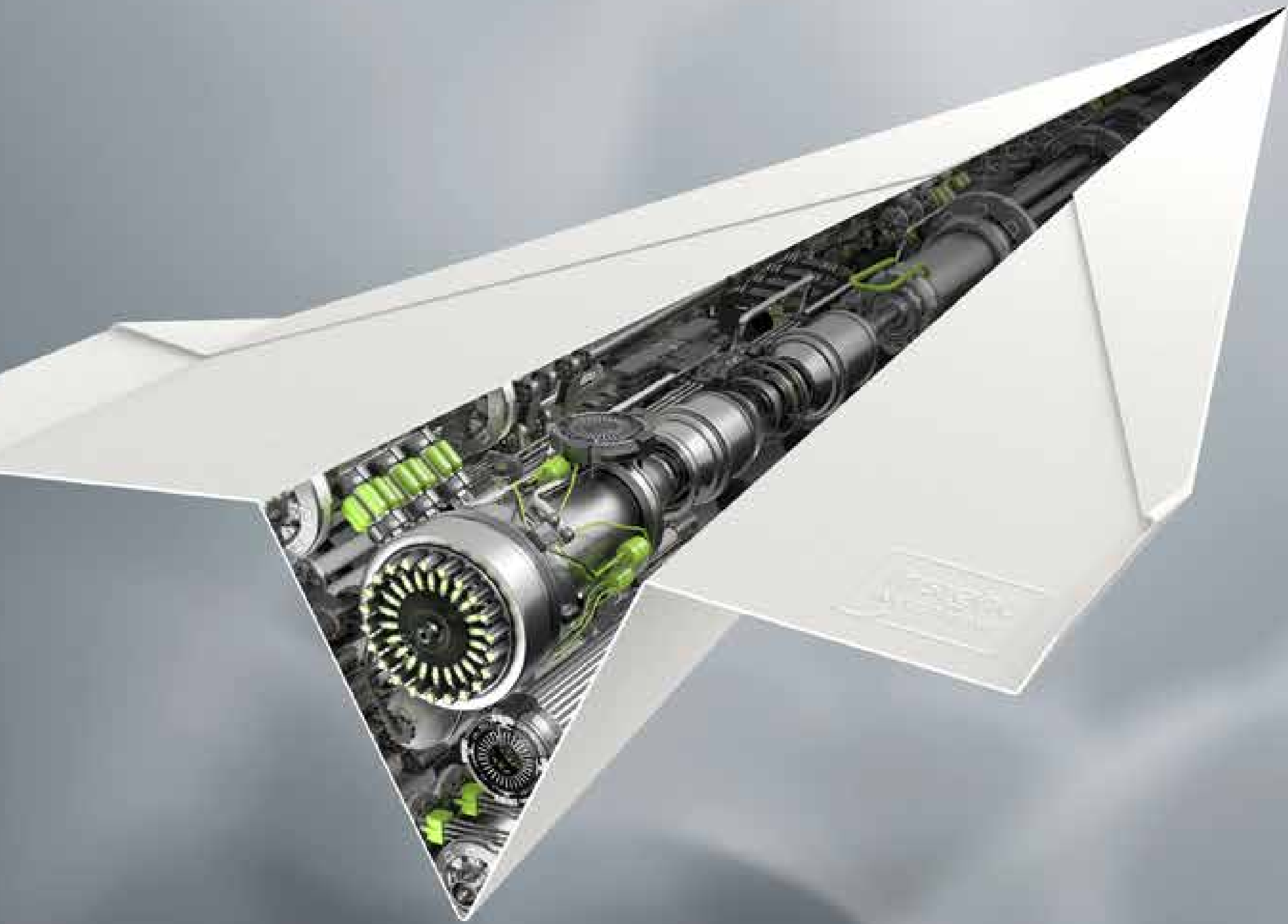
iQ
INSIDER QUARTERLY

AUTUMN 2017 ISSUE 63

ON THE EDGE?

Has the (re)insurance sector reached another cliff edge with mortgage credit risk?

The intelligent quarterly from the publishers of *The Insurance Insider*



SILENCE IS EXPENSIVE

One common characteristic of the strongest leaders is that once they know something important, they are unable to ignore it.

They don't procrastinate – they operate.

For instance, when someone I knew was told there was a reasonable chance that he might have testicular cancer he took the snap decision to have the offending item removed immediately.

He could have waited for barrage of tests to confirm the supposition, but he wasn't interested.

For him, the simple thought that he was harbouring something that left alone might kill him was enough to spur direct and decisive action. He made a tough call and the problem was quickly solved.

Our industry is somewhat different.

Unlike my friend, we know we are infected with a cancer, yet we are unable to take remedial action. We are petrified and paralysed. The infection has found its way into every corner of our business. Paradoxically, despite the spread, our vital organs are not affected and it is still not too late to act.

But this is a disease with no known cure, so remedial action must always be surgical and therefore painful.

Like all great emerging insurance pathogens, the loss event or events it can cause are extraordinarily hard to define. But unlike most other life-threatening agents it aggregates in a way that is unrelated to geography or to line of business.

This is the disease we call silent cyber exposure. Wherever it is not explicitly excluded it is tacitly included. We know this exposure is everywhere we look.

Contrary to the popular refrain, there is absolutely nothing golden about our industry's silence on this issue.

Remember how silence worked out with asbestos?

At least with that slow-motion catastrophe the underwriters of the day could rely on the defence that when they wrote the business they weren't aware that the near-ubiquitous powdery construction material was a carcinogen.

To this defence they can add the fact that the judiciary and legislators made rulings and interpretations after the fact that created retroactive insurance cover that was never intended to be offered and for which a premium was never collected.

This time there can be no such excuse. We are on alert.

It is far more akin to the US market's relationship with terrorism prior to 9/11.

Anyone could look at Europe going back into the 1960s and 1970s and see the exposure definitely existed. Indeed, far closer to home they could see the earlier 1993 WTC attack, which had already injured a thousand and collapsed the ceiling of the PATH station below.

Yet terror cover was still silent across classes eight years later in 2001.

So what's stopping a mass imposition of cyber exclusions? Simple – to do so in a soft market is far too painful. It would involve losing a hard core of longstanding profitable business to competitors willing to look the other way and stay silent.

There's also the experience of Y2K and electromagnetic fields.

Both were potential systemically aggregating risks – neither of which materialised.

Perhaps there is an element of wishful thinking? Perhaps a cyber clash event won't happen. But given what we know about the nature of the threat and the near ubiquitous interconnected exposure, I believe that to be enormously unlikely.

We know enough.

For some that is enough to act. Others need more evidence. The trouble is that in this case the evidence will be acquired very expensively, or indeed fatally.

Have a quiet Q3.

MARK GEOGHEGAN
Managing director, Insider Publishing

PUBLISHING Insider

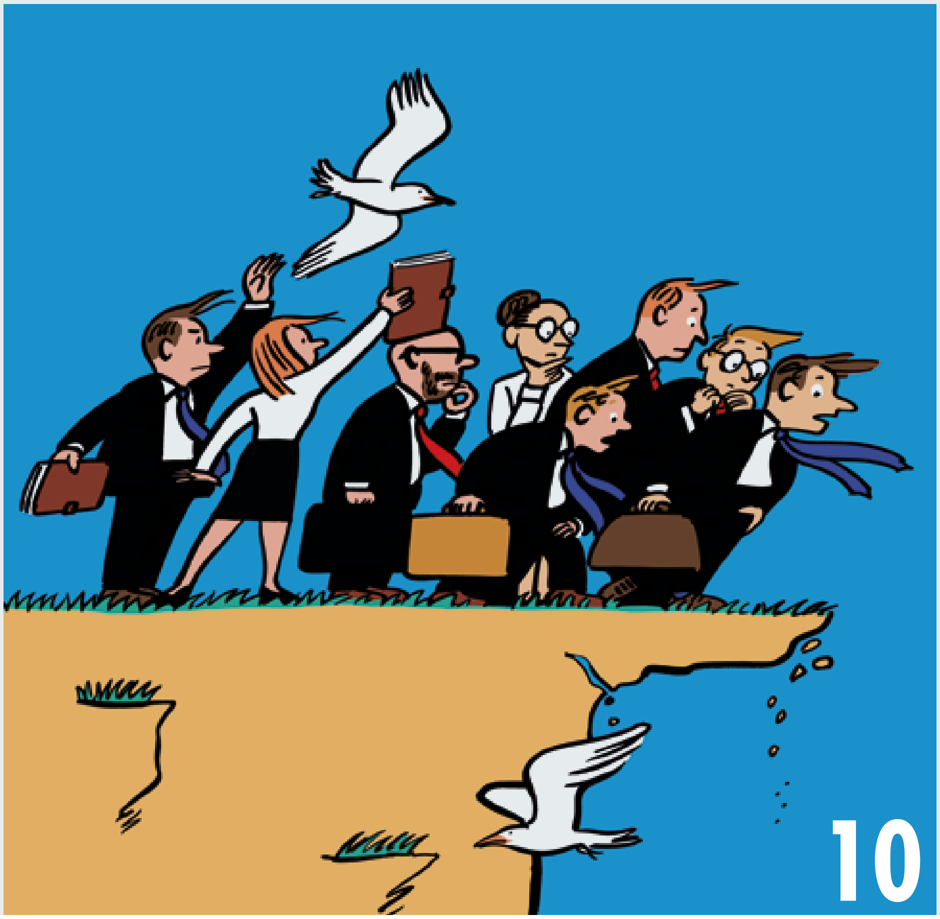
MANAGING DIRECTOR
Mark Geoghegan mark@insuranceinsider.com
EDITOR-IN-CHIEF
Adam McNestrie adam@insuranceinsider.com
EDITOR
Laura Board laura.board@insuranceinsider.com
US EDITORIAL DIRECTOR
David Bull david@insuranceinsider.com
US EDITOR
Ted Bunker ted.bunker@insuranceinsider.com
MANAGING EDITOR
Charlie Thomas charlie.thomas@insuranceinsider.com
NEWS EDITOR
Catrin Shi catrin.shi@insuranceinsider.com
FEATURES EDITOR
Gavin Bradshaw gavin.bradshaw@insuranceinsider.com
SENIOR REPORTERS
Fiona Robertson fiona@insuranceinsider.com
Dan Ascher dan.ascher@insuranceinsider.com
Lucy Jones lucy.jones@insuranceinsider.com
REPORTERS
Matthew Neill matthew.neill@insuranceinsider.com
Bernard Goyder bernard.goyder@insuranceinsider.com
Sofia Geraghty sofia.geraghty@insuranceinsider.com
RESEARCH ANALYST
Iulia Ciutina iulia.ciutina@insuranceinsider.com
COMMERCIAL DIRECTOR
Spencer Halladey spencer@insuranceinsider.com
SALES DIRECTOR
Rob Hughes rob@insuranceinsider.com
BUSINESS DEVELOPMENT MANAGER
Benjamin Bracken ben.bracken@insuranceinsider.com
SALES EXECUTIVE
Annie Lightholder annie@insuranceinsider.com
HEAD OF EVENTS AND MARKETING
Jennifer Lord jennifer@insuranceinsider.com
SENIOR MARKETING EXECUTIVE
Sophie Jansen sophie@insuranceinsider.com
MARKETING ASSISTANT
Beatrice Boico beatrice.boico@insuranceinsider.com
EVENTS PRODUCER
Matthew Sime matthew.sime@insuranceinsider.com
EVENTS CO-ORDINATOR
Holly Dudden holly.dudden@insuranceinsider.com
PRODUCT MANAGER
Carlos Pallordet carlos.pallordet@insuranceinsider.com
PRODUCTION EDITOR
Peter Williams peterw@insuranceinsider.com
SUB-EDITOR
Ewan Harwood ewan@insuranceinsider.com
ART DIRECTOR
Paul Sargent paul@insuranceinsider.com

3rd Floor, 41 Eastcheap, London, EC3M 1DT, UK
Tel main: +44 (0)20 7397 0615
Editorial: +44 (0)20 7397 0618
Subscriptions: +44 (0)20 7397 0619
Annual subscription – £2245+VAT/$3505

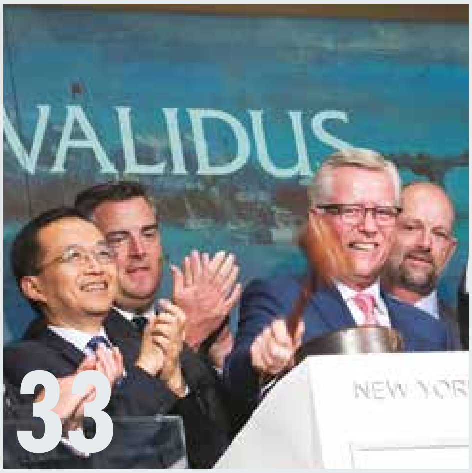
Tel +44 (0)20 7397 0615 Fax +44 (0)20 7397 0616
IQ@insuranceinsider.com
Subscription enquiries Annie Lightholder
Tel +44 (0)20 7397 0619 Fax +44 (0)20 7397 0616
annie@insuranceinsider.com

ISSN 1475-410X

IN THE **AUTUMN 2017** ISSUE



INSIDE CONTENTS



TECHNICAL BRIEFINGS

EXECUTIVE BRIEFINGS

AROUND THE WORLD

IQ's roundup of regional market developments

INDIA

Regulatory overhaul

A pair of Indian insurance experts have called for the country's watchdog to "step up to the plate" and transform the national insurance market.

The paper authored by H Ansari, former member of the Insurance Regulatory and Development Authority of India (Irdai), and Arun Agarwal, a former Lloyd's representative, proposes that Irdai shifts from a principles-based regulatory regime to a risk-based approach, and that India abandons its dual licensing regime between Mumbai and Gujarat.

In addition, the paper suggested harmonising the country's regulatory bodies in Mumbai, rather than having them spread between the capital, Gujarat and Hyderabad, as they are now.

The authors also called for the regulator to move away from tick-box enforcement to an agenda more focused on outcomes, and for Irdai to abandon the protectionist measures that give GIC Re first refusal on reinsurance business.

ARGENTINA

Reinsurance market reopens

Argentina's Superintendent of Insurance, Juan Pazo, has detailed plans to reopen his country's market to foreign-owned admitted reinsurers.

Speaking in June at an insurance event in London organised by the Argentine government, he hailed the reform as part of President Mauricio Macri's wider economic plan to "reinsert" Argentina into the global economy.

Pazo said that from 1 July of this year 50 percent of reinsurance could be placed with foreign-owned admitted carriers, which would rise to 60 percent at 1 July 2018 and 75 percent the following year.

Facultative and catastrophe covers with sums insured exceeding $35mn will be 100 percent liberalised.

The superintendent described the decision by the preceding administration of Cristina Kirchner to fence off and effectively nationalise the reinsurance market as part of a package of exchange controls as "really weird". He described the 26 home-grown reinsurers that sprang up in their wake as merely "brokers" that did not retain sufficient risk.

BELGIUM

Hiscox backs Lloyd's Brussels

Hiscox CEO Bronek Masojada confirmed that his company intends to use Lloyd's Brussels for its European big-ticket business.

Speaking to sister publication *The Insurance Insider* following the firm's half-year results, Masojada said Hiscox would set aside EUR50mn ($59mn) to capitalise its Luxembourg hub, which will support its existing Hiscox Europe retail unit.

The carrier's European big-ticket business will then be written via Lloyd's Brussels, which the Corporation aims to have up and running by 2018.

This quarter also saw MS Amlin choose Brussels for its post-Brexit EU hub, following in the footsteps of QBE and Lloyd's.

Amlin Insurance Societas Europaea SE CEO Kim Hvirgel said: "This is a strategic move that ensures our European brokers and clients experience no disruption from the UK's exit from the EU."

NEW ZEALAND

Regulator blocks Suncorp Tower bid

The New Zealand Commerce Commission has blocked Suncorp's agreed takeover of the country's third-biggest insurer, Tower.

The antitrust regulator said the NZ$236.1mn ($175.4mn) acquisition by Suncorp subsidiary Vero of 100 percent of Tower risked damaging competition in the personal insurance market.

Commerce Commission chairman Mark Berry said: "Without the competition that Tower provides, there is a real risk that consumers would end up paying higher prices for insurance cover while receiving lower quality, such as reduced insurance coverage."

Suncorp said it was "disappointed" with the Commerce Commission's decision. CEO Paul Smeaton argued the proposed takeover would not substantially lessen competition in the New Zealand market.

Tower said it is awaiting the regulator's reasoning and will work with Suncorp's Vero unit to "assess the implications" for the planned takeover. Suncorp's Vero initially offered NZ$1.30 per share for 100 percent of Tower in February this year.

Global market updates by class of business

Property

A fire at a state-owned Abu Dhabi oil refinery in January now looks set to cost (re)insurers well over $1bn, biting into an excess layer with a large AIG line.

Sources told sister publication *The Insurance Insider* that physical damage resulting from the inferno at the Ruwais facility constituted the largest portion of the loss, at about $800mn.

However, disruption to a neighbouring plastic plant has also inflicted hundreds of millions of dollars of contingent business interruption losses.

Cyber

UK retail giant Tesco has come to the London cyber market to secure a £400mn ($520mn) tower that has Beazley as the primary lead insurer.

The cyber placement is said to be one of the largest to have been written in London, and required almost all London markets to put down lines in order to meet the requested limit.

Beazley is understood to have written the £50mn primary layer via its capacity arrangement with Munich Re. The primary layer sits above a £10mn deductible, with AIG then leading the excess.

The rest of the tower is filled by the London market and taps the usual prominent cyber players such as Novae, Brit and Liberty.

Aviation

Aviation underwriters and their representatives have agreed on new policy wording to limit the impact of Brexit on multi-year insurance coverage.

The Aviation Insurance Clauses Group published the model EU continuation clause after a four-month consultation.

The clause stipulates that a (re)insurer can transfer the policy to another member of the same group under the same terms should it be unable to continue to provide cover after Brexit.

The transfer must be completed at least 45 days before the exiting carrier's right to provide coverage ends, and must be notified to the (re)insured via the broker within 10 days of the transfer.

US commercial

Rates in the US commercial P&C market showed signs of starting to flatten in July, although carriers stopped short of saying the market had finally found a bottom.

On an earnings call following Chubb's second quarter results, chairman and CEO Evan Greenberg said insurance rates had been either flat or the rate of decline had slowed in recent quarters, with rate increases seen in US commercial auto and US excess and surplus casualty. US directors' and officers' insurance also renewed flat.

However, reinsurance rates continued to fall on the whole, albeit at a slower rate than in previous years. XL Catlin said it experienced average rate decreases of 1 percent in reinsurance, and as much as 3 percent in global catastrophe business.

And quota share reinsurers are still absorbing the pressures faced in primary markets, according to Axis CEO Albert Benchimol, which led the carrier to reduce its participation or exit some treaties entirely.

Agriculture

Iowa start-up Crop Pro Insurance Services has passed two milestones by raising $8mn in venture financing and obtaining federal approval to offer US-backed agricultural cover.

The company is operating as an MGA and is based in Johnston near Des Moines.

It plans to offer multi-peril crop and hail cover in collaboration with both the US Department of Agriculture's Federal Crop Insurance Corporation and GuideOne Mutual Insurance in 13 upper Midwest states from next spring.

Co-founder and president Joe Young previously led AmTrust Agriculture Insurance Services as CEO and has held senior roles at The Climate Corporation and at John Deere's insurance arm.

Energy

A majority of insurers on the $500mn limit primary layer of SBM Offshore's construction all risks policy have settled with the Dutch-based offshore energy specialist for $247mn after a long-running legal battle.

In a stock exchange announcement in July, SBM said carriers providing 73.6 percent of the insurance on the Zurich-led layer had agreed to a cash payment.

However, it added that legal action against the remaining insurers, including those on two excess layers, remained ongoing pending a trial scheduled to begin in October next year.

The claim relates to the Yme North Sea mobile offshore production unit, which was dismantled after structural deficiencies were discovered in the platform's base in 2012.

Market intelligence on the QT

The other parrot sketch

The Lloyd's market saw a different side to Lloyd's former chairman John Nelson at his leaving drinks in May, as he retold a classic pet shop joke.

When a punter learns that the first parrot he has enquired about costs £15,000, because it speaks a number of European languages, he enquires after a slightly grubbier, sadder-looking one at the next perch.

"Oh," the pet shop owner exclaims, "he's much more expensive, £25,000 at least."

"Why so expensive?" the punter replies.

"Because he speaks Cantonese, Mandarin, Urdu, Punjabi and a number of other emerging market languages."

The punter turns to the saddest-looking parrot of all.

"Surely this one is cheaper than your other two parrots?"

"No," replies the shop owner, "he's the most expensive of all. I'd want £50,000 for him."

"What on earth does he do?" asks the flabbergasted buyer.

"Nothing at all," says the pet shop owner, "but the other two refer to him as 'the chairman'."

I Catlin: We need to talk about Stephen

As you'd expect from such a raconteur, Stephen Catlin's first book, *Risk & Reward*, is stuffed with fantastic anecdotes.

Catlin relates how he almost walked away from the industry altogether in the early days, fearing that he was simply a croupier-in-training. He then performed a volte-face by telling naysayers that, when pricing terrorism policies in the wake of 9/11, they should think of him as a bookie, who could spread the risk as long as enough money came in.

He also recalls how Lehman Brothers, one of the lead bookrunners on the $600mn debt raise in the wake of Catlin's acquisition of Wellington, initially encouraged him to settle for $300mn of debt and to wait until later in the year to bring the debt to market. Catlin encouraged them to double the issuance and do it in the summer of 2007. Two months later, the market collapsed...

ON THE EDGE?

Matthew Neill asks whether the (re)insurance sector has reached another cliff edge with covering mortgage credit risk

Almost a decade on from the 2008 financial crisis, when the world's monetary system faltered then finally crashed, the (re)insurance industry could be forgiven for thinking its walk-on part in the debacle is unlikely to be repeated.

The spectacular collapse of the sector's torchbearer, American International Group (AIG), has faded into history somewhat, after the company sought to rehabilitate its image following a humiliating bailout by the US government.

However, it still stands as a parable of what happens to those who would seek to flout the relatively conservative traditions of (re)insurance business.

AIG and the industry at large have done a solid job of distancing themselves from what occurred in the carrier's Financial Products unit and, to a lesser extent, elsewhere in the company.

