howden

A WORLD OF TROUBLE

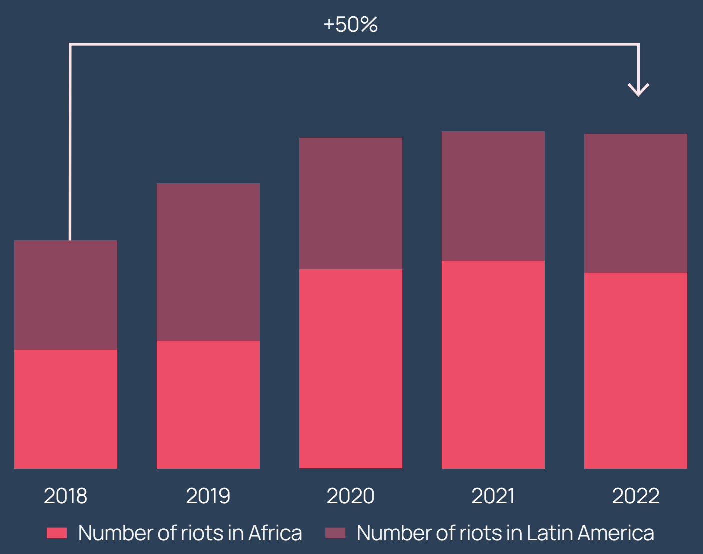
Key takeaways

Interacting macroeconomic and geopolitical trends portend a structural shift in loss frequency and severity for the standalone political violence (PV) market.

Such devastating losses have eroded a sizeable share of the standalone market's overall premium base, precipitating a correction that looks set to continue for some time to come.

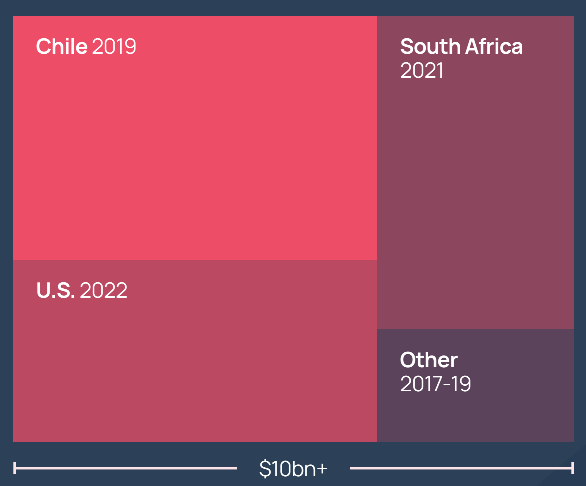
Strikes, riots and civil commotion (SRCC) + war = market reset

Number of riots in Africa and LatAm from 2018



Source: Howden analysis using ACLED data

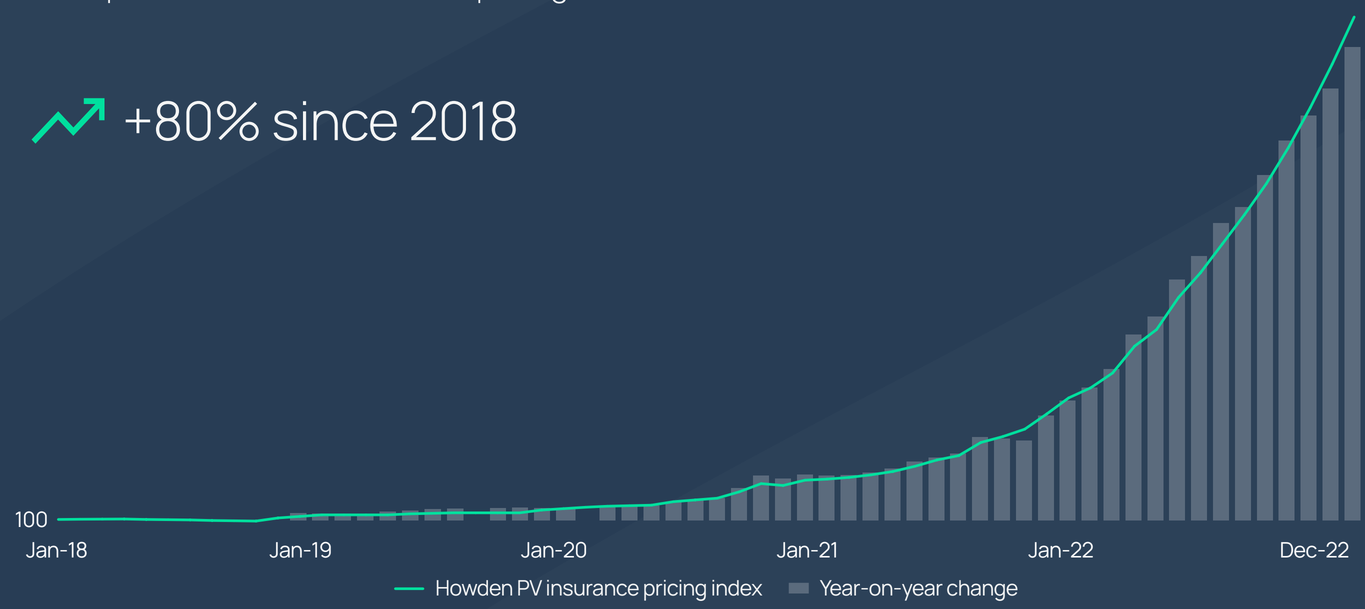
SRCC insured losses from 2017



Source: NOVA

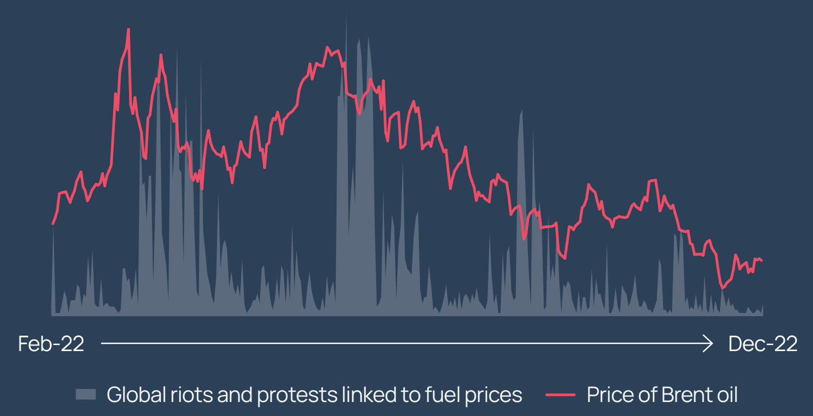
Shock events have transformed the pricing environment

Global political violence insurance pricing



Source: Howden

Global unrest vs oil price in 2022



Source: Howden analysis using ACLED data, St. Louis Fed

In addition to being another billion dollar plus loss for the PV market, the Ukraine war has aggravated an already hostile backdrop.

In order to put the standalone PV market on a more sustainable footing, its premium base needs to grow significantly in the next few years. **Price is part of the equation but (disciplined) new capacity will also be needed to absorb the levels of losses and demand we are now seeing.**

Executive summary

Compounding global crises have made the world a riskier place. Long-standing grievances tied to inequality and the rising cost of living have been inflamed by the (health and economic) effects of COVID-19, and, more recently, Russia's invasion of Ukraine. Resulting commodity shocks and more ingrained price pressures have sent inflation soaring to multi-decadal highs and elevated the threat of civil unrest (already at a high base) for businesses in both advanced and emerging economies.

This backdrop has added a big dose of complexity into an already complicated operating environment for political violence (PV) insurers and reinsurers. Just as the market was navigating an unprecedented rise in claims from strikes, riots and civil commotion (SRCC) events, and an attendant surge in demand, the Ukraine war exposed considerable geopolitical risks and led to what will become one of the largest PV losses ever.

> INCREASED FREQUENCY OF SEVERITY HAS PROPELLED SRCC CLAIMS TO RIVAL **OR EVEN SURPASS NATURAL CATASTROPHE LOSSES IN CERTAIN TERRITORIES.**

A risk reset

The analysis that follows in the pages ahead points to a structural change in the SRCC loss environment. Whilst the causes of civil unrest are disparate and often tied to discrete national circumstances, recent outbreaks of violence in places like Chile, the United States, South Africa, Sri Lanka and Peru – all of which are explored in detail herein – reflect an elevated and interconnected risk landscape that has reset loss expectations. The proliferation of social media is an additional complication, as the reach and near real-time information provided by platforms has seen incidents spiral quickly to affect multiple locations.

The shift in loss profile has been stark. Increased frequency of severity has propelled the quantum of SRCC claims in certain territories (such as South Africa and Latin America) to rival or even surpass natural catastrophe losses. That business leaders now see SRCC as the pre-eminent PV-related threat is testament to the scale of civil unrest, especially given the ongoing war in Ukraine and other geopolitical risks that extend to rising tensions between the United States and China.

A market reset

All of which has reset (re)insurers' views of risk. Property carriers are increasingly withdrawing SRCC cover whilst risk appetite in the standalone market has reduced significantly. The fallout represents something akin to a perfect storm: demand up, supply down, triple-digit loss ratios, reinsurance retrenchment and a market-changing pricing correction. With PV insurers holding significantly higher net positions post-1 January 2023 reinsurance renewals, the market could be one major loss away from dislocation.

Finding an equilibrium that continues to meet clients' expectations around capacity commitments, coverage and affordability, whilst ensuring that rates are commensurate to the degree of risk assumed, will be crucial to market sustainability and long-term relevance. Ultimately, the step-change in losses and demand will require the market to scale up considerably over the next few years.

Today's marketplace demands the very best intermediary expertise and leadership. It requires experience, market-leading thought leadership and unrivalled relationships with insurers. Howden's PV team exists to provide just that. We look forward to supporting clients through this period of transition and working on their behalf to forge a path towards a more sustainable market designed to navigate today's fast-moving threat environment.

