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REINSURANCE

H1 2024 Cyber Reinsurance Update

The pricing pendulum swings (slowly) towards buyers

This update of the Global Cyber Reinsurance Market in H1 2024 provides high level analysis for buyers of reinsurance and other stakeholders around the state of the cyber reinsurance market. It references market trends, product updates, capacity, claims and notable cyber incidents.

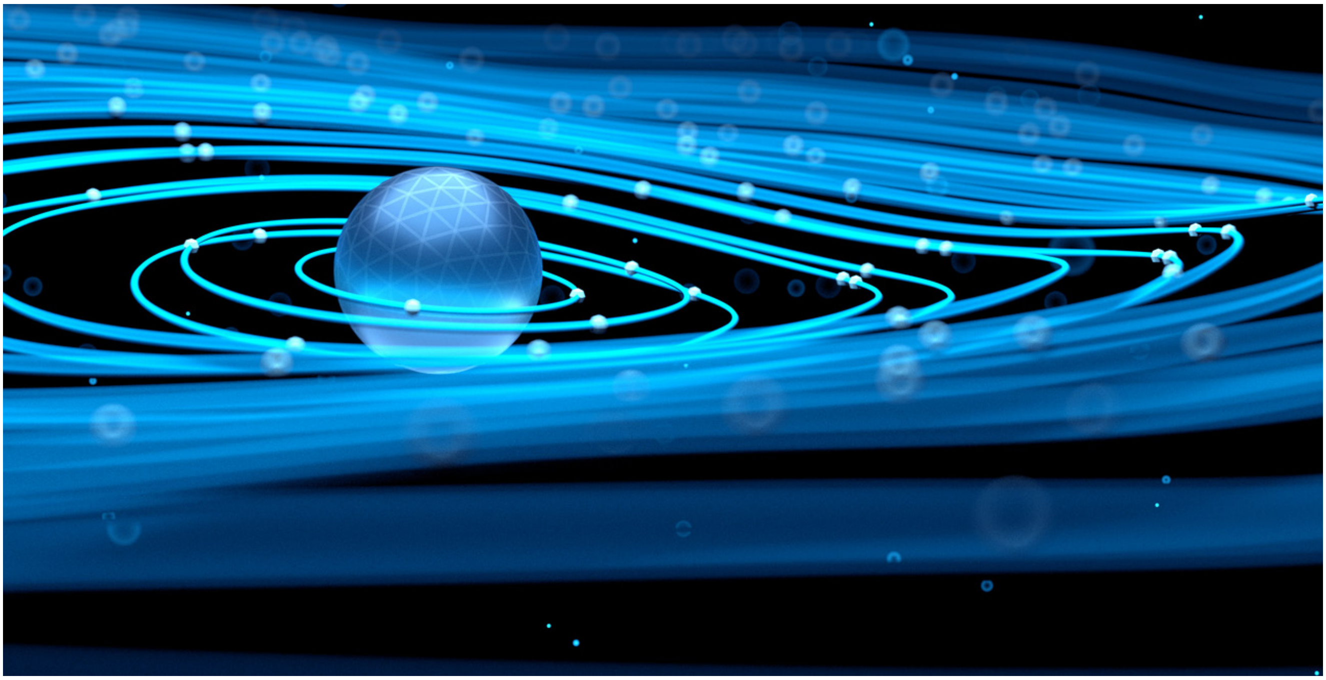
Reduced demand, together with increased supply, benefits cedants

There has undoubtedly been enhanced buying conditions for cedants who renewed their portfolio in H1 2024. Cedants have better confidence in their attritional loss ratios, and reduced volatility in results has helped improve outcomes.

As more experience is gained within the market about underwriting cyber insurance, as well as gathering claims data, there is more predictability for cedants when determining and predicting individual company losses. In addition, cedants have continued to invest in understanding and articulating their view of tail risk. Both factors led to increased comfort to expand their internal net risk tolerance. Ultimately the goal is to transfer less risk through to the reinsurance market. This has ramped up competition between reinsurers, and resulted in beneficial renewal outcomes for cedants.

This trend for increased net risk tolerance led to reduced demand for proportional structures. This was particularly evident among those with more mature portfolios becoming less reliant on the need for ground up support. Instead, specific parts of portfolios that cause them concern are prioritised for protection. As a result, we have seen cedants favour (and in some cases move altogether to) non-proportional structures as a method of portfolio protection.

Depending on the portfolio and risk tolerance, attachment points on non-proportional programmes vary widely. Cedants remained cautious with regards to how their non-proportional programmes were structured; remaining vigilant to the negative ramifications that can result from being too optimistic when forecasting premiums. If premium estimates are not met, minimum monetary attachments can translate into higher loss ratio percentage of attachment.