This is unsurprising, given that in the run-up to the financial crisis no other carrier was found to be taking on the stupendous level of risk that eventually sank AIG.

Choose your poison

AIG's issues stemmed from two concentrated pools of risk which, when combined, proved to be nearly fatal.

The first, and best-known, of these poisons was the company's exposure to the US sub-prime mortgage market.

The Financial Products unit's ill-advised decision to take on enormous levels of counterparty risk in a series of credit default swaps caused $25bn of losses within several weeks in September 2008, and AIG came within a whisker of outright failure before a reluctant US government finally offered the $85bn bailout the company needed to survive.

A second, less publicised, issue at the company was its securities lending scheme.

Securities lending is a common practice among institutional investors seeking to extract that extra little bit of yield from their portfolio, and is a mainstay of short selling.

The lender, in this case AIG, loans its shares of certain companies in which it holds a long position to other parties for whatever purpose they see fit, usually to short-sell the security in question.

Companies with the scale of AIG tend to be unconcerned about the temporary short position of firms such as hedge funds, and are happy to lend their shares out for a fee.

They can then get the shares back when the shorter has closed out their position and make a tidy profit off whatever, normally safe, investment the seller has made with the capital provided by the borrower, on what would otherwise be an immobile asset

Unfortunately for AIG, what it presumably thought would be an uninspiring, tepid, but ultimately secure investment choice turned out to be fuel for the fire ignited by its Financial Products unit.

According to a paper by Anna Paulson of the Federal Reserve Bank of Chicago and Robert McDonald, a professor of finance at the Kellogg School of Management at Northwestern University, the company chose instead to invest its temporary windfall into what it believed were the safest of all short-term plays: the US housing market.

One can't necessarily blame AIG for making what proved to be such a fatal choice. The bulk of these bonds were AAA rated and it was by no means the only company to have been caught out on this side of the transaction.

But why was AIG the only (re)insurer to suffer such heavy losses as a consequence of this investment?

Different times

Back in the early 2000s there were few carriers in the global specialty market with an appetite for the more exotic risks offered by the financial markets.

Given that interest rates were much more favourable than they are now, there was simply no need to take on the risk of products such as mortgages and other loans.

A review of (re)insurers' earnings

Continued on page 12

calls from the third quarter of 2008 is revelatory on this topic, as their results demonstrate the degree to which the industry was, to a great extent, insulated from the convulsions that rippled throughout the wider financial world.

Given the prominence of AIG's near-death experience, virtually every executive in the industry was questioned to a greater or lesser extent by analysts on this topic at the time.

But what is really remarkable is the sanguine nature of responses given by carriers. Consider this example from then Chubb chairman and chief executive John Finnegan:

"Our capital base, overall financial strength in ratings, underwriting excellence and reputation for premier claims service uniquely position us in the current market environment.

"Having worked so hard to position our company as a market leader, we intend to take advantage of those opportunities which are within our underwriting appetite and meet our pricing parameters."

This is not exactly sounding the alarm to abandon ship, aboard a Tarp-shaped lifeboat!

Tarp – the US government's Troubled Asset Relief Program – was perhaps anathema to the (re)insurance industry, as was suggested by WR Berkley founder William Berkley at the time:

"I think that Berkley as well as a number of other well-capitalised insurers are opposed to property casualty companies participating in the Tarp programme.

"We don't think we need it and we don't think that for the most part the insurance industry needs the participation of the Tarp plan, and those companies that are seeking participation are seeking it primarily because of liquidity issues that could be dealt with the falling in securities as opposed to capital infusions.

"So we're not in favour of Tarp at all, for the insurance industry at least." Even the vast bond portfolios of (re)insurers were considered immune from the shocks rippling through global financial centres, and the collapses happening elsewhere were not something to be worried about, according to AmTrust's Barry Zyskind:

"As we mentioned, half the portfolio is in the AAA MBSs [mortgage-backed securities], which are government-backed, and then in the corporate portfolio the names that we are left with are names that we feel very, very comfortable with, and we don't see this situation again which happened with Lehman and Washington Mutual."

Contrast this with the curt introduction of AIG's firefighting chief executive at the time Ed Liddy, who in all fairness just probably wanted to get on with the whole thing:

"We have a really an awful lot to cover this morning, so bear with us."

> A review of (re)insurers' earnings calls from the third quarter of 2008 demonstrates the degree to which the industry was insulated from the convulsions that rippled throughout the wider financial world

Seemingly, at the height of the financial crisis, when the largest carrier in the industry appeared to be on the verge of collapse, others in the industry were entirely unworried.

But given the shocks that have affected these and other companies in the decade since AIG's fall from grace, is it possible that the impact of the next collapse will be more widely felt across the sector?

Mortgage (re)insurance

The (re)insurance world is a markedly different place these days to the one carriers and brokers inhabited back in the early 2000s.

Years of steadily falling rates and overcapacity have not only forced the industry to change its assumptions about the fundamentals of hard and soft market cycles, but have also prompted participants to look elsewhere for growth and profitability.

This need to diversify away from the traditional, comfortable markets in which the (re)insurance sector has always operated has manifested itself in a number of ways.

While InsurTech gains a lot of attention as the greatest potential force for disruption in the industry, a more subtle but no less important harbinger of change has increasingly been targeted by carriers over the last decade: mortgage (re)insurance.

This market has proved to be a fairly lucrative area in recent years, and ever more carriers are keen to get into it. The most spectacular example of this trend was Arch's blockbuster $3.4bn bid for AIG's mortgage unit, United Guaranty Corp (UGC).

Standard & Poor's (S&P) credit analyst Hardeep Manku described the bid as evidence of the Bermudian giant "doubling down" on the mortgage market – a clear bellwether for industry sentiment and the belief that mortgages once again represent an opportunity rather than an existential threat for carriers.

Given this widening of the industry's direct exposure to the whims of the global credit markets, should (re)insurers be worried about becoming the next AIG?

At the epicentre

When we talk about the global credit markets and their propensity to wreak havoc, we really are referring to one country above all others: the US.

US sub-prime housing loans were at the epicentre of the global financial crisis – the trigger for a quake that impacted the world's financial markets in much the same way as a real earthquake can affect the (re)insurance industry.

However, much has changed in the US credit space in the past decade. The gargantuan government-supported enterprises (GSEs), Fannie Mae and Freddie Mac, have embarked on a mass transfer of mortgage risk from the state into the private markets, and this has created a lucrative opening for the (re)insurance industry.

Joe Monaghan, executive managing director at Aon Benfield, reckons around 200 carriers have got in on the action, with around 75 percent of the risk transfer being conducted through bonds.

He says the reinsurance broker has helped place over $12bn of limit for GSEs into the private market over the last three years alone, spread across some 50 individual transactions. The total premium for these placements comes in at about $2.5bn, Monaghan estimates.

And this mass transfer of risk to the private sector, with all the attendant discipline that companies in this area typically bring to bear on their exposures, has changed the scope of underwriting quality for mortgages in the US. "Obviously, post-crisis, the quality of the underwriting has been absolutely pristine, and you have multiple people buying mortgage credit risk transfer today that were not doing it before," says Monaghan.

He blames the GSEs' core mission of expanding homeownership rates in the US as a key factor in the deterioration in mortgage risk quality in the 2000s.

Monaghan argues this created an incentive to allow poor-quality risk to balloon. In addition, the knowledge that the state would backstop any losses meant that the originators and underwriters in the market had little incentive to ensure their products were of high (or indeed, any) quality.

"[The GSEs] strayed from those core underwriting principles. The GSEs also serve a mission to expand home ownership. How do you balance this with prudent underwriting?" he asks. "I think having a number of private investors, including mortgage insurers, taking this risk acts in many ways as a second set of eyes and [a] governor on underwriting standards."

Underwriting quality

Taoufik Gharib, senior director at S&P Global Ratings, echoes this sentiment. But he also cites the raft of regulatory change spurred by the financial crisis as a significant factor in ensuring that carriers are careful in maintaining the quality of their mortgage risk.

"The advent of Dodd-Frank and the regulation around qualified mortgages and QRM mortgages are two guidelines that have been out there since the crisis, which basically determines the amount and type of due diligence that lenders have to do," he explains.

"So there is a lot of focus on the ability to pay from the lenders' perspective, and they have been under the lens in terms of the kind of collateral that is coming through."

But is this short-term shift in attitudes and discipline that has enticed carriers back into the mortgage (re)insurance game sustainable?

Gharib highlights that underwriting quality across all lines typically deteriorates over time.

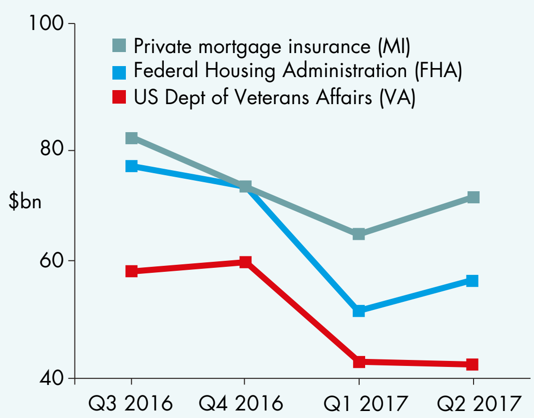
Given we are around a decade on from the last real estate bubble in the US, and just under a decade from the subprime mortgage-induced financial crisis, (re)insurers remain extremely conscious of the potential for their mortgage book to be an unexpected source of heavy and concentrated losses. The memories of AIG's spectacular decline are still fresh in the memory. "In any economic cycle, once the crisis hits you see a tightening of the mortgage underwriting quality, but over a period of time you see a sort of loosening because the risk appetite returns and there is an increase in how much a bank or lender wants to give out," says Gharib.

> AIG came within a whisker of outright failure before a reluctant US government finally offered the $85bn bailout the company needed to survive world

However, he adds, carriers are continuing to display a high degree of discipline: "[Loosening of underwriting standards] really has not happened yet. There has been some, but not to the extent that we would have expected."

His colleague Manku agrees, arguing that mortgage carriers have "learnt the lessons of 2008".

Total originations



Source: Inside Mortgage Finance

History repeating itself?

However fresh the scars of the 2008 financial crisis remain for the (re)insurance industry, mortgage business is increasingly becoming a source of growth and profits that is difficult to ignore at a time when the sector will jump at new opportunities for either. While (re)insurance rates continue their seemingly perpetual track downwards and the influx of excess underwriting capacity persists, carriers are bound to be attracted into new lines of growth. But those writing mortgage business should be aware that it comes with a warning label attached.

AIG managed to be pulled back from the brink only because of its sheer size and links with the wider economy; because the US government was willing to step in to stop further bloodshed following poor decisions made by a handful of operators.

Would it do so next time? The current mood in the White House suggests any form of government intervention in financial markets is unlikely in the near future. And other companies that do not carry the systemic importance of an AIG should think twice before hoping for a government bailout to stop their losses. Mortgage (re)insurance is here to stay. So let's hope the changes wrought in the market since 2008 are enough to prevent a similar – or even larger – crisis battering the industry once again.

Concord Specialty Risk®

Solutions for Mergers & Acquisitions, Uncertain Tax and Litigation

CorPro UNDERWRITING MANAGERS

Small-to-Middle Market Private and Non-Profit Management Liability

CorRisk SOLUTIONS

Solutions for Architects, Engineers and Landscape Architects

EmergIn Risk

Enterprise Solutions for Complex Cyber Risks

Global Special Risks®

Upstream and Midstream Oil and Gas Solutions

HG HUNTER GEORGE & PARTNERS

Solutions for Mergers & Acquisitions in Europe

INTERSTATE DELIVERS Insurance Management

Coverage for Transportation, Specialty Property and Casualty Exposures

LifeScienceRisk®

Pharmaceuticals, Medical Devices, Biotechnology and Supplements

PERse POWER · ENERGY · RISK securing the environment

Property and Casualty Coverage with a focus on renewable energy

RSG RYAN SPECIALTY GROUP DENMARK

Professional Liability solutions including D&O and Management Liability

RSG RYAN SPECIALTY GROUP SWEDEN

Professional Liability solutions including D&O and Management Liability

SAFEWATERS UNDERWRITING MANAGERS

Insurance and Risk Mitigation for Yachts and Cargo

SapphireBlue®

Professional and General Liability for large Healthcare Facilities

STARTPOINT EXECUTIVE RISKS

US and International Management Liability

TRU TechnicalRisk® UNDERWRITERS

Solutions for Complex Construction and Commercial Property

thinkrisk®

Professional Lines for Cyber, Media, MPL and Insurance Agents and Brokers

TRIDENT MARINE MANAGERS

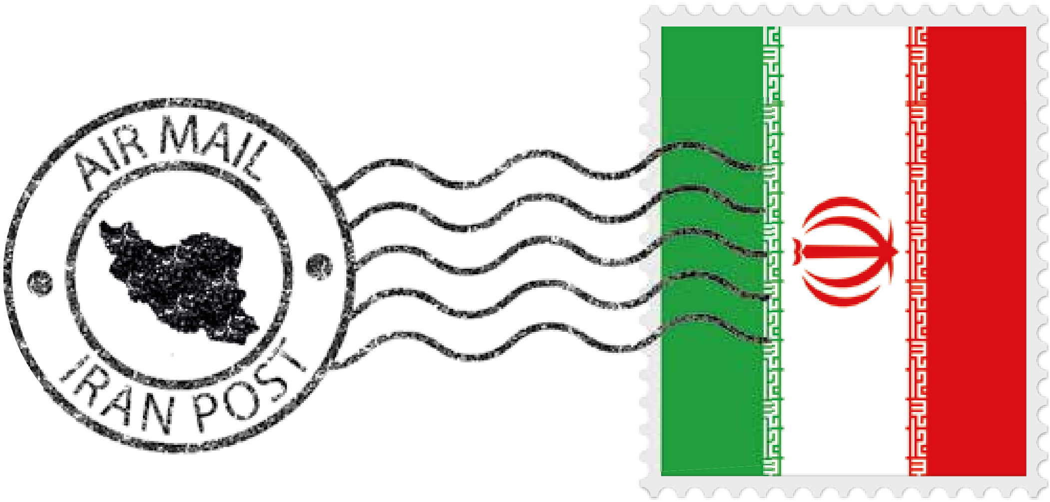
Marine and Offshore Energy Insurance Specialists

WINDWARD SPECIALTY

Commercial and Complex Property Solutions

wkfc® underwriting managers

E&S Property and General Liability Solutions



THE PERSIAN PARADOX

Bringing Iran on-risk involves negotiating a tangled web of competing political views, economic sanctions and financial regulations, writes **Bernard Goyder**

Iran presents a conundrum for global insurers. Since January 2016 EU financial sanctions have been lifted on the Islamic Republic, but carriers have held back, tentatively waiting for others to jump into a market hungry for international insurance and reinsurance capacity.

Iranian risks used to be a common sight on underwriters' desks in the London market, but demand has dropped since the United Nations introduced sweeping financial sanctions a decade ago.

The sanctions crippled an Iranian economy cut off from capital by US trade restrictions – a longstanding feature of the tense relationship between Tehran and Washington DC since the 1979 hostage crisis.

Now specialty insurers and reinsurers are exploring Iran's potential as a growth market.

To write Iranian business, carriers must navigate a Kaftkaesque web of contradictory rules, sanctions and political pressures.

The prize is a rapidly growing insurance market of 80 million people, living above the world's fourth largest oil reserves.

Brokering Iran

United Insurance Brokers (UIB) has been placing Iranian risks since the 1980s.

As Ralph Kabban, the managing director of UIB in Dubai, says: "Before the sanctions came in we did their entire oil and gas output."

"We've been there through all its political upheaval," Kabban continues. "We've seen it right through. Because of our history, clients in Iran have a sense of comfort dealing with us."

UIB has a representative in Tehran. The company works with Iranian insurers, reinsurers and brokers to place risks into the global market.

Kabban has been impressed by the quality of the risks available in the Iranian market, compared to the often ropey private sector energy assets in other countries. "Many of the energy risks are government-owned – as state assets they are well maintained, well taken care of," he says.

"Any London broker can do it," enthuses Kabban.

Ed is another intermediary putting Iranian risks into the market.

The wholesale broker, formerly known as Cooper Gay, has built a facility in the Lloyd's market, led by Munich Re Syndicate 457.

The arrangement gives facultative insurance to upstream energy risks, power plants, mines, third party liability, telecoms and even satellites.

Led by Ed's Iran country manager, Khosro Azad, the broker has lined up EUR1bn of upstream energy capacity, with up to EUR600mn available for

other lines. According to Ed, Iranian energy sector insurance buyers have responded enthusiastically, with policies covering the South Pars gas field now placed in the London market.

A sophisticated market

According to data from the Insurance Information Institute, the Iranian market wrote over $7bn in annual gross written premiums in 2015.

Cut off from Western insurance capital, Iran is reliant on its domestic market to cover complex assets, from ships and aircraft to oil installations and infrastructure construction.

"The Iranian market has become quite self-sufficient," Kabban notes.

Fast growth in personal lines is also set to push up demand for treaty coverage.

As Abdolnaser Hemmati, the head of Iran's insurance regulator Bimeh Markazi Iran, told *Business Tribune* in June, Iran's insurance penetration rate grew by 0.5 percent in the year to 20 March 2017, to reach 2.2 percent. That's higher than Greece, which had 2.0 percent insurance penetration in 2015.

Patrick Murphy, a partner at Clyde & Co specialising in shipping and sanctions, says: "There is actually quite a sizable local insurance market." "Anecdotally, most of it is reinsured in the domestic market. Bimeh Iran [the state-run insurance company] will write it," says the lawyer.

"It's the largest Islamic insurance market in the world," Murphy adds.

According to the Dubai Center for Islamic Banking and Finance, Iran makes up more than two-fifths of global sharia-compliant insurance premiums. To reinsure this booming market, Iranian carriers look east.

Three sources told *Insider Quarterly* that Chinese and Japanese reinsurers are involved in writing Iranian treaty business.

And an underwriter working at an Iranian reinsurer in the Arab world also told *IQ* that plenty of Iranian treaty reinsurance was being funnelled to India.

In April, Bimeh Markazi Iran president Hemmati met with Alice Vaidyan, the CEO of General Insurance Corporation of India (GIC Re), in talks aimed at tightening existing ties. The discussions in Bangkok took place on the fringes of the Asian Reinsurance Corporation board, on which Hemmati sits.

Mehr News Agency reported that Hemmati offered Vaidyan Iranian retrocession capacity, in a sign that

Continued on page 18

Iranian insurance market statistics (For the year to 20 March 2017)

PREMIUM

TOTAL MARKET PREMIUM:
277.2tn rials ($7.4bn)
(Growth of 22.5 percent compared with the prior-year period)

MARKET SHARE
Private companies:
62.2 percent
(3.0 percent growth from prior-year period)
Iran Insurance Company:
37.8 percent

CLAIMS

TOTAL CLAIMS PAID:
180.2tn rials ($4.8bn)
(Claims volume increased 24.8 percent year-on-year)

MARKET SHARE
Private companies:
57.3 percent
Iran Insurance Company:
42.7 percent

OTHER

INSURANCE PENETRATION:
2.1 percent
(Increase of 0.4% on the prior-year period)

LOSS RATIO
Overall market:
78.0 percent
Private companies:
59.5 percent
Iran Insurance Company:
74.2 percent

Source: Bimeh Markazi Iran press release, 2 August 2017

Iran will use its state-run insurance industry to strike deals with other emerging market powers.

Receding sanctions

After years of talks involving the US, the UK, Germany, France, Russia and China, Iran signed a deal limiting its nuclear ambitions that led to most sanctions being lifted in January 2016.

"When the EU sanctions were released we saw a flurry of queries," says Peter Hodgins, a partner at Clyde & Co in Dubai. "Things have quietened down since," he adds. "Frankly, everything ground to a halt very quickly."

American sanctions still ban US entities from engaging in Iran-related trade, making it impossible for US banks to clear Iranian transactions.

And banks have maintained de facto sanctions against Iran by refusing to touch dollars that have been anywhere near Iranian counterparties.

For banks, it is a case of 'once bitten, twice terrified' at the prospect of breaching sanctions. BNP Paribas, for instance, was fined EUR8.9bn by the US Justice Department in 2014 over sanctions violations. And in 2012, UK banks HSBC and Standard Chartered also felt the wrath of the US and coughed up heavy fines.

"As long as the US sanctions remain, the risks outweigh the benefits," comments Hodgins.

A reinsurance underwriter says: "It depends on who your banking partner is. I understand that Lloyd's and Xchanging are no longer cooperating, you have to do a direct payment."

"But if you've got a compliant bank, it can be done," the source notes.

The standard system for international cash transfers, Swift, does not work in Iran.

As Hodgins notes, although Iranian premiums can be handled in euros, in practice many banks have made it a condition of doing business that transacting with Iran is avoided.

"Everything has to be totally ring-fenced" says one political risk broker, "a lot of people are still blocked by their banks".

Export credit agencies

Government providers of export finance and trade credit insurance, known as export credit agencies (ECAs), are keen to fill in the gap left by the private sector in Iran. Swedish and Swiss ECAs are said to be active providers of credit insurance.

As far as the UK government's lending and trade credit insurance arm, UK Export Finance (UKEF), is concerned, things have been quiet. A source says that the banks' cautious attitude means that UKEF has yet to back British exports to Iran since EU sanctions were lifted, but that the agency is "ready to provide financing support as financing channels open up".

Part of the Persian paradox is that while one part of the UK Treasury, UKEF, is trying to promote exports to Iran, another group of mandarins in a different part of the same building is mandated with implementing existing sanctions on the country.

Individuals and businesses linked to the Islamic Revolutionary Guard Corp (IRGC), a branch of Iran's armed forces tasked with protecting the country's Islamic system, are subject to EU banning orders, as are all weapons exports.

There are 276 mentions of "Iran" on the UK sanctions list – including many individuals and companies connected to the IRGC.

Doing insurance business in Iran without attracting the ire of the US and its regional allies such as Saudi Arabia and the United Arab Emirates requires a lot of due diligence. As Kabban notes: "We have a stringent compliance regime."

The UAE has become the main entrepôt for Iranian reinsurers, despite restrictions.

"Officially, the UAE cannot transact with Iranian insurers," says a legal source. "However, there are ways round that that Iranians have. Dual nationality Iranians tend to operate in the UAE."