01

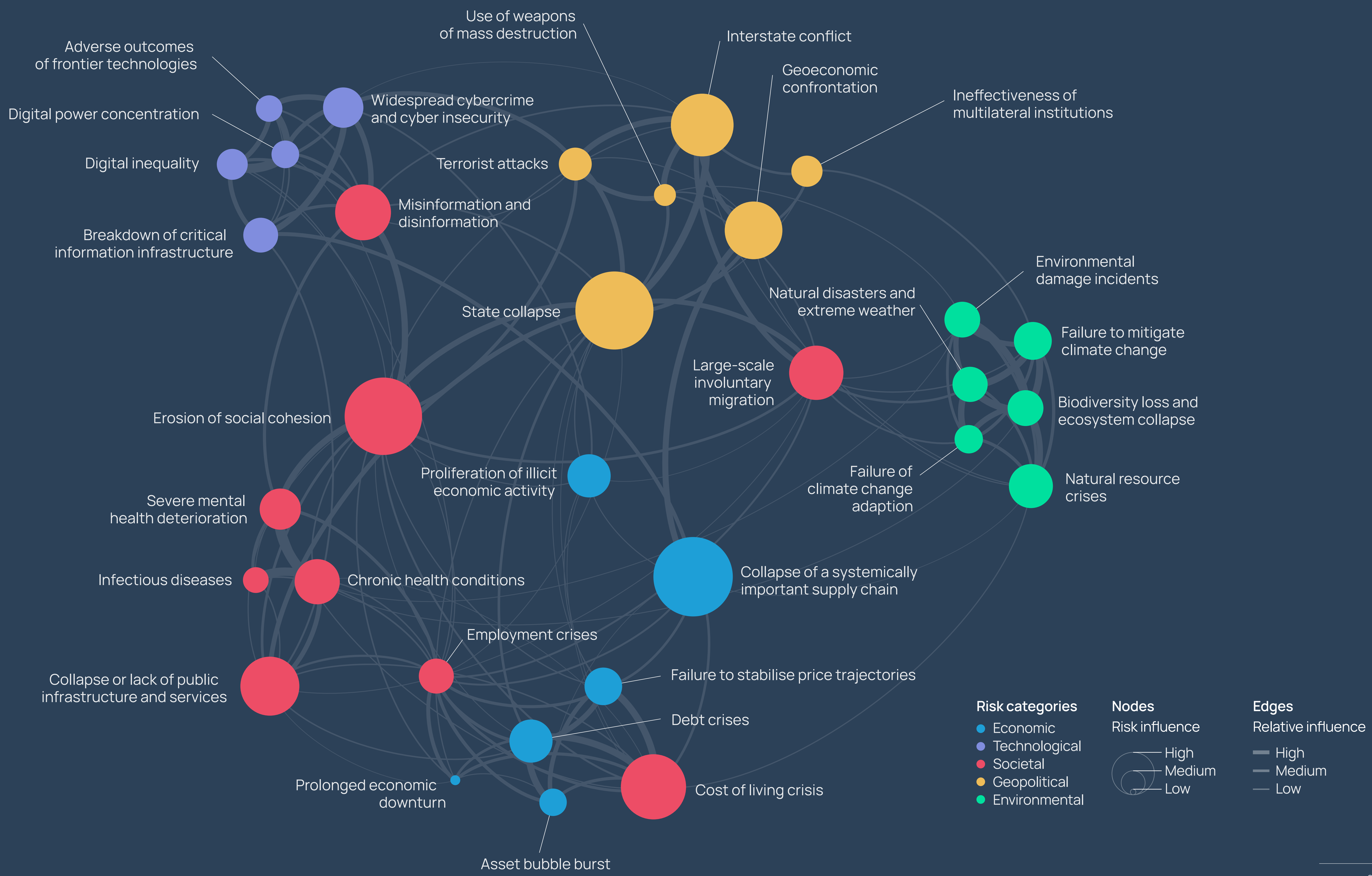
A world of trouble

Risks are escalating as the world navigates a succession of crises. Economic and geopolitical shocks have dominated agendas over the last 12 months as the effects of COVID-19 have collided with the devastating fallout from Russia's invasion of Ukraine.

The cascading impacts from these two events have created a new world (dis)order, characterised by a cross-border war in Europe, heightened security threats more generally, supply chain disruption, structurally higher inflation and rising interest rates. With other, pre-existing issues like economic malaise / inequality, protectionism, climate change, misinformation and technological risks exacerbating pressures, the corollary is a highly volatile and interconnected global risk landscape (see Figure 1).

A CROSS-BORDER WAR IN EUROPE, HEIGHTENED SECURITY THREATS MORE GENERALLY, SUPPLY CHAIN DISRUPTION, STRUCTURALLY HIGHER INFLATION AND RISING INTEREST RATES HAVE CREATED A NEW WORLD (DIS)ORDER.

Figure 1: Today's complex and interconnected global risk landscape (Source: World Economic Forum)



Heightened threat environment

The last few years have demonstrated how perils once viewed as distinct or independent – risks such as pandemics, conflicts, social unrest, extreme weather events, commodity price shocks and supply chain failures – can in fact be linked and strike simultaneously. The scale of events has moved loss scenarios from the theoretical to the real world and, in doing so, caused a marked shift in risk perceptions.

These developments have fundamentally changed several areas of the (re)insurance market, none more so than PV. Indeed, the inherently volatile PV threat landscape has become even more unpredictable in recent years as SRCC events have escalated.

Widespread economic and political instability – fed by social disparities, legacy-COVID-19 impacts, reset macro-fundamentals, intensified rivalries between major powers and the tactical use of new technologies – was already generating more frequent acts of violence, only to be compounded further by Russia's invasion of Ukraine, an event that looks set to become one of the biggest PV losses ever.

With little prospect of these issues relenting, businesses need to prepare for, and protect themselves against, a sustained rise in PV-related incidents. Such a hostile risk environment not only brings direct financial risks from property damage and attendant business interruption, but can also threaten operations, personnel, supply chains and reputations.

Figure 2: Megatrends driving unpredictability of PV risk landscape (Source: Howden)

Geopolitics

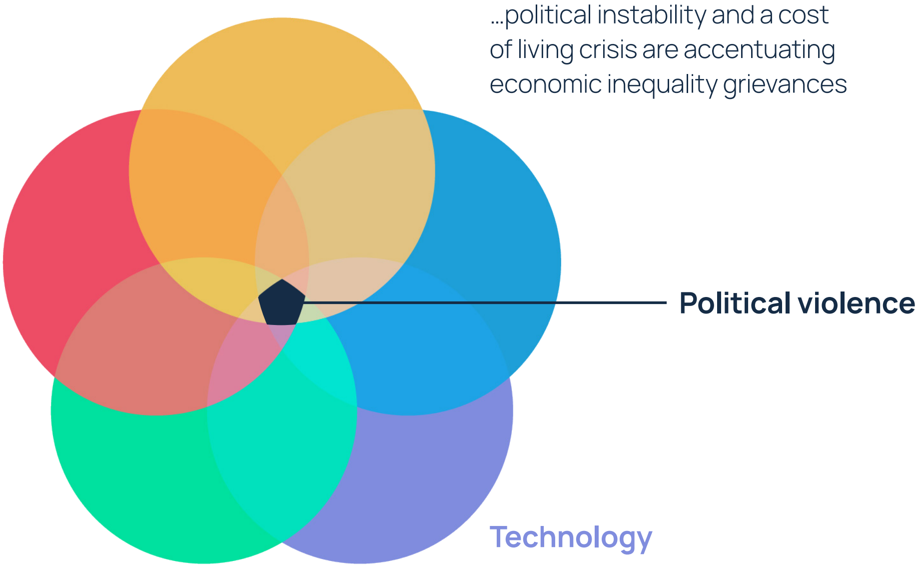
Growing rivalries between major powers = risk of conflict, proxy wars, protectionism...

...the Ukraine war is a major PV market loss and geopolitical tensions are rising elsewhere

Macroeconomics

Macro fallout from Ukraine...

...political instability and a cost of living crisis are accentuating economic inequality grievances



COVID-19

Short and long-term COVID impacts...

...tail-end of protests against lockdowns and dissatisfaction over public debt and services

Technology

Exploited to facilitate unrest...

...social media, cyber attacks, drones, 3D printing

Climate change

Extreme weather events...

...are adding to commodity price volatility and aggravating societal vulnerabilities

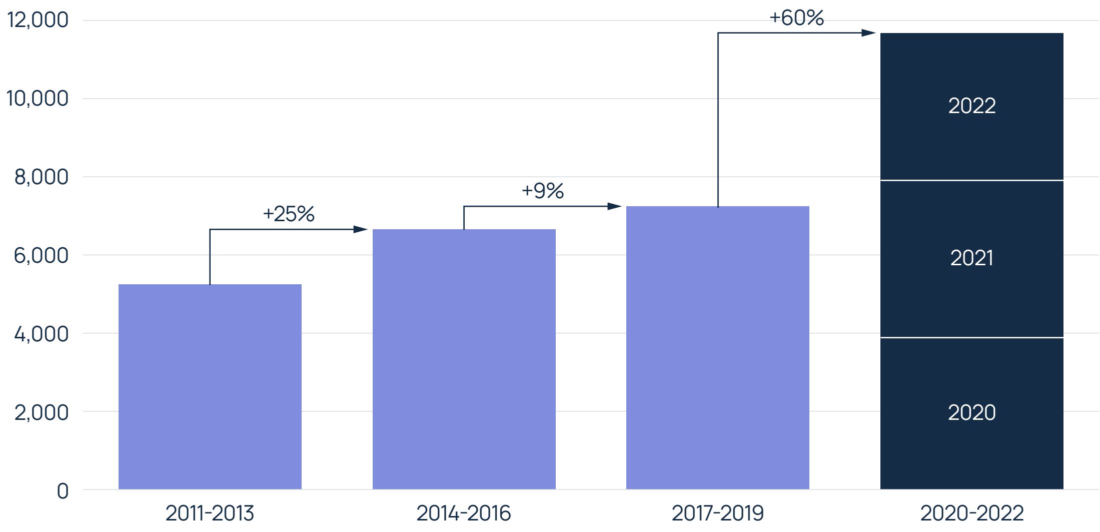
SRCC frequency and severity

Intensifying SRCC risks are a reflection of these megatrends, as well as long-standing (and intensifying) grievances such as the rising cost of living, food and energy insecurity, falling real incomes, political populism / polarisation, perceived poor governance and corruption.

The use of social media has also added an element of unpredictability, as the reach and near real-time information provided by these platforms has seen incidents spiral quickly to affect several locations rather than remain localised risks that typically capped losses in prior years. The role social media can play in fermenting unrest to simultaneously impact cities / states or even countries (as was the case for the Black Lives Matter movement) has exposed the potential for systemic losses to the PV market. All this is occurring as demand for standalone cover is rising rapidly as several all-risks carriers withdraw from the SRCC space.

Using data from the Armed Conflict Location and Event Data Project (ACLED), Figure 3 shows the number of riots recorded in Africa over the last decade or so. Increased episodes of unrest shown in recent years especially are indicative of trends observed in most other regions. Riots in Africa were up 60% between 2020 and 2022 when compared to the preceding three-year period, which was already at a high historical base.

Figure 3: Number of recorded riots in Africa by 3-year period – 2011 to 2022[1]
(Source: Howden analysis using ACLED data)



The accompanying step-change in severity, as demonstrated by a number of flashpoints in recent years, has been equally consequential. A shift in SRCC loss escalation that first manifested in Chile in 2019, where the scale and intensity of unrest transcended anything seen previously, was repeated in other territories during COVID-19, including the United States (2020) and South Africa (2021), despite government-mandated lockdowns.

Financial impacts from these events were differentiated by the degree of property destruction and looting, as well as the targeting of global brands in multiple locations. As the following case studies show, SRCC events have not only become more frequent across all regions, but their costs have spiralled to the point where they can impede economic growth or even trigger recessions. Incidents are also increasingly breaking out in more 'stable' territories.

Greater exposure at risk has culminated in damaging losses to businesses and unprecedented payouts for the (re)insurance market.