As a result of this trend, reinsurers which supported both non-proportional and proportional business, reacted to reduced quota share orders by seeking to increase their participation on non-proportional treaties.

For those reinsurers who solely supported proportional structures; market dynamics naturally created increased competition, with a focus on maintaining their position on existing treaties. Interestingly, for cedants with proportional structures, securing higher loss ratio caps was not as high a priority, instead pushing to increase ceding commission and an improved expected net underwriting result.

Competition for participation on new and existing non-proportional structures remained prevalent, with reinsurers using levers such as reinstatement factor options to incentivize cedants and win new business. We have also seen more flexibility on some other policy conditions such as removing non-concurrencies to ensure cedants have back-to-back cover, as well as conversations around no claims bonuses.

As a caveat, increasing competition between reinsurers has been somewhat dependent on the profile of the cedant portfolio in question. Portfolios with significant US exposure, or those with an imbalance of average limit to premium ratio, have not benefitted as much as other portfolios without such exposure or imbalance. There has been more enthusiasm among reinsurers to participate in programs with more geographic diversification.

The appetite change from reinsurers around US cyber risk is largely due to the diversification benefit. It is a common misconception that all cyber risks are global. The reality is different, because many core technologies vary by location and there are localised approaches to systems which could have a widespread impact if hit by a cyber-attack. Additionally, significant variation exists in legislation, regulation and litigation relating to data privacy and disclosure matters. As a result, geography and company size play a meaningful role in increasing the diversification of a portfolio.

New Capital

There have been several new reinsurer entrants in H1 2024, with more capacity from both traditional reinsurers and third-party capital sources. Newer non-proportional Event Excess of Loss coverages have picked up interest among cedants, resulting in several event program transactions.

Insurance Linked Securities (ILS) investors have notably increased their interest in the cyber market in the last few months, with the well documented cyber cat bond issuances of over $580m of new capital further growing supply. There is no one reason which can be attributed to this peak in interest in H1, but rather was seen as the result of continuous education from brokers to support investors. With growing comfort of cyber risk as a profitable and sustainable class of insurance, more are committing the time to investigate it as a viable investment opportunity.

However, many investors are still cautious, though the initial market making activity is driving engagement. As tail risk becomes better understood by investors, the perceived concern of how a cyber catastrophe could manifest diminishes. This in turn allows more efficient use of capital compared to traditional structures, with the aim of protecting specific areas of concern within portfolios.

Confidence and understanding of the outputs of cyber aggregation modelling continues to evolve, especially for ILS investors. Model vendors have released updated model versions complete with the most recent data and cyber catastrophe modelling tools. There is an understanding among all market participants that until more major cyber events occur, live claims data will be limited, and this is required for vendors to test and prove their assumptions, and ultimately recalibrate their models.

Potential choppy waters ahead

These better conditions for cedants are offset by three core issues:

1. Increase in Cyber Threat Activity

In recent months threat activity has now reached similar levels as was seen prior to the Ukraine invasion in February 2022. These cyber incidents have not yet translated into cyber insurance losses. There are competing schools of thought, as to whether insurance portfolios are of a higher quality of cyber hygiene (such as multi-factor authentication being a minimum underwriting standard), and therefore less likely to be impacted by ransomware, or whether losses just have not yet manifested; but have the potential to do so. Either way, it is a concerning backdrop. This area will continue to be monitored closely by market participants during H2 2024.

2. The potential of Change Healthcare impacting view of Systemic Risk

Since the devastating ransomware attack took place in February 2024, its far-reaching impact is indisputable. The attack on Change Healthcare has taken months to resolve, and was due to the lack of multifactor authentication. Many companies and patients in the US healthcare sector continue to be affected. However, notwithstanding dozens of claim notifications, significant insured losses have yet to materialize. It is clear though, that the event serves as a stark reminder that systemically important services upon which key parts of the economy and society rely on, have technology which is vulnerable to attack.

3. Pixel tracking and Liability issues linger

For those reinsurers with US exposures, there have been several concerning trends relating to liability arising from pixel tracking technologies. Some cedants cover wrongful collection risks, whilst others exclude these exposures. The extent of these exposures is harder for cedants to quantify given the uncertainty of ongoing litigation. One consistent factor is that these risks represent longer term liabilities, which mean claim development pattern could be longer tail in nature.

These issues have created a complex situation for reinsurers to navigate through with the varied dynamics of the market. Put together, the rate reductions seen during 2023 are unlikely to continue at the same pace in the coming quarters; and that the market softening is unlikely to continue in the same manner as experienced to date.

