Financial Review
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London and Bermuda Attract Capital as Insurance Market Conditions Improve

Bermudian and London market insurers have been able to raise equity with relative ease.

Principal Takeaways

- 2020 saw a slew of capital raising activity from both existing insurance players and start-ups in London and Bermuda, looking to bolster balance sheets and to take advantage of perceived improvements in pricing and conditions.
- Private equity, industry capital and public placements have contributed to capital inflows.
- New capital has been attracted by improving market conditions in a broad range of sectors in both primary and reinsurance markets.
- Third-party capital continues to flow into the insurance industry, but the pace has tempered.
- The impact that the economic consequences of the pandemic will have on demand for insurance is highly uncertain.
- Economic volatility caused by COVID-19 may constrain M&A activity in the short term, but longer term, consolidation pressures are likely.

Expectations of a broad hardening in market conditions, as well as the desire to bolster balance sheets in in the face of uncertainty around COVID-19-related losses, underpinned much of the capital raising activity seen in 2020.

Private equity, industry capital and public placements all contributed to the capital inflow, supporting the balance sheets of existing players, alongside some material scale-ups and a number of true start-ups.

Listed carriers including Beazley, Hiscox, QBE, Lancashire and Renaissance Re tapped public equity and debt markets, while privately-owned Convex and Fidelis raised capital from new and existing shareholders.

Start-up reinsurer, Conduit Re, joined the small number of specialty (re)insurers listed on the London Stock Exchange, a group that has dwindled over the past 10 years due to mergers and acquisitions. New Bermudian reinsurer, Vantage, and recent Lloyd's entrant, Inigo, were backed by capital from private equity. Established Lloyd's player, Ark, underwent a substantial scale up, which included conversion of its Bermudian reinsurance entity into a class 4 reinsurer, supported by capital from White Mountains.

The capital inflow partly reflects the absence of other opportunities for investors. The low interest-rate environment has forced investors – particularly institutional investors – to look further afield for yield opportunities. The risk and reward calculation posed by the insurance industry in a hardening market may look more attractive to existing and new investors.

Bermudian and London market insurers have been able to raise equity with relative ease. They have also been able to issue debt at relatively favourable rates, in spite of higher credit spreads. This suggests investors have confidence in the near-term prospects of the insurance industry, despite claims uncertainty in respect of COVID-19, social inflation and catastrophe exposure.

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Exhibit 1

London Market and Bermuda – Capital Raised, 2020-21, and AM Best Ratings of the Main Operating Entities of Capital-Raising Groups

AMB#	Company	Amount Raised	Equity/ Debt	Date of issue	Best's Long-Term Issuer Credit Rating (ICR)	Best's Financial Strength Rating (FSR)	Best's ICR & FSR Action	Best's ICR & FSR Outlook	Rating Effective Date
58459	Arch Capital Group Ltd.*	USD 1bn	Debt	Jun-20	aa-	A+	Affirmed	Stable	4-Dec-20
44770	Ark Insurance Holdings*	USD 605m	Equity	Jan-21	a	A	Assigned	Stable	4-Jan-21
46638	Ascot Group Ltd.*	USD 400m	Debt	Dec-20	a	A	Affirmed	Positive[1]	4-Sep-20
46515	Beazley plc*	GBP 247m	Equity	May-20	a	A	Affirmed	Stable	25-Jun-20
44835	Conduit Holdings*	USD 1.1bn	Equity	Dec-20	a-	A-	Assigned	Stable	7-Dec-20
44173	Convex Group Ltd.*	USD 1bn	Equity	Nov-20	a-	A-	Affirmed	Stable	1-May-20
		USD 500m	Equity	Jan-21					
44864	Core Specialty Insurance*	GBP 670m	Equity	Dec-20	a-	A-	Affirmed[2]	Stable	23-Dec-20
58455	Everest Re Group*	USD 1bn	Debt	Oct-20	aa-	A+	Affirmed	Stable	29-May-20
33824	Fidelis Insurance Holdings Ltd.*	USD 500m	Equity	Jun-20	a	A	Upgraded	Stable	3-Jun-20
		USD 300m	Debt	Jun-20					
		USD 125m	Debt	Nov-20					
		USD 60m	Equity	Dec-20					
54148	Helios Underwriting plc	GBP 20m	Equity	Oct-20					
51951	Hiscox Ltd.*	GBP 375m	Equity	May-20	a+	A	Affirmed	Stable	4-Dec-20
-	Inigo Ltd.	USD 800m	Equity	Nov-20					
51279	Lancashire Holdings Ltd.*	USD 365m	Equity	Jun-20	a+	A	Affirmed	Stable	22-Sep-20
		USD 0.75m	Equity	Dec-20					
33495	Randall & Quilter Investment Holdings Ltd.*	USD 100m	Equity	Apr-20	a-	A	Affirmed	Stable	15-Oct-20
		USD 108m	Debt	Dec-20					
86357	Renaissance Reinsurance Ltd.	USD 1.1bn	Equity	Jun-20	aa-	A+	Affirmed	Stable	13-May-20
44839	Vantage Group Holdings Ltd.*	USD 1bn	Equity	Nov-20	a-	A-	Assigned	Stable	19-Nov-20