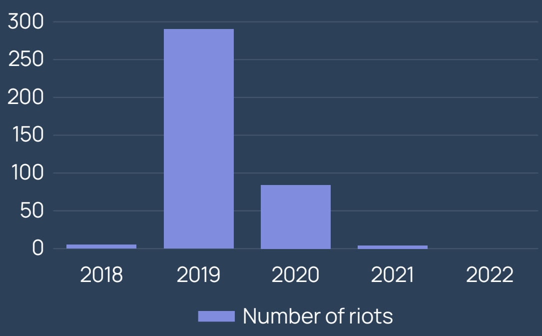
[1] A small number of countries (Cape Verde, Comoros, Mauritius, Mayotte, Réunion, Saint Helena, São Tomé and Príncipe and Seychelles) have been excluded from this analysis due to lack of comparable historical data.

Hong Kong (2019)

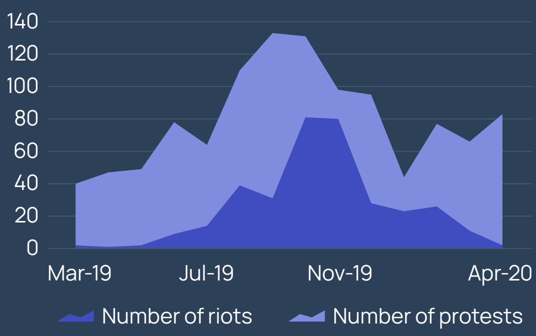
The catalyst for the protests in Hong Kong was the attempted introduction of the Fugitive Offenders Amendment bill in early 2019, a law designed to permit the extradition of suspected criminals to mainland China. The unrest damaged Hong Kong's reputation for social stability and the rule of law after protests escalated quickly to become one of the largest and most violent in recent history. Multiple businesses were targeted for their perceived support of mainland China during the demonstrations. Organisers claimed more than two million people attended rallies at the height of the movement.

Protestors' objectives broadened beyond the bill to include wider political reforms, leading to anti-government activists storming the Hong Kong Legislative Complex in June. Large-scale demonstrations continued after the bill was withdrawn in September, despite fulfilling one of the five demands of the protestors. Unrest persisted into the early months of 2020, before easing due to COVID.

Hong Kong riots by year



Hong Kong protests and riots by month

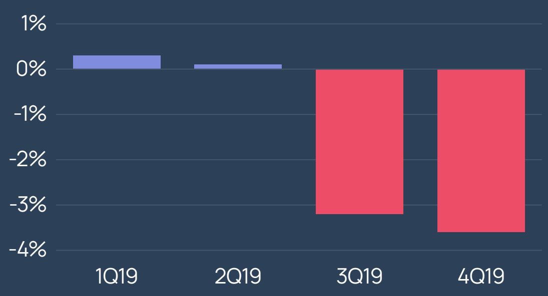


Data from ACLED

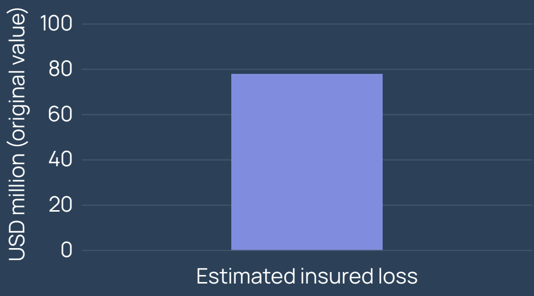
Economic and insured impacts

- Damage and disruption contributed to two quarters of negative GDP growth in 2019
- The retail and tourism sectors were badly hit whilst financial institutions and transportation infrastructure were also targeted
- Insured losses were estimated at the time of the protests to be less than USD 100 million
- Several businesses retained sizeable losses due in part to low standalone PV uptake, amongst small and mid-sized firms especially

Hong Kong GDP growth by quarter in 2019



Insured losses from Hong Kong unrest



Source: Howden, Hong Kong Federation of Insurers, Hong Kong Census and Statistics Department

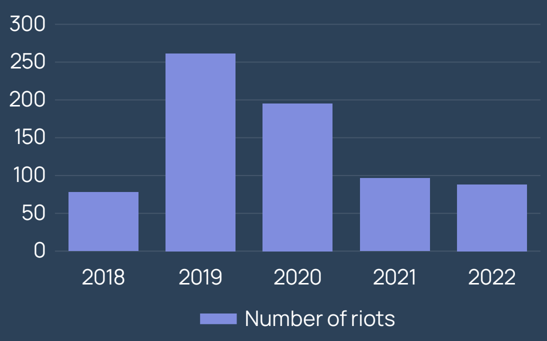
Chile (2019)

Chile has long been regarded as one of Latin America's most wealthy and stable countries, a view confirmed by the Institute for Economics and Peace's 2019 Global Peace Index, which at that time ranked the country with the likes of Germany and ahead of Italy and Spain.

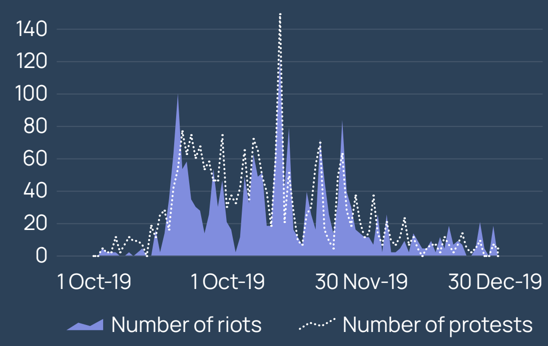
The degree of violence used during the demonstrations in late 2019 compounded the element of surprise. What started as student protests over rising metro fares in the capital of Santiago escalated into nationwide demonstrations against economic inequality and the rising cost of living that ran for several months.

Events in Chile marked a watershed SRCC loss for the (re)insurance market. Not only was the country regarded as 'safe', but violence and looting spread quickly, with assets of significant insured value (including supermarkets, pharmacies and transport infrastructure) targeted. International brands suffered disproportionate losses and highlighted unexpected exposures to single SRCC events.

Chile riots by year



Daily protests and riots in Chile in 4Q19

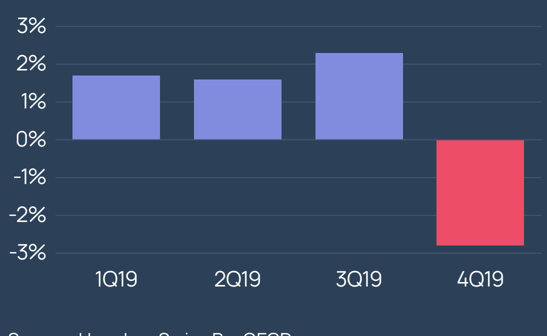


Data from ACLED

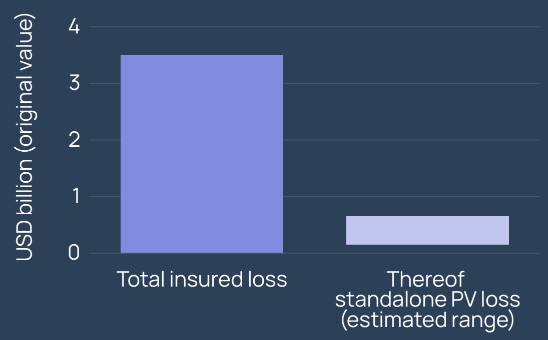
Economic and insured impacts

- Large, multinational companies (retailers especially) were targeted by protestors, causing significant property damage and business interruption losses
- A high percentage of the economic loss was insured due to property policies including SRCC coverage as standard
- Total insured losses are thought to have ranged between the USD 3-4 billion mark, with the standalone PV market estimated to have covered less than 15% of this amount
- A repeat of this type of event in Chile today would see the PV market assume the bulk of losses after SRCC coverage was removed from property policies or sub-limited following the riots

Chile GDP growth by quarter in 2019



Insured losses from Chile unrest



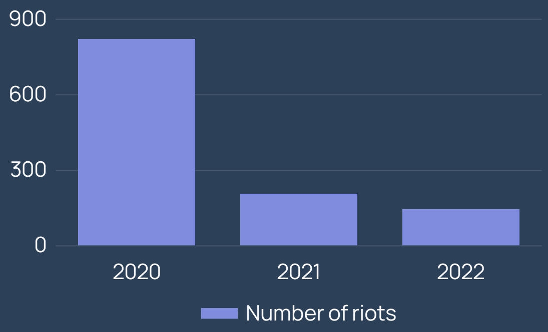
Source: Howden, Swiss Re, OECD

United States (2020)

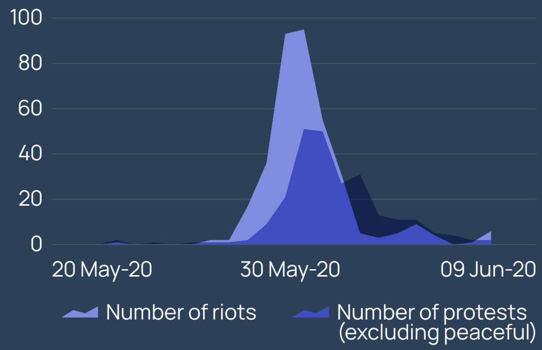
The murder of George Floyd by a police officer in Minneapolis in 2020 sparked widespread protests led by the Black Lives Matter (BLM) movement against police brutality and racial discrimination. Footage of the incident was shared immediately and widely on social media, which led to nationwide demonstrations in May and June (reportedly the largest in U.S. history) involving millions of people.

Whilst the majority of protests were peaceful, escalation in several cities led to vandalism, looting and clashes with police. A number of cities enforced curfews and National Guard troops were deployed in several states. Claims from the unrest stood out for their size and scale. Losses from the BLM protests were recorded in more than 20 states, culminating in a real-terms industry loss close to double that of the previous largest SRCC event in the U.S. (Los Angeles riots in 1992).

