CEO's report

"Our key differentiator as a pure-play global reinsurer is our unwavering commitment to allocate capital efficiently and effectively to where the most attractive opportunities lie"

Reflections on 2022

We launched Conduit Re in December 2020, with a five-year business plan centred on building a robust business with a diversified portfolio. The industry developments we have seen since 2020 now present a 2023 landscape that is well beyond those original expectations. Our team, pulling together from one location, is ideally positioned to respond to this.

Throughout our first two years, we remained focused on our approach and plan, pursuing our core underwriting philosophy: to identify the relative value in the reinsurance product chain and technically underwrite a balanced and diversified portfolio. Across our target classes, we have been able to build scale and presence – key elements in establishing Conduit's footprint, resilience and relevance.

The heightened extent of industry natural-catastrophe losses in 2022 is being described as an 'above average' year with estimated loss figures in excess of $120.0 billion. Increasing frequency and scale of natural-catastrophe losses are factors for which the industry should be prepared. Responsible deployment of capital in catastrophe-exposed classes should remain a key focus of portfolio construction.

2022 performance

In 2022, our gross premiums written have grown 68.3% to $637.5 million and, on an estimated ultimate premiums written basis, by 43.9% to $659.9 million. While our overall result for our second full year of operations was a comprehensive loss of $89.7 million or $(0.55) per share, the pure underwriting result was a profit of $0.3 million and a combined ratio of 107.0%. This is a commendable outcome by the team in only our second year, given the significant claims and other challenges that impacted the industry in 2022. It goes , long way to validating our focus on underwriting a balanced and diversified portfolio through careful risk selection across our target classes.

Beyond underwriting, the 2022 results were affected by the impact of the increased interest rates on our invested assets, with an investment return of (5.0)% mostly driven by a mark-to-market effect over the 12 months of $(67.8) million. Our principal approach remains to actively monitor and position the duration of our investments, to accumulate cash and reinvest when opportunities present themselves, and to avoid realising losses unnecessarily. We have always said that our strategy is to assume risk in our underwriting and to seek to protect our asset base to maximise our

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solvency capital and, consequently, we will continue to deploy our investments conservatively, maintaining a lower-risk profile with high average credit ratings (AA at the end of 2022).

Our operational set-up and efficiencies are already producing $11.8 million of gross premiums written per employee through year-end 2022 – a figure that we expect to increase significantly as we develop and deliver on our five-year plan. Within that plan, we set out a glide path towards our other operating expense ratio target of 5% to 6% and, at 7.1% for 2022, we are well on the way to achieving the target set, given the evolution of the expected earned premium base.

The more than $120.0 billion insured losses in the year impacted several regions, with North America alone incurring circa $90.0 billion of losses. Hurricane Ian comprises a significant element of this number (up to $55 billion according to some estimates) with our estimated net loss exposure to this storm being $45.4 million ($40.9 million net of reinsurance recoveries and reinstatement premiums).

In building a balanced view of risk, we continue to have the majority of our premium dollars emanating from non-catastrophe-exposed classes. This has enabled us not only to establish a great pipeline of margin-healthy, more predictable business but also to continue to grow through 2022 while still retaining the important balance in the overall portfolio.

The impact on Conduit Re from the Ukraine-Russia conflict is a good example of our underwriting philosophy, which is focused on achieving consistent technical profitability. Given the typical structure of the reinsurance treaty contracts that we underwrite, with event and aggregate limitations in place for the relatively small number of contracts that have exposure to the conflict, the ultimate impact from the event has been estimated at $24.6 million net of reinsurance recoveries and reinstatement premiums. Our approach is to be as transparent as possible with our disclosures and we believe that this is shown in our estimated ultimate net loss to the ongoing crisis being across the whole portfolio – primarily our property and specialty reinsurance books, via classes such as aviation, war on land and marine war – in both Ukraine and Russia.

While we plainly had no crystal ball prior to the Ukraine-Russia conflict, the loss impact on the Conduit portfolio from it was limited since it was clear to us some time ago that contract pricing in certain specialty areas did not reflect the underlying risk, causing us to decline many specialty submissions.

Underwriting view

As 2022 progressed into the fourth quarter beyond Hurricane Ian, it became apparent that a major re-forming of the marketplace was under way, with the supply versus demand imbalance starting to take real effect. A fundamental shift in the rating of property catastrophe risk was occurring, driving the market to embrace both a significant increase in premium rates and, crucially an improvement in the terms and conditions being offered.

The positive momentum behind the improvements in the pricing and terms and conditions of catastrophe-exposed property business has also been driving improvements in our margin expectations in the non-catastrophe-exposed business. This is enabling us to build upon our significant existing non-catastrophe-exposed property book.

