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INVESTMENT RESEARCH GROUP

RESEARCH NOTE

ABSOLUTE RETURN STRATEGIES | INSURANCE-LINKED SECURITIES

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2024 YEAR IN REVIEW

Insurance-linked Securities (ILS) markets and strategies performed well in 2024, the result of higher premiums and below average total insured damages despite above average activity during hurricane season. The Swiss Re CAT Bond TR Index, which tracks global USD-denominated CAT bonds, returned +17.6%. CAT Bonds allow insurers/reinsurers to sell peak loss and tail risk to the market.

- As expected, the ILS market remained "hardened", with capital demand largely outweighing supply, in 2024. The January renewal period, during which about 60% of global reinsurance transactions are finalized, exhibiting strong increases in loss-impacted premiums, while April (~10-15% of transactions focused on Japan) and June (~25-35% focused on US hurricane) were flat to slightly lower on a risk-adjusted basis.

Risk-adjusted rate change of catastrophe reinsurance at January 1, 2024

Territory	Loss-Free Program	Loss-Impacted Program
United States	0% to +10%	+10% to +50%
Canada	0% to +10%	+10% to +35%
Latin America & Caribbean	0% to +10%	N/A
Europe (large programs excluding Turkey)	+5% to +10%	+15% to +40%
Turkey	N/A	+100%
Australia	+2.5% to +10%	N/A

Source: Amundi Pioneer

- The ILS market also benefitted from elevated short-duration yields, collateral is held in Treasury bills, with the 1-year bill averaging a ≥5% yield over the year.

- Swiss Re forecasts 2024 global reinsured losses at $110 B, with the majority from wind and flood, relative to an average of $161 B from 2015 – 2023. In addition, higher retention levels, the losses held by primary insurers, mitigated the losses to reinsurers.

- US wind generally represents a third of portfolio peril exposure. The 2024 hurricane season (Jun – Nov) experienced above-average activity with 18 named storms, 11 hurricanes and 5 major hurricanes. This was in the range of the NOAA forecast of 17-25 named storms, 8-13 hurricanes and 5-7 major hurricanes, with La Nina and warmer-than-average ocean temperatures driving above-normal activity, and above the 1991-2020 averages of 14.4, 7.2 and 3.2 respectively.

2025 OUTLOOK

The market outlook for 2025 remains positive, though the tailwinds that supported markets and the fund in 2024 are not expected to be as strong.

- Early indications suggest the ILS markets remain hardened, though more balanced. The January renewal period is not finalized, but expectations are for elevated loss-adjusted premiums with the more favorable terms and conditions of the past few years remaining in place.

- Total returns will be impacted if the Fed cuts rates and the front end of the US Treasury curve continues to shift lower. The Treasury curve steepened meaningfully in 2024 with the 1-year yield falling from 4.84% to 4.15%.

- Tropical Storm Research is forecasting average activity in 2025, with 15 named storms, 7 hurricanes and 3 major hurricanes. Historically, however, there is not a strong correlation between the extended forecast (made in December and generally centering on long-term averages) and the actual number of major storms. Further, insured damages are heavily dependent where storms make landfall, which is impossible to predict before the storms form and difficult to predict even after the storms have formed.

California Wildfires

As of Jan 20th, the Palisades Fire had covered ~37 square miles, damaged or destroyed 6,000+ structures and was 59% contained. The Eaton Fire had covered ~22 square miles, damaged or destroyed 10,000+ structures and was 87% contained.

The preliminary industry insured loss estimates are in the $20 to $25 B range, but given the early stages of the event the impact on particular securities still uncertain:

- Some CAT bonds have priced lower to reflect the increase in potential insured losses.

- Quota shares are private, invitation-only contracts, so it is still too early to determine potential losses. Quota shares allow reinsurers to reduce risk by selling a portion of their insurance book, with buyers receiving a fixed proportion of premiums and losses.

