# IQ insider quarterly

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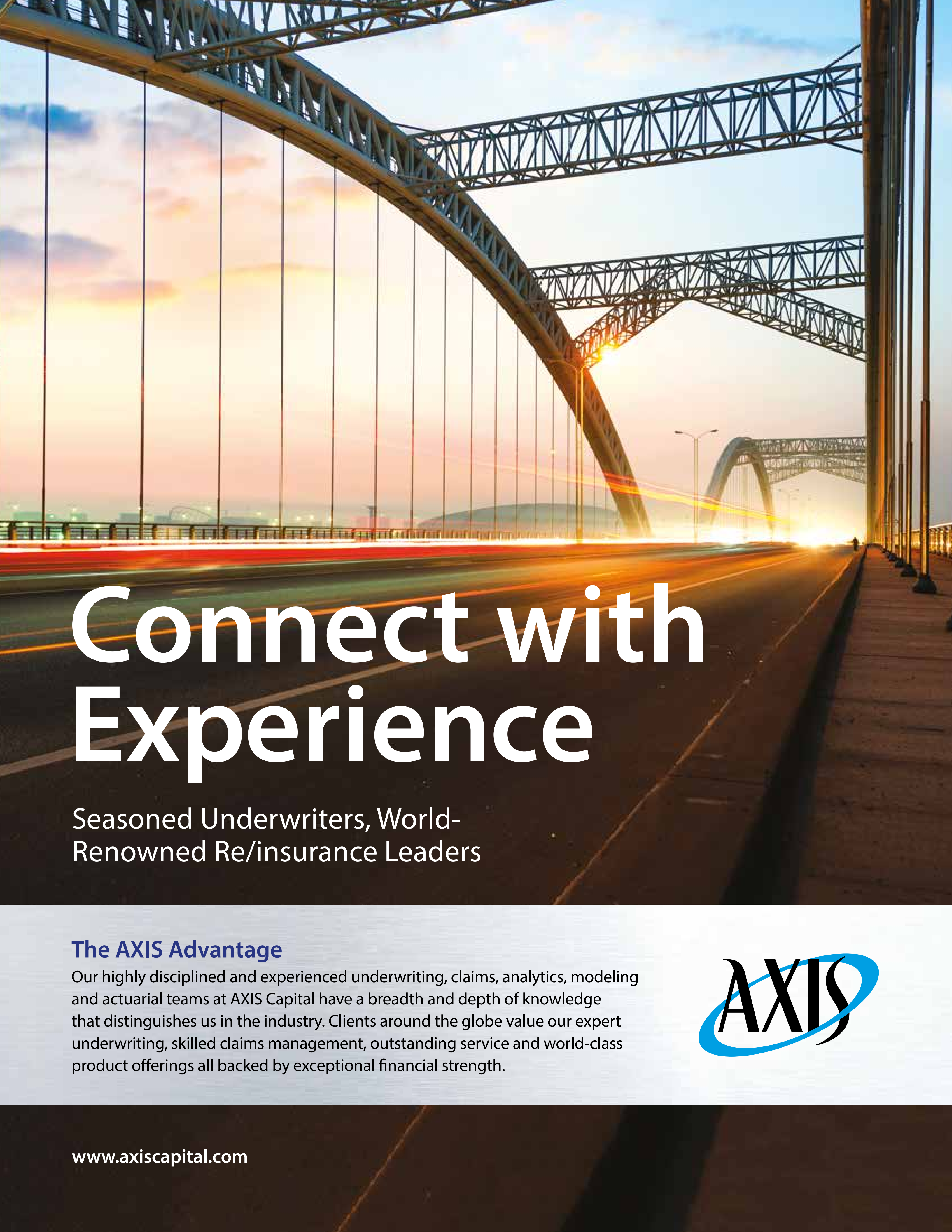
**Insurance | Insight | Intelligence**

# All aboard for Brexit

With EU passporting rights under threat, insurers weigh up new domiciles


The intelligent quarterly from the publishers of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# Sorry about that!

**When I first visited Germany I was amazed by the extraordinary phenomenon of being apologised to for the Second World War.**

I couldn't believe that some older members of the German population felt the need to say sorry to me personally for the events that had ended 24 years before my birth.

I was completely unprepared and it was disconcerting to hear expressions of sorrow and regret for something that had nothing to do with me or anyone in my generation.

What is one supposed to say?

My typical British instinct to immediately respond: "Oh, thanks, that's quite alright" seemed a little frivolous.

Eventually I perfected a more sober and thoughtful reaction, acknowledging and thanking the apologist's sincerity.

Then a few years later in a coastal town in Normandy a spritely French 90-year-old saw me get out of a GB-plated car and thanked me with three passionate Gallic kisses – again for the mere fact of my being British and a possible descendent of the liberating Allied armies of 1944.

I expect such greetings will die out as the last of that most troubled generation does the same.

But multiple decades of undeserved apologies and thanks just for being a loyal subject of her majesty Queen Elizabeth II is pretty amazing going.

It made me think.

I wonder how long into the future my children and I will have to apologise for Brexit?

Probably until after I die. I assume.

Brexit is pure politics and emotion. Logic, reason and a careful analysis of the facts were nothing to do with it:

The UK says it wants to go it alone outside the EU, but then wants the deepest and freest possible trading relationship with its old partners.

It says it wants to be a global beacon of free trade but to do so is leaving the world's largest free trade area whose single market it helped design.

It says it wants to regain sovereignty from Brussels and Strasbourg, yet the global trade deals it seeks will all need supra-national judicial mechanisms that have to be able to override individual governments if they are to work properly.

In insurance terms it is all pretty contradictory too.

The European free market in insurance works well and UK has just expensively implemented the biggest solvency regime changes for a generation – all to an EU template.

Meanwhile, Brexit will occur just as a covered agreement between the US and the EU will start to bring the world's two largest insurance markets together in mutual recognition.

Guess who did most of the heavy lifting on that one? The UK of course!

A desperate scrambling to restore the status quo is occurring as the UK establishment looks to remove the bullet it has shot into its foot.

There is no obvious net benefit to any of this, only net negatives as the frictional cost of doing business across Europe inevitably rises, just at a time when costs are under severe pressure across the board.

Perhaps the commitment to opening genuine EU subsidiaries will be the stimulus for UK firms to finally try and make the most of all the free EU insurance market has to offer?

After all, it is an area they have consistently neglected in favour of English-speaking trade up to now.

Maybe.

But until that day comes it will be: Sorry, *desolé*, *es tut mir sehr leid* for Brexit.

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# AROUND THE WORLD

IQ's roundup of regional market developments

## 01 US
### Florida ratings

There was news of a reprieve for a number of Florida insurers considered vulnerable to Demotech's February downgrade threat, with the agency signalling that carriers' ratings would not be lowered below the crucial A range, as originally feared.

Demotech said it would reveal which Florida homeowners' insurers it has affirmed or downgraded no later than 16 March, after reviewing year-end results that included $155mn of aggregate surplus growth for 2016.

The higher surplus, combined with an extra $200mn of loss and loss-adjustment expense reserves on balance sheets compared to year-end 2015, was the culmination of "a remarkable recommitment to Floridians seeking property insurance", Demotech said on 7 March.

The firm said the increase in surplus was the result of capital contributions along with operating profits at some carriers.

## 02 UK
### Ogden decision

The UK government shocked carriers in February by announcing a far steeper-than-expected cut to the discount rate shaved off lump-sum personal injury compensation.