Note: AM Best's ICR and FSR ratings do not apply to raised capital or equity.
* Rating applies to the main operating entities of the group.
[1] FSR outlook is Stable.
[2] ICR and FSR removed from under review.
Source: *Best's Financial Suite - Global*, AM Best data and research

Investors Responding to Price Hardening

Going into 2021, there was considerable optimism in respect of pricing, particularly in commercial lines and reinsurance. Rates in a number of lines of business continue to harden as the market responds with increased underwriting discipline to adverse claims experience driven by social inflation in the US, COVID-19-related losses and, in recent years, elevated catastrophe experience.

Capital constraints in local markets are leading to more business flowing to wholesale markets, such as London. As a result, insurers are seeing attractive opportunities to deploy capital, particularly in specialty excess & surplus (E&S) markets and more recently in reinsurance. This was demonstrated by the strong growth recorded by existing London market insurers in 2020, with results announcements detailing double-digit rate increases for some lines of business.

With retro market capacity constrained, cat business was more expensive to place at 1/1 renewals – although actual increases appear to be at the lower end of expectations going into the renewal season and optimism as to whether this will be a sustained hard market for reinsurance appears to have waned to a degree.

In recent years, insurers writing US casualty business have been hit by an increase in both the frequency of attritional claims and a rise in the severity of large losses, largely reflecting the issues with social inflation and rising jury awards in the US. Directors' and officers'

(D&O), errors and omissions (E&O), excess casualty and healthcare liability lines have been particularly affected, as insurers have strengthened reserves for recent underwriting years and set more prudent current year loss picks. In response to adverse claims trends, affected lines of business have been pruned with the subsequent squeeze on capacity supporting material rate improvements.

In a difficult and uncertain claims environment, there has been a concern that some risks, even where there have been material rate increases, are still not adequately priced. The persistent squeeze on capacity means rates have continued to rise in these lines and there does now appear to be growing confidence around price adequacy.

However, there are significant uncertainties ahead in terms of the supply-demand balance for both commercial insurance and reinsurance, which will be driven by factors including:

- Economic conditions - as economies shrink, so does the value of insurable risk, which will impact demand for insurance
- The ultimate size of the COVID-19 loss, how quickly it develops, and the impact on the earnings and capital of the insurance vs reinsurance industry
- The development of casualty reserves, particularly in the US
- Catastrophe loss experience

Pace of Third-Party Capital Inflow has Slowed

In recent years, the emergence of collateralised reinsurance vehicles (known as sidecars) as well as the popularity of insurance-linked securities (ILS) has given third-party capital an efficient way to move in and out of the market. The popularity of such vehicles had dampened expectations of a swathe of new formations emulating the classes of 2002 and 2005.

This year, third-party capital continues to flow into the market, but the pace has tempered, following a period of high severity losses. Linked to this, there have been issues surrounding collateral release, which has resulted in a renewed focus on credit and dispute risk. So while the catastrophe events of 2017 and 2018 represented a significant test of alternative capital use and affirmed the persistence of third-party capital owners, they also led to a re-evaluation of return requirements and governance structures.

Longer than anticipated claims settlements associated with some catastrophe losses – particularly Hurricanes Irma and Maria, the Californian wildfires and Typhoon Jebi – have also caused both investors and capacity users to pause and assess what changes need to be made in underlying agreements. This may lead to a more measured use of alternative capital structures going forward.

Also, while third-party capital has typically focused on widely modelled property catastrophe exposures, the opportunities presented by the current hardening market potentially reach into much broader exposures, with US casualty being an obvious example.

New Capacity May Not Increase Industry Capital Materially

Although the bolstering of capacity at company level is not insignificant, it does not currently represent a material addition to industry capital, particularly when combined with existing third-party capital capacity.