The worst nightmare for corporates is getting on the wrong side of the US. The US Treasury Department's Office of Foreign Asset Control (OFAC) operates in Dubai, where it works closely with the local authorities to ensure US sanctions are complied with. The legal source says no one wants a knock on the door from OFAC. "It's a very apt name for that agency," he jokes.

Parallel state

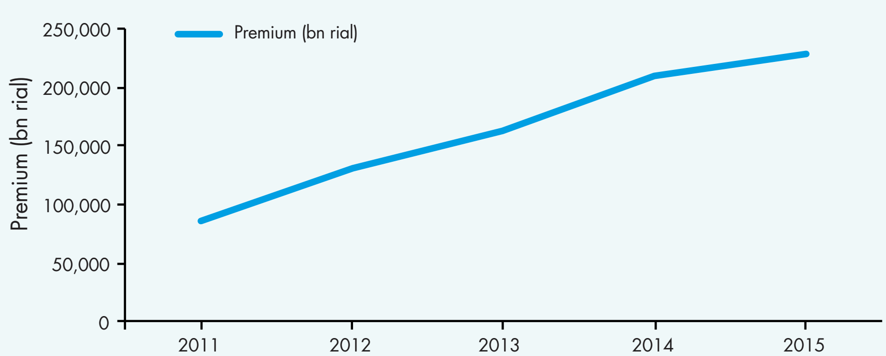
"It is very important to keep in mind that Iran has at least two parallel foreign policies going on at once," explains Laura James, a senior Middle East analyst at the advisory consultancy Oxford Analytica.

Iran's reformist president, Hassan Rouhani, was re-elected with over 57 percent of the vote in May. Rouhani has been the leading the effort to bring Iran back into the world economy by making concessions on nuclear weapons development.

But in his way stands not just US president Donald Trump, who has described the Iran pact as a "bad deal", but also more conservative forces inside Iran.

"There's the Rouhani nuclear deal foreign policy, and then there

Iranian insurance market premium growth



Source: Bimeh Markazi Iran Annual Report 2015-2016 is the Islamic Revolutionary Guard Corp foreign policy. The IRGC gets to decide which countries Iran intervenes in and helps militias and sends arms to," says James.

Iran exercises a muscular foreign policy in the Middle East. The country is allied to the Iraqi government of Prime Minister Haider al-Abadi and President Bashir Al Assad in Syria. In Lebanon, Iran has close military ties with Hezbollah which, as well as being a heavily armed militia, sits in the country's ruling coalition government.

"The US still classes them as a state sponsor of terror," says Clyde & Co's Murphy.

And James argues that Rouhani will be unable to remove sanctions totally.

"Plan A was: agree the nuclear deal with the US and world powers, get sanctions fully lifted, get foreign investment flooding in, and then you don't have to worry about more difficult reforms to banking and pensions and the insurance industry – that's not so important, because you've got the foreign investment influx.

"He's not going to get plan A to work," she says.

US lawmakers have been unwilling to give full sanctions relief. While Trump has kept the nuclear deal in place, the unpredictable president has a tendency to execute volte-faces on important policy issues.

James believes that companies are still going to hang back from investing in Iran, "because they are worried about what the US is planning to do... [Rouhani is] going to have to focus on plan B, with Asian money coming in and some European money".

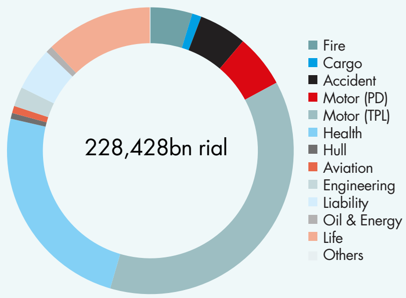
For the insurance industry, the difficulties of attracting investment to Iran mean that the bulk of Iranian risks being covered by international (re)insurers are likely to remain domestic for some time to come.

Foreign investments

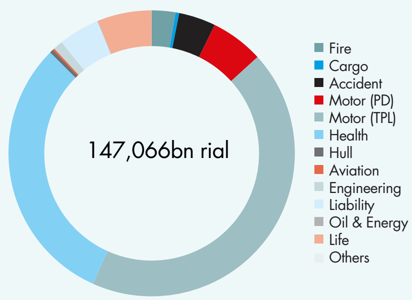
Nonetheless, the pipeline for insurable risks exposed to Iran is looking healthy. In July, Total signed

Iranian (re)insurance market

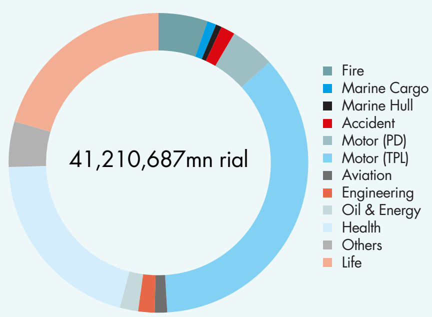
Direct insurance premiums (2015)



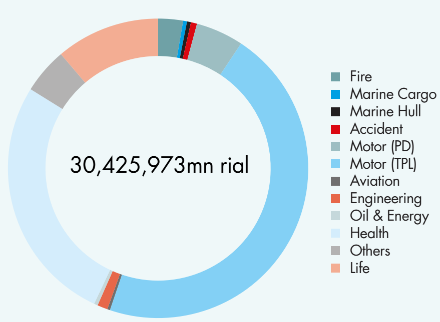
Insurance claims paid (2015)



Reinsurance business (2015-2016)



Reinsurance claims paid (2015-2016)



Source: Bimeh Markazi Iran Annual Report 2015-2016

a $4.8bn deal with Iran giving the French oil giant a 50.1 percent stake in the world's largest gas field, South Pars 11.

The French are keen to do business with Iran. Kabban notes: "French reinsurers are the most ahead. [They] have a long history of dealing with the Iranians."

Shell signed an agreement in December 2016 to develop Iranian oil and gas fields, while the Italian oil company Eni signed a similar contract in January.

An underwriting source tells *IQ*: "There was this early promise of gold at the end of the rainbow. There's certainly business coming through, [but] there should be more, particularly in terms of some of the development projects, and particularly with the likes of oil majors like Total back in the region. There will be some more construction activity coming down the line."

Even Boeing has received an exemption from OFAC to sell planes to Iranian airlines. The aircraft manufacturer finalised a credit insurance facility with Marsh, but it remains to be seen whether the broker will allow the loans financing Boeing's exports to Iran – which are controversial in the US – to be insured through its facility.

Bird without wings

Iran presents an immense challenge to (re)insurers. The legal and financial complexities of insuring Iranian risks are a compliance department's nightmare and a City law firm's dream.

For more adventurous brokers and carriers, the rewards are clear. A rapidly growing insurance market, with a growing appetite for treaty capacity, and an oil industry that requires specialty insurance solutions can provide global carriers with a welcome injection of premium.

But working to build understanding and respect for Iran and Iranians must be a prerequisite for doing business in the country.

As the medieval Persian poet Saadi Shirazi said: "A traveller without knowledge is a bird without wings."

POWERING AHEAD

The power and energy sector is set for a cyber insurance explosion, finds **Laura Board**, but accurately assessing the risk can still confound insureds and carriers alike

December in Western Ukraine isn't a time or a place where you'd want to be without electricity, but an estimated 230,000 people experienced just that in 2015 when hackers shut down the supply from three utilities by disseminating malware.

Within Ukraine, the attack was immediately suspected to have emanated from its easterly superpower neighbour. Outside the civil war-stricken country, the event took on a different significance. It confirmed fears that where once hackers targeted customer data at retailers, banks and internet service providers, they were now seeking to wreak physical damage on critical infrastructure.

Obstacles to coverage

Power and energy companies haven't traditionally seen themselves as obvious targets for hackers.

Back in 2015, an Aon risk management survey showed only 14 percent of utilities respondents had already purchased cyber cover, the lowest proportion of any sector.

And in the oil and gas industry, an oil price slump from June 2014 crimped energy insurance premiums overall and made cost-conscious management think twice about spending on what is often very limited cyber protection.

But attacks in Ukraine and elsewhere have forced a reassessment, just as energy groups' and utilities' growing reliance on interconnected technology has made them increasingly vulnerable.

The World Energy Council and the European Commission (EC) both recently highlighted cyber risk as a prime concern in the energy sector, given that it could cause major operational failure of an asset.

In a February 2017 report, the EC called on the insurance industry to develop instruments to address potentially catastrophic losses in the sector.

And demand for cyber insurance is clearly on the rise. The 2015 Aon survey found that more respondents in the utilities sector than any other industry planned to buy it in future.

Andrew Herring, head of Marsh's Emea energy practice, says: "We are seeing a significant increase in energy companies' appetite to buy cyber insurance. It is more prevalent in North America and that is also reflected in the oil and gas industry, though power has been ahead of oil and gas in that regard."

But there are obstacles on the carriers' side too. As with cyber risk in general, underwriters complain of insufficient data to price risk accurately and say that energy companies aren't always coming

Continued on page 22

clean about cyber breaches. Clyde & Co partner Helen Bourne, who is head of the law firm's UK cyber team, notes: "There are undoubtedly challenges for insureds in being able to give a fair presentation of the risk. The environment they are operating in is possibly unique and cyber risk introduces a lot more doubt into the process. Another challenge is that there isn't a universal cyber security standard that any company has to meet."

A further obstacle is the lack of a common policy language, with carriers taking divergent routes to providing cover for energy clients.

Marsh's Herring says: "We need to be able to offer clients hundreds of millions of capacity for that remote but potential cat event, but if we can't get a common approach from carriers we can't get that sort of cover."

Standard exclusion

Cyber attack became a standard property policy exclusion in 2003, with most markets using clause CL380 to exclude cover for losses "indirectly caused by or contributed to by, or arising from the use or operation, as a means of inflicting harm, of any computer, computer system, computer software program, malicious code, computer virus or process or any other electronic system".

In the past few years, underwriters in the downstream sector have begun providing cover for physical damage caused by cyber attack-related fires and explosion. But many are holding out in the upstream sector.

Herring says: "Carriers are restricted by what their treaties will allow them to do and the message from the treaty market is somewhat confused. CL380 is driven by marine and energy treaties and while exceptions are available on a referral basis, it is a pretty clumsy approach."

John Cooper, JLT Specialty's managing director of technical energy business, offers an additional explanation.

"In the downstream market there's arguably a much wider pool of leaders, so they haven't been able to resist the brokers' attempts to include resultant damage from cyber attacks, whereas in the upstream market there is a more concentrated pool of potential leaders who have been able to resist the deletion of CL380," he says.

> With cyber risk in general, underwriters complain of insufficient data to price risk accurately and say that energy companies aren't always coming clean about cyber breaches

Moves to rethink the CL380 exclusion are divisive. In the upstream sector, carriers including QBE and XL Catlin have begun offering the so-called cyber attack buyback endorsement (Cabbe), which offers a partial CL380 writeback. Clyde & Co is currently assessing the Cabbe wording for the Lloyd's Market Association.

But critics point out several shortfalls with Cabbe, including the fact that indemnity is restricted to the value of the largest asset attacked, and that contingent business interruption insurance is excluded.

Writebacks

More comprehensive cover is offered by Marsh's Cyber Gap insurance product, which effectively negates the CL380 exclusion, electronic data exclusion NMA2914, and an associated terrorism exclusion. The product offers a limit under standalone cover of $432mn for a single client.

And this year Munich Re Syndicate launched a new cyber product for small and mid-sized upstream and midstream energy clients.

Munich Re Syndicate chief underwriting officer Dominick Hoare says: "The basic concept is that the cyber risk in the energy sector, particularly the upstream oil and gas sector, is increasing significantly, and as everything becomes more automated we certainly see a heightened risk."

The product writes back the CL380 cyber exclusion completely without the restrictions of a Cabbe. The syndicate is offering $100mn of sub-limit to the original policy and expects to increase that over the next 12 months where demand warrants.

"If the original policy gives business interruption, this gives business interruption. We are keeping it very simple and very broad," says Hoare.

The cover also provides non-physical damage business interruption insurance in the event of a data breach.

Munich Re's Hoare is alarmed by some of the efforts to address the energy cyber gap, while both the Prudential Regulation Authority and Lloyd's have expressed concern about risk aggregation.

Hoare says: "There are elements of the energy market offering on occasion CL380 writebacks, but there is no risk assessment nor technical pricing. Unless you approach [underwriting] from a technical point of view it is going to fall apart pretty soon."

He adds: "A personal concern of mine is that many entities are not paying due attention. They are not looking at the accumulation of the risk, so there could be a big issue somewhere down the line.

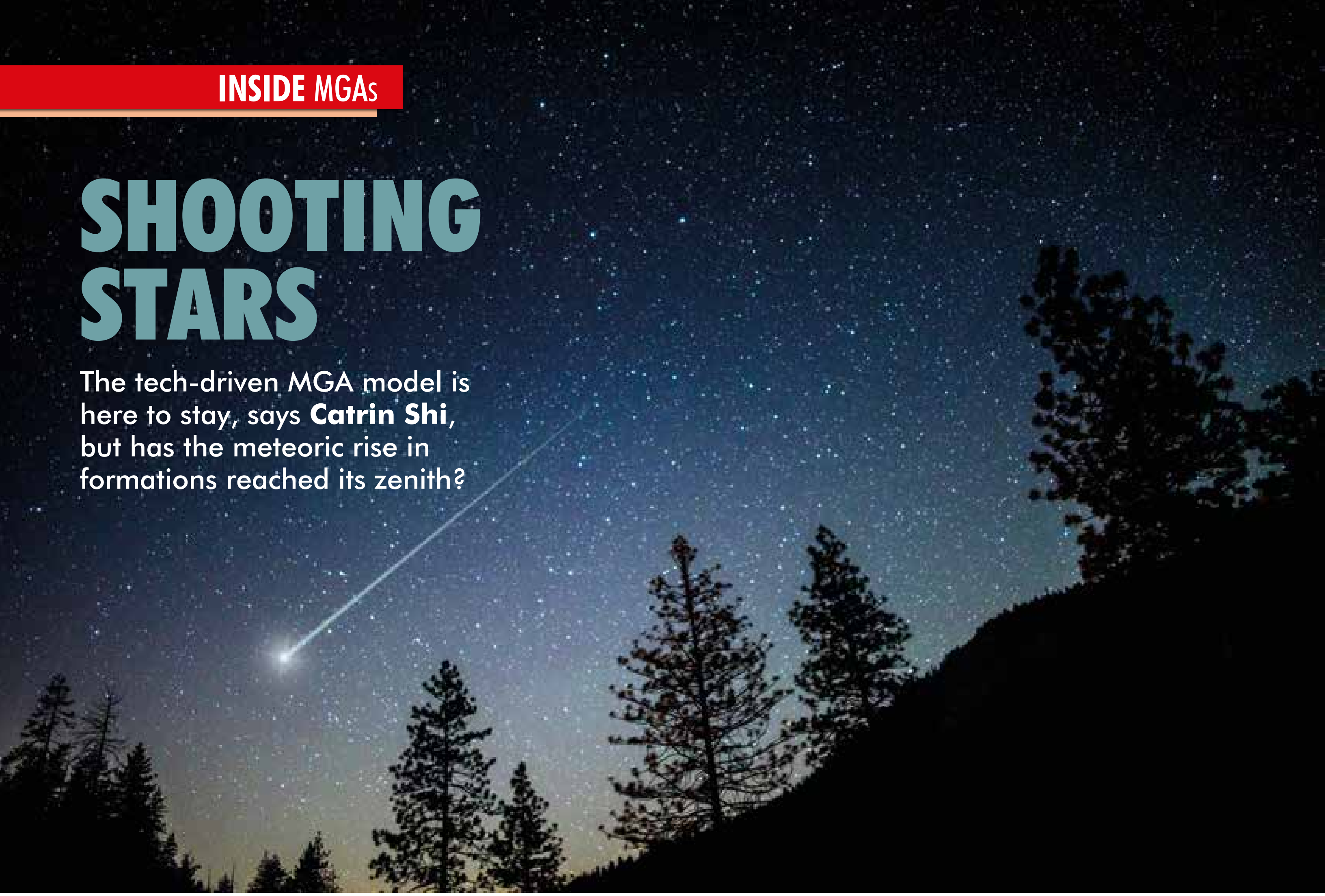
"That would be very damaging for a market that is trying to grow."

Market participants appear to share a "not if, but when" expectation of a major cyber-related energy sector event, which could generate many hundreds of millions of dollars in losses.

Whether that involves the catastrophic breakdown of high-speed machinery at a petrochemicals facility, coordinated attacks on nuclear installations or oil rig explosions, the cyber energy insurance market would get an instant fillip.

However, it could also leave some insurers extremely exposed.

As one underwriter says: "The issue for all these markets is a systemic problem. If one platform blows up, we can deal with it. If 10 platforms blow up, that isn't what we want to confront."



SHOOTING STARS

The tech-driven MGA model is here to stay, says **Catrin Shi**, but has the meteoric rise in formations reached its zenith?

Few phenomena in the London market have attracted as much attention this year as the increasingly prolific formation of MGAs.

With multiple launches, M&A deals and eye-wateringly expensive private equity buy-ins, the MGA space has made the headlines on numerous occasions during the course of 2017.

Seasoned observers of the (re)insurance sector will argue that delegated authority business is nothing new in this industry, and therefore perhaps not worth the column inches, but the rate of increase in the number of these agencies in London alone has been enough to raise the question of whether the humble MGA has the potential to change the shape of the market for good.

It is thought that there are now in excess of 300 MGAs across the UK, underwriting gross premiums in the region of £5bn.

But while they may have previously carried the stigma of loose underwriting, poor record-keeping and the unnecessary loading of cost and complication onto naïve capital providers, that image problem is now receding.

The new breed of MGA is capital-light, cost-efficient and uses technology and data to its advantage to target niche product lines and distribution channels.

"The days of a delegated authority business held by brokers burning a syndicate or an insurer I think are gone," says Peter Staddon, managing director of the Managing General Agents' Association. "They are much more professional, much more intelligent."

But the easing of the old MGA stigma has only played a part in encouraging new MGAs to the sector. And while many would call the rise in the number of MGAs a symptom of the prevailing soft market, there are other factors at play which have contributed to this trend.

"There have been a number of success stories in the MGA space recently: Dual, Pioneer, CFC and Nexus being the more high-profile," explains Colin Thompson, executive chairman and founder of Nexus Underwriting. "The MGA model provides a framework for innovative and entrepreneurial underwriters to create value for themselves and for their underwriting partners."

Entrepreneurial streak

The MGA model offers a fast-track route to market with low barriers to entry, as well as the chance to hold an equity stake in your own firm. MGAs are also cash-generative and debt-friendly – an attractive combination for underwriters with an entrepreneurial streak.

Current market forces have made it extremely difficult for start-ups to build sufficient critical mass for a balance sheet business, which also comes with an extra regulatory burden.

Meanwhile, London market success stories such as cyber-specialist CFC – which secured a 15x forward Ebitda valuation in its 40 percent buy-in from private equity house Vitruvian – have demonstrated that MGAs and fee-generating businesses can command rich multiples at the deal table.

"I think certainly in my years working in the insurance market there are some routes entrepreneurs would have traditionally gone down which are less attractive now, as there is more red tape to go through and it takes much longer," says Mark Birrell, CEO of MGA incubator Castel.

"The speed to market is very appealing to these entrepreneurs, and an MGA offers the opportunity for them to be judged on their own performance of their book, rather than being part of something bigger."

However, for an MGA to be effective, it must be able to provide its capacity providers with a route to niche products and distribution that they would otherwise find difficult to access, Birrell explains.

This could be in the form of niche underwriting areas, new customer bases or targeting business too small for traditional carriers to write economically – and is certainly the formula MGA start-ups in the London market have followed in the first half of 2017.

Examples include superyacht-focused Yachtpod Risk Partners, led by former MS Amlin underwriters Iain Cotton and Vladimir Mirosevic-Sorgo, and two M&A insurance-focused MGAs – Acquinex and Capital Risks – which have chosen to home in on warranty and indemnity cover for smaller deal sizes currently underserved by the traditional market.

Other specialist MGAs known to be in the pipeline include a cyber reinsurance-focused start-up, led by former Hiscox Re specialty head Rob Ashton in collaboration with Fidelis, as well as a Novae-backed bloodstock MGA and an airline MGA led by former AIG airlines head Andy Trundle.

Rise of the incubator

However, not all underwriters with a good idea and big ambitions can successfully launch an MGA.

"There are lots of very, very good underwriters out there – but very few know how to run a business," explains Staddon. "And that's where incubators start to play."

With the rise of the MGA has also come the rise of the MGA incubator – platforms designed to give entrepreneurs a financial and logistical leg-up in the market.

A growing number of incubators have been launched to feed the demand for MGA or cell start-up services, which, in the case of traditional carriers, can provide a welcome additional stream of fee income in a soft market.

Tom Milligan's venture capital launch Beat Capital started backing MGAs in January this year, with Geoff Pryor-White's cyber launch Tarian marking its first investment.

> "The MGA model offers a fast-track route to market with low barriers to entry, as well as the chance to hold an equity stake in your own firm"

Pine Brook's Vibe also launched an MGA incubator in June. It will compete with the likes of Pioneer, Castel, Nexus, Acappella, Eaton Gate and service-focused offerings such as those from Asta and Capita.

Using an incubator allows the entrepreneur to leverage the platform's regulatory approval and infrastructure to launch their business more quickly and cost-effectively than going it alone.

The incubator will often look to invest in the start-up, with a view to exiting via a capital event at a later date.

"If you go your own route, it can take six to 12 months just to get Financial Conduct Authority sign-off," explains Birrell. "In parallel with that you have to create all the infrastructure, get your capacity on board and the capital behind you to do it.

"In our incubator model we are very keen for the entrepreneur to get equity in the business from day one, and we provide them with the infrastructure so they can get trading very quickly."

Entrepreneurs also benefit from being around other innovative and ambitious types, Birrell adds.

"Whenever you start up a business you have incredibly high highs and incredibly low lows. What we like to think is that with the Castel model – having all our underwriting cells under one umbrella – we can help smooth out those highs and lows."

Entrepreneurs usually present their own business plan to incubators, or are introduced to an incubator by brokers, capacity providers or headhunters.

The business plan is then scrutinised by the platform on its financial merits, the market appetite for the proposed business and also on whether it aligns with the incubator's own interests.