Justice Secretary Liz Truss cut the so-called Ogden rate from 2.5 percent to minus 0.75 percent, in a move described by the Association of British Insurers as "crazy".

The cut – which will impact the levels of reserves that must be carried on motor business – is much greater than predicted, as most insurers and analysts were anticipating a move to either 1.0 percent or 1.5 percent.

Reinsurers will be hit hardest by the UK government's surprisingly steep reduction in the rate, with Willis Towers Watson estimating that reinsurers collectively will bear the brunt of a one-off reserve charge estimated at £5.8bn ($7.2bn).


## 03 Mexico
### Political violence loss

Riots in Mexico in January over the price of petrol are expected to cost the international insurance market between $200mn and $250mn, according to market sources.

Protests against a 20 percent hike in fuel prices led to looting in the Latin American country.

Walmart is submitting a $60mn-$70mn claim to the political risk market following the riots, sources told *The Insurance Insider* in February.

The US retail leviathan is set to tap its insurers under a wide-ranging global political risk policy. The cover was placed by political risk specialist BPL Global and includes political violence protection against strikes, riots and civil commotion.

The policy is led by QBE, which has a $15mn line on the $7mn primary layer. Other carriers involved include Pembroke and Talbot, both with $11mn lines.

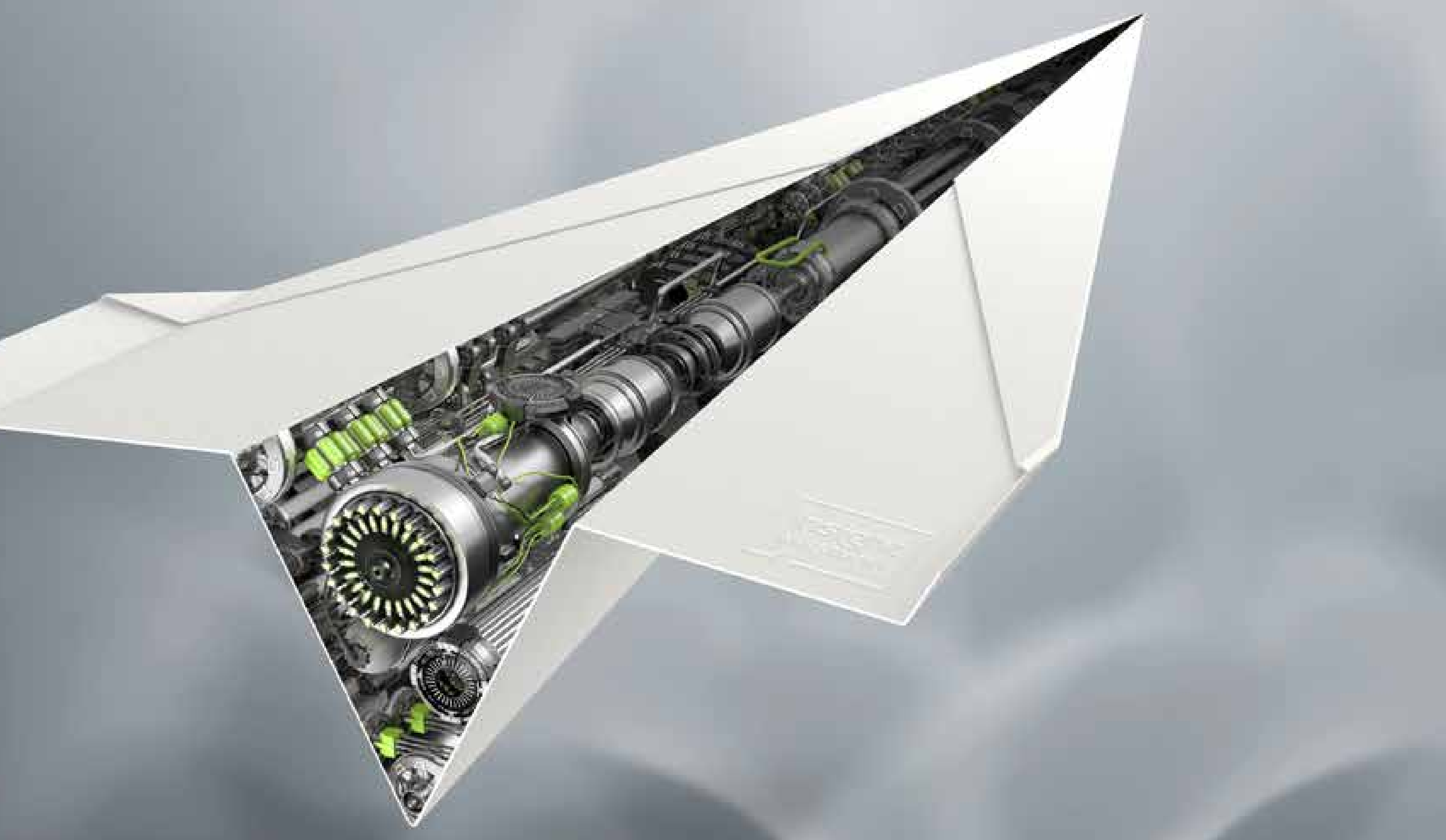
## 04 India
### Lloyd's approval

Lloyd's has received final "R3" approval from the Indian regulator to establish a branch in the country and plans to begin writing business in time for the April reinsurance renewals.

The office will be based in Mumbai and will offer a variety of specialty reinsurance classes of business.

The launch coincides with the introduction of new regulations in the country stipulating that all ceded reinsurance business is to be offered to local companies ahead of overseas reinsurers.

The Indian government has also granted in-principle approval for five state-owned general carriers –New India Assurance, United India Insurance, Oriental Insurance, National Insurance and GIC Re – to list on the country's stock exchange.



# A touch of class

Business class updates for the global market

## Marine

**MS Amlin is the lead insurer on a $25mn marine war loss from a ship sunk off the coast of Yemen in October.**

Sources told sister publication *The Insurance Insider* that the loss related to a United Arab Emirates-registered aluminium catamaran-style vessel named the HSV-2 Swift, which Houthi rebels in Yemen claimed to have hit with an anti-ship missile on 1 October.

The policy was 100 percent placed via a Marsh marine war facility in Dubai.

It is understood MS Amlin, Talbot, Ironshore and Munich Re underwrote the risk. The loss is understood to be the largest to hit the marine war market for several years.

## Aquaculture

**A spate of algae infestations that killed millions of salmon and tuna will see London market underwriters take a share of a $45mn bill.**

A trio of losses originated in Mexico and Chile as a result of harmful algal bloom events, in which algae populations quickly accumulate and generate toxins that can kill off entire fish farms.

A portion of the losses were reinsured into Lloyd's through an Alwen Hough Johnson consortium called Global Aquaculture Insurance and Company.

London-based (re)insurers Novae, Sompo Canopius Re, Tokio Marine Kiln, MS Amlin, Ascot, Sirius, Chubb, Aegis, ANV and Swiss Re Corporate Solutions are all understood to be part of the consortium.

## Cyber

**New cyber security regulations from New York State's Department of Financial Services may heighten the stakes for directors' and officers' coverage providers, according to Fitch Ratings.**

The regulations, which took effect on 1 March, require an executive or a director at a covered firm to annually certify compliance with the rules, which apply to a variety of financial services businesses, including insurers.

"If management and directors of financial institutions that experience future cyber incidents are subsequently found to be non-compliant with the New York regulations, then they will be more exposed to litigation that would be covered under professional liability policies," Fitch said.