U.S. riots by year



Daily BLM protests and riots in 2Q20

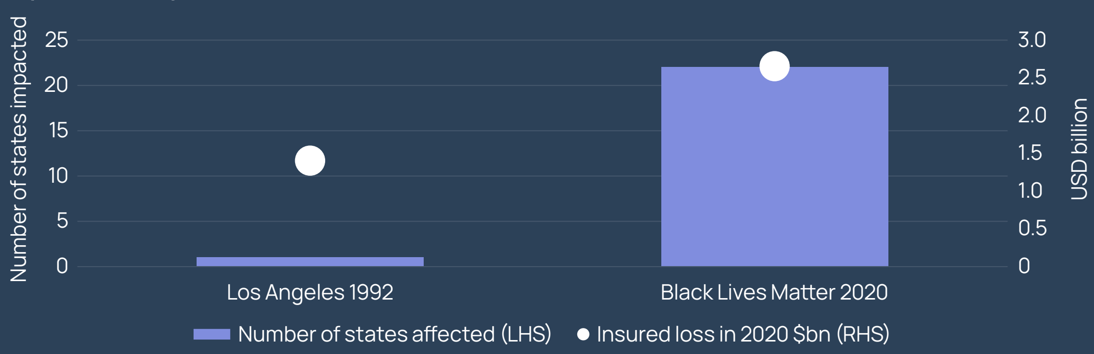


Data from ACLED

Economic and insured impacts

- Insured losses were weighted heavily towards commercial assets, with a high proportion of losses emanating from a small number of businesses
- Insured losses for the protests are estimated to have exceeded USD 2.5 billion
- The vast majority of losses were covered by all-risk carriers, with a relatively small amount being picked up by the standalone PV market
- Despite the sizeable losses, U.S. property policies typically continue to offer an element of protection for SRCC risks

Impact of BLM protests vs LA riots



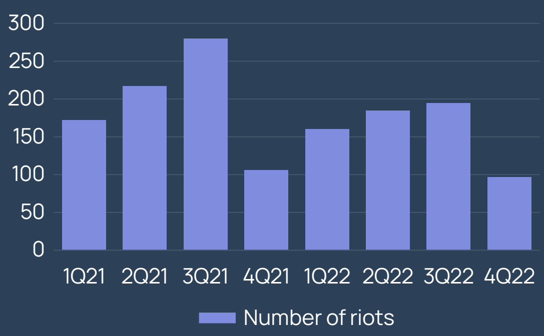
Source: Howden, World Economic Forum, PCS

South Africa (2021)

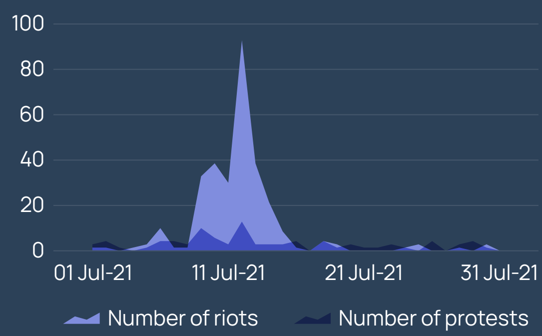
Protests triggered by the imprisonment of former President Jacob Zuma in 2021, aggravated further by underlying tensions around economic inequality, corruption, high unemployment (>30%) and COVID-19 impacts, led to a wave of riots in South Africa that spread quickly. Looting and arson occurred across the provinces of Gauteng and KwaZulu-Natal in mid-July, with the major cities of Durban, Johannesburg and Pretoria suffering significant damage.

Days of violence resulted in the looting of thousands of shops and malls. Supermarkets (including South Africa's biggest grocer), retail warehouses, food packaging outlets and manufacturers were targeted. Extensive damage was reported. Around 25,000 troops were deployed to quell the violence. Some of the underlying causes for the outbreak of violence in South Africa, including frustration at government corruption and national blackouts, remain unresolved.

South Africa riots by quarter



Daily unrest in South Africa in July 2021

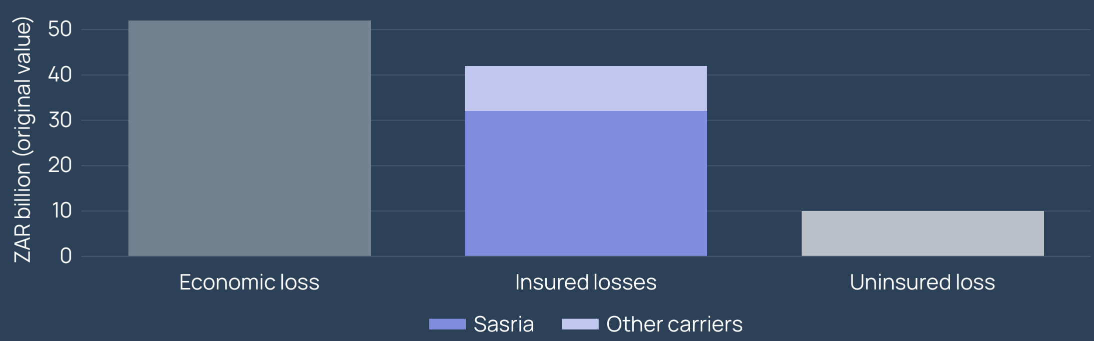


Data from ACLED

Economic and insured impacts

- Economic losses from the riots are estimated to have exceeded ZAR 50 billion (USD 3 billion)
- State-owned PV carrier, the South African Special Risks Insurance Association (Sasria), said it received claims of up to ZAR 32 billion (USD 1.9 billion), with retailers, malls and warehouses the biggest claimants
- Sasria's estimate of an additional ZAR 10 billion (USD 600 million) of claims being covered by private carriers are elevated beyond the USD 1 billion mark once reinsurance payments for the pool are factored in, with the London market covering the vast majority of these losses

Breakdown of losses from South African riots



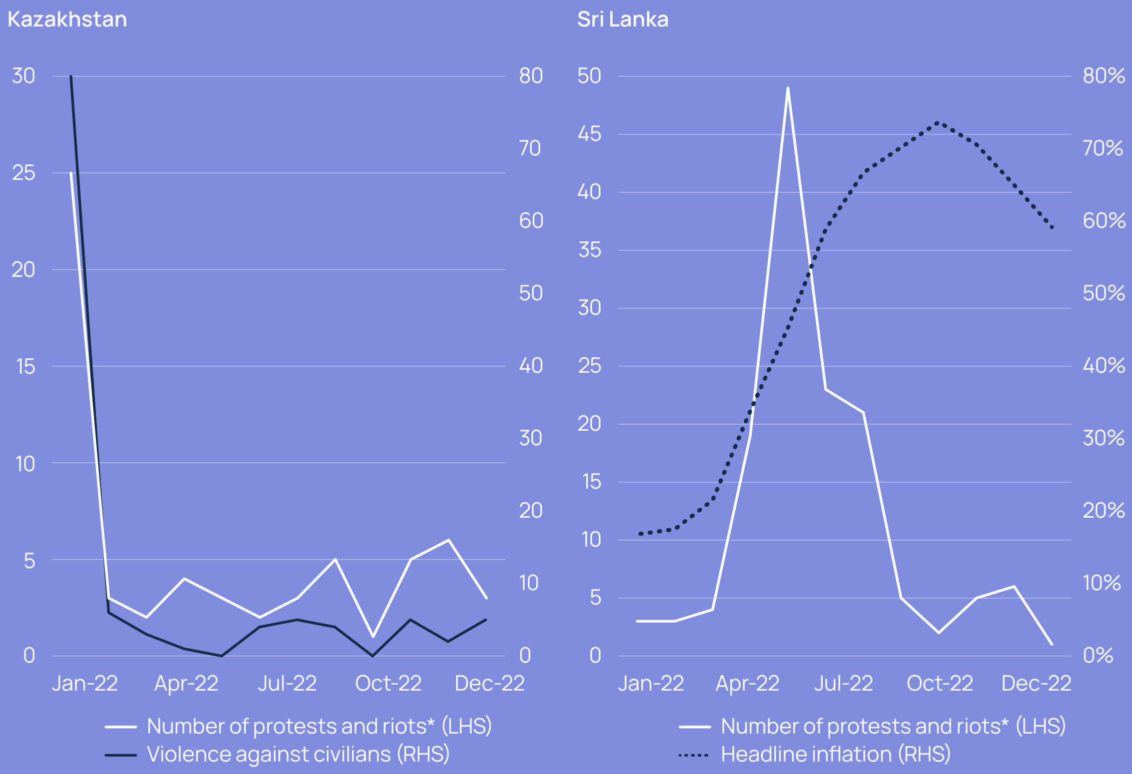
Source: Sasria, IOL.com

States of disarray

Mass protests continued into 2022, with notable events – including unrest in Iran over women's rights, rising fuel prices in Kazakhstan, collapsing living standards in Sri Lanka, an economic crisis in Argentina and COVID restrictions in China – indicative of rising discontent amidst multi-decadal high inflation and certain governments' attempts to suppress movements by force (e.g. Kazakhstan – see Figure 4). The end of the year also saw anti-government protests break out in Peru (more on this shortly).

Events in Sri Lanka laid bare the potential magnitude of spontaneous mass protests after President Gotabaya Rajapaksa was forced to resign in July. Such escalation reinforces the types of incidents businesses and carriers should be preparing for in other countries.

Figure 4: Anti-government protests in Kazakhstan and Sri Lanka in 2022[2]
(Source: Howden analysis using ACLED data, Central Bank of Sri Lanka)



* Excludes peaceful protests

EVENTS IN SRI LANKA LAID BARE THE POTENTIAL MAGNITUDE OF **SPONTANEOUS MASS PROTESTS.**

[2] Data comes from ACLED. The white lines in both charts exclude recorded peaceful protests and the black line for Kazakhstan shows reported instances of violence against citizens by organised armed groups.

Ukraine war

The spillover effects of the Ukraine war were instrumental in feeding protests last year. Whilst the causes of civil unrest are disparate and complex, and often tied to discrete national circumstances, sudden political and economic shocks, especially those that influence the cost of essential goods and services, can inflame grievances and lead to spontaneous protests.

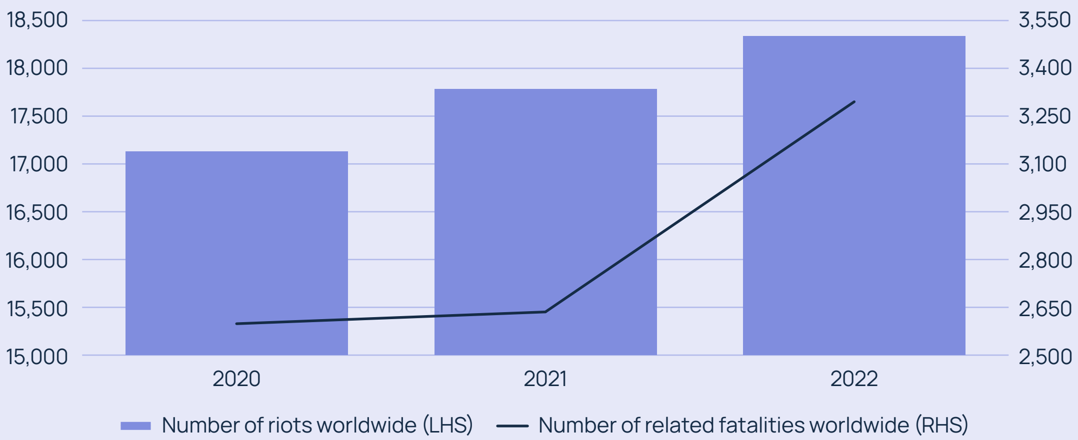
Figure 5 uses ACLED data to plot the daily number of protests and riots worldwide linked to rising fuel prices last year and how they correlated to oil price fluctuations following Russia's invasion of Ukraine.

Figure 5: Daily reported protests and riots over fuel prices vs cost of oil in 2022
(Source: Howden analysis using ACLED data, St. Louis Fed)

* Includes peaceful protests

In addition to being another billion dollar plus loss for the PV market, which carries considerable upside potential given the complexities and duration of the conflict, the Ukraine war has aggravated an already hostile backdrop. With violent demonstrations already at a historically elevated base, ACLED data in Figure 6 shows 2022 marked an all-time high for global riots and related fatalities.

Figure 6: Number of riots and associated fatalities worldwide – 2020 to 2022[3]
(Source: Howden analysis using ACLED data)



[3] A small number of territories (including Oceania, Bermuda and Canada) have been excluded from this analysis due to lack of comparable historical data.