"For me the MGA still really is about the individual," explains Danny Maleary, CEO of Vibe MGA Management. "There are a lot of MGA teams that I see that are not MGA underwriters. The MGA underwriter is typically a developmental underwriter who sees innovation around product, who isn't looking to create an empire, and is looking to make a difference to the customer experience."

Capital events

Many of the underwriters behind the start-up MGAs will ultimately be looking for a capital event, and recent deals have shown private equity is ready with money to spend.

CFC's 15x forward Ebitda valuation is often highlighted as an example, but this hefty multiple does not necessarily set a precedent for other MGAs looking to secure private equity funding, explains KMPG UK head of financial services M&A Mark Flenner, who advised on the deal.

Continued on page 26

"What the CFC deal indicated is that for the right size, good management and good results you can command a good price," he says. "It also reinforces the view that private equity is attracted to the non-risk carrying segment of the UK and US insurance market, which they see as high-margin and high-growth."

At the small end, private equity will look to invest £10mn-£20mn of capital in MGAs, but this can go up into the hundreds of millions, he explains. For a £10mn-£20mn investment, a business would need to have a value of about £20mn-£30mn.

To gain the attention of the private equity houses, a certain scale is needed – a difficult feat to achieve organically at the current stage of the soft market. This desire to secure a capital event could push the market to consolidate, explains John Holm, MGA investments executive at Asta Underwriting Management.

"M&A gets you up to critical mass and makes you more attractive to sale," he said. "But more generally I expect more consolidation among MGAs – you are seeing it already. We also saw it in the broker market, where founding executives were reaching retirement and wanted to cash in their equity."

Nexus' Thompson also claims the MGA space is "definitely ready" for consolidation. He points to the US, where there are a number of MGAs each writing over $1bn in premium.

"This puts them in a more powerful negotiating position and also delivers economies of scale," he says.

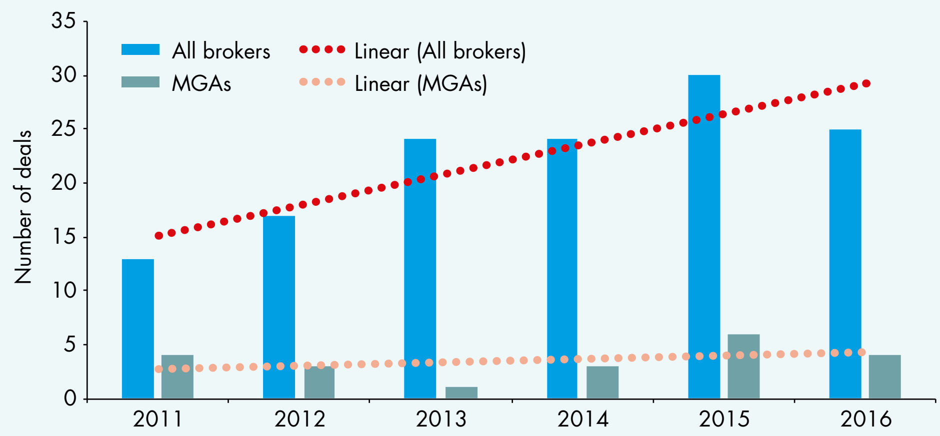
MGA peak?

Does that mean then, that the London market has reached peak MGA?

MGAs will always have a certain level of vulnerability, as they are dependent on their capacity providers for business. Asta's Holm notes that after the 9/11 terror attack, capacity was quickly withdrawn from the space, which pushed many MGAs to the brink.

Holm and others concur that the MGA model is here to stay – however, it will continue to evolve, with some even starting to take on risk themselves.

M&A deals 2011 to 2016



Source: IMAS

"Those MGAs who do embrace technology and have control around data will become more confident around the risks they are seeing," says Vibe's Maleary.

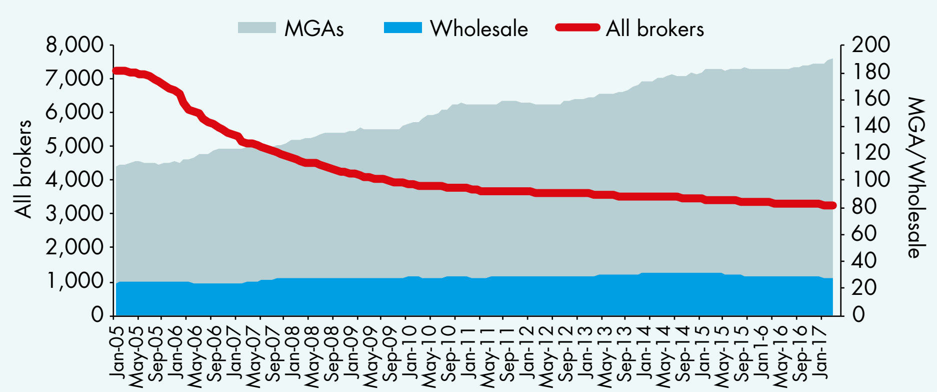
"I believe they will start to retain risks themselves in addition to traditional delegated authority business with third-party capital." He adds: "If I was a chief underwriting officer of an insurance entity I would absolutely be embracing the world of delegated authority alongside my traditional open market platforms, especially when you think that cost reduction is such a huge focus at the moment."

MGAs can also evolve by sourcing reinsurance for their own portfolios, which is then ultimately purchased by their underwriting partners, giving MGAs more control over the coverage offered by the reinsurers and therefore more consistency going forward, Thompson at Nexus notes.

But the executive chairman also believes MGAs must embrace InsurTech to be seen by the market as forward-looking and relevant at every level of the transactional process.

Thompson says: "Overall I think it will be a blend of MGAs operating as a 'virtual' insurance company, underwriting at greater capacity, offering a more varied product range, and all underpinned by leading technology, to remain cost-efficient and competitive."

MGA and wholesale brokers vs total broker market



Source: IMAS


Specialist Outsourcing & Consulting
THE MARKET LEADER IN
LEGACY PORTFOLIO
MANAGEMENT
Pro is the trusted service provider focused solely on the global (re)insurance industry. We provide end-to-end solutions for all run-off portfolios, combining our 30 year expertise to fully manage your legacy books.
Our experienced run-off practitioners work in conjunction with clients to define, plan & implement bespoke legacy management strategies. Delivering flexible and innovative solutions that are tailored to your needs, whatever size or complexity.
Find out more at pro-global.com
Pro.

BUILT-IN RESISTANCE

Can cat bonds help end poverty? **Lucy Jones** investigates how retro-fitting catastrophe-prone properties could spur ILS coverage in emerging nations

Medellín, Colombia – one target for Build Change's retrofitting programme

The destiny of South America's shanty towns may soon be aligned with insurance-linked securities (ILS) investors in an ambitious transaction that aims to improve their chances of withstanding natural catastrophes.

The project is the brainchild of US-based non-governmental organisation Build Change, which designs disaster-resistant homes and schools in emerging nations in partnership with catastrophe risk modeller RMS.

Their vision is to retrofit dozens of neighbourhoods in about six cities to make them attractive to ILS capital.

Alongside the World Bank's $425mn pandemic insurance facility and the proposed UK foreign aid catastrophe bond, the project is one of several where ILS investor appetite for new risk is being channelled into emerging world development.

Risk transfer is now seen by the UN as a "fundamental arrow in [its] quiver" to address disaster risk, as Robert Glasser, the UN Secretary-General's special representative for disaster risk reduction, said at the Global Platform for Disaster Risk Reduction in Mexico in June.

It was also a mantra of the previous UN Secretary General Ban Ki-moon that insurance was central to reducing the exposure of the poorest people to climate catastrophes. In 2015, the G7 promised climate risk insurance for 400 million of the world's most vulnerable people within five years.

In so-called "informal neighbourhoods", such as those seen in some Latin American countries, buildings are frequently built spontaneously, without any design practice or legal procedures, using poor-quality construction materials.

As families grow, upper storeys are added on top of buildings, making these homes highly susceptible to flood and earthquake.

Over the past decade, working in 12 countries, Build Change has made over 50,000 such buildings safer and trained 30,000 people to do the same. Sometimes structures are rebuilt, but often they are reinforced.

Retrofitting is already underway in Bogota in Colombia, but discussions on similar schemes are also taking place with authorities in the second largest Colombian city, Medellín, as well as Quito in Ecuador, San Juan in Puerto Rico, Santiago in Chile and Mexico City.

A forum of interested parties was held recently, at which the World Bank and Swiss Re became part of the conversation about disaster-resistant homes.

Parametric pay-off

Once these neighbourhoods have been made insurable through retrofitting, the plan is to structure a parametric ILS transaction protecting the dwellers against hurricane and flood.

The aim is to construct a multicity transaction from the outset, with local governments paying the premiums and the risk being farmed out to the capital markets.

One issue that the buyers of cover often raise about parametric ILS transactions is whether the trigger – which is aligned with physical characteristics of an event such as shake strength or wind force – will provide protection that meets their actual losses.

But anxiety about basis risk "should never be a showstopper", says RMS managing director Daniel Stander.

"It's well understood that the bond is not in place to recover all of a municipality's losses, so a perfect match between loss experience and payout isn't really the goal," Stander says.

It is important to quantify the sources of basis risk and design a transaction which meets a city's appetite for it.

"City officials are looking for an injection of cash or services immediately post-event. If used effectively, this liquidity can accelerate emergency response, expedite recovery and prevent a disaster becoming a humanitarian crisis."

Such a transaction could be at least two years off, and the various political wills need to be aligned, but the result would be a naturally diversified portfolio that could be bundled up into a single public or private deal.

"Resilience bonds", as these types of transactions have been dubbed, are currently being scrutinised by Swiss Re's Global Partnerships division, which was established in 2011 to help national and municipal governments strengthen their ability to face disaster.

The idea is to find ways of monetising avoided losses, says Ivo Menzinger, a leader of Europe, the Middle East and Africa at Swiss Re's Global Partnerships.

If risk is reduced, the expected loss is lower, which means the insurance premium reduces over time.

"The key question is whether the saving in the future can be leveraged today to partially finance risk reduction measures," says Menzinger.

Catastrophe reinsurance schemes

Year	Initiative	Amount ($mn)	Description
2017	Philippines cat risk scheme	206	Covers typhoon, earthquake; reinsurers include Nephila, Swiss Re, Axa, Hannover Re
	Philippines parametric insurance	19.5	Pilot project, provides typhoon and earthquake insurance for 25 provinces
	Mexican cat bond	360	IBRD for Mexico's Fonden natural disaster fund
	World Bank pandemic insurance facility	425	Designed to respond quickly to a pandemic outbreak
	UK foreign aid bond (proposed)	NA	Dfid exploring whether insurance can replace foreign aid
2016	Parametric insurance in Heilongjiang, China	348	Natural hazard reinsurance backed by Swiss Re
	Parametric insurance in Guangdong, China	350	Natural hazard reinsurance backed by Swiss Re
2015	African Risk Capacity (ARC) risk pool	192	Founded by African governments to provide natural disaster cover
2007	Caribbean Catastrophe Risk Insurance Facility (CCRIF)	620	Hurricane and earthquake policies for Caribbean governments

Source: *Trading Risk*

Data challenges

Build Change's director of education, Michael Collins, says another barrier to deploying a risk financing deal for a retrofit has been the lack of data available, but that is now changing.

The organisation presently collects more data on structure characteristics in informal neighbourhoods than companies issuing commercial policies in the US.

"We're researching whether this previously unavailable information can be used to generate a more granular overview of risk," he said.

In some emerging countries large amounts of data are available, in part due to the systems put in place by international development agencies over the past few decades, which can be used to develop models for insurance solutions.

Both sides need to agree on the view of risk provided by a model that is going to be used as the basis for a risk transfer, says Claire Souch, director of AWHA Consulting, which advises on catastrophe risk modelling and management.

"We've learnt that working with local experts in the country is crucial," she adds.

In countries where data has not been collected, substitutes are becoming available.

The UK's Met Office is pioneering a process called reanalysis where modern data assimilation techniques are applied to historical periods.

Using reanalysis, the atmosphere around the globe over several decades can be recreated on an hourly basis to provide reliable information about the state of a climate in any given region.

In the past 18 months, says Souch, there has been a coming together of development agencies and the private market which could benefit countries that cannot afford to pay for commercial models.

ILS affordability

Cost is usually a chief concern of governments, which generally consider a risk transfer transaction as a cost item on their budget sheet rather than an investment.

"Country X can say 'That's great, but we can't afford that'," says Bill Marcoux, a partner at law firm DLA Piper.

"They have competing demands on their budgets. For example, they are trying to build hospitals, schools and roads, and trying to feed kids. They know they have exposure but can't spend the money on it."

This financial constraint has led to discussions on providing assistance with premiums at the outset to get countries involved, he says.

Another challenge is the absence of legislation in some countries that would allow the use of a cat bond.

The question of who a payment is made to and whether it can be misspent has also arisen, although the World Bank and UN, through trial and error, have experience of deploying funds that can be passed on to the insurance industry.

Insurance education

Rowan Douglas of the Insurance Development Forum says the relationship between the insurance industry and developing world was once characterised by "mutual bewilderment".

While this is changing, it takes a significant shift in thinking

Continued on page 30

to convince governments and organisations of the benefits of a risk transfer transaction.

As it may take a long time to establish risk transfer deals, they typically require bipartisan political support.

In addition, governments may have the resources to pay for cover but then have little to show for it if there is no claim, which is no vote winner.

This year, Jamaican MPs questioned the rationale of the country belonging to the Caribbean Catastrophe Risk Insurance Facility after failing to receive a payout since signing up for the scheme in 2007.

Moreover, using insurance to manage risk could also be a major shift for the charitable sector as well.

The Global Partnership for Education (GPE), a Washington, DC-based organisation which aims to strengthen education systems in developing countries, is researching whether risk transfer can replace grants to get schools up and running again when disasters strike.

"Integrating insurance approaches into our work will be a challenge because it moves beyond GPE's traditional focus of grant-making and delivering technical assistance," says CEO Alice Albright.

"But it also promises to bring big benefits. It could lower the amount of money we need to keep on hand against uncertain future disasters and it forces us to account for and manage the risks we face," she adds.

Quantifying the pay-off

Research shows that the rewards of investing in insurance cover for the developing world can be substantial, justifying the shift away from post-disaster donations.

> Once neighbourhoods have been made insurable through retrofitting, the plan is to structure a parametric ILS transaction protecting the dwellers against hurricane and flood

According to research by RMS, commissioned by the UK Department for International Development, insurance schemes could nearly quadruple the amount of disaster relief going to low and low-to-middle income countries within the next 10 years.

It found that insurance plans could provide payouts that would meet 11 percent of average annual losses in such countries, up from the 3 percent insurance cover that exists presently.

Current cover provides about $0.9bn of the $29.1bn average annual disaster loss across low and low-to-middle income nations, with a further 8 percent, or $2.2bn on average, covered by humanitarian aid.

According to Sophie Evans, programme director of capital, science and policy practice at Willis Towers Watson, it is also possible to incentivise appropriate behaviour to manage risk – for example, by giving credit to a region that has made an adequate disaster response and risk reduction plan. "ILS... can be structured to deliver value beyond the financial mechanism itself," she says.

There has been no shortage of investor interest in the recent flurry of development-related cat bonds.

For example, amid investor demand, the World Bank's pandemic cat bond expanded from an initial $100mn to a final $320mn, with specialist ILS funds making up the largest group of investors.

And there are opportunities to place these products in institutional or high net worth portfolios given the diversification benefits, low correlation and, of course, social and environmental impact, says United Nations Development Programme (UNDP) special adviser Jan Kellett.

The UNDP is currently scoping out ILS financing to equip municipalities in the Western Balkans to reduce the risks associated with flash floods, earthquakes and droughts.

"We envision these products to be particularly well suited to those investors looking to intentionally create positive impacts in addition to financial returns, so are confident in the wide-reaching applicability," he says.

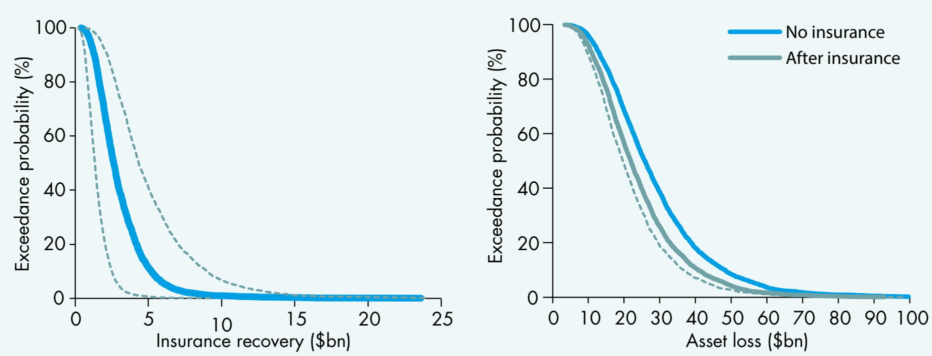
But while the risk and the capital are both there in abundance there is an ongoing failure to pair them up.

The Centre for Global Disaster Protection established by the UK government in July and the Insurance Development Forum both hope to act as matchmakers.

The protection gap space is undoubtedly getting more interest and offers a huge opportunity to the ILS sector, but reaping rewards is likely to be challenging.

As Marcoux says: "No one would say this is low-hanging fruit."

Insurance sensitivity analysis

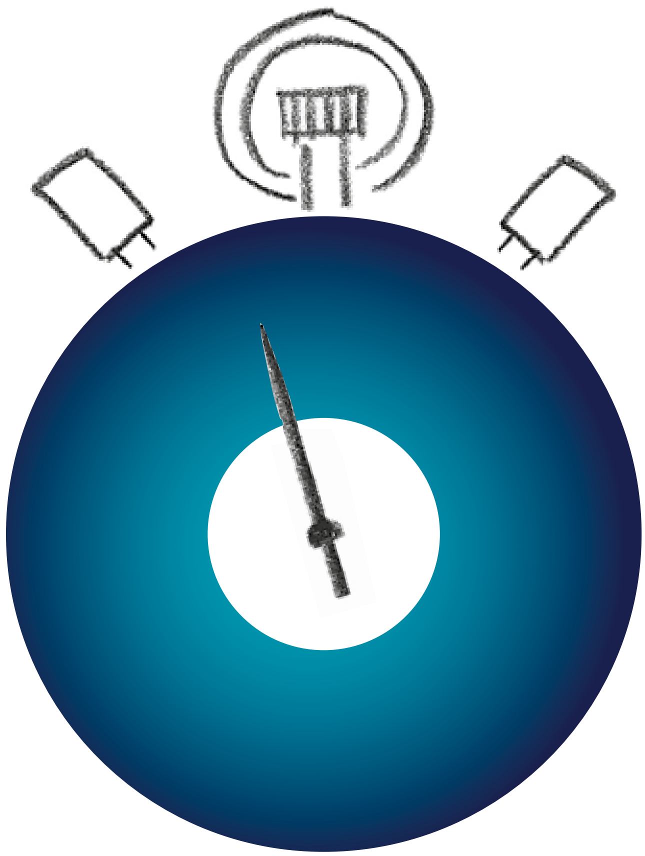


Simulated exceedance probability curve for total insurance recovery using base (solid line) and sensitivity (dashed lines) insurance assumptions

Simulated exceedance probability curves for total losses net of insurance. The green lines show losses assuming base (solid line) and sensitivity (dashed lines) insurance assumptions

Source: RMS report, "Mapping the role of insurance in managing disaster losses," May 2017

WE EMPOWER OUR UNDERWRITERS TO MAKE TIMELY DECISIONS.



Our underwriters are highly experienced specialists, which is why they are able to make decisions when you need them. Without wasting time going round a hierarchy. You can relax in the knowledge that the decisions are taken by someone who knows you and your business.

Contact us at **qatarreinsurance.com** or meet us in person at one of the industry conferences. It'll be time well spent.

QatarRe

Re-imagining insurance software

- Succeed in the digital era - rethink the traditional insurance software model
- Rapidly respond to new market opportunities
- Increase your competitiveness in an ever changing insurance market

Advantage Platform

Digital Insurance Platform

Multi market digital platform providing agnostic microservices to support digital transformation and the adoption of the latest technologies including IoT and AI

Advantage Suite

Navigator, Acumen & Exact

(Re)insurance Processing

Multi market, cloud and on-premise, web technology policy administration, analytics and risk aggregation

For more information visit: www.insurance.niit-tech.com

Validus CEO Ed Noonan and management team ringing the closing bell at the New York Stock Exchange

REAL NEWS

As Validus celebrated 10 years in the public markets, CEO Ed Noonan sat down with *Insider Quarterly* to discuss broker disintermediation, Bermuda's politics and world domination

"This has got to be against company policy," jokes Validus CEO Ed Noonan as he, two of his top executives and their entourage crowd into the same panelled elevator to reach a conference room in the New York Stock Exchange, where they are due to ring the closing bell later that afternoon.

Validus started life as a short-tail catastrophe reinsurer with $1bn of capital in 2005. Less than two years later it had acquired Lloyd's syndicate Talbot and was preparing to go public. Since then it has launched alternative capital vehicle AlphaCat; expanded into Latin America, Asia and the Middle East; and bought Flagstone Re, IPC Re and agricultural reinsurer Longhorn Re.

More recently, the Bermudian acquired specialty insurer Western World in 2014 and Crop Risk Services earlier this year.

Now the business has a market cap in excess of $4.3bn and subsidiaries with offices around the world.

But Noonan isn't willing to stop there.

"I think you have to start with our vision statement for the company, which we've never published but it's been the same since the day we started," he says. "That is: 'Global domination leading to the ultimate enslavement of mankind towards arguable purposes'."

Broker compensation

In recent months, one could be mistaken for thinking that the executive views broker facilities as the main obstacle standing between him and his dream of becoming supreme leader of the human race.

He has previously been outspoken in his view that brokers' clients are only "passively aware" of compensation arrangements.

"They're not actively focused on the fact their business isn't being offered to some of the markets that paid their claims for years because the insurers don't participate in some broker's facility," Noonan told sister publication *The Insurance Insider* earlier this year.

But speaking to *Insider Quarterly* in the conference room overlooking New York's iconic Wall Street, he was somewhat more measured. "In some ways some of these facilities actually make perfect sense," he muses.

"If a broker can arrange $250mn of terrorism capacity in advance with

Continued on page 34

a broad slate of Lloyd's syndicates, that's a genuine service to the client, therefore that's a very sensible facility."