## Aviation

**Allied World is moving its aviation book and underwriters onto the platform of Dubai-based managing general agency (MGA) Elseco.**

Sources told *The Insurance Insider* that Allied World's aviation specialist Olivier Marre will primarily write airline business through the Elseco platform, with a launch being targeted before 1 April.

The Dubai-based MGA is looking to secure capacity to support a $150mn line size, although it will also attempt to grow beyond this level in time as it seeks to build lead capacity.

Elseco already writes a general aviation account, and had a maximum capacity of $10mn for hull and $100mn for liability in 2016.

## Energy

**The upstream energy market has settled a major construction claim related to the faulty Big Foot platform in the Gulf of Mexico for $550mn – far less than first feared.**

Lead insurer Munich Re Underwriting struck the deal at the outset of the year, with carriers agreeing to pay out $550mn to the Chevron-led joint venture. Mexican state-owned energy company Pemex and its insurers have also settled a claim relating to an April 2015 platform fire for $650mn, bringing the loss in just below the reserve currently held by the market.

The loss had initially been notified to the market by broker Marsh at $670mn-$780mn, but in March last year Pemex revised this upwards and sought to claim the full $1.3bn policy limit on its programme.

## Auto

**The rising frequency and severity of US auto claims hit carriers' fourth quarter and full-year 2016 results.**

Liberty Mutual posted a 31.6 percent drop in Q4 operating income to $359mn, primarily due to increased losses in its US personal and commercial auto liability book. Meanwhile, US mutual giant State Farm reported a $5.5bn underwriting loss for 2016 after claims and expenses from its auto book outstripped premiums by $7bn.

And Maiden Holdings reported a Q4 loss of $69.7mn (Q4 2015: $26.4mn profit) after a pre-announced reserve charge mostly related to auto insurers.


# Market intelligence on the QT

## Booze ban

A sobering thought for followers of the news that Lloyd's has officially banned its staff from drinking alcohol during working hours: what will happen to One Under Lime?

As news of the prohibition swept through the market, many of EC3's finest became concerned for the wellbeing of the regular drinking haunt, situated right underneath the iconic Lloyd's building. Some wag suggested it could be turned into a juice bar, drawing in millennials from nearby trendy Shoreditch to supplement its income.

*IQ PI* has scoped out the bar since and it seems that broking and underwriting patrons are keeping its tills ringing.

## Executive expletives

**The UK government's announcement that it was cutting the discount rate for personal injury payments from 2.5 percent to minus 0.75 percent was enough to tip some Lime Street worthies over the edge.**

**One CEO rattled off an impressive set of expletives at the sheer madness of the situation, especially given the timing of the announcement, which arrived mid-way through results season.**

**"What the fluffing hell is going on? Why the flip did they fluffing well think it was a good idea to do this during flipping results season? They clearly have no fluffing idea what they're doing. Bumpkins," the executive [sort of] said.**

## The usual?

Who, from time to time, doesn't consider themselves the lead character in a movie of their own life? The hero of the hour, the main man/woman, the celestial entity around which all other life revolves. Most of us are aware that this is also a cosy little fiction – day-to-day life provides ample, painful evidence of this.

The swaggering CEOs of EC3, on the other hand, are the epicentre of their organisations. So spare a thought for the swaggering CEO who entered the esteemed Lloyd's Club one afternoon, expecting to sip a delightful vintage cognac, but who was instead served a harsh dose of *réalité du jour*.

Upon ordering "the usual" at the bar, the bemused waiter swiftly replied: "Of course, and what exactly would that be?"


# All aboard for Brexit

The UK insurance industry might be on red alert for the outcome of Brexit negotiations, but carriers are also laying the foundations for long-term market access, says **Laura Board**

**Prime Minister Theresa May's January pledge to navigate the UK towards a "bold and ambitious free trade agreement" on Brexit rather than sail within the familiar waters of the EU single market might, for hard-line leavers, have evoked the pioneering spirit of 18th century explorer Captain James Cook.**

For many in the insurance industry, already in the throes of contingency planning, it has confirmed that they too will need to plot a new course.

If generalisations are possible on such a divisive issue, it's fair to say that Brexit hasn't thrust the London market into the state of abject gloom engulfing many banks and fund managers.

That's largely because the EU, excluding the UK and Ireland, accounts for a relatively modest slice of London market premiums.

At Lloyd's, for example, 14 percent of the £26.7bn ($33.3bn) of gross written premiums (GWP) written in 2015 emanated from the EU outside the UK.

The Corporation estimates that up to 6 percent of Lloyd's premiums could be affected by the loss of the intra-European Economic Area financial services access rights known as passporting.

Neither is the EU generally cited as one of the London market's most promising growth markets, unlike China – where Lloyd's GWP surpassed 2bn yuan ($271.2mn) in 2016 – India or Latin America.

But that's not to say that Brexit won't stifle the way that many players do business. Worries include: reduced market access, increased capital and regulatory burdens, potential hiring restrictions, and the impact of the fracture on both UK and EU economic growth.

## Restructuring options

Proof of how seriously insurers are taking the changes lies in the flurry of restructuring options under consideration.

Brexit preparations already in train include so-called Part VII portfolio transfers – court and regulator-sanctioned schemes that advisers say can take up to a year. At least one company is seeking to revive a mainland EU subsidiary currently in run-off, while others are considering swallowing the capital disadvantages and establishing EU subsidiaries for the first time.

Beazley said on 2 February that its Dublin-domiciled reinsurance business filed a Central Bank of Ireland (CBI) application to become an EU insurance company in November.

Meanwhile, Chaucer filed in October last year to establish an EU subsidiary, while trade credit

Continued on page 12

All aboard for Brexit
continued from page 11

insurer Equinox is planning to establish a Hamburg-based German limited liability company, or GmbH.

And in February Hiscox said it had narrowed its choices for its EU-based insurance company to Luxembourg and Malta. The company said last year it generates GWP of £260mn in the EU; the 2016 group total was £2.4bn.

AIG Europe became the first major player off the mark when, on 8 March, it selected Luxembourg as the location for its EU subsidiary. QBE Europe said in February that it was close to making a decision after weighing locations including Dublin.

And many others are making preparations under the radar.

"People spent the fourth quarter of last year weighing up their options," says one insurance industry consultant. "In the first quarter you are going to see refinement, a narrowing down of options or companies selecting their preferred option, with applications going in during the second quarter."

The source adds that companies are "planning to have the model they need to have in place in two years' time" – before the expected end of Article 50 negotiations in March 2019.

And all are closely watching Lloyd's decision. The Corporation is understood to be veering towards a Benelux hub, though Ireland and Germany also made the shortlist. In January, Lloyd's CEO Inga Beale told a meeting of sister publication *The Insurance Insider*'s London 100 forum that she favours a jurisdiction that would allow for an "infrastructure-light" operation, in part so Lloyd's can swiftly pedal back should the UK secure satisfactory market access rights.

## On the move

Of the options under consideration for the (re)insurance sector overall, Luxembourg and Dublin have emerged as the frontrunners, with the latter arguably pulling ahead in recent weeks.

Dublin's appeal includes a common law legal framework that closely replicates the UK's. It already hosts the operations of US and Bermudian insurers, as well as of UK groups.

The CBI is an experienced regulator and oversees the second-largest number of internal models – or bespoke risk assessment structures – under Solvency II in the EU, after the UK.

However, the CBI's insistence that subsidiaries located in the Republic of Ireland have a significant on-the-ground presence appears to have dented its allure.