We have spoken several times about the differing product forms – quota share or excess of loss – available to a reinsurer when accepting risks and the fundamental differences between them. Both forms have merit at differing points of the cycle and we see both as being able to contribute in the present market environment. However, in 2021 and 2022 our strategy was to lean away from the greater volatility we saw in the catastrophe-exposed excess of loss product and we focused more of our attention on the more predictable earnings stream available in writing the quota share product showing attractive margins with lower inherent volatility. We are now seeing the benefits of the quota share earnings stream coming through, which gives us an excellent base on which to grow. Going forward as the market dynamics change we will of course keep this product mix under review as evidence of pricing improvement emerges in the various excess of loss classes.

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The casualty business, in our experience through the year, remained on a relatively stable track with the underlying insurance market continuing to behave responsibly in managing and pricing for claims inflation. We have been very selective in underwriting the casualty book and we have a high renewal retention here with the business in our view being well risk managed by the client base. The data and analysis shared with us informs our decisions to deploy or not in any one casualty class, occupancy, or indeed geographic region. Where the submissions have not met our risk appetite we have not written the business. This was often the case with European and broader non-USA casualty risks. Overall, however, the longer-tail casualty business that met our underwriting criteria continues to be a valuable contributor to our overall broad risk diversification strategy.

Turning to the specialty reinsurance market, our experience has been that it has been a tough place to find consistently good quality business with adequate embedded margins. There has been an increasing trend to bundle different classes of risk into broad composite covers, with minimal transparency on underlying risk and exposure profiles and consequently this has inhibited the ability of reinsurers to price the risks satisfactorily. Starting in 2022 and continuing into 2023 we have seen the specialty market change behaviour and loss-impacted classes are seeing a significant uplift in rates. Those risks previously lost in a bundled approach are now in the open, to be evaluated on a class-by-class and client-by-client basis. The recent renewal season was in our opinion the real start of this process and, alongside the growth in our property book, the specialty classes offer a significant opportunity for us to deploy more capital into the space. Specialty reinsurance remains an attractive proposition overall for Conduit, especially when the natural-catastrophe correlations with our property classes remain at lower levels, enabling us to capture attractive technical margin from premium flows that are not predominantly associated with natural-catastrophe risks.

As regards distribution, the excellent support that we have received from clients and brokers in this, our second year of trading, is very much appreciated. The channels that we have established to access business are deep in all of our product lines and our strong capital position will enable us to continue to grow. To that end, the 1 January 2023 renewal period did indeed deliver exceptional business growth, both in renewing and new business for us and on the back of continued improvements in pricing and terms and conditions. We see this as an enduring environment, creating the opportunity for improved margins in our business throughout 2023 and beyond.

Conduit Re's key differentiators

Though we may no longer be considered a start-up, we have retained several key differentiators from our first days in operation. Over and above the energy and forward-facing mindset that comes with launching a new business, we have none of the legacy issues of more established businesses. Given the market's re-calibration on prior year reserves in this new inflationary environment, these legacy issues are now very much front and centre in the broader industry cross hairs and we are pleased not to be impacted by such distractions.

On the asset side of the industry the combination of heightened catastrophe losses, mark-to-market impacts on investments and the legacy reserving issue has had a significant impact on capital management and the ability to deploy capital optimally to take advantage of fast-emerging opportunities. At this point in the cycle a freedom to deploy capital is crucial, as is being able to lean swiftly into a significantly improving market.

Along with a strategic approach to capital deployment goes the need for efficiency and quality of decision making in the business. Our experience continues to show the clear advantages to having a localised 'hands on' control of business being written. This is especially so at the moment, where the pace of change in the market has been rapid.

People

Our progress over the last 24 months would not have been possible without the hard work, application and passion of our teams. We have been committed from day one to build our own culture, by seeking out and attracting high-quality people. We are now at 54 employees and in 2022 we conducted our first in-house employee engagement survey. I was very pleased with the positive results and feedback. One final comment: in the post-COVID world we have already adopted a return to 'in office' working as our norm and we believe both the business and our employees benefit from this approach as it improves the information flow and knowledge 'pass down' through the entire organisation.

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Outlook

When Conduit Re was formed it was against a backdrop of several years of industry underperformance including the impact of the COVID-19 pandemic. We were quietly confident that, over the next two to three years, we would experience a broad reinsurance market correction, and what we are witnessing now is a fundamental shift in risk versus return metrics presenting opportunities to accelerate our growth plans.

Our underlying book of business remains on track to deliver a mid-80s combined ratio in the medium term and benefits from an efficient and effective business model here in Bermuda.

I have witnessed several moments of significant market disruption in my career and what we are experiencing in the industry right now is one of the most dramatic in scope and impact. In my view, it is at these moments that the greatest opportunities present themselves and I firmly believe that Conduit Re is extremely well positioned to respond to these opportunities as we continue to grow.

Trevor Carvey
CEO
3 March 2023