But, he insists, the client should have a say in the intermediary's compensation for structuring the deal, which they don't today.

He writes off other facilities as "incentive schemes" for brokers that fail to add efficiency and neglect to provide clients with the full range of coverage alternatives.

The executive's other pet peeve relates more broadly to the cost of doing business at Lloyd's. Or in Noonan's words: "The market inefficiency is really quite stunning."

But, he says: "That's not a criticism of Lloyd's, the institution, or any particular syndicate."

"It's just a fact of life that the [general and administrative expense] ratio at Lloyd's is completely unsustainable."

He says that paring back broker remuneration and the general cost of doing business would inevitably mean that more of the premium dollar would go toward claims payments.

"It wouldn't stick to underwriters' ribs because we tend to compete down to whatever our acceptable level of return on capital is," Noonan explains.

"So Lloyd's would be much more efficient, much more competitive and of much greater value to the global market," he concludes.

Stifled innovation

But Noonan's next point should – at the very least – be the focus of some existential reflection for those on the Corporation's upper floors.

He says "the UK's desire to be the model pupil under Solvency II" has led to "the ultimate set of belts and braces" regulations and capital requirements, which have stifled the market's capacity for innovation.

That, he says, has left Lloyd's "at the sharp end of the spear".

He continues that the level of capital the Corporation demands in order for underwriters to write any new class of business puts carriers at a competitive disadvantage.

"Lloyd's was a great entrepreneurial forum for underwriters and Names who were willing to take risk and put their own capital at risk," Noonan says.

> Our vision statement for the company, which we've never published, [has] been the same since the day we started: 'Global domination leading to the ultimate enslavement of mankind towards arguable purposes'

"But the regulatory regime has really choked that out of the market, such that Lloyd's is no longer an innovative centre anywhere near the scale it once was."

He goes on to say that things would have to change for Lloyd's – and the London market more broadly – to maintain its position as the global centre of excellence for specialist risks.

Further, he adds, Lloyd's is missing out on another class of business that has until recently been a staple for the market.

"The US wholesale distribution market is bringing less business to Lloyd's than it used to," Noonan says.

He questions why an American retailer would take their business to Lloyd's and have an independent wholesaler collect 7.5 points of commission to place it in London, when it could be written at home. Those savings, he says, could be passed on to customers or retained to expand profit margins for carriers.

"Lloyd's distribution costs are leading to disintermediation, hence also the rise in local markets around the world."

When opportunity knocks

Referring to Talbot, Noonan says Validus has been letting the syndicate shrink, explaining that it "isn't a great time" to be growing the business. "We're trying to preserve margin rather than market share."

But he continues there will be a time when opportunities present themselves more broadly at Lloyd's, adding that Validus will be happy to grow again when they do.

"We haven't wavered on our commitment to London in any way shape or form, nor our commitment to Lloyd's," he says. "We just think that Lloyd's could be so much more and doing so much better."

Instead, Validus has its sights on the US for growth. Noonan says the American market, while "fully competitive", still has more room for growth than any other major market in the world.

"We see better opportunities here," he says. "We're not growing as if it's a hard market in the US. It's just the world's biggest market and there's more room in the US market for growth."

Noonan was speaking just two days after an event that many feared could cause an upheaval for the business community in Validus's native Bermuda.

After the general election on the island, Bermuda's Progressive Labour Party (PLP) regained control of the House of Assembly from the business-friendly One Bermuda Alliance (OBA), which had been in power since 2012.

But Noonan didn't share the concern of others on the island. "We started the company under the PLP, the company flourished under the OBA, and so I tend to think the Bermuda government in general has done an excellent job of creating a climate for international business to thrive," he says.

"We don't start with the view that the PLP is somehow unsupportive to business – the track record is just the opposite."

But he appears to have somewhat less faith in the US government. Asked whether Bermudian reinsurers would be forced to consider moving onshore if American lawmakers slap the proposed border adjustment tax (BAT) on offshore carriers, Noonan retorts: "You see a possibility of any tax change in the US? You see the possibility of anything getting done in the US?

"This [the BAT] is clearly fake news," he says.

CREATIVE INNOVATION

Threat versus opportunity: the impact of InsurTech is largely a matter of perspective, says Willis Re's **Andrew Newman**

The insurance value chain is under pressure. Whether disruption beckons or opportunity unfolds is primarily a matter of perception relative to a company's position in the value chain, amplified by how, or the extent to which, it chooses to embrace or reject innovative technology.

This article is, hopefully, not yet another homage to technology, using Uber as the fable to extol the virtues of embracing it. However, it is a serious attempt to ensure that insurers focus hard on both how and with whom they can truly leverage technology to better meet or exceed client demands at a lower cost.

The fact is that the vast majority of InsurTech start-ups do not want to go to war with incumbents in our industry, and very few are driving disruption for disruption's sake. Their overwhelming focus tends to be on leveraging technology to create value within the insurance value chain – not collapsing it.

Incumbents have options: they can embrace the technology that InsurTech companies usher in where they see internal and external improvement, or they can reject it – although the latter seems either courageous or short-sighted.

Unimaginable as it would have been a decade ago, maybe insurers in that camp consider the regulatory framework as de facto immunity against the threats from alternative sources of capital leveraging technology (or vice versa). However, those barriers are not insurmountable.

In many cases, the temptation within the current value chain will be to seek to accommodate technology – in other words to harness parts of it within the existing model as an accoutrement, rather than unleashing the full power that could fundamentally challenge the status quo.

Change is awkward and painful – but not as painful as being rendered increasingly inefficient and ultimately redundant.

Embrace or reject?

At Willis Re, we are observing an increasing number of insurers and reinsurers constraining the extent to which they engage with InsurTech in order to defend themselves. Yet, the available technology is invariably complementary to most current processes in our industry, and we should look to embrace this, not ignore or reject it, or keep it at arm's length.

> New sources of data and information have the potential to rapidly dismantle the data-related barriers to entry in the insurance industry and accelerate the participation of alternative capital in the sector

It is not the technology that is disruptive, but the degree to which a competitor can successfully wield the technology compared to another.

After all, in their most basic form, insurers are simply pools of capital targeting a profit by accessing pools of insurance risk and leveraging superior risk selection, exact risk pricing, effective claims resolution and operational efficiency.

The more successful tend to be able to connect the industry holy trinity: proximity to clients; access to the lowest average cost of capital across the business cycle; and the ability to gain a tangible advantage by optimising all forms and sources of information.

ANDREW NEWMAN is president and global head of casualty at Willis Re

Technology generally, and InsurTech specifically, will be significant in changing all three and has the potential to collapse large swathes of the value chain. This is nothing new, but modern, innovative technology such as artificial intelligence (AI), applications of big data, and machine learning has accelerated this change to unprecedented levels of speed, cost and transparency.

Furthermore, with the widespread proliferation of portable smart technology, distribution channels and user experience (UX), platforms have been blown wide open and brought to our armchairs.

InsurTech demystified

Consequently, although keeping track of the technological capabilities that InsurTech companies are bringing to market can be quite daunting, it can be enormously beneficial.

It is estimated that there might be as many as 1,500 recognised InsurTech firms globally at this moment in time. The diversity within this cohort is broad, from the "simple", such as expediting a single process, to full-stack, end-to-end online insurance companies regulated in several geographies, with underwriting, rating, pricing and claims capabilities.

Within Willis Re we place InsurTech clients and prospects into five distinct categories based on whether the primary focus is structural innovation, distribution, sales/marketing, data/analytics, or claims/fraud.

Each tech silo individually offers evidence of changes taking place in the value chain. For example, app technology on smartphones is transforming the distribution

Continued on page 36

ecosystem by improving the customer experience and getting closer to the customer – thereby satisfying one of the three elements of the holy trinity mentioned above.

Similarly, in data and analytics, the insurance industry has cultivated decades of premium and claims information from which it seeks to improve its risk assessment and pricing. New sources of information are available, however, which could – and I suggest will – begin to replace the industry's accumulated proxy data with real-time data.

Modern sensors embedded in or on physical assets have the capacity to measure and broadcast internal and external data that not only improves the accuracy of risk quantification and concomitant pricing, but accelerates the notification of threats and reduces the ultimate cost of losses. And since improved pricing and reduced cost of claims addresses both sides of the profitability equation, the obvious conclusion is that new information not only conveys advantage to those who harness it but threatens those who don't.

These new sources of data and information have the potential to rapidly dismantle the data-related barriers to entry in the insurance industry and accelerate the participation of alternative capital in the sector as it gravitates towards business models with an intrinsic data-driven advantage, whether in sourcing, selecting or pricing risk.

Pace of change

Nonetheless, paranoia about InsurTech remains strong across the industry. For many, the fast pace of change is naturally alarming. But while InsurTech, and the associated modern technology leveraged by insurance start-ups, has been labelled as imminently "disruptive", the truth of the matter is more nuanced and varies depending on customer type, complexity, size, product and territory.

As we see it, the real challenge for the incumbent marketplace is avoiding the temptation to only engage with InsurTech firms to leverage short-term gains whilst simultaneously constraining their true potential in order to preserve the status quo.

The more research Willis Re undertakes, the more we observe that InsurTech businesses can profoundly complement insurers' books of business and fortify core competencies.

And this is a trend we see going in only one direction, as illustrated by the increasing number of partnerships between old and new (colloquially referred to as "MatureTech meets InsurTech").

If managed properly, technologies that improve efficiency and outcome are game changers. Why wouldn't an incumbent player in our industry seek to harness that capability?

Yet, to date, there has often been a smokescreen placed around InsurTech businesses and their transformative capabilities, creating the illusion that many are the industry's foe.

The reality is that sourcing capital and overcoming regulatory hurdles are more complex than forging alliances. These companies would far rather leverage their technology to provide solutions for the incumbents than seek to replace them.

The claims space is already starting to show how, through strategic partnerships, insurers, loss adjusters and other third-party adjusters are cooperating to use the technological expertise of InsurTech start-ups. This ranges from the use of real-time, high-resolution photo imagery to outsourced claims handling through state-of-the-art chatbots.

In utilising these capabilities, the claims experience is being improved for consumers – and lest we forget, claims are invariably the only instance where a policyholder spends considerable time communicating with insurers.

Costs are being driven down, and insurers are able to differentiate themselves through excellent claims services. Fraud is being tackled aggressively and insurers have a far greater chance of improving their customer retention rates.

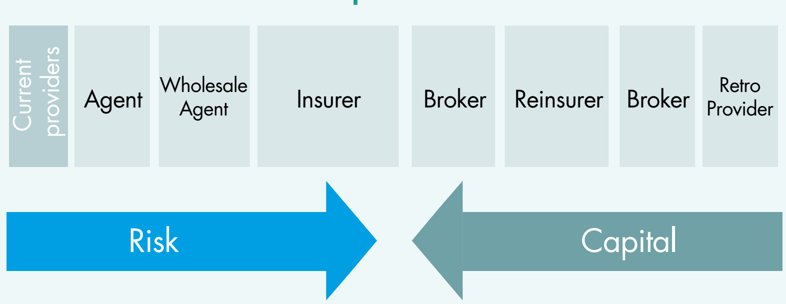
The value chain

Any technology that compresses the insurance value chain, allowing capital more direct access to the consumer and creating high capacity for disintermediation, does of course have the potential to be disruptive to broker, insurer and reinsurer alike.

Doing nothing or the bare minimum seems an increasingly blinkered choice. Just as the Luddites failed in the 19th century to reverse the impact of technology by attacking weaving machines, so too will those who hope that technology will pass by the insurance industry and move into some other, less threatening biosphere.

Today's insurance business model is rooted in the Industrial Age notion that the key participant is the capital provider and, by extension, the risk taker. The hypothesis is that the risk taker is entitled to the majority of the reward, based on a time when capital was scarce. However, technology has come along and permeated the sector, tipping the balance of power between capital providers and the authors of ideas dramatically in favour of the

A value chain under pressure



Source: Willis Towers Watson

entrepreneurs. This is consistent with the post-industrial era, which has fundamentally reordered the hierarchy of priorities by lowering the importance of (now plentiful) physical capital and raising the prominence of human capital. Brainpower is not capital-intensive.

In insurance, where technology has the potential to eliminate barriers to entry, weaponise data and create new forms of information from which to more precisely gauge risk, thereby lubricating the appetite of alternative capital, who, frankly, can afford not to engage in the brave new world? As such, could we be looking at a new insurance company structure of the future?

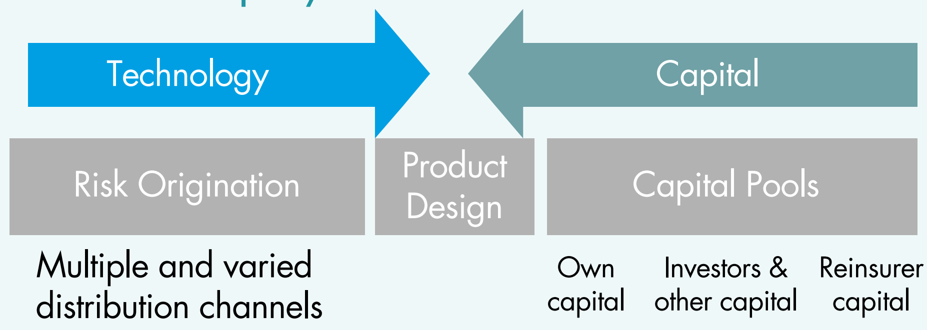
Change of perspective

These dynamics create massive opportunity on an unimaginable scale. The good news is that we could be looking at the greatest dislocation in the insurance industry in 100 years, and if you're a start-up seeking guidance on how to enter insurance, we are constantly searching for companies with good ideas for shaking up the industry.

Likewise, for the incumbent insurers and reinsurers in our ever-changing sector looking to utilise and maximise the opportunities being created by the "Schumpeter's gale" of widespread creative disruption being driven by InsurTech, we urge you to connect with us.

We can help firms collaborate in a way that will both ensure your historic book of business is protected, and also offer you the opportunity to partake in the increased risk origination pool that is being brought into the growing marketplace.

Insurance company of the future?



Source: Willis Towers Watson

MOORE STEPHENS

1,920
active users across the market

100%
speciality insurance classes covered

Over 25%
of LLoyd's syndicates are using RuleBook

2,200
brokers access RuleBook platforms

10
deployed in over 10 countries

THE ULTIMATE INSURANCE BEAST

RuleBook is a market leading pricing, underwriting and distribution tool. Our latest generation, multi award-winning platform is now used by over 25% of Lloyd's syndicates, with clients across three continents. Trusted by some of the leading names in the market, RuleBook is helping our clients become more agile in pricing, giving better control of the underwriting process and allowing them to distribute products fast and wider than ever before.

www.moorestephensconsulting.com

LOCKING DOWN FRAUD

Analytics, intelligence and collaboration are the keys to tackling insurance fraud, says **Dan Gumpright**

Insurance companies have long been seen as easy and, in some cases, acceptable targets for committing fraud. Globally, insurance fraud is the second largest and most financially lucrative criminal enterprise after illegal narcotics.

For that reason, whenever insurers put counter-fraud defences in place to stop the progression of organised crime, fraudsters will find a way around them. Criminals are continually evolving and the speed at which they develop new behaviour is impressive. In order to keep up, insurers need to maintain technical agility.

Technological advancements in fraud detection, if deployed correctly, enable insurers to tackle the continual threat they are facing, and help prevent fraud losses from affecting their combined operating ratio.

Customer retention

Just like in any other sector, new customers are costly for insurers to come by, yet it's far easier than it ever has been for consumers to switch suppliers. Customer retention is of utmost importance.

Many executive teams are taking a zero-tolerance approach to how fraud impacts genuine customers. Claims have to be resolved quicker, often driven by regulation, and customers are increasingly expecting faster claim resolution and payment.

Currently a percentage of claims normally have to be resolved within 24 hours, or five working days. The challenge insurers face is they know that somewhere between 10 and 20 percent of claims contain fraud – either opportunistic or criminally organised. But how do you find that one-in-five, and at the same time not slow down payment to your genuine customers?

In select cases the market is moving toward low-touch or touchless claims and straight-through processing, reducing the overall cost of claims management. As the market moves so will fraud and it's important that companies keep in advance of the fraudsters.

The challenge of both validating genuine customers and spotting fraudsters requires insurers to move faster than ever before.

Policy screening

While claims fraud detection remains a vital capability for insurers and its importance cannot be understated, recent emphasis has been placed on fraud detection at point of application – screening people as they come through the door.

Continued on page 40

The boom in online channels – offering the ability to communicate with insurers in ways consumers couldn't before – has had a significant impact on the need for policy screening. The control is now very much in the hands of the consumer, rather than via a broker.

Before, individuals would go to see a broker and buy the policy they recommended. Now, there are multiple online channels, aggregators and price comparison websites. Consumers can shop around, change their details slightly here and there – there's little personal contact.

That loss of personal contact over the last five to 10 years means that insurers have had to increase the sophistication of fraud detection techniques.

Traditionally, fraud checks at policy inception have taken the form of "data washing" i.e. has the carrier seen this applicant before and are they suspicious? This can generate a lot of false positives.

However, sophisticated organised fraud rings and emerging modus operandi mean social network analytics (SNA) and machine learning need to be employed to detect suspicious activity at the point of claim and policy inception.

High-volume, low-latency detection is truly important here. Dealing with high volumes of data quickly is vital.

The scale of the data processing that insurers need to be capable of is such that they can't do it with existing technology. In the past, insurers would process a lot of this data on traditional relational databases, scripting languages and analytics tools, but they need to be able to scale the amount of processing they're doing on much cheaper hardware.

Hosted solutions and clusters of commodity-based hardware can be used to provide greater processing power and the flexibility to dial capacity up or down just when it's needed.

Smart data

Insurers hold a large amount of data that can be harnessed for effective fraud detection. The growth of artificial intelligence, the Internet of Things and smart devices has increased the amount of data insurers have access to. The challenge is how to apply that wealth of data to streamline claim resolution and fraud checks, thus enhancing efficiency and customer satisfaction as a result.

Over and above the information an individual insurer has access to, there is general recognition of the value that third party data can bring to the fight against insurance fraud.

There's intel from the Insurance Fraud Bureau, the Insurance Fraud Register, information from credit bureaus, publicly available information such as the electoral roll, unsatisfied County Court judgments and bailiff searches.

All of this data, if used effectively, can be used to prove the identity of a customer, and aid in indicating risk.

When it comes to data use, insurers have historically been ahead of other industries, and have used data from outside their organisation. The challenge is the maturity of their approach to then using that data, and the analytics they've performed on it.

Collecting data for the sake of it is costly. For fraud detection purposes, insurers need to be performing appropriate analytics and using the right tools to find that proverbial needle in a haystack at the lowest cost.

Sharing data

To some, the insurance sector may traditionally have been seen as behind others technologically. However, in the area of data sharing, particularly in the UK, the industry is ahead of the curve. The IFB, part of the Association of British Insurers, is a fantastic example of this.

Challenges still exist internally with sharing intelligence such as tip-offs, known fraud lists or internal black or grey lists across different parts of the business. In the fight against fraud it is paramount that intelligence is managed carefully and appropriately, but also disseminated in a secure and timely manner to aid investigations.

The problem is less about data siloes in this case – it's about intelligence siloes. The fraud team knows a lot about what's going on in the claims world, but they often have no process or way to effectively share that intelligence with the systems that are in place to detect fraudsters earlier in the lifecycle, including at policy inception.

> "Sophisticated organised fraud rings and emerging modus operandi mean social network analytics and machine learning need to be employed to detect suspicious activity at the point of claim and policy inception"

DAN GUMPRIGHT is global product manager for insurance at BAE Systems

Advances in analytics

Insurers need to deploy their fraud detection technology with agility in mind.

The conversation they need to have can be summarised as: "I don't know what problem I'm going to need to solve yet, so let's architect our solution in a way that means I can solve problems I've not yet anticipated, with volumes and types of data that I've not yet seen."

Applying advanced analytics and machine learning to the vastly increasing data volumes and appropriately managing data and intelligence within and across organisations is absolutely fundamental to detecting fraud quickly and efficiently.

Insurance companies need to build their processes, train their staff and have the right connections between departments to ensure that they're mitigating every threat.

Plundered antiquities from the ancient city of Palmyra in Syria, which has twice been captured by Isis, have turned up in Lebanon

PLUNDERING FOR PROFIT

Tony Baumgartner and **Owen B Carragher Jr** explore the murky world of funding terrorism through the looting of antiquities

Sadly the looting of and trafficking in antiquities is not just the stuff of popular Hollywood fiction such as Indiana Jones and Lara Croft.

In the real world the so-called Islamic State of Iraq and Syria (Isis) is plundering for profit and using looted antiquities to fund its domestic and international activity and terrorism.

The G7 group of nations' Financial Action Task Force, a Paris-based governmental body, estimates that Isis has raised tens of millions of pounds from stolen antiquities in the past few years alone.

In July Clyde & Co ran a seminar which examined how terrorism was being funded through looted antiquities, in an event that brought together two of the world's leading experts in the field: Matthew Bogdanos, Assistant District Attorney of New York and a colonel in the US Marine Corps, and Amr Al Azm, associate professor of history and anthropology at Shawnee State University in Ohio.

Professor Al Azm vividly discussed how Isis has systematically overseen the widespread looting of Syria's six Unesco world heritage sites since 2014. He spoke of the sinister trade that has built around the transportation and sale of stolen Middle Eastern antiquities, which involves a complex web of smugglers, middle men and often unwitting art experts and collectors.

When Isis fighters are filmed destroying some of the world's ancient and historical religious buildings and relics, they claim to be doing so for ideological reasons, but the truth is often that they are doing it purely for profit or for the purposes of propaganda.

A well-trodden path

According to Colonel Bogdanos, plundered antiquities tend to take a well-used path from theft to sale on the international market. However, to aid in their false legitimisation some items may take many years before coming onto the market.

Colonel Bogdanos reported that there are five key nodes of trafficking:

Theft and excavation: antiquities are looted either from the ground from known historical ruins, or from museums

Transportation: the items, some of which are up to 10,000 years old, then start their journey out of the Isis stronghold, usually by taxi or lorry (often with shipments of arms) into Turkey or Lebanon

Initial sale: once over the border they are taken to a network of local dealers and tourist shops who purchase the goods

Into Europe and the US: the goods are then covertly smuggled to Europe or the US, where they are taken to art experts and professors to insert into legitimate channels

Sold to international dealers: once a provenance has been fabricated for an item it then often finds its way to an auction house or dealer for promotion to their specialised client base.