Alternatively, a brass plate on a door in Luxembourg City may afford Lloyd's and other restructuring companies greater nimbleness. Another point in the country's favour is the percentage of premiums the Commissariat aux Assurances will allow carriers to reinsure out of Luxembourg, sources say. It also has an attractive tax regime, even though its headline corporate tax rate is almost double Ireland's.

Germany's regulator, Bafin, isn't generally known for being accommodating. Indeed, it is one of the few in the EU that imposes collateral requirements on "third country" reinsurers.

For US carriers at least, this requirement will fall away if the covered agreement-in-principle struck between the US and EU last month becomes reality. However, insurance companies report that the German regulator has also been helpful to Brexit refugees.

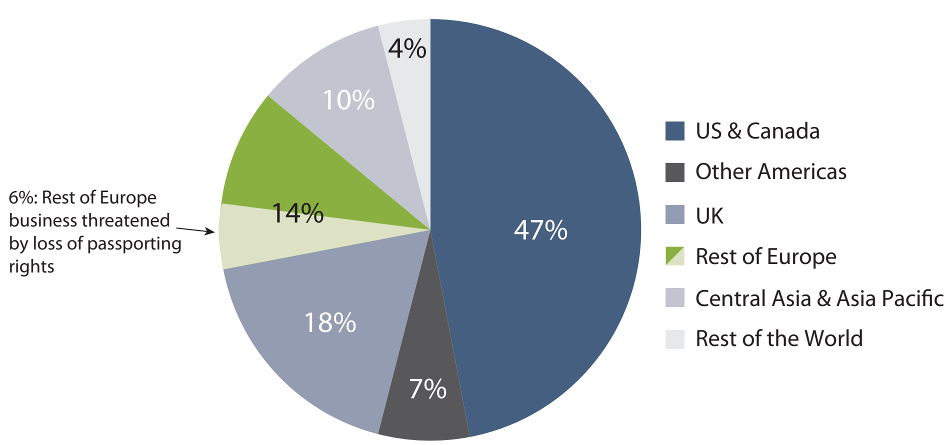
And even the French regulator, the Bank of France's Autorité de Contrôle Prudentiel et de Résolution, has an English language section on its website to elicit queries related to Brexit.

Equinox CEO Mike Holley says he's observed a regulatory "window of opportunity, where if you are a British company in financial services the red carpet will be rolled out". Equinox's Hamburg unit will give it passporting rights elsewhere in the EU, where it has operations in France and Netherlands.

## Passport control

Passporting, under EU treaties and Solvency II, gives an insurer in one EU or European Economic Area nation the right to either offer services elsewhere in the

## Lloyd's GWP by region (2015)




Source: Lloyd's Annual Report 2015

region or establish branches, depending on the type of passport it has. A single regulator vets the entire operation and a single balance sheet supports the risk.

A loss of passporting rights raises question marks over UK-based insurers' ability to write or control from London any non-marine, aviation or transport (MAT) risk emanating from Europe.

Particularly vulnerable to the loss of passporting, says Sidley Austin partner Michael Membery, are those "many insurers who engage agents/brokers/MGAs to act on their behalf in the EU – which has the effect of bringing the UK insurer onshore".

Some observers believe passporting rights could yet form part of the "transitional" arrangement the UK prime minister said she would seek from Brussels. Alternatively, something similar to passporting may be a component of "the freest possible trade in financial services between the UK and EU member states" that May said she wants in the UK government's 2 February Brexit White Paper.

However, one seasoned Brussels-based insurance representative calls such hopes "beautifully naïve", given the EU mood music.

What seems more achievable than passporting is a form of regulatory recognition known as equivalence.

Equivalence, as defined by Solvency II, has three planks. Two concern regulation and capital requirements for non-EU groups operating in the EU, and EU groups with subsidiaries in countries deemed "equivalent" from a regulatory perspective.

The third pertains to reinsurers and means that "third country" reinsurers from "equivalent" jurisdictions don't need to pledge collateral to write new business in the bloc. Direct insurers do not feature in this arrangement.

"A UK-based insurer that buried its head in the sand and did nothing between now and March 2019 would probably still have options after Brexit"

Since the UK's Prudential Regulation Authority is arguably one of the most enthusiastic – and hard-nosed – Solvency II watchdogs in Europe, it would be hard for even the most embittered of the UK's jilted EU partners to argue that its insurance regulations weren't comparable.

But it's far from ideal, not least because it would likely preclude the UK insurance industry's desired tweaks to the Solvency II framework. Equivalence can also be cancelled with 30 days' notice.

What many in the industry are rooting for instead, therefore – as is May herself – is something less "off-the-shelf".

"If you are looking at equivalence from where we are now – which is full compliance – it is likely to allow less flexibility in terms of what adjustments we can make for the UK market, but mutual recognition allows us to be more bespoke for the UK," says PwC's UK insurance practice leader Jim Bichard.

"We may not have passporting per se, but if we have the ability to still trade in a similarly competitive way as we could before, that is the right way to approach it," he adds.

## Options open

A UK-based insurer that buried its head in the sand and did nothing between now and March

Continued on page 14

## Effect of Brexit on London company market

According to the International Underwriting Association, when factoring in:

- premium actually written in London;
- premium written in other locations, but overseen or controlled by the London operation;
- premium written in London by branch offices of parent companies in continental EU states;
- and premium written by companies with parents in a third country outside the EU who are using their London office to obtain EU passporting rights…

The total amount of premium that will potentially be directly affected by a changes in the rules governing UK participation in the EU single market and the existing passport regime totals **£7.337bn**

| | London operation status | European premium excluding UK and Ireland (£bn) | All premium (£bn) |
|---|---|---|---|
| **Passporting out** | Parent headquartered in UK | 0.267 | |
| | Parent headquartered in third country and using London office to access EU business | 1.094 | |
| **Passporting in** | Parent headquartered elsewhere in EU and using passporting rights to write London market business | | 5.976 |

Source: The International Underwriting Association – London Company Market Statistics report 2016

**All aboard for Brexit continued from page 13**

2019 would probably still have options after Brexit, even if the amicable divorce Prime Minister May is seeking is rejected by lawmakers at home or in the EU.

Solvency II rules already allow third country insurers to establish branches in Europe, albeit under the supervision of individual local regulators. And World Trade Organization regulations permit cross-border writing of MAT risk, both direct and reinsurance.

Some London market protagonists already have EU subsidiaries, while others have operations in the "equivalent" jurisdiction of Bermuda or in the US – which has a type of provisional equivalence and should begin to benefit from the reinsurance covered agreement struck last month with the EU well before the March 2019 Brexit agreement deadline.

Thomas Dawson, a partner at law firm Drinker Biddle, says: "Pending negotiation of a bilateral EU-UK (re)insurance trading agreement, many groups have options, perhaps multiple options, to continue to write European-origin reinsurance business."

And new options could be in the pipeline.

Marsh UK and Ireland CEO Mark Weil believes his firm has come up with a legally watertight "Plan B" alternative to the complex business of establishing EU subsidiaries. He notes that these licence applications risk being "timed out" by the two-year Brexit process, or falling victim to political interference or even to additional fragmentation of the 27-nation bloc.

His firm is offering what it calls a "bridge solution" that would formalise the type of fronting arrangements commonly used in Latin America into a defined structure. The arrangement, which Marsh may facilitise, offers what Weil believes is a means to achieving EU market access that "puts clients back in control".

Weil says he doesn't see Brexit as "existential" for the London market. "I don't think Brexit will be the issue that makes or breaks London," he adds.

## Long-term play

Some Brexit optimists go so far as to argue that the global free trade agreements May is promising in addition to her Brexit deal with the EU could ultimately leave British insurers better off, while fewer rules could provide opportunities.