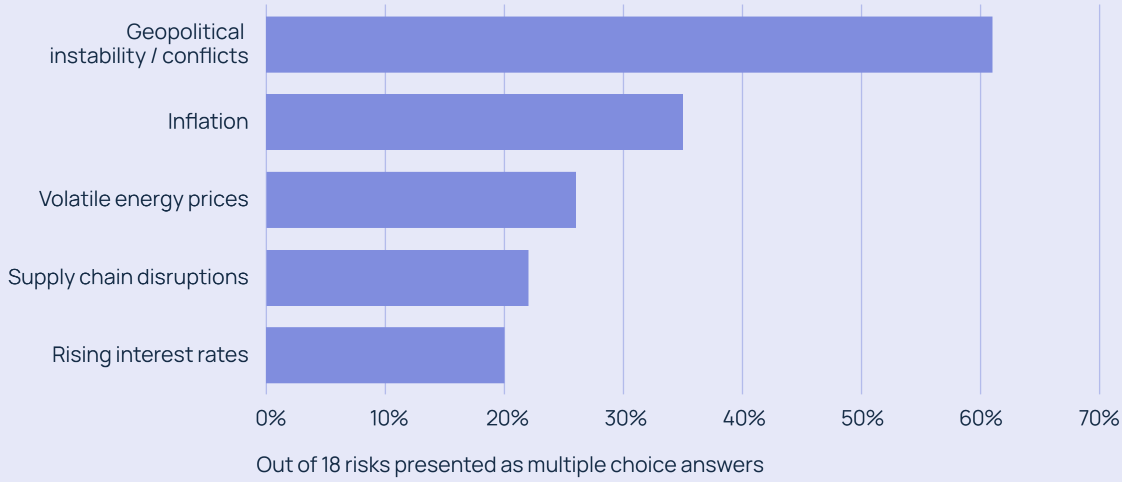
Looking ahead

Global civil unrest is unlikely to abate any time soon. Indeed, 2023 has got off to an ominous start, with nationwide protests in Brazil, Peru and France causing further losses and even challenging the legitimacy of incumbent governments. The case study opposite provides more detail on the outbreak of unrest in Peru.

The frequency and severity of recent SRCC events are unlikely to be a series of random acts, but indicative of an elevated and interconnected risk landscape that has delivered a new reality in terms of loss frequency and loss expectations. Interacting macro drivers are exposing businesses and (re) insurers to a greater degree of PV risk across all regions. As the rising cost of living continues to cause widespread grievances, conditions remain in place for unrest to continue.

Heightened geopolitical tensions remain a wild card for the PV threat landscape. Wholesale energy prices, which have fallen significantly in recent months, are tied closely to the Ukraine crisis. Risks also extend beyond Russia and Ukraine, with tensions mounting between the United States and China as well as within the Middle East, thereby accentuating the range of critical risks confronting businesses at this time.

Figure 7: Potential risks to economic growth in 2023 (Source: McKinsey)



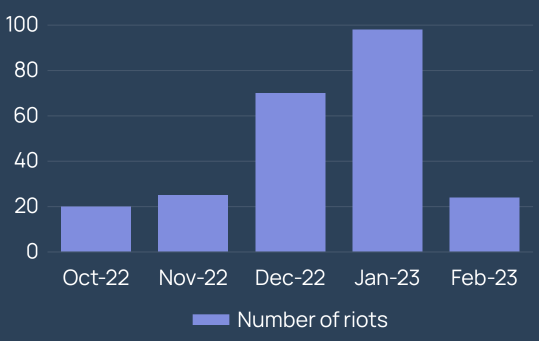
All of which creates a febrile PV environment for (re)insurance buyers and underwriters. Shifting supply and demand dynamics, compounded by increasingly prevalent SRCC exclusions in property contracts, have led to the most significant recalibration since the PV market's inception 20 plus years ago. Specialty (re)insurers have long made a living by turning challenges into opportunities, and by providing clients with the capacity needed to protect assets against SRCC and broader PV risks they can once again showcase differentiation and relevance whilst also growing into firming market conditions.

Peru (2022/23)

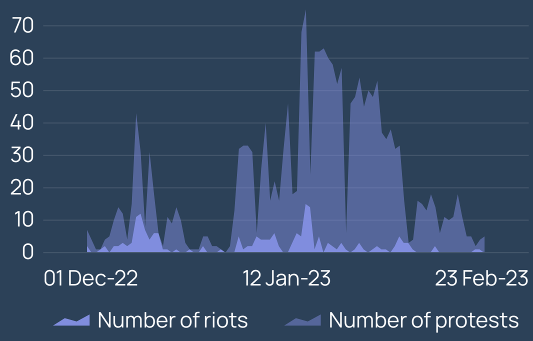
Protests broke out in Peru in December 2022 following the impeachment of then President Pedro Castillo. Castillo's failed attempt to pre-empt corruption charges by dissolving Peru's congress culminated in his arrest and Vice President Dina Boularte assuming power.

The unrest, led by supporters of Castillo, who are demanding his reinstatement, has been concentrated in Peru's copper-rich southern provinces, causing significant disruption to the country's mining sector, as well as to tourism and transportation. Several mines have been forced to reduce or pause operations, prompting a state of emergency in several southern areas.

Peru riots by month



Daily unrest in Peru from Dec-22 to Feb-23

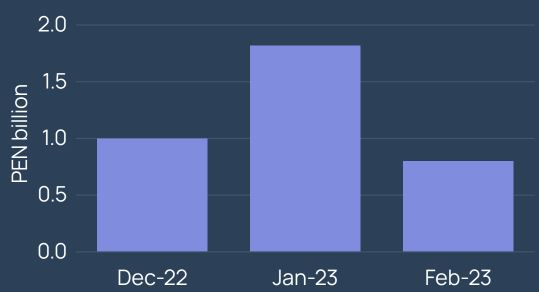


Data from ACLED

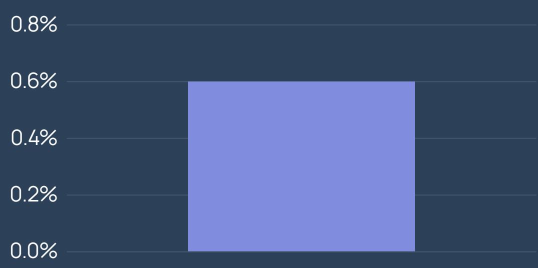
Economic and insured impacts

- Peru's economy minister estimates the economic impact from the protests to be in excess of PEN 3.6 billion (USD 950 million)
- Insured losses remain unclear, but the standalone PV market is likely to absorb the majority of claims, with potentially sizeable business interruption exposure from the copper mines
- A greater share of the loss is likely to be retained by PV insurers in the wake of 1 January 2023 reinsurance renewals, where capacity and terms tightened considerably

Economic impact of protests



Economic cost as % of 2022 GDP



Source: bnamericas

02

A watershed moment

The highly dynamic threat landscape has brought transformational change to the PV (re)insurance market. Following a period of high profitability for the best part of two decades, a series of historic losses since 2019, coinciding with a hard property market, attendant SRCC exclusions from all-risk policies and multi-decadal high inflation, have reset supply and demand dynamics.

The fallout represents something akin to a perfect storm: demand up, capacity down, triple-digit loss ratios, reinsurance retrenchment and a market-changing pricing correction. Finding an equilibrium that continues to meet clients' expectations around capacity commitments, coverage and affordability, whilst ensuring that rates are commensurate to the degree of risk assumed, will be crucial to market sustainability and long-term relevance.

The backstory

The standalone PV market has a strong track record of responding quickly to the demands and needs of insurance buyers. It came to prominence after the 9.11 terrorist attacks, emerging from a small cohort of carriers that had underwritten SRCC coverage from the late 1980s for certain high-risk countries such as Colombia, South Africa and Sri Lanka.

Several government-backed terrorism pools were created in the wake of the 9.11 attacks to ensure capacity was available when businesses needed it the most. The security provided by these backstops was crucial to the continued provision of terrorism insurance during this period and helped to support the growth and innovation of the private PV market.

Coverage designed to respond specifically to physical damage and business interruption losses arising out of acts of terrorism have evolved over time, with specialty carriers now offering a broad array of solutions that include sabotage and terrorism (S&T), as well as SRCC and full PV (see Figure 8).

Figure 8: Core PV perils and coverages (Source: Howden)

	Full political violence	Strikes, riots and civil commotion	Sabotage and Terrorism
Terrorism	🟢	🟢	🟢
Sabotage	🟢	🟢	🟢
Civil unrest	🟢	🟢	🔴
Malicious damage	🟢	🟢	🔴
Insurrection, rebellion, revolution	🟢	🔴	🔴
Mutiny, coup d'etat	🟢	🔴	🔴
Civil war, war	🟢	🔴	🔴
Counter-insurgency	🟢	🔴	🔴

Standard cover: property damage and business interruption

Standard exclusions: CBRN, 'Five Powers' (U.S., U.K., France, Russia, China), cyber, active war*

* Active war exclusions apply unless purchasing full PV cover

The scope of coverage has changed significantly as the market has matured, demonstrating its ability to respond to fast moving risk developments. Broader coverages to emerge over the years, including denial of access, loss of attraction, active shooter and cyber, are indicative of the PV market's ability to adapt to buyers' shifting coverage priorities. Long-held definitions have also come under review as recent events have blurred the boundaries between perils.