Legal and moral obligations

Colonel Bogdanos and Professor Al Azm both emphasised the part that the insurance industry can play in helping to identify stolen pieces and deter future plundering.

In particular, insurers have a role in checking their insureds have sufficient and documented due diligence procedures before cover is in place or engaged.

And apart from the moral obligation to help try to end the illicit tracking of antiquities, there may also be a legal obligation to report suspected loot under the UK's Proceeds of Crime Act 2002 (POCA). Failure to do so could result in criminal proceedings.

POCA creates a number of offences relating to "criminal property", each of which can cover stolen antiquities. In short, sections 327 to 329 of POCA create offences of concealing, disguising, converting, transferring or removing criminal property from England and Wales; entering into or becoming concerned in an arrangement which facilitates another person's acquisition, retention, use or control of criminal property; and acquiring, using or possessing criminal property.

Those offences can be committed by knowing or suspecting property is "criminal property". In order to hold the relevant suspicion, all a defendant must think is that there is a possibility, which is more than fanciful, that the relevant facts exist. POCA does not require the suspicion to be clear or firmly grounded and targeted on specific facts, or even based upon reasonable grounds.

Red flag questions

Dealers, auction houses and collectors, together with the insurance industry, each have a role to play in identifying looted antiquities and helping to prevent their ongoing sale.

Due diligence "red flag" indicators have been highlighted, which could raise suspicion that the antiquity might be looted, as follows.

Does the piece have a documented provenance? If not, is there any other way of establishing the history of the piece? For example, is there an historical photograph of the piece? How old is the photo? As a general rule, the higher the value of the item, the more likely it is to have been photographed at some stage in its collection life – so if the earliest photo is relatively new then this is a potential red flag.

> Plundered antiquities tend to take a well-used path from theft to sale on the international market

TONY BAUMGARTNER is a partner in the London office of Clyde & Co

OWEN B CARRAGHER JR is a partner in the New York office of Clyde & Co

Is its provenance documentation pre-1970? If yes, check the documentation thoroughly for authenticity. Prior to the 1970 Unesco Convention on the Means of Prohibiting and Preventing the Illicit Import, Export and Transfer of Ownership of Cultural Property, there was no set of uniform international rules dealing with the recovery and return of illegally exported or stolen cultural property, and so documented provenance post-1970 is more likely.

Has it crossed any international borders? Lawfully exported valuable antiquities cannot miraculously appear in another country; they must have proper customs declarations and, possibly, export permits to be taken across international borders legally.

Has the piece been insured before? If yes, where is the paperwork?

How did it get into the hands of the present owner? Has it been named in a catalogue and its provenance documented before – and does the provenance pass the "sniff test"? Something catalogued as "From a 19th century French collection" is unlikely to provide proper provenance on its own. What condition is it in? If a statue has cuts below the shoulders and hips – or has nicks on it consistent with a power tool – then there's a good chance it's stolen.

What's the item's country of origin – and the date it appeared on the market? If it corresponds with war or conflict, then there's also a good chance of it being looted.

In addition to considering these red flag questions, items should be checked under a UV light, as increasingly SmartWater is being used (by people on the ground trying to save antiquities) to mark items with a green dye that is revealed only when under UV light.

Those involved in transacting antiquities (including insurance brokers and underwriters) should also be aware of the relevant country patrimony law dates, which are conveniently listed on the Unesco website. Pieces appearing on the market for the very first time after the relevant patrimony law date should sound the alarm bell.

What more can be done?

Brokers should confirm that there is full provenance documentation for pieces which are proposed for cover under an insurance policy.

Pieces for which such documentation cannot be produced should be carefully scrutinised by both brokers and underwriters before being underwritten for cover.

Underwriters should make it plain to both brokers and insured that the policy does not cover looted or stolen antiquities. This is best done through a clearly worded exclusion clause.

Looting antiquities is a lucrative business, so it's not likely to be stopped until there is international and local cooperation between those trying to stop it at source and those at the other end of the shipping chain.

The insurance industry has its part to play by making sure looted antiquities are not covered by insurance policies, thereby removing a vital link in the chain that often underpins the dealing process.

It can do so by asking the right questions, and knowing what to do if an item is suspected loot.

GO WITH THE FLOW

Ahead of the Monte Carlo *Rendez-Vous*, **Paul Latarche** warns that the London market has to embrace technology if it is to remain competitive

Over recent months, London has rightly seen many of the discussions and debates around the issues that may or may not arise with the UK's withdrawal from the European Union.

Indeed, as a firm, we have been advising a number of underwriters on the potential decision they may have to make, depending on the ability of the two sides to reach an agreement over the free movement of financial services.

However, in recent months many of the strategic discussions I have had with brokers and carriers have been around the broader issues of the London market's ability to remain relevant to its clients across the world.

The brokers have expressed their concerns that not enough business is flowing through the various facilities into the London market. Indeed, the view is that business is being increasingly placed with local carriers rather than being offered to London.

There may well be several reasons for the growing inability of London to see risks that traditionally would have been brought to the market. The overriding one for many is the time and cost that doing business in London entails.

We live in an age of technology that enables fast decision-making and for information to be transferred instantly. Clients are no longer prepared to wait for answers, and therefore will look locally for decisions that can be made far more quickly.

It is also the case that ever more risks and their solutions are being commoditised, with the range of specialty risks that have long been the foundation of London's business, and that require bespoke solutions, becoming ever smaller.

With 40 percent of Lloyd's business being underwritten on a delegated authority basis, the market is facing challenges.

The regulators are becoming more prescriptive in the fact that underwriters must treat delegated business as if it was underwritten within the carrier itself.

The other issue for the market is the ability to understand what it is underwriting. When you hand your pen away, it may well be that the first you know of the risk is six weeks after it has incepted and, for the class underwriter and actuary, it is only when the bordereau arrives that they can fully understand the exposure and aggregation of the risks.

It is much the same in the locality. If the broker is looking for, perhaps, a D&O quote and receives three from local carriers within two days yet doesn't get anything back for a week,

> We live in an age of technology that enables fast decision-making and for information to be transferred instantly. Clients are no longer prepared to wait for answers

there is little expectation of that quote making it to the potential client.

Again, the current bordereau system does not allow the carrier to understand the changes that may affect the success of the product.

If you are offering a Canadian cyber product which had a 70 percent success rate, and that suddenly falls to 45 percent, you need to be able to identify the issue quickly and then make the changes that you believe will make the product more attractive to clients.

In many ways, the London market is facing a disruption of a very particular kind.

It is clear that while the personal lines and, increasingly, the smaller commercial risk classes are seeing the application of more sophisticated processes, the bespoke nature of major commercial business and reinsurance looks to be largely untouched.

For the London and international markets, the threat of disruption comes from the inability to get products and policies to the intermediary in a timely fashion.

Without a doubt, brokers are feeling the pressure from clients who are demanding that their risks are covered ever more quickly. The ability to place personal lines insurance in a matter of minutes is having an effect on commercial risk.

While appreciating that commercial risks are more complex and cannot be fully met by an off-the-shelf solution, there is view that although it cannot take minutes, it should not take weeks.

PAUL LATARCHE is a partner and head of the Insurance Division at Moore Stephens

This demand links to the challenge of agility. Listening to the InsurTech experts, it is clear the successful underwriters of the future will be those that are most agile.

Again, due to the issues I have already outlined, there is no expectation that the specialty markets will be as nimble as their personal lines peers, but there are areas where there should not be any difference in speed.

Specialty insurance is dynamic. A major natural event or a fundamental change in the global economy can have a profound effect on the level of exposure, and therefore the price of the risk.

In a heavily overcapitalised market where there is no shortage of replacement capacity should a current underwriter look to withdraw from a particular class, pricing remains under intense pressure.

Underwriters need to be able to react to changes by their competitors on premiums charged and breadth of terms or conditions.

The ability to change terms and pricing quickly and, more importantly, communicate this to the distribution channels, is where the underwriter's agility can become either a USP or a barrier to trade.

It is at the heart of the industry's future to improve operational efficiencies and analytical capabilities across all stages of the underwriting cycle, while reducing frictional costs and speeding up response times.

The ability to enhance pricing analytics and underwriting data to enhance both pricing accuracy and speed is now seen as a core component in the reinsurance market's efforts to enhance client service, reduce claims risk and squeeze greater profitability from the currently depressed pricing.

Brokers are keen to access capacity and underwriting decisions quicker and the use of technology and a platform system to do so has become ever more attractive as the benefits are realised.

The goal for underwriters is to increase underwriting speed and performance, enhance the ability to analyse portfolios, reduce the levels of data input while delivering a consistent approach to pricing, and meet the ever-increasing reporting requirements from the regulators.

It is a case of developing the areas of the underwriter's business that it can control. The fewer man-hours devoted to the internal processes that drive the business the better for underwriter, broker and client.

Already we are seeing evidence of underwriters adopting this new approach and creating platforms that allow brokers to access products, offer risks and communicate with underwriters more effectively.

But in many ways, this is not enough. Underwriters need to be confident that the information pertinent to a particular class or risk is being delivered to those that require that information and not to those that do not.

It requires the ability to allow an intermediary access to areas of a platform that will enable it to obtain a quote quickly, but to also reassure the broker that the data shared in order to obtain that quote remains proprietary to them and cannot be accessed by others.

There is little doubt that in the months and years to come the underwriter's platform will become its major marketing and distribution channel. It will be the speed with which it can deliver the quote and communicate changes to existing products to reflect the market's dynamics that will drive success.

RuleBook is relatively new, but it is testament to the desire from the market to have such a platform that 25 percent of the London market now utilises it to speak to over 2,000 brokers across the world.

It enables the underwriters to operate their own specific portals to deal with specific partners while using RuleBook itself to offer products to the entire user community.

The expectation is that brokers will increasingly demand a greater ability to drive business on ever more seamless systems. Underwriters that fail to deliver that agility will more than likely find themselves ever further behind the curve.

GETTING A GRIP ON AUTOMATION

Claims automation will improve the customer experience, says **Dr Bernard Cosgrave**, but it is the combination of human and technological resources that will drive progress

Today's Fourth Industrial Revolution encompasses machine learning, genetic engineering and automation – promising more leisure time as work demands are removed by better, cheaper and more efficient technology.

The possibility that mechanical or automated processes might one day free mankind from the burden of labour is a widely shared utopian concept, but the dream has its nightmarish aspects.

Ever the since the First Industrial Revolution, work has been seen as the way in which people justify their existence. The rise of automation, industrialisation and creeping modernity must be set alongside the memory of the Luddite riots and the Great Depression, and indeed many sociologists have warned about the dangers of automation, which comprise one of the fundamental themes of modern dystopian fiction.

The fear today is that the cyber threat in its widest sense (setting aside data and hacking perils) could result in the decimation of entire industries from black cab taxi drivers to bookkeepers, lawyers and, potentially, insurers – including their claims teams.

Organisations like McKinsey Global Institute (MGI), the business and economics research arm of management consultancy firm McKinsey, have been exploring the implications of workplace automation across multiple industries.

Towards automation

A McKinsey report on automation ("Where machines could replace humans – and where they can't (yet)", July 2016) presents some stark conclusions.

For example, it says: "automation will probably change the vast majority of occupations, and up to 45 percent of all work activities in the United States, where MGI performed its analysis, can be automated right now with current technology.

"But significant changes are clearly approaching in many industries, including insurance, whose potential for automation resembles that of the economy as a whole."

More optimistically, McKinsey speculates that some positions will be engines of job creation. These include analytics teams tasked with detecting fraud, and smart claims avoidance.

To meet these new challenges, the report advises that: "Insurers will need to source, develop, and retain workers with skills in areas such as advanced analytics and agile software development; experience in emerging and web-based technologies; and the ability to translate such capabilities into customer-minded and business-relevant conclusions and results."

Using advanced investigative data analytics and developing data mining techniques to detect and investigate fraud is one option. Risk managers in sectors outside of insurance are already using data mining techniques to assist FTSE 100 companies and government bodies in successfully prosecuting civil and criminal cases with asset recovery orders and custodial sentences. Similar practices in insurance can expect to bring in proactive and reactive counter-fraud data mining strategies to assist in the development and implementation of continuous monitoring solutions.

Using automated claim-scoring tools to identify which claims to fast-track could yield operational efficiencies and increase staff availability to recognise and follow false claims. This would enable London market carriers to spend less time on legitimate claims that warrant payment and help them to allocate more time to addressing larger volumes of claims that are potentially fraudulent.

The third generation of link-analysis tools allow the automatic visualisation of linkages between elements in a data set that can then serve as the canvas for further exploration or manual updates.

From operational efficiency to a more in-depth view of claimants, claims technology is now contributing to underwriters' ability to reduce the risk of fraud.

Under pressure

The fear persists, however, that when we eventually move from automated process into true artificial intelligence it could be game over for the skilled underwriter and claims specialist.

A new white paper produced by research and analytics firm Insurance Nexus explores themes such as insurance practitioner fears of automation by interviewing underwriting and claims professionals.

According to Steve Tait, RSA's head of claims automation: "We are always under pressure to deliver more with less and that drives the focus to how can we reduce the amount of expenses in claims.

"And also, there is a pressure to understand how we can do more with the information we have access to and convert that to data to drive insights that reduce claims cost. Basically, be leaner as a business; that is a constant."

In today's challenging market conditions, underwriters in London are coming under pressure to cut costs and that pressure is being applied to claims teams. The London market is a different beast to the personal lines and SME market, however, and when it comes to major corporate clients and major risks, clients still demand the personal touch. People can still make a difference, but they can be supported by automation.

Hiscox's head of UK claims, Eva Berg-Winters, suggests: "Win the hearts of the team and allow them to flourish and drive the answer. It's their future and they should be the ones shaping it. If the team believes and can see how automation changes their working lives in a good way, they will not only support it but drive it."

Customer experience

It is obvious that speedier claim resolution is going to play an important role in improving customer experience. At the same time, a superb customer experience and falls in indemnity costs are two sides of the same coin. Improving one benefits the other.

The key point to make here is that intelligent application of both human and technological resource will be the major driver of improvement.

Docosoft attends numerous events throughout the year focused on the joys of innovation, where panellists talk glowingly of new start-ups like Lemonade transforming the insurance landscape and generally causing a fizz. There is no doubt that some InsurTech start-ups will shake things up but we believe that we forget the human element at our peril.

At Docosoft we are strong believers in innovation that works in practice, in real-time – that is, today. The benefits of automation are clear but we are not breeding a new race of insurance Cybermen here, we're just looking to create useful systems and tools that help claims adjusters to serve their clients better.

Taking advantage of the data insights in an organisation requires new ways of automatically organising, classifying and labelling documents. Using advanced machine learning techniques, for example, Docosoft Data Analytics, does just this.

It takes thousands of documents as inputs and outputs their hidden thematic structure and relationships, which leads to actionable insights such as improving compliance, cost structures and competitiveness.

Our machine learning technology crunches petabytes of data more efficiently and makes sense of a complicated claims world.

Insurance professionals have always had access to a vast pool of unstructured digitised documents but have never been able to structure their hidden value advantageously.

> Intelligent application of both human and technological resource will be the major driver of improvement. There is no doubt that some InsurTech start-ups will shake things up but we forget the human element at our peril

Our new solution provides a statistics-based method that can automatically read insurance texts.

The advanced data analytics technology magnifies text (or data) that is indistinct and brings it into more granular focus, with practical benefits for insurance companies and their clients.

At Docosoft we will be consulting our clients and listening to their needs and concerns. Let us not all get carried away by talk of disruption and the end of the insurance market as we know it.

Change is going to come and in the long run it will have profound implications for the way we do business.

The Docosoft view, however, is that it is important to focus on what can be achieved today and generate tangible automated efficiencies that support rather than replace the claims team.

DR BERNARD COSGRAVE is chief data scientist at Docosoft

GUIDING CLIENTS, DRIVING MARKETS, WORKING TOGETHER

We **guide** our clients through the insurance market place working **together** in partnership. We **drive** markets to deliver the best cover, pricing and wording available.

Contact us now:
Tel: +44 (0)20 7378 4000
info@shepherdcompello.com
www.shepherdcompello.com

shepherd: *one who cares for, guides and protects a group*
compello: *to drive together* [**com** *"together"* + **pello** *"drive"*]

EMERGING OPPORTUNITIES

In the current yield environment, there is a compelling argument for expanding the investment universe to emerging markets, says **Colm McDonagh**

Insurers are facing considerable economic, political and regulatory uncertainty. The lack of clarity surrounding the UK's Brexit negotiations, clouded further by the recent general election result; the political gridlock facing the Trump administration; and heightened terrorist threats are just a few recent examples. We believe that this uncertainty is likely to persist.

One longstanding constant though, has been the low interest rate environment in most developed countries. This has forced insurers to seek new asset strategies that provide sufficient returns to meet investors' and shareholders' requirements.

Government and corporate bonds have long formed the bulk of insurers' portfolios, however in the last few years a clear increase in allocations to corporate bonds, combined with a progressive move down the credit spectrum into lower-rated debt, including high-yield issues, has been evident.

More recently, many insurers have been attempting to take advantage of the retrenchment of banks from lending markets to capture an illiquidity premium without significantly increasing the credit risk in their portfolios.

We are strong believers in the benefits of diversification across credit markets and geographies. In the current yield environment, we believe there is a compelling argument for expanding the investment universe to emerging markets (EM). The breadth and type of opportunities, as well as the credit quality of issuers, is often underestimated in this $20.6tn asset class.

Opportunities in emerging markets

With more than $7tn of government debt trading at negative yields (as of the end of June 2017), the opportunity in EM debt seems increasingly compelling. We believe it offers some of the most desirable risk-adjusted income streams around and, unlike in developed markets, valuations are still relatively attractive (see chart).

EM economies now account for more than half of global GDP, and are generally less indebted than developed markets. The share of corporate finance via bond markets in EM has nearly doubled since the global financial crisis as banks have aimed to deleverage and shrink their loan books.

The opportunities for insurers are many and varied. Some EM have a fully developed range of capital markets instruments, including interest rate swaps and foreign exchange options. A larger group of EM countries offer at least four types of debt instruments to foreign investors.

The key challenge for insurers is how best to access the opportunity in a risk-managed way.

Managing exposures for insurers

Given a desire to avoid excessive volatility, an opportunistic approach to EM debt that harnesses multiple return drivers, while aiming to preserve capital, could be more suited to insurers' objectives.

Many EM issuers are under-researched, under-owned and unloved by mainstream investors. This creates mispricing and opportunity, in spite of EM debt's status as a rapidly maturing asset class.

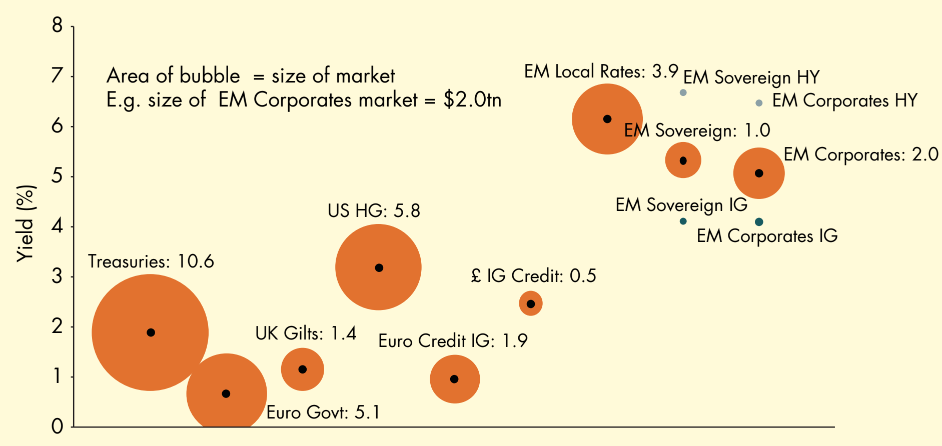
According to the Institute of International Finance, net capital inflows to EM will rise to $78bn in 2017, reversing the large outflows experienced in 2015 and 2016. Inflows are expected to accelerate to $167bn in 2018.

Through much of 2016, headlines were unremittingly bad – focusing on fears of a hard landing in China, sharp declines in commodity prices and perceived negative impacts of an appreciating US dollar on EM debt sustainability, as well as idiosyncratic events such as the political crises in Brazil and Turkey.

These concerns became factored into the valuation of EM debt instruments and caused currencies to weaken,

Continued on page 50

Attractive yields are still on offer in EMD



Source: Bank of America Merrill Lynch

enabling many countries to improve competitiveness and external balances.

Many of these stories have now turned around. Concerns about Chinese growth have dissipated, and capital outflows have stabilised. Commodity markets appear to have bottomed, with the oversupply of recent years coming to an end as growth in demand has brought many markets back into balance.

The US dollar could strengthen once again, but policy tightening is well signalled, whilst missteps from the Trump administration have raised concerns about its ability to legislate for its pro-growth and pro-business agenda.

As the fundamental outlook has improved, with painful reforms in many countries now allowing them to benefit more fully from improving external factors, so currency volatility has declined.

This in turn has reduced fears regarding debt sustainability and a potential spike in defaults, due to mismatches between dollar-denominated liabilities and local currency-denominated assets – a fear we have long felt was misplaced.

The emerging market debt universe

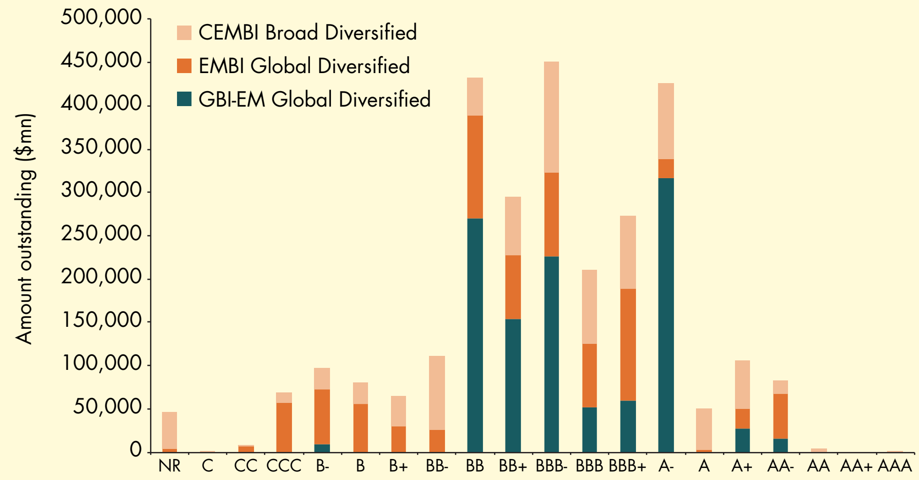
The asset class consists of three types of exposure which have different risk profiles and a different regulatory capital treatment for insurers: US dollar-denominated government debt, local currency-denominated government debt, and corporate US dollar-denominated debt.