AM Best said last month it would take no ratings action on UK life and non-life insurers as a direct consequence of Brexit, although it acknowledged that the UK's retreat is credit negative.

And among the Brexit contingency planners it's notable that several, including Beazley, say they don't expect a major impact from the fracture.

Speaking in a private capacity last month at a Brexit event organised by insurance software group Sequel, industry veteran Michael Wade was sanguine about the opportunities for the London market – and noted that the fallout would cut both ways.

The former Besso chairman, who is now a senior adviser to the Cabinet Office and to Swiss Re, estimated that about £8bn of London market direct and reinsurance premiums are written from the UK in the rest of the EU. He said about £6bn is written by EU companies from outside the UK using passporting.

"We have an absolute commonality of interests," he said.

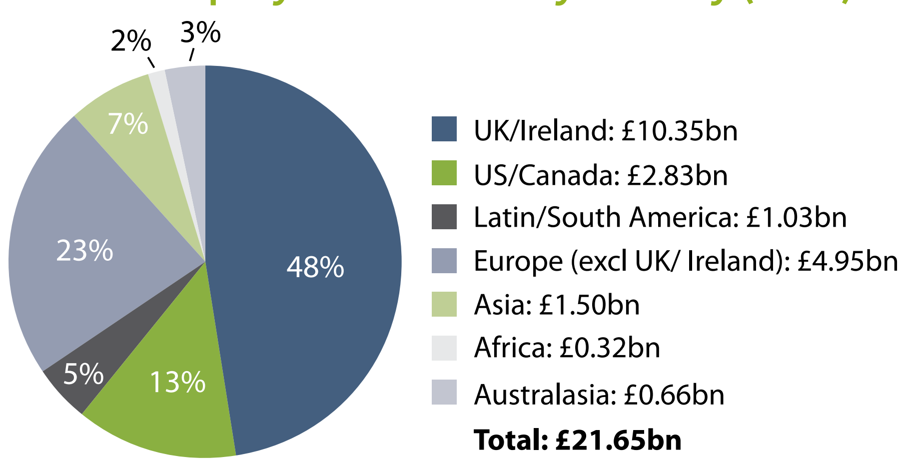
Wade, a "remainer" in the referendum, called for the London market and continental reinsurers to lobby for the UK to obtain equivalence – an effort he said doesn't need to be part of mainstream Brexit negotiations.

"My conclusion for the London market is one of considerable confidence and optimism," he said. "I think we are in quite good shape to carry on and expand our business interests."

And expansion – rather than the status quo - is the key, according to Beale. At the London 100 event last month, the executive dismissed the notion that that the EU wasn't terribly important for the London market.

"This is a long-term play," she said of Lloyd's Brexit preparations. "This will all be part of ensuring we can be around for hundreds of years to come."

## London company market GWP by territory (2015)




Note: Includes both premium written in London and 'controlled business' overseen by London operations but written elsewhere
Source: The International Underwriting Association - London Company Market Statistics report 2016


International carriers are flooding into India following the overhaul of its insurance sector, but challenges to the profitability and ease of doing business in the country remain, says **Charlie Thomas**

**Narendra Modi, the first Indian prime minister to be born after India became independent from the United Kingdom, has been relentless in his task of modernising the country through privatisation and liberalisation of the economy.**

Part of that economic drive has involved the radical alteration of India's foreign direct investment rules to allow more overseas investment in several industries. Modi's policies are aimed at stimulating India's economy, and one of the industries to feel the benefit of these changes is reinsurance.

Since the local regulator, the Insurance Regulatory and Development Authority (Irdai), was formed in 2000, it has set about transforming the Indian insurance market from a structure that only had four state-owned general insurance companies, one state-owned life insurer and one state-owned reinsurer, into a more dynamic market.

On the insurance side, the changes introduced by the watchdog have seen global insurance giants such as AIG, Allianz, Fairfax, Chubb, RSA, Tokio Marine and Standard Life, among others, enter the marketplace.

They also transformed the nature of the Indian insurance market, shifting it from a tariff-driven model to a free pricing regime. Fire, engineering and motor were de-tariffed under the regulator's guidance, while it maintained high solvency standards at domestic carriers.

"The underlying principle behind any of the regulator's decisions or measures has been purely to maximise insurance penetration in India and develop it into a more lucrative market," says Neeraj Das, regional practice head of the strategic client group at JLT India.

"The regulator has always been pro-active in monitoring the market and has intervened to uphold the sanctity and sanity of the marketplace."

More recently, the reinsurance market has become the latest segment to be galvanised, with Irdai agreeing to allow overseas reinsurers to apply for a licence to operate as an onshore carrier in India.

Swiss Re, XL Catlin, Munich Re, Scor, Hannover Re and Reinsurance Group of America have all been given permission to set up fully licensed R3 offices in

India, along with Lloyd's.

So what's attracting all of these overseas carriers, and what risks should they be aware of?

## Growth potential

India is widely recognised as the world's fastest growing economy at present. Real gross domestic product (GDP) growth was almost 7 percent for 2016.

For reinsurance, the future looks bright. Hitesh Kotak, CEO for the new Munich Re branch office in India, predicts that real premium growth across emerging Asia will average 9 percent in property and casualty each year until 2025. For India, the P&C estimates are even higher, at 9.2 percent, and if you include crop cover that figure increases to 11 percent.

"From our perspective, the picture is promising," says Kotak. "Two thirds of [India's] population is below 35 years of age, the GDP is services-dominated (56 percent) and the political environment is stable – all signs that insurance penetration will grow substantially in the future.

"If you convert these factors into reinsurance opportunities, we expect strong growth in the construction, energy, liability and agricultural segments, and also with new risks and trends such as cyber, autonomous cars, wellness, smart cities and more."

Michael Marx, managing director for Asia Pacific at Hannover Re, believes the increase in natural catastrophes hitting the market will lead nat cat coverage to grow over the next few years. The agricultural sector is also one to watch, driven by a change in government policy, he says.

> **"There's $1bn of business in the facultative market, which we see growing at a double-digit rate over the coming years"**
> **Vincent Vandendael, Lloyd's**

The Pradhan Mantri Fasal Bima Yojana (Prime Minister's Crop Insurance Scheme) was launched by Prime Minister Modi on 18 February 2016. It envisages a uniform premium of only 2 percent to be paid by farmers for so-called Kharif (autumn) crops, and 1.5 percent for Rabi (spring) crops. The premium for annual commercial and horticultural crops will be 5 percent. It's likely that the risk will be carried by one insurer, with that risk then being reinsured by the newly enlarged market.