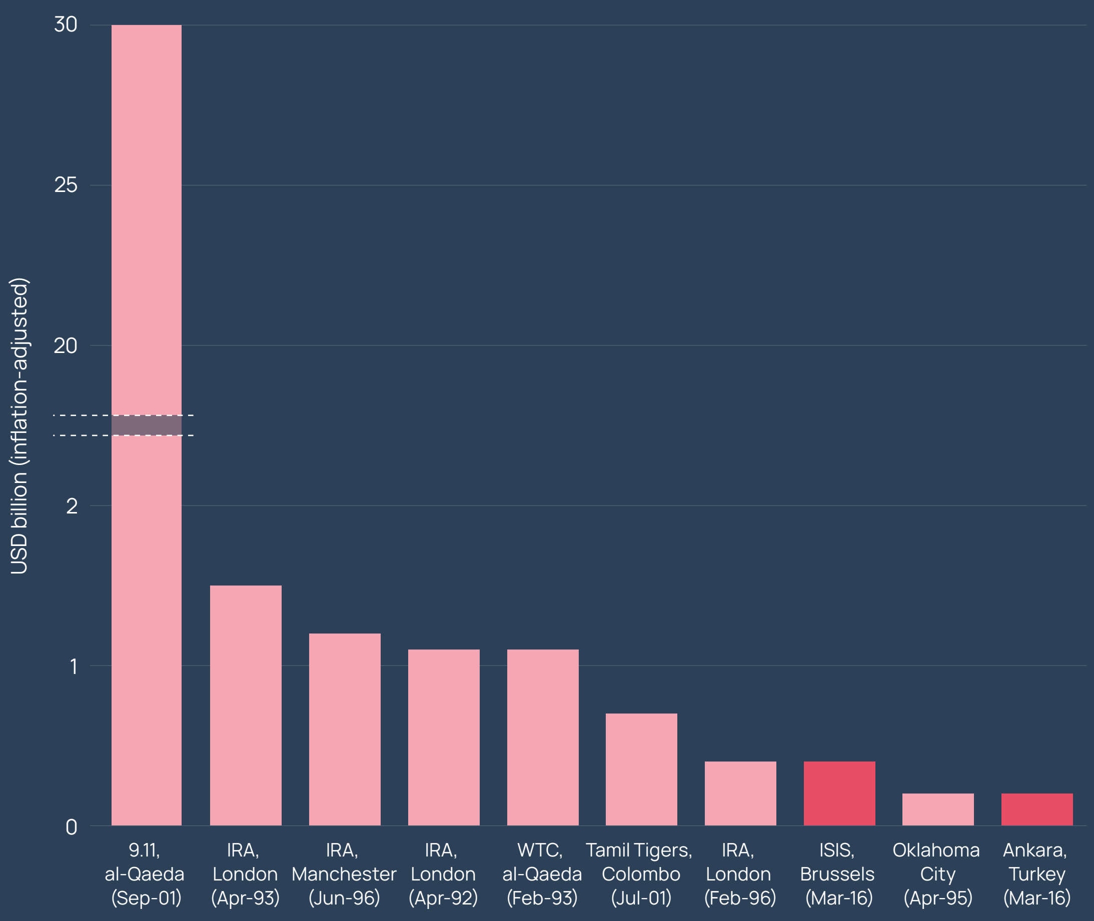
Terrorism losses

Market conditions were driven originally by the global terrorist threat, and the potential for substantial property damage and business interruption losses from catastrophic events (akin to the IRA attacks in the 1990s, 9.11 and other large-scale al-Qaeda attacks).

A marked shift in the 2010s, when Islamic extremist attacks concentrated primarily on crowded spaces in order to cause mass casualties, presented a new type of risk where property damage was no longer the primary loss driver. Despite a high frequency of these types of attacks in the mid-2010s, insured losses were restricted by perpetrators' unsophisticated capabilities (ranging from isolated lone wolf incidents to co-ordinated shootings and low-level bombings in urban centres) and limited uptake for the new forms of (non-damage) cover on offer.

Figure 9 shows the ten most costly terrorist attacks since 1990 by (real-terms) insured losses. 9.11 is a major outlier at USD 30 billion plus, with all other events to breach the billion mark caused by large-scale bomb attacks. The Brussels airport attack and Ankara bombings of 2016 are the most recent events to feature in the list, falling at the lower end of the loss scale but indicative of the ongoing threat.

Figure 9: Top 10 terrorist attacks in terms of insured property loss – 1990 to 2022
(Source: Howden, Insurance Information Institute, Swiss Re, BLS)

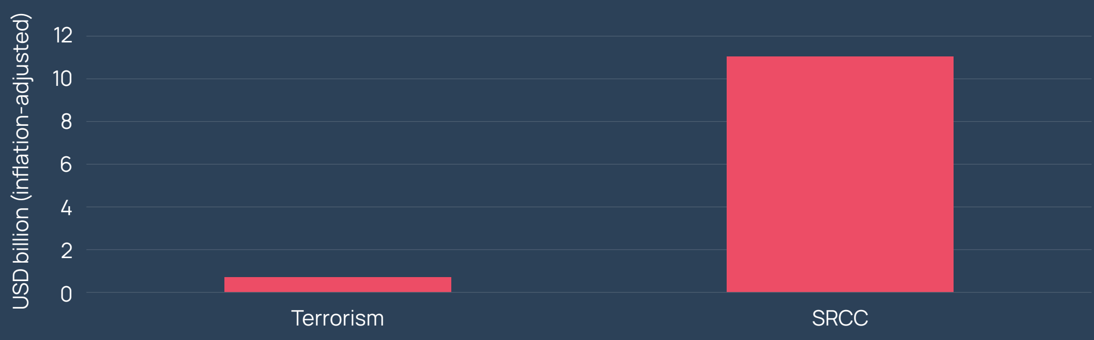


Shifting threat spectrum

Modest terrorism losses in recent years have nevertheless coincided with increased frequency and severity of SRCC events. The shift in loss profile is stark when analysing the effects in monetary terms.

Figure 10 uses data from Howden's NOVA platform to show how overall insured losses for major terrorist and SRCC events have aggregated since 2015. Whereas terrorism losses accounted for the bulk of claims early in the period, multi-billion dollar SRCC events in Chile, the United States and South Africa, combined with other losses in Mexico, Bolivia, France and Colombia, led to considerable payouts for insurers and reinsurers.

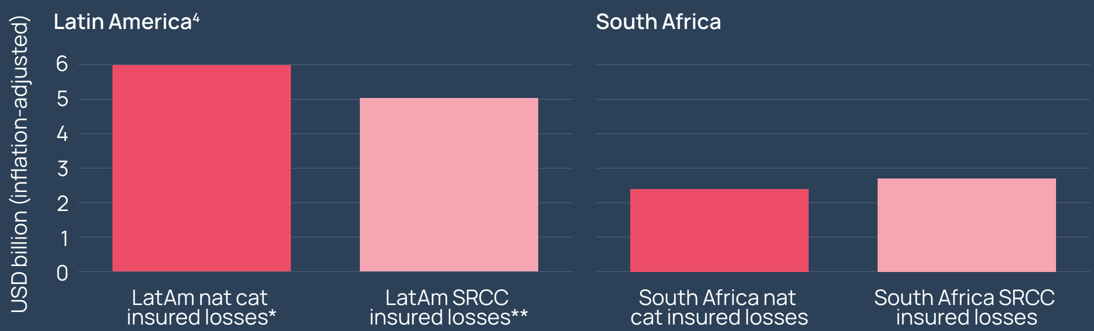
Figure 10: Insured losses for terrorist and SRCC events – 2015 to 2022 (Source: NOVA)



Indeed, SRCC claims in certain regions have been comparable in quantum to major natural catastrophe losses (see Figure 11 for data in Latin America and South Africa since 2015). This is not down to some lull in catastrophe activity – both territories experienced a number of sizeable natural disaster losses during this time (including record-breaking floods in South Africa) – but a reflection of the unprecedented scale of civil unrest.

High insurance payouts relative to reported economic losses – afforded in these cases by the penetration provided by the state-backed pool in South Africa and the prevalence of all-risk and standalone SRCC coverage in Latin America – sent claims spiralling beyond levels seen previously, triggering reinsurance treaties and leaving a small cohort of PV reinsurers with losses that were unanticipated and unpriced.

Figure 11: Natural catastrophe insured losses vs SRCC insured losses – 2015 to 2022 (Source: NOVA)



* Excludes drought
** Excludes losses from Peru in Dec-22

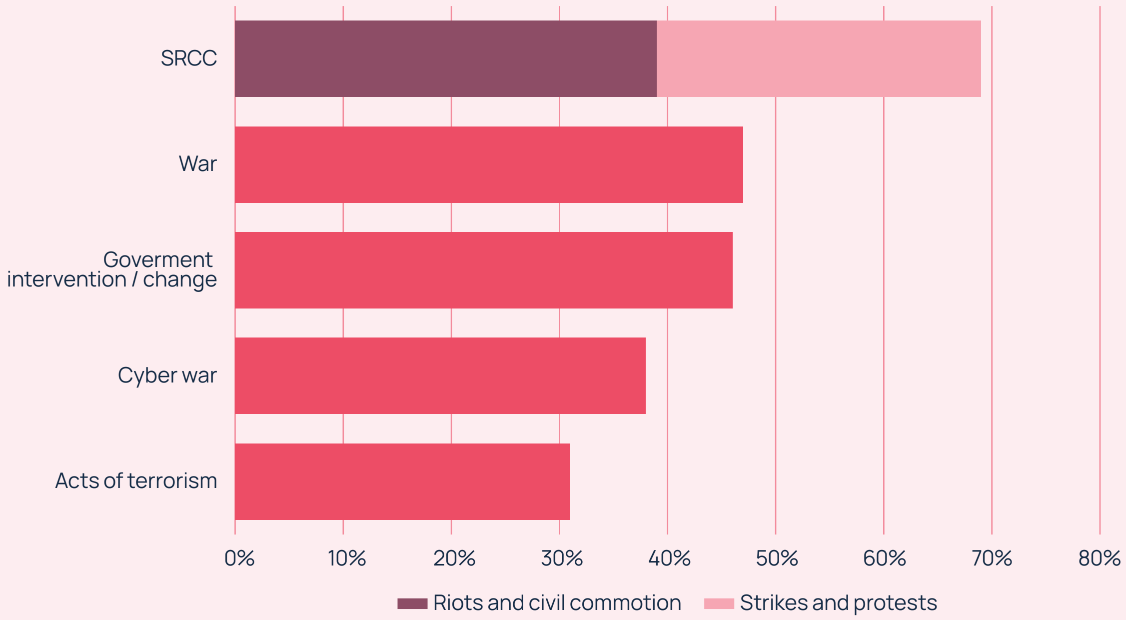
[4] Latin America = Central and Southern America (excludes the Caribbean)

Rising to the SRCC challenge

Surging costs from global civil unrest has seen SRCC become a major concern for risk managers and c-suites. Recent geopolitical and macroeconomic developments have aggravated grievances tied to the cost of living and energy security, exacerbating instability more generally and elevating SRCC in the minds of executives to become the pre-eminent PV-related threat (see Figure 12 for results from this year's Allianz Risk Barometer).

Businesses looking to protect assets against future flashpoints are increasingly prioritising specialist PV insurance and the high level of protection and expertise it offers. Risk transfer should also be supported by risk management best practice that includes monitoring civil unrest activity, identifying potential asset and supply chain vulnerabilities and creating business continuity provisions.

Figure 12: PV risks of most concern to businesses (Source: Allianz)[5]



357 respondents; more than one risk could be selected

Demand for specialist PV advice and cover has never been higher. With no end in sight for adverse loss trends, it is incumbent on brokers and carriers alike to deliver the solutions clients are looking for, as well as ensuring that costs are appropriate for the exposures involved. Capacity is key, and the prospect of higher returns in one of the hardest PV markets ever offers (re)insurers an opportunity to put capital to work.

Conditions have unquestionably become more difficult, but few areas of (re)insurance have such an innate ability to respond to a rapidly changing threat landscape. Howden is leading the charge by leveraging expertise within our group and engaging with an array of market participants to secure the best coverage available for clients and entice more capacity into the market.

[5] *Allianz Risk Barometer 2023*, https://www.agcs.allianz.com/news-and-insights/reports/allianz-risk-barometer.html.