For example, actively managed local currency debt offers insurers without significant net currency risk genuine diversification and potential capital benefits under regulatory frameworks such as Solvency II.
Additionally, much of the EM debt universe is investment grade, meaning that insurers have access to plenty of opportunities without needing to increase credit risk exposure (see chart).

Insulated from Brexit

EM countries should be relatively insulated from the implications of the UK's decision to leave the EU.

EM debt is a deep and varied asset class



Source: JP Morgan

The major exception is Eastern Europe, which is an integral part of the European manufacturing supply chain. For now, the region is benefiting from the broad upswing in regional growth, but if tariffs were introduced on exports to the UK, then demand could be negatively impacted.

Another argument, though, is that in order to remain competitive in that scenario, even more investment could be directed towards those lower cost countries from the core.

Asia and Latin America are both more insulated from events in Europe and the UK, with China and the US the key drivers for those regions. We believe that as the global economy shifts towards an increasingly tri-polar world, it will create investment opportunities.

Meanwhile, a very gradual normalisation of policy in the developed world, with the neutral level of interest rates believed to be well below historical levels, should continue to press investors into EM assets, particularly given the availability of significantly higher prospective yields for the same credit ratings as developed market equivalents.

Local rates markets also look attractive overall, while local currency will continue to move in step with global risk appetite, warranting a tactical approach.

As with all investments there are risks, which ironically look more centred on events in developed markets, such as the ongoing policy uncertainty in the US or the potential for early Italian elections.

COLM MCDONAGH is head of emerging market debt at Insight Investment

Reconsidering allocations

In light of depressed long-term yields, insurers are reconsidering asset allocations to try to access higher returns without taking excessive risk.

EM debt may be one of the few asset classes that can achieve these conflicting aims, provided that exposures are managed appropriately with a focus on downside protection.

While some strategies combine exposure to different segments of the market as part of the total return approach, insurers' portfolios are still typically managed with reference to mainstream indices seeking to minimise tracking error.

In our view, a better strategy is to seek to harness the favourable characteristics exhibited by EM government and corporate debt issued in both local and hard currencies and target portfolio diversification, income generation and capital growth.

These types of approach can be aligned more closely with liabilities and tailored to specific risk requirements and objectives. They aim to enhance returns beyond traditional index allocations without being overly influenced by either US interest rate policy or moves in EM currencies.

14th SIRC
Singapore International Reinsurance Conference

NEW PARTNERSHIPS IN REINSURANCE

31 October to 2 November 2017

Sands Expo & Convention Centre, Marina Bay Sands Singapore

Guest-of-Honour: Mr Lim Hng Kiang
Minister for Trade & Industry (Trade)
and Deputy Chairman, Monetary Authority of Singapore

1 November 2017

Industry Keynote Address

Mr Ulrich Wallin
Chairman of Executive Board
Hannover Rueck SE

Keynote Address

Mr Marc Faber
Editor & Publisher
The Gloom, Boom & Doom Report

High Level Executive Panel Discussion
"Reinsurance - Responsibilities and Opportunities in the New World Disorder"

Panelists:
Mr James Nash
President, International Division, Guy Carpenter
Mrs Doina Palici-Chehab
Interim Chief Executive Officer, AXA Asia
Ms Jayne Plunkett
Regional President Asia and CEO Reinsurance Asia, Swiss Re
Mr Hermann Pohlchristoph
Member of the Board of Management Munich Re
Mrs Alice Vaidyan
Chairman-cum-Managing Director, GIC Re

Moderator:
Prof Hellmut Schütte
Emeritus Professor of International Management, INSEAD and Dean Emeritus, CEIBS

2 November 2017

Keynote Address

"The Second Half of the Chess Board - Disruptive Technologies, Innovation and Global Impacts"

Mr Peter Hacker
Co-Founder & Partner
Distinction. Global

Moderator:
Mr Peter Hacker
Co-Founder & Partner, Distinction. Global

Executive Panel Discussion
"Future of Reinsurance - A View from the Outside"

Panelists:
Mr Tony Hobrow
CEO, NexAssure Group Pte Ltd
Mr George Kesselman
Founder, InsurTech Asia
Dr Paul Mang
Global CEO of Analytics at Aon

For Sponsorship Details, please refer to http://www.sirc.com.sg/sponsorship.asp

Organisers: singapore reinsurers' association

Co-organisers: RBAS, Singapore College of Insurance

Official Media Partner: Asia Insurance Review

Supported by: Singapore Exhibition & Convention Bureau

RIPPLE EFFECT

As the digital transformation starts to spread throughout the insurance sector, **Mark Crichard** asks whether InsurTech is a disruptive force or a complementary innovation

While the FinTech sector has been active for several years, the technological advance in the insurance arena has been slower off the blocks. However, that is definitely changing. No article, seminar or event in the insurance world would now seem complete without mentioning the phrases "digital transformation" or "InsurTech".

This is also reflected by the flow of money into this space. InsurTech, in 2016 alone, attracted $1.69bn of investment, and money backing UK start-ups tripled from 2015 to 2016.

So, InsurTech is set to revolutionise the way insurance is sold and the working practices of underwriters, brokers, managing agents and many more. But, what does it actually mean? And how does it fit into the future of the insurance industry?

The phrase probably means different things to different people. In broad terms, it typically means either the use of new technology to improve the efficiency or reduce the costs of the (existing) insurance "supply chain", from product development through to claims, or "disruptive" technology-based businesses offering new or innovative insurance products.

Utilising InsurTech

The perception is that it is historically difficult for large institutional organisations, like insurers, to be nimble and agile enough to respond to a rapidly changing technological environment and shifting consumer preferences. Indeed, the insurance market presents some unique opportunities and challenges, particularly in the context of the more disruptive InsurTech offerings.

At one level the purchase of insurance (and then claiming on it) is probably just a necessity at best, or a distressed activity at worst. Encouraging customers to buy more insurance or, in some cases, to take out cover at all, is challenging.

Being a reputable, dependable and predictable insurer would certainly be seen as a good thing, but it doesn't necessarily fit well with the type of brand profile that is seen in the digital world. So, building a brand and technology that cuts through that is more difficult.

That said, it's not all doom and gloom. The industry is already looking at and using new technology, albeit in less high-profile areas. For example: the London Market Group is looking into the potential use of blockchain technology as part of the London market Tom Innovation workstream; traditional insurers are trying to better exploit data analytics; and the use of some form of robotic process automation is now pretty much universal in any insurance-related outsourcing deal.

A recent PwC survey found that 85 percent of respondents reported that data analytics would be the main area of technological investment over the next year.

As yet, no one has had their "Uber" moment in the InsurTech industry and threatened to fundamentally change the way risk is managed. However, several start-ups have emerged with the goal of finding new ways to meet genuine consumer demands at a fraction of the current cost and in a simpler manner. A good example is Brolly.

Brolly helps consumers adjust to the change from buying insurance through a broker to predominantly purchasing insurance through comparison websites.

The company spotted that purchasing insurance on the internet results in consumers: (i) being over- or under-insured; (ii) taking a fragmented approach to purchasing insurance, where documents are stored in emails with no interlink with other related insurance; and (iii) staying with insurers on renewal, despite having to pay more, due to the difficulty of switching.

As a result, Brolly designed an app that provides users with a single place to view, manage and buy insurance. Their app: (i) searches your inbox and "scrapes" existing policies into a "locker" with key details set out; (ii) spots gaps in insurance that a consumer may have and asks if they need a quote; and (iii) provides push notifications on the best time to renew policies (and when a customer renews, Brolly is paid commission by the insurer).

The ultimate goal is for insurers to pay for inclusion in the app, thereby giving themselves access to a pool of new customers that are more likely to purchase insurance because of the app's ability to make a complex process simple.

Similar apps on the market are having success in leveraging large insurers' reputations, distribution channels and regulatory approvals while also capitalising on their desire to move into the digital space, such as Sure (with its smartphone insurance offering).

Interestingly, InsurTech start-ups are proving that they also offer complementary innovations for existing insurance companies, as opposed to being the disruptive force that many predicted.

Zurich's head of business transformation, Antony Elliott, summed this up when he was recently quoted as saying "a few years ago, the insurance sector thought that these start-ups were coming to eat our lunch, now we see them more collaborating and joining us for lunch".

In fact, many insurers have spotted this opportunity and are actively seeking involvement with start-ups. For example, Munich Re has begun investing and partnering with start-ups and Travelers recently acquired Simply Business (an insurance platform) for $490mn.

"Data is increasingly going to be at the centre of the InsurTech revolution. Those businesses best able to capture, control, analyse and exploit it are most likely to thrive"

Disruption ahead?

Despite the collaboration, InsurTech has the potential to be a disruptive force and threaten the traditional model of writing insurance business. Reflecting that, the same PwC survey found that 86 percent of those (traditional businesses) surveyed considered that revenue was at risk from InsurTech players.

The disruptive effect can be seen in the world of motor insurance. Start-up By Miles has recently been authorised by the UK Financial Conduct Authority (FCA) to act as a broker to offer a pay-per-mile insurance policy that works in tandem with a smartphone app.

The policy targets lower-mileage drivers based in cities who commute into work on public transport, with the idea of simplifying the process of obtaining car insurance while also making it cheaper and more cost-effective. With By Miles set to launch its offering later this year, the impact of this method of managing risk remains unknown. It will be interesting to see if this is approach is applied to any other insurance lines.

For the start-up community, leaving aside the usual issues with raising finance, managing cash flow etc, the biggest unique challenge is the regulatory environment behind the insurance world (and the associated capital requirements for those writing the insurance).

While we have seen several new payment service providers spring up in the banking and payments arena, almost without exception, start-up InsurTech businesses need to rely (at some stage) on existing insurance carriers.

For those trying to be more radical, scaling up will inevitably involve the considerable costs of obtaining and maintaining appropriate authorisations. Although initiatives such as the FCA's Project Innovate help, it is interesting to note how few InsurTech start-ups have applied or been accepted into any of the FCA's regulatory sandboxes.

Data is increasingly going to be at the centre of the InsurTech revolution. Those businesses best able to capture, control, analyse and exploit it are most likely to thrive, provided, of course, they can do so within the ever-tightening regulatory grip of data protection legislation.

Ultimately, the potential benefits of InsurTech are yet to be fully utilised and, in the words of PwC global InsurTech lead Jonathan Howe: "Whether it is partnering with, or acquiring start-ups, or fostering innovation internally, insurers need to find a way to bring the benefits of InsurTech into the mainstream." (PwC 2017 Global FinTech survey).

For the UK's insurance industry, tapping into the opportunities that InsurTech offers is perhaps all the more important, as it looks for ways to cement its market-leading position while Brexit looms large.

MARK CRICHARD is a partner with law firm RPC specialising in technology and outsourcing

CROSSING BORDERS

Michael Frith assesses what proposed US tax reforms could mean for the export of risk

The world is a dynamic place, with constant economic rebalancing, shifting geopolitical priorities and ideological differences, all in the very human quest for prosperity.

With that constant change comes constant risk, and an unmanaged risk is a threat to prosperity. Hence, insurance and reinsurance.

The risks the world faces are not restricted by jurisdiction, and the most effective solutions for the management of those risks are similarly not restricted by jurisdiction.

Bermuda is a testament to that principle. The island has steadily evolved into a centre for risk management solutions, working alongside – and to the benefit of – the international financial community. Bermuda reinsurers support the Lloyd's and European markets, and are critical supporters of the US insurance market, across all lines of business.

For the US property market in particular, Bermuda reinsurers help foot the bill when major disasters strike – whether natural or man-made.

And the island's steady and sophisticated regulatory framework ensures that the US, and the world, can be confident that they will continue to pay claims when future disasters threaten prosperity again.

MICHAEL FRITH is a director in the corporate department of law firm Conyers Dill & Pearman

So what is the threat posed to the international reinsurance market generally by proposed domestic US tax reforms, and in particular the suggested "border adjustment tax" (BAT)?

While it remains uncertain what form the BAT proposal will take – or if it will be adopted at all – the concern is that, as currently presented, the proposals could have the effect of limiting access to global risk management solutions. And that is a threat to prosperity.

In short, the proposals being put forward in relation to BAT will, if enacted, make it more expensive for a US insurer to purchase its reinsurance outside of the US, by imposing a tax on the "import" of that reinsurance protection.

If the reinsurance protection is made more expensive or, worse, is not available due to a shortage of capital, insurers must pass on the higher risk management costs to their insureds.

That will have a negative impact on the effectiveness of risk management strategies by US businesses and consumers, and that, in turn, will necessarily have a negative impact on prosperity.

To be clear, the BAT proposal is not aimed specifically at reinsurance (unlike other previous tax proposals – such as the Neal Bill – that have targeted the reinsurance market). Rather, it appears to be directed at imports into the US generally.

The "import" of reinsurance would simply be caught in that very wide net, along with imports of commodities, manufactured goods, etc.

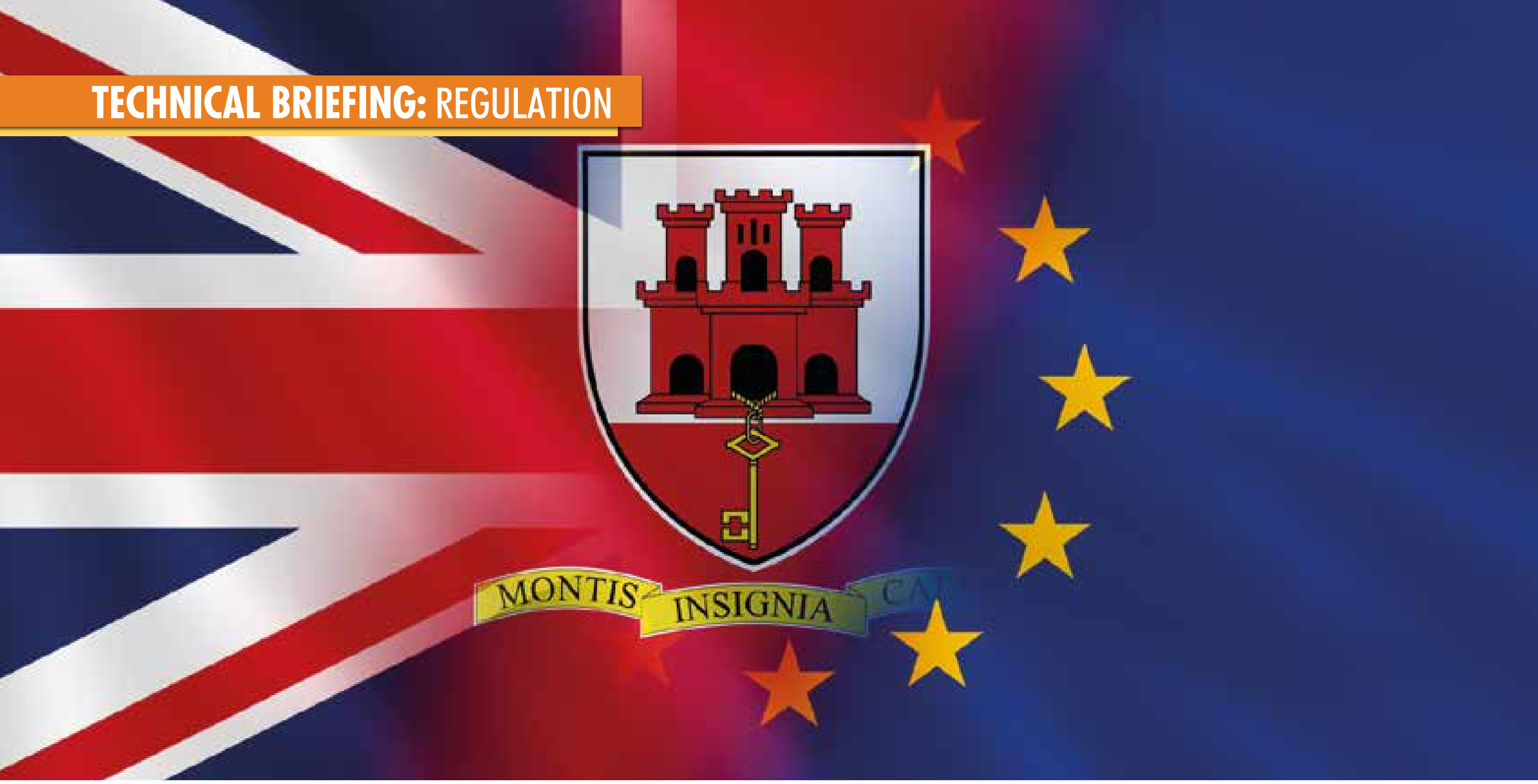
We are not saying that such an import tax is necessarily bad. Indeed, there may be good reasons for having such a broad import tax implemented, if the politicians see fit. The question is, is it appropriate for reinsurance to be included in the scope of such a tax?

Simply put, there is far more capital to be found outside of any one country's borders than there is inside. It stands to reason, therefore, that when seeking the broadest possible array of solutions, and the capital to support them, there should be no – or at least minimal – hindrances to doing so, wherever in the world those solutions may be found.

Indeed, it would be far more appropriate to view the purchase of risk management solutions (in this case, reinsurance) from a market outside of one's own borders as an export of risk, rather than as an import of protection.

Recognising such transactions as the diversification and transfer of risk that they are, rather than simply regarding them as a service import, can only help in the management of risks, and therefore aid in the quest for prosperity.

Whatever the view of BAT may be generally, only time will tell what final form US tax reform proposals – and in particular the BAT – may take. But it should be our collective hope that those proposals do not seek to limit or penalise the export of risk.



THE KEY TO THE FUTURE

Gibraltar's passporting rights make the jurisdiction a strategic post-Brexit location for EEA insurers that write business in the UK and the City of London, says **Michael Ashton**

Gibraltar's insurance sector has grown significantly over the last 17 years, from just 13 licensed insurers in 2000 to over 40 currently writing new business today.

In 2016 these insurers collectively wrote approximately £4.8bn in gross premium income. The core element is motor insurance, which accounted for around £3.7bn of gross premium income. One of the Big Four accountancy firms estimates that Gibraltar motor insurers currently have more than a 20 percent share of the UK motor insurance market.

In June 2016 the Gibraltar electorate voted overwhelmingly to remain within the European Union. In fact, the 96 percent vote in favour of remaining was the largest majority of any electoral community.

However, Gibraltar and its people, situated as they are right at the confluence of the Mediterranean Sea and the Atlantic Ocean, have been traders for over 300 years. The Brexit decision, while initially unwelcome, was quickly seized upon as an opportunity for Gibraltar's financial services community.

The government of Gibraltar undertook a detailed survey to establish just how much of its financial services business was in fact "European" and the result, rather like the Brexit outcome, was a surprise.

Although Gibraltar has worked hard in recent years to attract business from continental Europe, the survey found that over 90 percent of Gibraltar's financial services business was with the United Kingdom. As a British Overseas Territory with historically strong ties to the United Kingdom and the City of London, in retrospect this was not so surprising.

While the terms of the United Kingdom's exit from the European Union are still far from certain and there has been much talk of hard and soft Brexits, it looks possible that some form of transitional period will be agreed upon following the official deadline of March 2019. As Gibraltar joined the European Union in 1973 along with the United Kingdom, it will exit along with the UK.

The people of Gibraltar, in my opinion, are positive and confident that the United Kingdom will ultimately succeed in maintaining close trading relationships with the European Union, albeit after some difficult negotiating and under "new" rules.

We also believe that the United

Kingdom will forge new trading partnerships around the world and that, after some bumps and bruises in the short term, it will maintain its position as the world's fifth largest economy.

New relationships

In the same way that the United Kingdom is seeking to establish new trading relationships, so is Gibraltar. Much effort is being made to seek new trading opportunities with businesses in eastern and southeast Asia.

Irrespective of Brexit, Gibraltar's common law system, English language and pound sterling currency continue to make it an attractive jurisdiction for financial services.

Importantly, while Gibraltar may not retain its status as the "gateway" to the European Union, Gibraltar's passporting rights into the United Kingdom are paramount. The Crown Dependencies of Guernsey, Jersey and the Isle of Man do not have the same ability to transact insurance business directly with the United Kingdom.

In October 2016 Liam Fox, one of the three key Brexit ministers in the UK government, said: "When it comes to financial services, there are strong mechanisms already underpinning Gibraltar's access to the UK market which are enshrined in UK law," adding that, "The government's clear intention is to maintain that access."

In January 2017 Robin Walker, parliamentary undersecretary of state at the Department for Exiting the European Union, said "one of the most striking bits of evidence" provided by the Gibraltar government to the British government was the importance of the UK market to the Rock's economy.

"It's important that we work together to maintain and strengthen those ties," Mr Walker told the Lords Committee. "When it comes to financial services, there are mechanisms already underpinning Gibraltar's access to the UK market which are enshrined in UK law. And we clearly want to maintain that access and will work at an official level to make sure that access is well supported."

MICHAEL ASHTON is senior finance centre executive for insurance at Gibraltar Finance

Passport to success

In January 2016 the Bank of England listed around 750 European Economic Area (EEA) insurers that were writing insurance business in the United Kingdom. About 10 percent of these companies had established UK branch offices, but the vast majority utilised freedom of services to passport into the UK.

> There has been much press about UK insurers' plans to establish new insurance companies in cities such as Brussels, Frankfurt and Amsterdam as part of their post-Brexit strategies, but not so much press about how continental insurers will retain their UK books of business

There has been much press about UK insurers' plans to establish new insurance companies in cities such as Brussels, Frankfurt and Amsterdam as part of their post-Brexit strategies, but not so much press about how continental insurers will retain their UK books of business.

For those EEA insurers that have large books of business in the United Kingdom a new authorised UK insurance company is a likely option. An alternative route, with Gibraltar's passporting rights being maintained into the UK, would be to consider establishing a new Gibraltar-based insurance company.