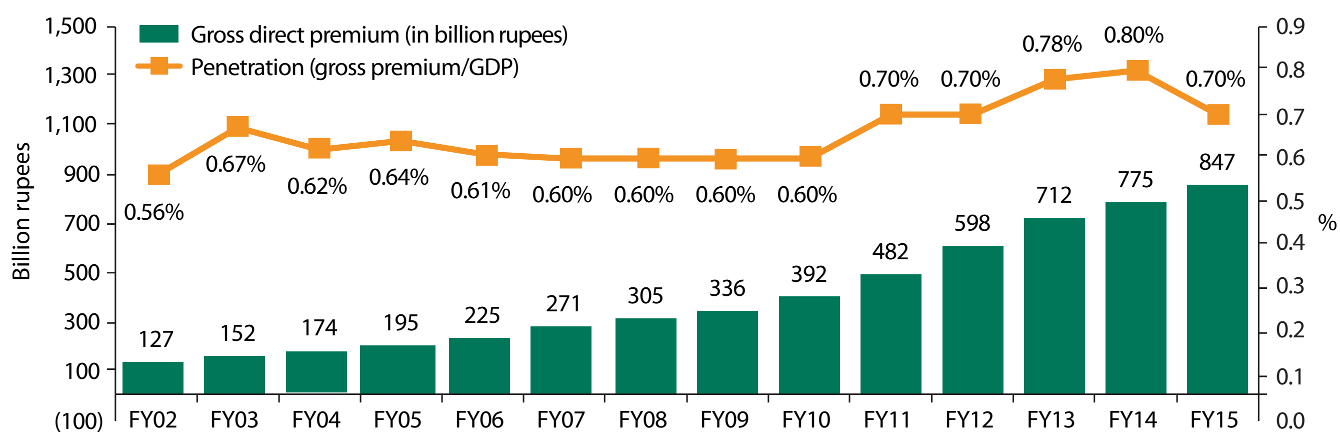
It's not just the overseas carriers sitting up and taking notice. ITI Re, India's first privately owned reinsurer, has just launched ahead of the all-important 1 April renewals season. ITI Re will begin writing Indian reinsurance business across property and casualty lines, before targeting other geographies in the coming years.

Under the current proposals, year one will see ITI Re focus on establishing a foothold in the Indian reinsurance market, before branching out into neighbouring countries in year two. The carrier is backed by a Mumbai-listed financial services company, Fortune Financial Services.

GIC Re, India's state-owned reinsurer, estimates that gross premium income in the Indian non-life insurance market has grown four-fold in the last decade, with a compound average growth

Continued on page 18

## Evolution of India's non-life insurance industry




Source: EY, Life Insurance Council, Irdai, Swiss Re "World Insurance" reports rate of 15.6 percent.

Despite this, penetration remains low, at about 0.7 percent of GDP, but per capita the non-life side has grown steadily in recent years.

Brokers are also seeing an opportunity in India. The large global players have all had a presence for decades, and are particularly well integrated into the distribution chain for P&C and specialty. The general insurance market – which includes motor and private health – is less well penetrated, but many retail advisers are training in order to advise on general insurance business, and domestic start-ups are launching on a regular basis.

### Lloyd's in India

When Lloyd's was granted its R3 approval on 19 January, chairman John Nelson hailed it as a "watershed moment" for the Corporation.

And while it's certainly another nice addition to the platforms in Singapore, China, Dubai and elsewhere, the decision to become an onshore reinsurer in India was also a defensive one, as Vincent Vandendael, chief commercial officer at Lloyd's, explains.

"We have more than $200mn of premium that could be affected by the order of preference rules, so it was important for us to get specific legislation for Lloyd's in India," he says.

Lloyd's own study reveals that the Indian reinsurance market is around $2.8bn, with 40 percent of that currently placed offshore. It's that 40 percent that's now at risk.

"But there is an opportunity as well. India is the fastest growing economy and major investments are planned in infrastructure. That's important for Lloyd's as it's tunnelling, roads, airports, investments in energy etc.

"The other element we found attractive is that there's $1bn of business in the facultative market, which we see growing at a double-digit rate over the coming years."

The timing of Lloyd's licensing was opportune – some 55 to 60 percent of Indian treaty business renews at 1 April, with a significant skew towards property treaty.

And while there are concerns over the profitability of the proportional business, the sorts of risks Lloyd's is looking at are likely to be more attractive for EC3's finest, according to Vandendael.

"The other thing to consider is the order of preference rules don't apply to retrocession. [Indian state-owned reinsurer] GIC Re is an important customer for Lloyd's. Of the $2.8bn in reinsurance, 46 percent goes to GIC Re and some of that is then reinsured."

The Indian market is likely to offer Lloyd's a warm welcome.

> "We expect strong growth in the construction, energy, liability and agricultural segments, and also with new risks and trends such as cyber, autonomous cars, wellness, smart cities and more"
> **Hitesh Kotak, Munich Re**

Alice Vaidyan, CEO of GIC Re, comments: "Lloyd's brings to India centuries of tradition and expertise in underwriting capabilities. I believe the Indian market will certainly benefit from the rich international experience Lloyd's brings in. We certainly hope that most participants in the Lloyd's London market will be part of Lloyd's operations in India."

And while everyone expects there to be a relatively limited impact this April, most predict that Lloyd's will enjoy a decent amount of success in the 1 April 2018 renewals window.

"I foresee a major impact on the next 1 April as they will not only have time to prepare for the treaties but would also have had their fair share of facultative requests coming their way during the year," says JLT's Das.

Looking ahead, Lloyd's will be hoping that the order of preference rules (see below) will be relaxed to create a more even playing field and allow more syndicates to join the Indian platform. At the time of writing, one unnamed syndicate had confirmed it would be on the platform in time for 1 April, with another handful understood to be assessing their options.

In addition, Lloyd's hopes it can develop the coverholder model on the ground in India. "We need to talk to the regulator first, but that would be the next step for us," Vandendael confirms.

### Respect to the regulator

One thing all parties were agreed on was the helpful nature of Irdai. Everyone *Insider Quarterly* spoke to for this article describes the watchdog as approachable and pro-active, and said that it is regularly consulting the market through discussion groups or one-on-one meetings.

There is one major bone of

## Indian non-life market profitability

| | Year ending | | | | | | Half-year ending* | |
|---|---|---|---|---|---|---|---|---|
| **Date** | **Mar-11** | **Mar-12** | **Mar-13** | **Mar-14** | **Mar-15** | **Mar-16** | **Sep-15** | **Sep-16** |
| **Combined ratio** | 125% | 117% | 112% | 110% | 114% | 117% | 113% | 117% |
| **Pre-tax margin** | -1% | 2% | 9% | 10% | 9% | 6% | 9% | 6% |

*Estimates
Source: AM Best, Industry Association of General Insurance Companies (India)

contention, however. Under rules implemented by Irdai this year, cedants have to offer their reinsurance business to GIC Re, the state's reinsurer, before they can offer it to other carriers.

Those overseas carriers with R3 licences will then be offered the risks. ITI Re will be offered the business next – it is not in the same category as its global peers since it is required to report a minimum credit rating and maintain strong financial results for a historical period of three years. Following that, the business will be offered to other overseas carriers without an onshore licence.

To say the move is unpopular would be an understatement. And it's not just the carriers that are opposed to it. Indian (re)insurance brokers called for the abolition of the rule in January this year, claiming the proposed regulations are anti-competitive. The Insurance Brokers Association of India demanded the immediate repeal of the "regressive, anti-policyholder and anti-competitive" regulation.

However, some domestic players have endorsed it. Ashok SN, an underwriter for a life reinsurer, claims the order of preference is a "good idea to start with" and suggests it should remain in place for the first five years or so "to ensure the multinationals demonstrate the appetite for the kind of risks emanating from the market".

Alice Vaidyan of GIC Re, the obvious beneficiary from the rules, comments: "I believe the regulator has the best interest of policyholders at heart, and in the context of government philosophy of achieving macroeconomic objectives, particularly optimising retention within the country, I am inclined to believe that this is the best approach."

There is some good news for overseas reinsurers though – Irdai plans to review the process within a year, meaning the order of preference rules may not last for very long. The other thing to consider is that the rules don't apply to retrocession, so there is plenty of opportunity for overseas carriers to make their mark here.

## Concerns for the future

It would be remiss not to consider the limitations of the country, and the potential risks it poses for those doing business there.