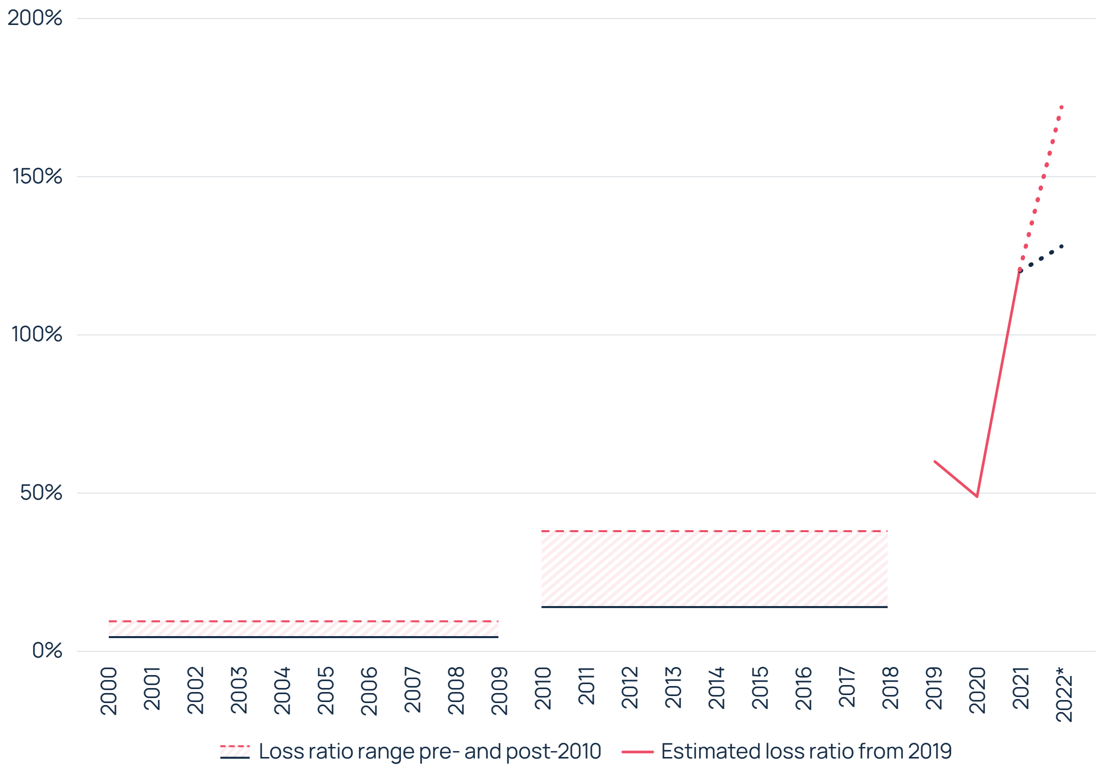
Market correction

Buyers can expect to continue to encounter difficult market conditions in 2023. The series of major SRCC losses sustained in the past four years, combined with the Ukraine war, have reset carriers' views of risk and brought structural changes to the market. Further sizeable losses in 2023 would likely test market resolve.

Figure 13 illustrates the abrupt change in conditions experienced by the London PV market. Single-digit loss ratios in the 2000s and market-beating returns through much of the 2010s underscore the extended run of profitability experienced by the market, even with the uptick in loss activity that emanated from the Arab Spring and relatively small-scale terrorist attacks during the latter period.

2019 proved to be a watershed moment. Long-standing soft conditions, characterised by marked declines in pricing and strong competition (some property insurers offered SRCC protection for little or no extra cost during this time), were arrested by major losses that culminated in the market's loss ratio exiting its (favourable) pre-existing range and entering the uncharted territory of underwriting losses. Put simply, PV insurance was an under-priced product prior to the recent correction.

Figure 13: London PV market performance – 2000 to 2022 (Source: Howden)



*Dark blue and red hashed lines for 2022 are informed by current low-end and mid-range market estimates of the ultimate PV Ukraine loss

In fact, annual premium is likely to have been wiped out in 2021, as a sizeable share of losses from South Africa filtered into the London market, only to be compounded further by Russia's invasion of Ukraine in 2022. The ultimate loss for Ukraine remains highly uncertain (with ongoing hostilities making access for loss adjustors difficult), but will likely be record-breaking given the levels of exposure that are insured or reinsured into the London market.

Even at the lower end of current ultimate PV market estimates, losses from Ukraine look set to be equivalent to more than a year's worth of premium. The market is not currently of sufficient scale to absorb such losses and a bigger premium-base is needed to put it on a more sustainable footing.

A hard reality

Such a pronounced shock has transformed the pricing environment. After a prolonged period of sizeable rate reductions through much of the 2010s, pricing stabilised towards the end of the decade before the correction started to materialise in late 2020, accelerating rapidly into hard pricing territory in 2022.

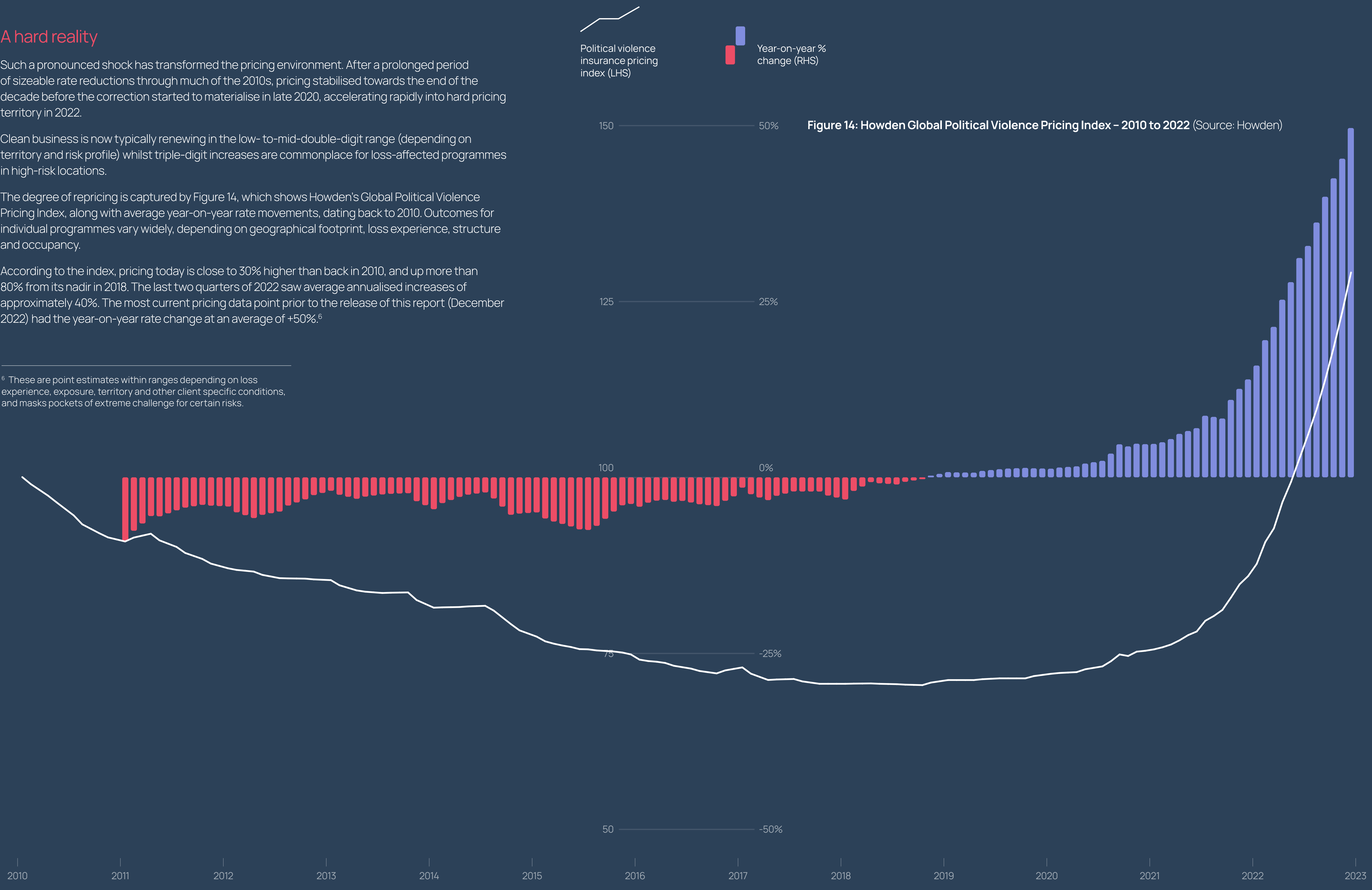
Clean business is now typically renewing in the low- to-mid-double-digit range (depending on territory and risk profile) whilst triple-digit increases are commonplace for loss-affected programmes in high-risk locations.

The degree of repricing is captured by Figure 14, which shows Howden's Global Political Violence Pricing Index, along with average year-on-year rate movements, dating back to 2010. Outcomes for individual programmes vary widely, depending on geographical footprint, loss experience, structure and occupancy.

According to the index, pricing today is close to 30% higher than back in 2010, and up more than 80% from its nadir in 2018. The last two quarters of 2022 saw average annualised increases of approximately 40%. The most current pricing data point prior to the release of this report (December 2022) had the year-on-year rate change at an average of +50%.[6]

[6] These are point estimates within ranges depending on loss experience, exposure, territory and other client specific conditions, and masks pockets of extreme challenge for certain risks.

Figure 14: Howden Global Political Violence Pricing Index – 2010 to 2022 (Source: Howden)



A reinsurance tipping point?

The market correction is likely to continue for much of this year (at least), with pressures compounded by considerable tightening in the reinsurance sector during 1 January 2023 renewals. Widespread terrorism and SRCC exclusions in property contracts and pared back specialty composite covers meant some cedents were forced to purchase standalone PV protection, as well as pay significantly more to secure capacity (for excess layers especially).

Reinsurance appetite declined at 1 January 2023 compared to the corresponding renewal in 2022, particularly if cedents were unwilling or unable to meet markets' pricing expectations. Impacts varied by peril: some reinsurers reduced capacity commitments for SRCC and full PV by 30% and 60%, respectively. Insurance buyers are already feeling the effects of these developments, as insurers rework underwriting strategies to reflect higher net positions.

These changes, along with tighter event definitions and terms and conditions, reflect attempts by reinsurers to control aggregates after sustaining disproportionately large losses in recent years from both standalone and all-risk policies. Raised awareness for potential systemic losses was also a factor. Renewals at 1 January 2023 marked a deviation from previous years, where underwriting action was restricted mostly to loss-affected programmes.

The corollary of higher reinsurance costs and retentions for primary markets points to challenged conditions for insurance buyers in 2023 and beyond. Pressures are being exacerbated as businesses increasingly turn to specialty insurers to secure similar levels of protection once afforded by all-risk policies. With any further large-scale losses likely to weigh on reinsurers' aggregates, there is a risk of supply not meeting demand in certain areas this year.

HIGHER REINSURANCE COSTS AND RETENTIONS FOR INSURERS POINT TO **MORE CHALLENGED CONDITIONS FOR INSURANCE BUYERS THIS YEAR.**

CHANGES TO PRICE AND RETENTIONS AT 1 JANUARY 2023 REINSURANCE RENEWALS, ALONG WITH TIGHTER EVENT DEFINITIONS, **REFLECTED ATTEMPTS BY REINSURERS TO CONTROL AGGREGATES.**

03

Political violence perspective

Carriers are reacting to fast moving risk developments, which in turn is driving a rigorous insurance placement process. Given the prevailing macroeconomic and geopolitical environment, there is unlikely to be any let up in market conditions any time soon. Preparation and timing are paramount in this marketplace, and companies need to anticipate a prolonged and meticulous renewal process in order to secure capacity.