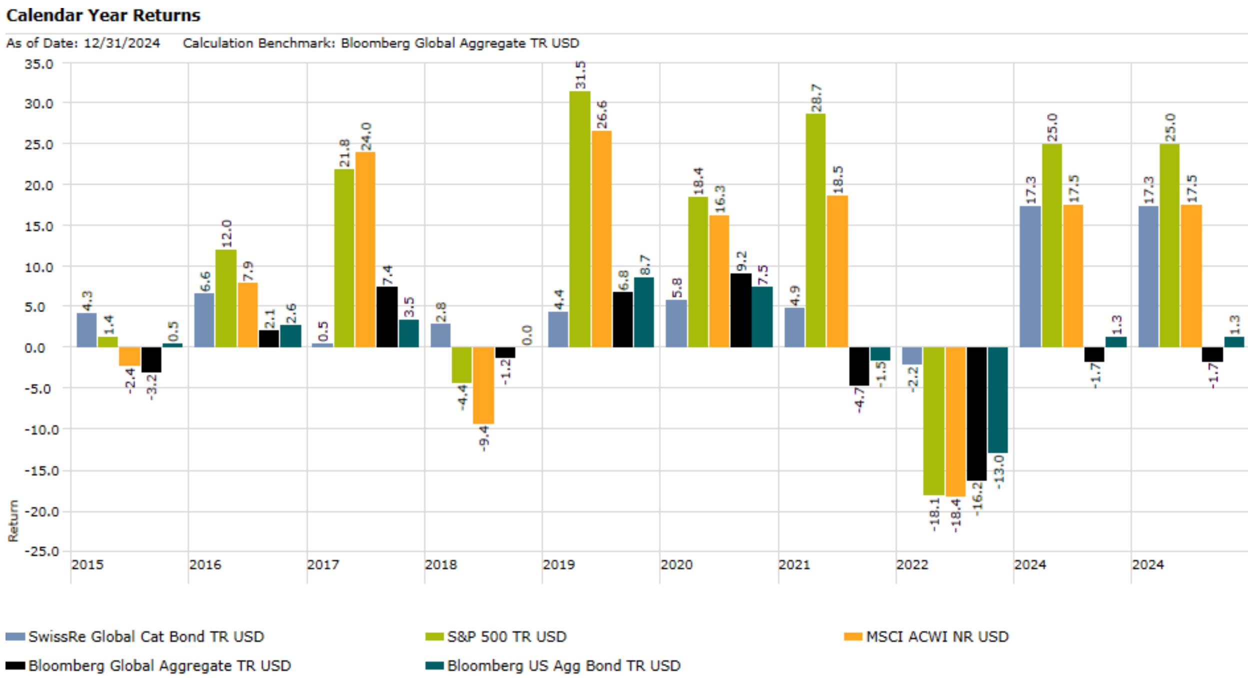
The potential mitigating factors:

- The California market is dominated by the nationwide insurers who tend to retain a higher level of insured losses.

- The California FAIR Plan, the insurer of last resort providing basic fire insurance when it is not available in the private markets, will likely absorb a portion of the wildfire loss. The Plan reports receiving 3,600+ claims with potential exposure of ~$4.8B, insuring ~22% of structures (~$4 B exposure) affected by the Palisades fire and 12% ($775 MM) by the Eaton fire.

CONCLUSION

Barring a surprise during the January renewals, we continue to expect ILS markets to provide solid long-term risk-adjusted returns, capturing risk premiums that are **unrelated** to public markets, a profile we find particularly attractive given our cautious outlook for risk assets at current valuations.



- As we've seen, however, there is always the potential for negative returns in years where insured losses exceed expectations, which can occur in consecutive years, alongside negative returns in public markets and take several years to recover.

- While the run of high-teen returns may not continue, given the potential for lower Treasury yields, ILS is expected to benefit from a hardened market and higher retention levels.

- Risk models are backward looking, so there is always the potential they do not fully reflect catastrophic outcomes. However, broad diversification across perils combined with higher retention levels is expected to mitigate downside tail risk.

- The insurance industry is aware of and adapting to climate change. Over time, reinsurance is unprofitable if the industry **consistently** undercharges for the risks taken. The ILS market reprices annually, with premiums and retention levels adjusting after losses, while the climate is evolving over a much longer horizon.

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