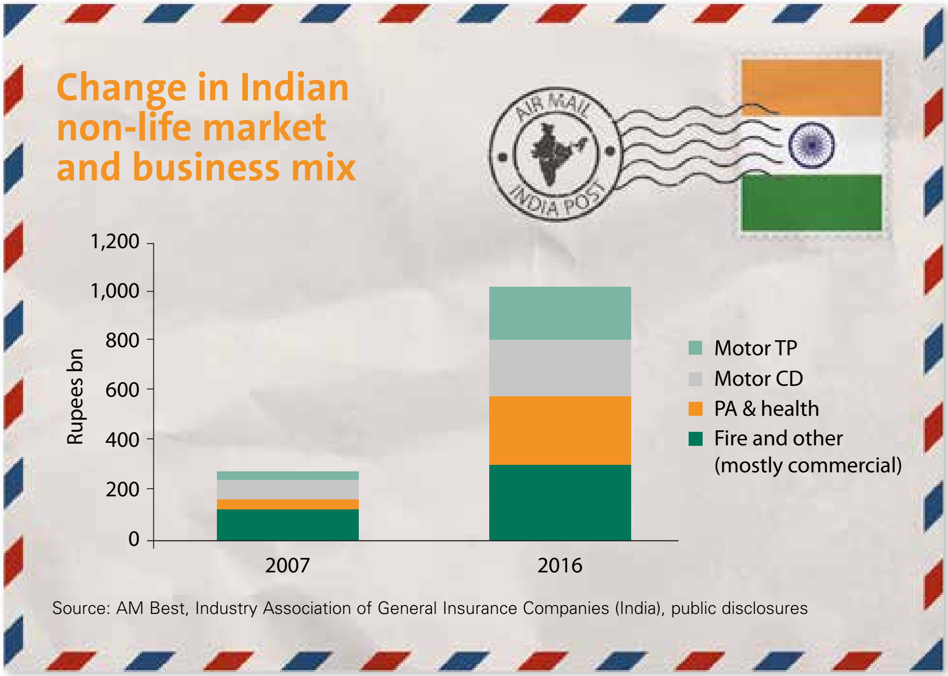
Unlike in other emerging territories, many of the global reinsurers and brokers have been operating in India for decades, so they are well aware of the cultural differences in the Indian market. An emphasis on networking is key, and there is a distinct lack of data and modelling, which could cause headaches in the early years.

A far bigger concern though, is the profitability of Indian business. It's well known that loss ratios in much of India's reinsurance business is unattractive. AM Best published a report in February detailing that the combined ratio of the country's non-life insurers remained at 117 percent, with the pre-tax margin coming in at just 6 percent.

These figures are skewed by high motor and health loss ratios, which dominate the non-life market at present, although participants also noted an increase in the fire line's attritional loss ratio in 2016.

For Lloyd's and the other overseas reinsurers, sticking to P&C covers should help. Lloyd's Vandendael insists that the research the Corporation has done suggests the business its syndicates would look to write is profitable, though he declines to disclose any figures.

A cultural shift is also needed in the mindset of Indian insurance buyers. As GIC's Vaidyan points out: "The Indian market and economy needs to appreciate the role of insurance from the viewpoint of disaster mitigation and financing. Competition also has to evolve from a price-based focus to a coverage- and service-based focus."




Source: AM Best, Industry Association of General Insurance Companies (India), public disclosures

# Silicon slip

While Silicon Valley has contributed significant funding to InsurTech development, partnership with a willing (re)insurer could be the golden ticket for start-ups, finds **Matthew Neill**

**In an episode of the hit HBO tech-centred television programme *Silicon Valley*, the gifted-but-awkward protagonist of the show Richard meets an old friend and fellow start-up CEO Javeed to discuss the future of his company.**

Richard's start-up, Pied Piper, is under pressure to secure new investment, and he is hoping to glean some advice from his hitherto uber-successful colleague on where he should get the money he needs to save it.

Javeed, downcast and dishevelled after he being forced to sell his own company and walk away without a cent, offers Richard a warning: "You take money from the wrong dudes, you'll get smoked as bad as I did."

The scene has become familiar to many since the concept of the tech start-up entered the mainstream consciousness in the 1990s, and the conundrum has now become a feature of the (re)insurance landscape.

As InsurTech start-ups have bloomed over the last few years, they have brought with them a new ecosystem of investors. Individuals and firms that previously ignored insurance in favour of its more alluring sibling – the banking sector – are now jostling each other to get to the front of the queue and invest in companies with the potential to "disrupt".

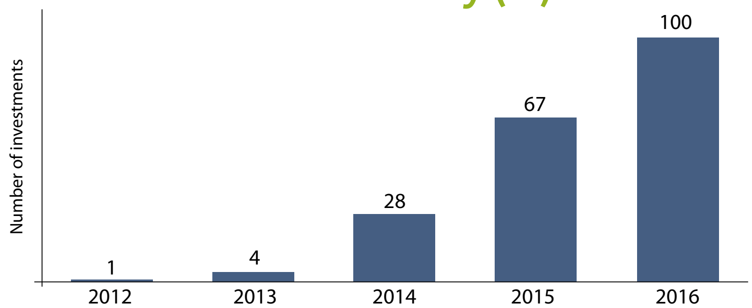
Belying its reputation for backwardness and inertia, the insurance industry has responded by setting up venture capital divisions, research arms and investment vehicles of its own to ensure it is not left in the dust.

The industry's upper echelons have been quick to act. Companies including XL Catlin, Munich Re, MS Amlin, Allianz, Axa, Scor and Swiss Re have, in one way or another, marked out their territory in the InsurTech space.

These firms have swept into the room with venture capital divisions of their own, by partnering for research into technology that could benefit all participants – such as with the blockchain consortium B3i – and by sponsoring a multitude of accelerators and incubators across the world.

Opportunities abound for insurance industry entrepreneurs,

## Private tech investments by (re)insurers




Source: CB Insights

but who is winning the battle for funding supremacy in InsurTech?

## Breaking new ground

According to venture capital research firm CB Insights, InsurTech companies secured $1.7bn of funding across 173 deals in 2016 – the second consecutive year investment has topped $1bn.

These are astounding figures for an industry that just a year before operated in a small and seldom visited corner of the FinTech galaxy.

But while the scale of the investment in itself is enough to make serious people sit up and take notice, it is the source of the funding for these ventures that will drive the future direction of the industry.

An analysis of several high-profile InsurTech ventures on start-up online database Crunchbase shows almost all have received funding from a mixture of (re)insurers, often through a company's venture arm, and from traditional venture capital firms that have made a foray into the industry.

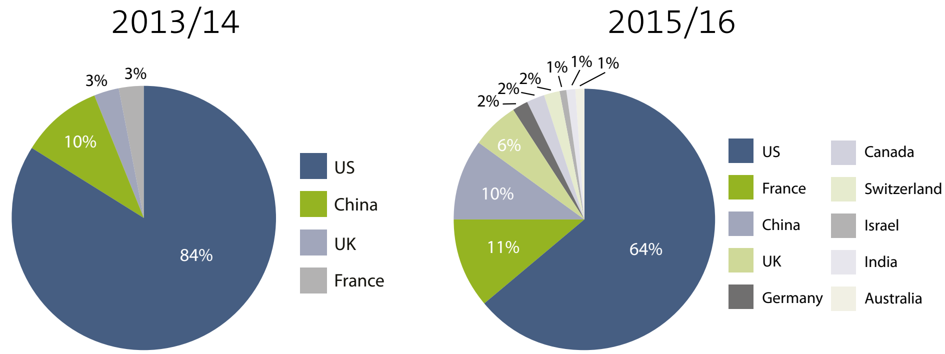
Previously, start-up CEOs looking to launch an insurance business would have to scrap it out for their investment in a sector deemed unattractive by the powers that be in the venture capital world.