M&A Likely to be Constrained in the Short Term

In the short term, AM Best expects the prospects for merger and acquisition (M&A) activity to be diminished. Volatile equity markets have contributed to difficulties in assessing the true value of companies. In addition, the financial and operational impact of the COVID-19 pandemic is likely to create uncertainty around integration and the prospects for combined businesses for some time.

Over the medium to longer term, deal activity is likely to pick up as some insurers come under increased financial pressure.

Meanwhile, AM Best expects to see further portfolio transfers in the forms of disposals of non-core businesses to strategic buyers, financial buyers and run-off specialists. Over the past 10 years, companies have become more focused on capital efficiency and analysing their balance sheets to determine which liabilities are absorbing capital that could be better used elsewhere. In a hardening market, and against a backdrop of very low interest rates, insurers are more likely to want to use capital to write new business.

Also, as COVID-19 increases economic uncertainty and distress, insurers are expected to turn to as many sources as they can to unlock capital to support their core operations. Consequently, there are potential opportunities for run-off providers.

Nevertheless, new capital flowing into the industry, and the resultant increase in capacity – through start-ups, scale-ups and capital raises by existing players – could have a dampening effect on price improvements. However, it should be noted that there are other so-called "moving parts" in this equation that could influence prices.

A portion of the additional capital raised in 2020 has already been required to absorb adverse prior-year loss reserve development and upward revisions in COVID-19-related loss estimates. And the extent to which losses related to COVID-19 have been recognised by insurers going into 2021 remains unclear.

The impact that the economic consequences of the pandemic will have on demand for insurance is highly uncertain and will largely depend on the length and depth of the economic downturn. As economies shrink, so does the value of insurable risk. But when businesses come under financial pressure, their appetite to retain risk may also reduce – increasing demand for insurance cover.

For the reinsurance segment, rising demand from insurers that have constrained financial positions because of underwriting losses and the impact of COVID-19-driven market volatility on their assets, coupled with reduced availability of retro cover, could offset the impact of the flow of capital into the segment on supply.

Another important factor is the need for price correction to produce adequate shareholder returns. A prolonged period of weak market conditions, coupled with catastrophe losses and adverse claims inflation trends in casualty, has meant that (re)insurers in the London and Bermudian markets have reported lacklustre results over the past five years. At the same time, concerns remain about the potential impact of social inflation on results. This need to improve underwriting margins should help sustain underwriting discipline and rate improvements, particularly when the very low investment returns available are taken into account.

Requirements for an AM Best initial rating assignment

For AM Best to proceed with an initial rating assignment, certain conditions and factors must be present:

1. A clearly defined five-year business plan with which all principals are in accord and well-qualified and capable to implement. That includes the following:
   - Policy statements on underwriting criteria, investment guidelines and risk management
   - A thorough description of the products offered pricing standards and the company's distribution and market strategy
   - Financial projections along with the underlying quantitative and qualitative assumptions and the anticipated use of capital

2. Initial financing in place or expected to be paid into the capital of the rated (re)insurance entity concurrently with the initial rating assignment
3. Stress-tested capitalisation that conservatively supports the business plan
4. Experienced management and the appropriate staff and operational infrastructure in place (or adequately addressed in a detailed implementation plan which may include use of third-party services) to support initial activities and meet regulatory and rating agency scrutiny
5. Management board members, strategic investors, investment bankers, actuaries and other advisors available for discussions with AM Best to provide comprehensive disclosure of requested information
6. A follow-up process to measure the effectiveness of the initial business plan and to monitor the company's strategic and financial development.

Opportunities for Start-ups

It is a favourable time to be entering the market but there remain significant hurdles for new companies looking to establish themselves quickly to take advantage of the beneficial conditions. Hurdles include the need to secure capital, regulatory approvals, licences and underwriting teams. Start-up (re)insurers in 2020/21 also face the unique challenge of creating an organisation's internal culture and gaining acceptance in relationship-driven markets during a period when remote working is the norm.

The path to success for new insurance players will be through maintaining discipline through the underwriting cycle, combined with prudent management of catastrophe exposure, particularly in the early years of operation.

Any new start-ups in 2021 are likely to be attracted by improving market conditions in a broad range of sectors in both insurance and reinsurance markets. In addition, there may be some new technology start-ups and a greater push on technology-driven solutions which have not yet come to the fore.

New companies benefit from clean balance sheets that are unencumbered by legacy claims. This is particularly pertinent at a time when more market participants are strengthening reserves for US casualty business. The absence of legacy systems could also be a positive, as these companies are able to use the latest technology to support, for example, the collection, processing and analysis of data.

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