest side, where people want to write business, there's full of non-catastrophe business. Casualty business is deemed attractive. Shorter-tail casualty business is very attractive. And obviously, like I said, you got some people will take a view on cat risk. People charge exorbitant rates.

And 12 months later, we could have a conversation to decide whether or not they were right or wrong. That's the best way I would say it. But what I would say is that the rates that they're charging and the terms and conditions they're going to get have never been better.

Tegus Client
What about personal lines, homeowners, auto?

Chief Executive Officer & Founder at Pyrrhic Re
Well, personal lines, we're speaking from a range perspective?

Tegus Client
Yes.

Chief Executive Officer & Founder at Pyrrhic Re
Personal lines is again, the rates are on specific states such as Florida, which is internally sort of fundamentally broken from a legislative perspective because it's something that's known as assignment of benefits, which quite frankly, just promotes fraud.

I think it's very challenging for a Florida insurer to continue to exist in this marketplace because of the pressures that will be put on them by reinsurers in terms of cost of the reinsurance program to protect them. I really don't know what's going to happen there. I certainly see some of the Florida insurers throughout the rest of the U.S.

Again, they're going to see considerable increases in the cost of reinsurance, but they're also passing that cost on to their policyholders with rate increases. On the auto side, what we know is nonstandard auto is a bit of a basket case at the moment. Again, because its elements are predominantly around sort of coverages or coverages that are provided.

Mainly something known as personal injury protection, which is right for fraudulent activities and for things like that, which obviously are causing nonstandard auto insurers and their reinsurers who lose money. General, if you're a GEICO, or if you're Allstate, or your State Farm, and you're insuring typical standard auto insurance, you're making money. And that is not reinsured.

Tegus Client
Got it. Thank you. This is super helpful. I really appreciate your time today.