> GIVEN THE MACRO AND GEOPOLITICAL BACKDROP, **MARKET CONDITIONS ARE UNLIKELY TO RELENT ANY TIME SOON.**

PREPARATION AND TIMING ARE **PARAMOUNT IN THIS MARKET.**

All of which elevates the importance of differentiated risk transfer advice. The following Q&A sessions provide insights from a broking and underwriting perspective around market conditions and what companies need to think about in terms of their risk profile, submission data and renewals strategy in order to achieve the best possible results in the current environment.

Today's marketplace demands the very best intermediary expertise and leadership. It requires sector experience, market-leading thought leadership and unrivalled relationships with insurers. Howden's PV team provides all this and more. Come and talk to us.

Q&A: a broking view

Tom Bradbrook, *Executive Director, Howden Specialty*
Tom Downing, *Divisional Director, Howden Specialty*
Tim Woodhouse, *Divisional Director, Howden Specialty*
Steve Bessant, *Executive Director, Howden Tiger*

The PV market is undergoing a major correction. Howden's global broking teams provide insights here to explain what is driving the market and help clients prepare for what will be another difficult year ahead.

Q. How would you characterise the standalone PV market today?

A. For the cover that is most sought after currently – namely SRCC and full PV – conditions are difficult. Demand is up due to heightened risk awareness and SRCC exclusions in the property market whilst a succession of major losses in the last four years has reduced underwriting appetite. Although we are not (yet) seeing insurers exit the market, line sizes have been cut across the board and certain risks are difficult to place, especially in more volatile areas.

Pressures are less acute in the S&T market, but as we show in our report, this is not where the pressure points lie currently. Macro and geopolitical conditions are feeding the SRCC and PV threat landscape and it is here where clients need protection.

Q. What is driving the correction?

A. The loss environment is the most obvious. This is an area we explore in detail in the report, with multi-billion dollar losses in countries like Chile, the U.S. and South Africa pointing to a structural shift in frequency and severity. Insurance claims from recent SRCC events have rivalled or exceeded natural disasters in some regions, and the standalone market's share of future losses is only likely to increase as property insurers withdraw from the SRCC space. Then there is of course what looks set to be one of the biggest PV losses ever in Ukraine. Losses in the last two years have wiped out a significant portion of premium, a development that would move any market.

There are more opaque issues at play too. With the benefit of hindsight, we can see that the cost of premiums has not been sufficient to compensate fully for the high limits offered. Strong competition played a part in driving rates down through the 2010s, and the base effects of low premiums and low losses during this period have amplified the effects of the current correction. Whilst the market has gone some way to restore price adequacy, further (moderated) increases are likely to be needed before we reach that point.

Q. Is the standalone market filling capacity gaps left by property insurers' withdrawals?

A. In the main, yes, but there are nuances around line size and price depending on peril, territory and occupancy. Clients accessing the PV market this year will not be able to replicate the level and cost of cover they are accustomed to in their property contracts, regardless of territory and risk profile. But if expectations are managed adequately (which they should be by a good broker), then standalone capacity is available in most regions within certain pricing and line size parameters, even for SRCC and full PV cover.

The situation in territories deemed to be high-risk is more difficult, with capacity geared by peril. Whilst coverage for S&T is still available in most high-risk areas, SRCC and full PV is capacity constrained, especially in countries that have suffered losses.

Q. What are your expectations for pricing this year?

A. Ranges vary considerably by territory and peril, but for exposures in places like Western Europe and the U.S., buyers looking to purchase SRCC cover can expect similar outcomes to those of last year (i.e. up 10-15%). Mid-double-digit increases can be expected in less benign countries (for clean business), with full PV cover seeing the biggest increases. Price corrections for loss-affected accounts are now into the triple- or quadruple-digit range (South Africa specifically for the latter).

Sector (or occupancy) and programme structure are other important inputs into pricing. Assets such as airports, government buildings and retail buildings have been targeted in recent attacks, and are now deemed higher risk, whilst higher layers in programmes are undergoing considerable corrections as recent losses have demonstrated greater levels of tail risk than originally thought.

Q. Is now the time for new capacity come in?

A. We would of course welcome new capacity, and think shifting risk vs reward dynamics will encourage new markets to enter over time. In order to service rapidly rising demand and put the market on a more sustainable footing, we believe the premium base of the standalone market may need to double in the next few years. Price is part of the equation but (disciplined) new capacity will also be needed in order to absorb the levels of losses we are now seeing.

The market otherwise runs the risk of damaging its credibility and seeing clients consider alternative, self-insurance arrangements. A return to profitability in the near-term would help restore confidence, and the market is certainly more resilient today to the type of SRCC events we have seen recently. Further shocks in 2023 will nevertheless test market resolve and could lead to a few (exposed) carriers exiting the market.

Q. What can clients do to secure the protection they need?

A. Access to the best intermediary advice is crucial. Fast-moving developments across the (re)insurance value chain have created cascading effects for buyers, many of whom had become accustomed to soft market conditions. In fact, this cycle of price hardening is the first most PV buyers have experienced. And they are now having to navigate additional headwinds following a highly challenged 1 January 2023 reinsurance renewal, as cedents adjust to higher costs and net positions, as well as considerably tighter terms.

As reinsurance constraints exacerbate market pressures, it is vital that companies work closely with their broking partners well in advance of renewals to prepare for what is an intensive process. With little prospect of an immediate let up in market conditions, broking expertise and leadership are needed to help businesses secure PV protection at the best terms possible.

Q&A: an underwriting view

James Hannan, Head of Crisis Management at Convex Insurance, offers insights on the PV market from an underwriting perspective, and how structural changes to the loss environment, alongside significant tightening in the reinsurance market, have reset market conditions.

Q. Is the current macro and geopolitical backdrop feeding loss frequency and severity?

A. The PV threat landscape is highly macro-driven and the world has undoubtedly become a riskier place following recent geopolitical and macroeconomic shocks. Energy insecurity, rising interest rates, structurally higher inflation and heightened security threats have aggravated underlying grievances tied to inequality, the cost of living crisis and broader disenfranchisement.

Rather than a series of random acts, recent SRCC losses in places like Chile, the United States, South Africa and Peru are – I believe – more a manifestation of a highly challenged macro-environment, fuelled further by the proliferation of technology and the reach provided by smartphones and social media platforms. Losses are no longer siloed by geography and perils once viewed as distinct are increasingly intersecting to create a highly volatile threat environment. As long as these dynamics persist, we see SRCC-related risks remaining elevated.

Q. Is this seeing more demand for standalone cover, and is supply sufficient?

A. Yes, demand is up on several fronts. We saw a 10% uplift from existing clients due to inflation alone last year and there is heighted risk awareness from companies' boards and c-suites following the series of large-scale events. More business is also coming into the standalone market from the property market as SRCC exclusions become increasingly prevalent.

Per risk PV capacity is theoretically similar to previous years, but appetite has reduced significantly as carriers look to manage and limit exposures to territories perceived to be higher risk. This is having a significant impact on deployed line sizes, layering and sublimits but these changes are necessary in the current environment. Aggregations at city or country level are now under close scrutiny following 1 January 2023 reinsurance renewals, though I would say the direct market continues to function and supply is meeting demand overall.

How dynamics play out for the rest of the year will depend on what happens in the property market and how losses develop. Another major loss (in the region of USD 750 million to USD 1 billion) could lead to real dislocation.

Q. You mentioned reinsurance renewals there. Sounds like they are already having an impact?

A. Yes, a big impact. The market is still adjusting to the changes made at 1 January 2023, but considerable reinsurance protection was lost overall. Retentions and pricing doubled in certain instances and changes to event definitions could see insurers facing multi-retention losses if damage occurs in multiple locations. Given most recent events have spiralled to simultaneously impact numerous cities or states, this is a huge deal. I am not certain this change has been fully realised by market participants yet, reinforcing my earlier point on the market being one major loss away from dislocation.

Price increases dominate the headlines but changes to terms and structures are equally (if not more) important on this occasion. Retentions are much higher on a risk-by-risk basis and restrictions around event definitions (e.g. terrorism moving typically from an entire city or no definition at all to a 250-metre capped radius) will mean that losses outside of these zones (including denial of access, contingent business interruption) will no longer be aggregated into the event or recoverable. War event duration is also being limited on some reinsurance contracts to 14 days vs 30 days previously.

Reinsurers pushed hard at 1 January 2023, with market commentary pointing to overreach to the detriment of relationships in certain instances. Insurance carriers are far more focused on what they are writing, as a result. Any terrorism or PV related loss will now see the insurance market retain a far higher percentage than in recent years. So yes, insurance buyers are absolutely feeling the effects of changes to reinsurance treaties.

Q. Difficult adjustments for both buyers and underwriters then, but perhaps a route to a more sustainable market?

A. The changes made to date around price, aggregations, sublimits and line sizes have been necessary when you consider the loss environment we are facing. The market has absorbed big losses at 12 to 18 month intervals for successive years now. Pricing, structures and terms all needed to move in response to that and all the other structural changes we have discussed. Supply vs demand dynamics always prevail and how they evolve from here will depend in large part on future losses.

The journey to sustainability is underway but it will take time to reach the destination. Capacity providers continue to be cautious given the loss and macro backdrop. Pricing dynamics in high-risk territories especially need to be sustained: a sizeable share of premium continues to come from terrorism coverage in less volatile markets, and underwriters will be looking to be compensated adequately in the territories and perils where the losses are occurring. We need to move away from any notion that good business can subsidise bad. I believe that additional capacity – insurance and reinsurance – will flow into the market once we get to this point.

Q. What can clients do to secure the coverage that they need?

A. The major inputs into underwriting – loss history, location, occupancy, the macro and geopolitical environment – are largely beyond the control of companies, but relationships matter in this business and long-term buyers will typically be prioritised over new entrants. Strong and early engagement with brokers and insurers is crucial. Finally, data is becoming a genuine differentiator – the more granular the data the better prospect companies have of securing cover. Put differently, bad data = no cover.

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Contacts

Howden Broking Group

Julian Alovisi
Head of Research
+44 (0)7593 576 024
julian.alovisi@howdengroup.com

Howden Specialty

Tom Bradbrook
Executive Director
+44 (0)20 7645 9382
tom.bradbrook@howdenspecialty.com

Howden Tiger

Steve Bessant
Executive Director
+44 (0)20 7456 7952
steve.bessant@howdentiger.com

Expert contributor

Convex
James Hannan
Head of Crisis Management
+44 (0)7585 427 106
james.hannan@convexin.com

Howden

One Creechurch Place,
London, EC3A 5AF

T +44 (0)20 7623 3806
F +44 (0)20 7623 3807
E info@howdengroup.com

www.howdengroup.co.uk