AM BEST SINCE 1899 ®

BEST'S MARKET SEGMENT REPORT

Our Insight, Your Advantage™

June 24, 2024

Market Segment Outlook: Global Cyber Insurance

AM Best's outlook for the cyber insurance market is Stable due to cautious underwriting in a dynamic risk environment

AM Best is assigning a Stable outlook for the global cyber insurance segment owing to the following factors:

- Greater demand/favorable intermediate-term growth prospects as take-up rates steadily improve
- Continuously improving cyber security hygiene
- Expected profitability over the intermediate term
- Improvements in underwriting practices and policy language
- Supportive reinsurance market and recent access to alternative risk transfer products such as insurance-linked securities (ILS)

Key countervailing factors include:

- Increased competition and modest premium growth in US, perhaps a sign of what's to come internationally
- Growing sophistication of attacks using AI, as well as ransomware and business e-mail compromise
- Aggregation risks from widespread use of cloud computing and essential software with large footprints across geographies and industries
- Model risk and divergence among models
- Heavy dependence on reinsurance

Over the past decade, the cyber insurance market has grown rapidly, navigating between fast-moving hard and soft market cycles while countering sophisticated threats and rising claims frequency and severity.

Strong Performance Despite Recent Rate Moderation

AM Best expects that cyber coverage will continue to grow over time, as the heightening awareness of cyber risks contributes to an increase in exposures and, correspondingly, an increase in demand for cyber insurance. Cyber premiums grew rapidly through 2022, but declined slightly in 2023 owing to decreasing rates that were driven by additional capacity and competitive pressures. The cyber segment has had a limited impact on the risk-adjusted capitalization of the (re)insurers rated by AM Best. For most insurers, cyber remains a diversifying line and represents a fraction of the overall premium base. For cyber specialists, the risk-adjusted capital is appropriate to their rating level as estimated through cyber risk modelling and stress testing practices.

Over the last few years, more stringent underwriting standards have been implemented as (re)insurers set exclusions and limits for cyber—for example, more and more (re)insurers

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are excluding cyber war or silent cyber. Refinement of underwriting standards, as well as active monitoring of risks and exposures, enables (re)insurers to provide more efficient and cost-effective coverage. Overall, results for this segment have been marked by mostly consistent loss ratios, and improving clarity in policy language and wording has helped lower defense and litigation costs.

There was a spike in loss ratios due to the COVID-19 pandemic as businesses had to cobble together remote work environments in haste without paying much heed to cyber security. Despite an increase in claims frequency and severity at the start of the pandemic, the market was able to reprice quickly and has benefitted since then from consistent operating performance. Modelling firms and sophisticated insurers have simulated the impact of a potentially widespread catastrophic cyber event on their clients and the industry, but outcomes vary greatly depending on data and methodologies. AM Best expects more consistent outcomes as models continue to mature and the data quality and consistency continue to improve.

Given the growing number of threats and local regulatory requirements, AM Best expects demand for cyber coverage to increase and remain strong over the medium term as companies, particularly small to medium-sized enterprises (SMEs). SMEs, which generally have less sophisticated risk management tools than larger organizations, are likely to increase their cyber covers as they refine their risk appetites and tolerance.

Cyber risks have increased owing to the growing sophistication of cyber attackers, the increase in ransomware and business email compromises (BEC), heightening geopolitical tensions, and the rising threat of AI, as well as the burgeoning awareness of business interruption (BI) and the exponential increases in the use of proprietary and third-party data.

Greater awareness of potential cyber incidents has led to improved cyber hygiene among insureds and better defense against cyber attacks, with quicker response times when attacks occur, helping to limit losses. Cyber insurers have been proactive in working with clients' cyber risk management. Good insurance processes have become a partnership between clients and the insurers.

Reinsurance capacity remains adequate

Cyber relies heavily on reinsurance and the market has become more of an ecosystem that exists among customers, managing general agents (MGAs), brokers, insurers, and reinsurers. Reinsurance has historically been in the form of quota share and capacity in the reinsurance market seems to be sufficient. In addition, reinsurers bring unique skill sets to the table and help the primary market with their expertise in underwriting and risk management. However, long-term reinsurance capacity will depend on whether or not cyber insurers are able to sustain their profitability. The market has also been experimenting with other forms of reinsurance such as excess of loss and stop loss structures.

About half of all cyber direct premiums written is ceded to reinsurers, far more than any other line of insurance. If reinsurers pull back capacity, primary insurers may find it difficult to meet the demand for coverage. The cyber market is still not mature, as signified by the volatility in the rate environment (both on the upside and downside). As insurers understand the risk better, we can expect to see increasing maturity of the cyber market.

Early Signs are Encouraging For Catastrophe Bonds

The ILS market for cyber remains nascent, but the increase in cyber catastrophe bond issuances in 2023 and 2024 is a positive, as it helps to further diversify the segment. However, ILS activity will need to grow to support (re)insurers' capital needs. Traditional lines such as property can mitigate

risks through geographical diversification; cyber doesn't allow this and remains a much smaller line of business. The premium base is small, but probable maximum losses (PMLs) can be high and balance sheets can quickly reach the risk tolerance level, constraining (re)insurers that write cyber. The emergence of catastrophe bonds and ILS issuance should expand capacity for writers. Additional capacity will help primary carriers meet the demand for cyber insurance, given the dependence on reinsurance. These excess of loss reinsurance structures and catastrophe bonds help insurers lay off catastrophic risk while retaining the more profitable attritional risk.

Potential Negatives Looming

Insurers have been writing cyber coverage for two decades, but the collection of data has been inconsistent and inadequate from a regulatory perspective. Around two-thirds of global cyber premiums come from the US. Outside of the US, reliable data and track records are lacking, although the situation is improving. More insurance companies are writing cyber business, but not all have the maturity and sophistication to do so.

Geopolitical tensions and an increase in the frequency of attacks is a persistent threat to the cyber segment, even as actors become more sophisticated and threats appear in all directions. Cyber loss aggregation could cause a multiplier effect and has the potential to escalate a cyber incident to the level of a catastrophe.

Artificial intelligence will benefit cyber security and the insurance industry but will also provide cyber criminals with more tools to spread malware, deploy scams, use stolen data, and create harm in new ways. These could certainly be detrimental to organizations without insurance; they can also impact insurers' profitability.

GUIDE TO BEST'S MARKET SEGMENT OUTLOOKS

Our market segment outlooks examine the impact of current trends on companies operating in particular segments of the insurance industry over the next 12 months. Typical factors we would consider include current and forecast economic conditions; the regulatory environment and potential changes; emerging product developments; and competitive issues that could impact the success of these companies.

A Best's Market Segment Outlook can be Positive, Negative, or Stable.

Best's Market Segment Outlook	
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