Growing comfort with newer structures

Cedants continue to mature, aided by increased exposure, and claims data capture. There is a growing confidence of the attritional performance. As a priority to retain more income, alternative non-proportional structures such as event excess of loss have attracted more interest. The lower attachment point of these programmes demonstrates that, for the appropriate portfolio, there is a higher likelihood of recovery in comparison to other traditional structures on offer.

For some portfolios, particularly those with limited delegated business (where acquisition costs are kept lower), proportional programme structures remained a reliable risk transfer mechanism for cedants renewing in H1. This was particularly evident for new entrants into the cyber insurance market looking for reinsurance support whilst their portfolio was in its relative infancy.

There is no hard and fast rule of structure options for cedants; each portfolio is nuanced in its level of diversification, size, and risk appetite. What remains clear is that the key driver to improved decision making is an understanding of a net risk appetite and building a custom program to meet the priorities.

Cyber Catastrophe Understanding

There is increasing awareness of the potential economic and societal consequences of a major cyber event. Industry stakeholders have been engaged with governments about potential solutions to mitigate the worst financial impacts of a cyber catastrophe. The topic of Public Private Partnerships has gathered pace in both the UK and US, with ongoing discussions about the shape and structure of a potential cyber insurance backstop. There is industry interest in the topic and a mutual understanding that this will be a long process.

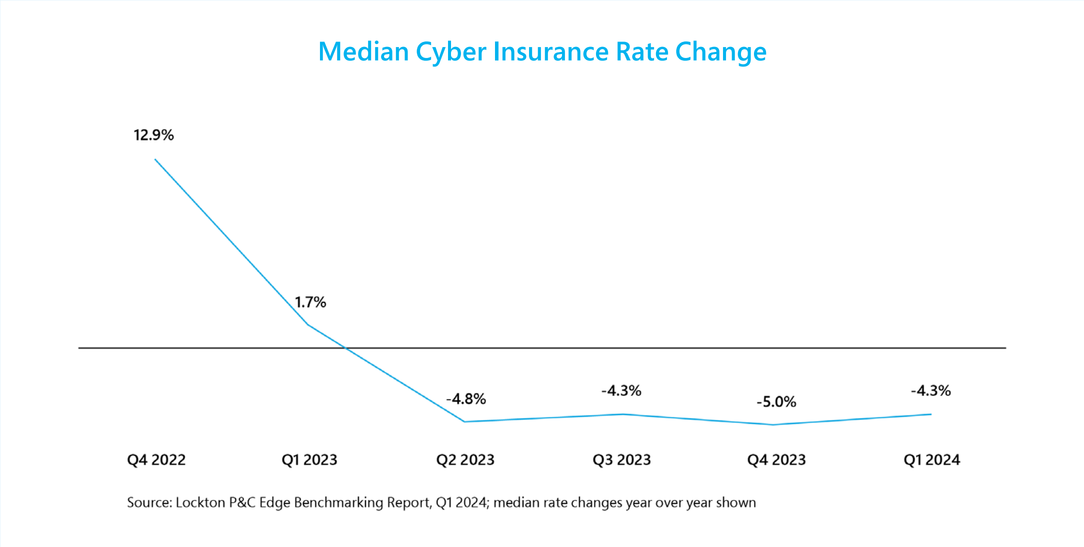
The long shadow cast by the debate over the Cyber War exclusion is fading slowly. Cyber War Clause discussions are ongoing, and the publication in May 2024 of Lloyd's bulletin Y5433 was welcome and beneficial for the market, serving to add more clarity to Lloyd's approach to cyber war. There are specific timelines and targets for certain coverages.

Outlook for H2

Whilst uncertainty is synonymous with the cyber threat landscape, there are still plenty of reasons for optimism in the continued development of the cyber market. The growth of the market is not a predesignated straight-line path, but rather one with inherent peaks and troughs. The big picture remains buoyant, though there are potential headwinds for some segments of the market; specifically in regard to short term oversupply causing some continued rate softening. Such reinsurance rate softening is positive for cedants, who benefit from reinsurer competition for their programmes. Additionally, cedants will continue to benefit from the collaboration between reinsurance brokers and reinsurers to innovate new products and programme. The goal is to continue to evolve structures which improve efficiencies and are fit for purpose.

The graph below shows year over year pricing trends for original insurance pricing from Lockton Insurance. This backdrop provides a material shift from the peak of the hard market of early in 2022. Frequency and severity of losses continues to creep up as cyber threat activity shows no sign of slowing.

This is good news for policy holders. Increased stability in pricing is welcome. The takeaways from H1 2024 are that, whilst the specifics may vary, the market continues to mature, and an ongoing game of cat and mouse in relation to the cyber threats is here to stay.



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Legalities

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