For those EEA insurers that have smaller books of business in the United Kingdom, the economics of establishing a new UK insurance company or a new Gibraltar insurer are less compelling.

Fronting arrangements are an obvious option, but whether such arrangements offer sufficient certainty over the medium-to-long term and are economically viable will depend on individual circumstances.

Gibraltar was the first European Union jurisdiction to adopt protected cell company (PCC) legislation in 2001 and so the concept of PCCs is well developed and understood.

Gibraltar's independent financial regulator, the Gibraltar Financial Services Commission (GFSC), has recently undertaken a review of the business that can be underwritten within Gibraltar PCCs. The GFSC's "Innovate and Create" team concluded that third party business could be permitted within Gibraltar PCCs provided there were appropriate safeguards in place, with applications being reviewed on a case-by-case basis.

This opens up a potential route for EEA insurers to retain their UK books of business. Thus, EEA insurers that currently passport insurance services into the United Kingdom could utilise a Gibraltar PCC structure while using a 100 percent reinsurance cession from the cell back to the EEA insurer. In fact, such a structure could be set up in the short run, providing stability for the customer base.

A key aspect of using a Gibraltar PCC cell structure will be the GFSC's close scrutiny of the business plan and the cell's assets and reinsurance programme, which will be crucial in determining if such business is to be authorised.

The approach to new applications will be heavily reliant on the quality of the business plan, the quality of the people and organisations involved, together with a robust and comprehensive regulatory process.

If all these aspects are satisfied then both Gibraltar insurance companies and Gibraltar PCCs have the potential to offer flexible platforms to accommodate the transformations that will be required by many EEA insurers.

Disclaimer: While the author works for the government of Gibraltar, this article represents his own views and opinions, which are not necessarily those of government or future policy.

HIGH WATER MARK

Recent thinking on flood events has shifted towards understanding resilience in order to stop the claims "floodgates" from opening, says **Ian Gibbs**

After the flood events of 2007 the UK government commissioned the Pitt Report, which provided a comprehensive review of the lessons learnt from the floods, and actions flowed from this report.

Since then there have been further studies and research funded by government into all aspects of flooding and resilience, but as individual pieces of work they have not had a significant impact.

Recently, the focus has shifted from the expectation that the government will prevent flooding by building flood defences to how the UK can cope better with the impacts of flooding by adapting homes and changing behaviour.

The impact for insurers will be on how architects, developers and surveyors design buildings that are more resilient to flooding. Adjusters will then have to review how they undertake resilient repairs after flooding.

Action plan

In the past 12 months, key stakeholders including the Department for the Environment, Food & Rural Affairs (Defra), the Environment Agency, the charity sector, corporates and the Royal Institution of Chartered Surveyors have been working together on a roundtable group to produce a route map and bring consistency to flood resilience.

This "Property Flood Resilience Action Plan" was launched in October last year at Westminster and has the ongoing support of Thérèse Coffey, Parliamentary Under-Secretary of State for the Environment, and floods minister.

The plan sets out the key steps to increasing property-level resilience, as follows:

1) Exploration of how building regulations can be used to encourage flood-resilient construction/reinstatement;
2) Examination of how Flood Re can support and possibly incentivise flood resilience;
3) The creation of a rigorous independent standards and certification process;
4) An independent online information portal to inform householders and small businesses on flood resilience; and
5) A partnership between key stakeholders to encourage and enable the uptake of resilience measures.

Cunningham Lindsey is part of this process, working to ensure all professionals involved understand the skills needed in this complex issue.

The skills that we need to bring to the market are:

1) An understanding of the types of flooding and how they can combine to affect a property and interpretation of the flood risk survey;
2) A good understanding of building pathology and building defects so the impact and effectiveness of resilient methods of repair can be assessed;

Continued on page 60

3) The ability to understand the cost benefits of the different approaches to resilience;
4) The interpersonal abilities to empathise with a customer in the trauma of a flood, which is when most resilient works are undertaken;
5) The knowledge of the different approaches to resilience and the products available; and
6) The capability to ensure the installation of resilient measures meets the required standards.

Resistance and resilience

There has historically been a clear separation between "resilience" – using alternative methods of construction and resilient materials to minimise the extent of actual damage and reduce the drying time in the event of future flooding – and "resistance", which involves constructing or altering a building to resist the ingress of flood water.

However, the end goal for a customer is a property that is better equipped to handle the risk of flooding so that they can recover more quickly after a flood.

Therefore, in communication with claimants, the focus is no longer on differentiating between whether something is a resistant or resilient measure, and is instead on how well equipped the property is for coping with flood water.

We now talk about this end goal and explain how to make a business or property more flood-resilient, using appropriate measures.

A customer who wants to install resilient measures has three stages to go through to create a more resilient property and they need a surveyor to guide them through this process. These stages are: a flood risk survey, to understand the flood risk for the property; a building survey and advice, to provide recommendations on appropriate flood-resilient measures; and installation of resilient measures, completed to the correct standard.

The customer will need a trusted professional to coordinate these three stages. The recent experience of many homeowners (for example, during the 2016 floods in Carlisle), was that a resilient product manufacturer persuaded them to move straight to stage three, resulting in the installation of ineffective measures.

However, the current development of a Flood Resilient Database by the Building Research Establishment, working in conjunction with insurers, will help in this area, as there will be the requirement to use suitably qualified professionals in the process.

The database will be easily accessible by insurers, so they can identify properties which have had suitable flood resilient measures installed that have a demonstrable impact on reducing the effect of a flood. Each property will be given a property flood resilient (PFR) score, like an energy rating, to help insurers make decisions on providing cover and the level of premium.

> "The focus is no longer on differentiating between whether a measure is resistant or resilient, and is instead on how well equipped the property is for coping with flood water"

The three stages require individual skills and knowledge, but we also have to consider how they interrelate to deliver the service to customers.

Flood risk survey

A standard flood risk survey will identify the types of flooding the building is at risk from, likely depth of flooding and risk of flooding.

For example, if you have a property in an area at risk of groundwater flooding with a suspended timber floor then resistance would not be suitable and resilience would be the approach to take.

Building survey and advice

Going forward, we must understand how resilient the existing building materials are to water. The current practice of stripping properties back to the structure and removing resilient materials suggests more training is needed in this area.

The understanding of the impact of water on materials goes hand in hand with the need to understand how they can be dried using modern methods of drying. The benefits to be gained by reducing strip-out and using the appropriate drying techniques need to be explained to the customer.

The customer will need reassurance that resilience works, especially if they have been flooded before, as they probably would have experienced a complete strip-out.

Installation of resilient measures

It is common to see products that have been sold to customers that are totally ineffective, inappropriate or poorly installed. Cunningham Lindsey ensures this does not happen by providing a holistic service to make the property resilient, including ensuring products are fit for purpose and properly installed.

However, most resilient measures involve standard construction processes (so do not need a specialist installer), and so we ensure these are properly specified and then inspect and confirm the resilient repairs have been properly completed.

A key question insurers and brokers need to understand is the cost of undertaking resilient measures to properties of standard construction.

Recent research undertaken by Defra has modelled different property types and detailed resilient measures and their costs. This demonstrated with practical examples that the additional cost of a package of selective resilient measures was between £1,900 and £4,700, above normal insurance reinstatement costs. This would have to be funded by any future government grants or the homeowner.

This education about the practical cost and benefits provides the professional with the knowledge to provide good effective advice to their customers and spread the word that low cost resilience measures work.

IAN GIBBS is national technical manager at Cunningham Lindsey


Insider
LONDON
MARKET
CONFERENCE
etc. Venues, Liverpool Street, 155
Bishopsgate, London, EC2M 3YD
2 November 2017
08:15 – 19:00
SPEAKERS INCLUDE:
Bruce Carnegie-Brown, Chairman, Lloyd's
Greg Case, President & CEO, Aon
Stephen Catlin, XL Catlin
Steve Hearn, Group CEO, Ed.
Denise Garland, Group Chief Operating
Officer, Tokio Marine Kiln
Kelly Lyles, Client and Country
Management, XL Catlin
Grahame Millwater, CEO, Beach Capital
Piyush Patel, COO, MS Amlin
Further speakers to be announced
in association with
DXC.technology
Sponsored by
DOCOsoft
NIIT technologies
New Ideas, More Value
MOORE STEPHENS
HOW TO BOOK YOUR PLACE...
Subscriber rate £495, earlybird rate
(until 10 September) £595, delegate rate
thereafter £695 (all prices exclude VAT)
www.insiderlondonmarketconference.com
TO BOOK YOUR PLACE OR
FOR FURTHER INFORMATION
please contact Beatrice Boico on
beatrice@insuranceinsider.com /
+44 (0)20 7397 0619

BREXIT – THE PATH AHEAD

John Shepherd, CEO of Shepherd Compello, shares his views on the post-Brexit future for the insurance sector

A year on from the EU referendum, John Shepherd, CEO of Shepherd Compello, shares his views on the future of insurance and why the company will continue to prosper.

Insider Quarterly (IQ): How do you feel now about the decision to leave the European Union?

John Shepherd: I will start by saying, did we really know what we were voting for last summer? For example, a hard or soft Brexit? I, for one, never recall this being part of the debate.

Leaving the customs union and the ability to trade freely was not on the ballot paper. For sure, free movement and migration were big talking points, with many wanting to see greater restrictions. However, we have since found out that, as far as EU citizens are concerned, these are already in place.

I didn't know for example that, under European law, it's OK to deport people from other European Union countries if they fail to find work after three months or if they can't prove they've got sufficient capital to sustain their lifestyle. In Belgium, EU citizens have just three months to show evidence they have found a job or they will be removed from the country.

To summarise, I think a great deal of information has come out since that would have helped us all at the time.

IQ: This time last year you were "passionate about staying in Europe" – how do you feel now?

Continued on page **64**

John Shepherd: I still feel passionately about Europe and I also respect the democratic decision to leave – I made that clear last year. I also stated that as a businessman my decision was based on the commercial facts that I could see around me and what I could hear in the market.

A year on, if anything, my business instinct is that it was the wrong decision, but one which we will have to make the best of – the best being for all of us, regardless of the way you voted.

Closest to me is the Shepherd Compello family and the people in our firm. For example, we run a multilingual service centre in South Quay under our trading name EPG Administration Services Ltd, helping clients across many countries. The majority of this team are not UK citizens, they come from many nations, including France, Bulgaria, Belgium, Ukraine, Italy and Germany.

I have a moral duty to look after this family, which is why I am still passionate about the practicalities of what Brexit means and retaining them within our business.

IQ: What kind of practicalities do you mean?

John Shepherd: Well, for starters, we need to appreciate that the largest market this nation trades with is the EU. So let's talk turkey about Europe rather than chlorinated chickens from the US.

We need the ability to trade in the EU at Shepherd Compello, as this represents a large proportion of our business.

My immediate concern is that we are a year on and, with the clock ticking, we have no real clarity on what will happen.

This means that making informed business decisions is impossible.

Multinational firms with huge resources and operations around Europe are already announcing that they are on the move. Liberty Specialty Markets, RSA, AIG, QBE, Lloyd's, Markel, Beazley, FM Global, CNA Hardy and Chaucer are moving parts of their business.

Interestingly, their destinations include Ireland, Luxembourg, Belgium and Germany – so there is no consensus on where to go.

Also, for firms that do not have the luxury of the resources or ready-made hubs, the decisions are tough. For us to set up a hub in Europe would be a considerable investment in time and money. We do not have teams of strategists around the world, but we do want to trade and continue to fly the flag.

Add to this the fog that hangs over the whole process and you can see the challenge.

IQ: You talk about a fog – what needs to be done to lift it?

> "We need to appreciate that the largest market this nation trades with is the EU. So let's talk turkey about Europe rather than chlorinated chickens from the US"

John Shepherd: I think that is a really good question and our industry bears a responsibility to lobby for our interests and the wider economy.

I read that, according to the EY Brexit Tracker, some 68 percent of firms have said nothing about Brexit. Think about that – the single biggest issue in Britain at the moment and most business leaders are not willing to talk about the ramifications.

That is why it is refreshing to see the CBI announce that we should stay in the customs union until a post-Brexit trade deal is agreed. That kind of clarity would certainly help to lift the fog.

As an industry, I welcome the work done by Biba, Liiba, the LMA and Lloyd's. Biba is lobbying the government with 11 key questions affecting brokers and their customers during Brexit negotiations. Within their proposals, they ask that we "preserve our leading position as the European centre of insurance broking". Who in the UK would disagree with that?

Meanwhile, the LMA has set out a roadmap to protect clients' access to London. They estimate that £8bn is brought annually to the market by brokers on behalf of EU customers.

IQ: So what are the key concerns you have that need to be addressed?

John Shepherd: For me, there are three key issues that would help me and, I believe, the wider insurance industry.

First, we need to understand how the current passporting rights which enable EU financial services companies to trade freely in the EU will be affected.

Second, there needs to be a roadmap detailing the key milestones because, as it stands, it is very vague and some are even questioning if we will meet the two-year departure deadline.

Third – and this is linked to point two – we need clarity on the transitional arrangements and how long these will be in place.

Talk of a cliff edge is emotive and not in the least helpful to business.

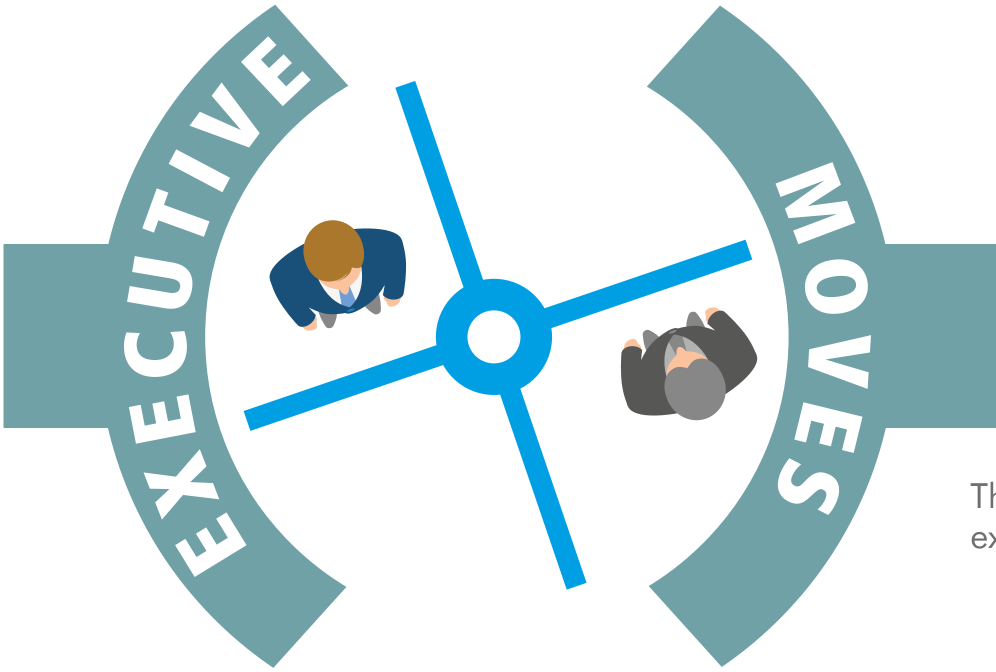
As it stands, we are being asked to run a business with new rules without knowing what those rules will be.

To illustrate this, look at what Andrew Bailey at the FCA has to say. He wonders how useful it is for firms to make contingency plans when they have no idea what the outcome of negotiations is likely to be.

IQ: How do you view the "Brexit" future?

John Shepherd: I am, by nature, a "glass half full" person. Of course, I have concerns, which I have outlined above.

However, at an individual, company and industry level, we need to do all that we can to "drive forward together" – that's what Compello means after all!



The Ins and Outs of the executive job market

Mike Donegan

Mike Donegan has stepped down as CEO of Price Forbes and taken up a position as a strategic adviser to parent company The Ardonagh Group. Sources said staff were told that Donegan was relinquishing the CEO role, which he has held since 2004, in favour of chairman of non-marine James Masterton.

Matthew Moore

Liberty Specialty Markets (LSM) has installed Matthew Moore as president and managing director, replacing Nick Metcalf, who is retiring, with immediate effect

Moore became chief underwriting officer (CUO) of Liberty Syndicates in 2009 and took the group CUO role at LSM in 2014 after parent Liberty Mutual created the new operation.

Adam Cragg

Lloyd's insurer Novae has hired Adam Cragg as its new group chief operating officer, reporting directly to chief executive Matthew Fosh. Cragg joins from Beazley, where he served as head of operations for the UK and rest of the world, having joined in 2008 as business technology manager.

Bob Stevenson

Bob Stevenson, the longstanding head of relationship management at Lloyd's, is planning to retire by the end of this year, it is understood.

Stevenson, who has been at Lloyd's for more than 25 years, was also a member of the New Entrants Assessment Group.

Ron Lockton

Independent broker Lockton has named vice chairman Ron Lockton to replace Glenn Spencer as president and CEO, effective immediately.

Spencer resigned for personal reasons, according to the company. Ron Lockton is the son of the broker's late founder Jack Lockton and the nephew of chairman David Lockton.

Ian Posgate

Ian Posgate, one of the most prominent Lloyd's underwriters of the second half of the 20th century, has died, following a short illness.

Posgate, who was profiled in Issue 59 of *IQ*, underwrote 20 percent of the Lloyd's marine market in the 1960s and 1970s, earning him the nickname "Goldfinger".

James Kent

Willis Re has confirmed that deputy global CEO James Kent will become global CEO at the end of this year, following John Cavanagh's decision to step down.

Kent joined Willis Re in 2004 and has been global deputy CEO since December 2016. He was appointed president of North America in 2010.

Michel Liès

Zurich has nominated former Swiss Re CEO Michel Liès as its next chairman.

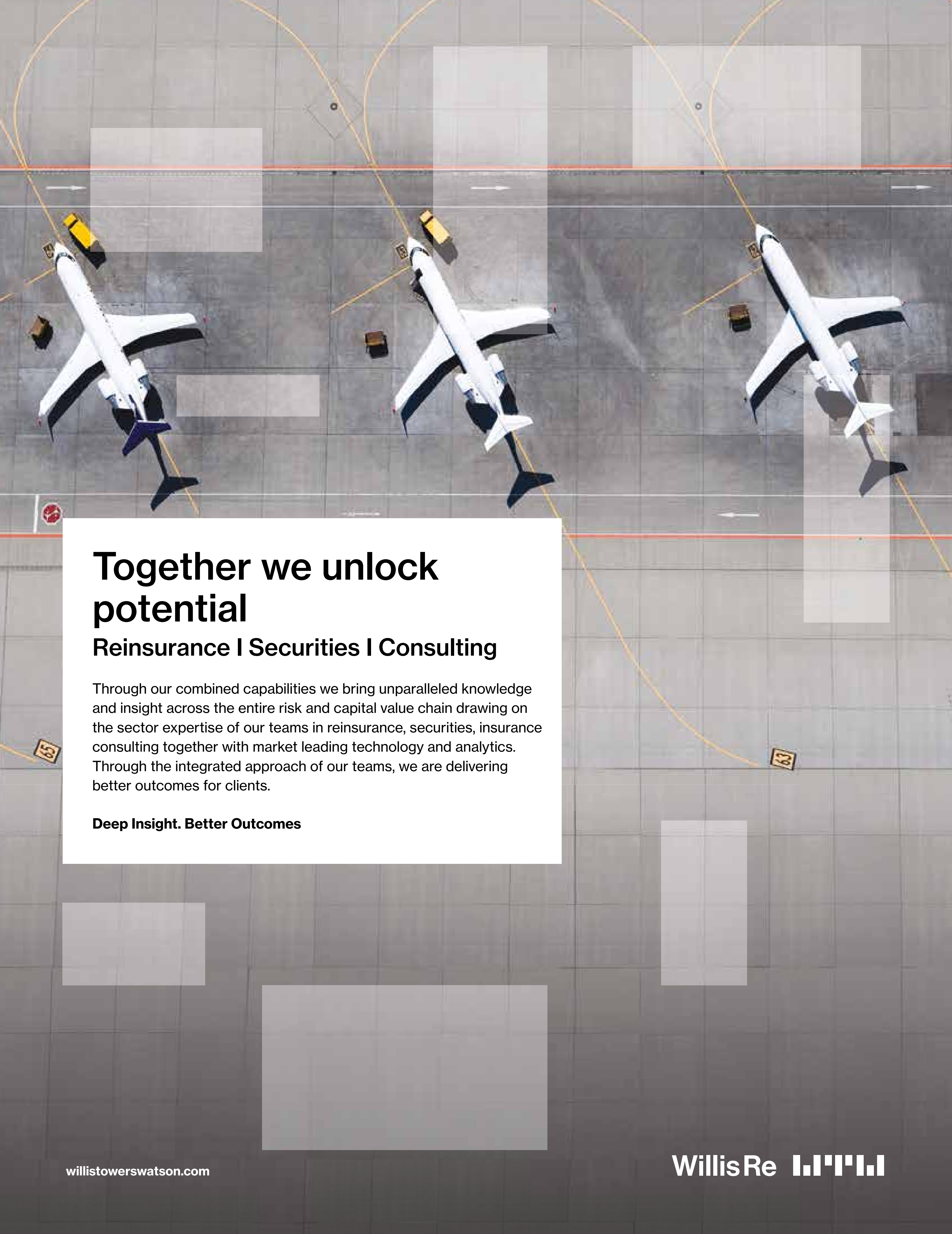
He will be put forward by Zurich to replace the incumbent Tom de Swaan at its next annual general meeting in April 2018. Liès worked at Swiss Re for 38 years, most recently as CEO from 2012 to 2016.

Peter Zaffino

Peter Zaffino, CEO of Marsh, is set to join former Marsh & McLennan Companies (MMC) and Ace head Brian Duperreault at AIG.

AIG confirmed that Zaffino will be joining the company as global COO, making him the effective deputy of Duperreault, who was recently appointed CEO.

LGT


Together we unlock potential
Reinsurance I Securities I Consulting
Through our combined capabilities we bring unparalleled knowledge and insight across the entire risk and capital value chain drawing on the sector expertise of our teams in reinsurance, securities, insurance consulting together with market leading technology and analytics. Through the integrated approach of our teams, we are delivering better outcomes for clients.
Deep Insight. Better Outcomes
willistowerswatson.com
Willis Re