Now that trend has reversed as more firms want to ensure they have some skin in the game and don't miss out on lucrative investments or lose out to their competitors on technology that could be of use in their own company.

## Insiders' club

Adrian Rands established his data integration and analytics company QuanTemplate in 2012. His professional background and subsequent change of career are emblematic of the changes taking place within insurance. Previously

## Tech investors by (re)insurer geography




Source: CB Insights

a Lloyd's reinsurance broker with Howden, Rands left the firm to pursue his start-up idea.

The QuanTemplate CEO says the InsurTech investment landscape has changed markedly since he originally struck out alone in 2010, particularly as corporate entities and venture capitalists have begun to take notice.

Having initially self-funded the operation that would grow into QuanTemplate, Rands now receives numerous enquiries from interested investors every week. "At the time it felt like the industry would take time to adopt to new technology. But things are moving much faster now," he says.

Rands first received venture capital backing in 2014, as Silicon Valley money began to see the insurance industry, often perceived as staid and inefficient, as the next frontier for the digital revolution.

While slow to realise the potential for change in (re)insurance, venture capital firms have now descended en masse. Rands estimates over 100 firms are now active in the insurance software sector, with the majority of investment clustering around a handful of well-regarded companies.

He says: "Insurance has traditionally been an insiders' club. The network of people is relatively closed and there hasn't been much crossover with other industries. Much of the capital and funding has come from within the industry."

But with the advent of InsurTech, Rands has noted a change in the landscape. Now (re)insurance companies have become more influential, and have started to hire InsurTech veterans to run their corporate venture arms.

## Venture capital invasion

Indeed, some major Silicon Valley venture capitalists have taken notice of the insurance sector. One of the most high-profile InsurTech start-ups, New York-based Lemonade, has received $60mn of funding from eight investors, including a Series B funding round totalling $34mn, according to Crunchbase.

The backers include California venture capital behemoth Sequoia Capital, alongside Thrive Capital, Expansion Venture Capital and Israeli firm Aleph.

Similarly prominent start-ups including Trov, Slice Labs and Bought by Many have also received venture capital funding from firms such as Oak Capital, Anthemis Group and Octopus Ventures.

However, in none of the above cases has the start-up received backing exclusively from venture capital sources. Each funding round has included the participation of a major incumbent company. Munich Re

Continued on page 22

Silicon slip
continued from page 21

has been particularly active in the space, as has XL Catlin's venture arm XL Innovate.

David Hill, managing director of Advent Solutions Management, has worked with start-ups across the (re)insurance industry for over 14 years.

Hill says the biggest change he has observed in the industry over the last few years, as InsurTech has come to prominence, is the changing attitudes and approaches of the insurance companies themselves.

He says that while mainstream capital providers were reluctant to invest in companies at the "seed" stage of funding, reinsurers in particular were keen to provide this initial capital boost. He argues that the reinsurers' approach was in part influenced by the conditions of the broader reinsurance market.

Hill explains that global reinsurers are now faced with a contracting core book of business as insurers continue to reduce their use of reinsurance. As this problem has increasingly bit into reinsurers' balance sheets, they have become more willing to embrace the growing opportunities offered by InsurTech companies.

> "New York-based Lemonade has received $60mn of funding from eight investors, including California venture capital behemoth Sequoia Capital, alongside Thrive Capital, Expansion Venture Capital and Israeli firm Aleph"

"For reinsurers it is a double bubble," he says. "The likes of Munich Re started [InsurTech divisions] because their core book is beginning to dwindle."

## Cooperation or competition?

While they are often castigated for their inertia in the face of radical change, the major (re)insurance companies have by and large joined the venture capitalists on top of the InsurTech bandwagon.

In addition to their venture capital arms, many companies have set up internal research divisions to see how InsurTech can be made to work for them, and almost every conference in the industry addresses the topic through one moniker or another.

But the question going forward is not whether the (re)insurers continue to get more involved in InsurTech – it is clear at this point that the issue is not being ignored – but whether they opt for continued cooperation in the space or choose to go it alone.

There are those who believe that the saving grace of incumbent companies in the face of the InsurTech onslaught will be the barriers to entering the industry.

High capital requirements, a regulatory quagmire and the importance of branding are often cited as a defence against companies being disrupted out of existence.

In this context, a partnership with a (re)insurer could be viewed as the golden ticket for a start-up. The young company gets all the help and funding it could dream of, and the (re)insurance partner gets the tech they want or need.

The shape of funding for InsurTech start-ups thus far seems to bear out this scenario for future investment.

Venture capitalists, of course, want a piece of the pie, but at this stage they have neither the expertise nor the willingness to commit in full to InsurTech start-ups.

The entry of an independent, solely insurance-focused venture fund into the mix, InsurTech Venture Partners, may be a sign of things to come.

But for now, (re)insurers hovering around the entrance to the InsurTech space, waving venture capitalist investors and start-ups through, would do well to take a deep breath and walk right in before the door shuts in their faces.

## Largest financing deals: 2016

| Start-up | Description | Select round investors | Amount | Date |
|---|---|---|---|---|
| Oscar Health | Tech-enabled health insurance carrier | Fidelity Investments, Founders Fund, General Catalyst Partners, Goldman Sachs, Google Capital, Horizons Ventures, Wellington Management, Khosla Ventures | $400mn | Feb 16 |
| Clover Health | Data-driven health insurance start-up | Greenoaks Capital Management, First Round Capital, Wildcat Venture Partners, Sequoia Capital, Social Capital, AME Cloud Ventures | $160mn | May 16 |
| Metromile | Per-mile car insurance | NEA, Index Ventures, Intact, Mitsui & Co, SV Angel, First Round Capital David Friedberg | $103.1mn | Feb 16 |
| Bright Health | Data-driven health insurance start-up | New Enterprise Associates, Flare Capital Partners, Bessemer Venture Partners | $80mn | Apr 16 |
| Metromile | Per-mile car insurance | China Pacific Insurance | $50mn | Sept 16 |
| Cyence | Economic cyber risk modelling | NEA, IVP, Dowling Capital Partners | $40mn | Sept 16 |
| Lemonade | Online insurance carrier offering homeowners' and renters' insurance | General Catalyst, Thrive Capital, GV, Sequoia Capital Israel, XL Innovate, Aleph | $33mn | Mar 16 |
| Justworks | Payroll, benefits, and compliance services | Bain Capital Ventures, Index Ventures, Redpoint Ventures, Thrive Capital | $33mn | Mar 16 |
| Huize Insurance | Chinese online insurance agency | Beijing Wanrong Times Capital, Shenzhen CDF-Capital Co | $31mn | Mar 16 |
| Namely | HR, benefits, payroll software and brokerage | Sequoia Capital, Greenspring Associates, Matrix Partners, True Ventures | $30mn | Feb 16 |

Up to 21 December 2016

Source: CB Insights

# All change

In an era of great uncertainty and the threat of growing instability the political risk and trade credit insurance market is coming into its own, says **Bernard Goyder**

**It is a busy time to be a political risk and trade credit underwriter.**

The UK is plunging out of the EU and Donald Trump is now US president. A move by countries towards greater protectionism could see trade credit losses rise. And a more isolationist US would have unpredictable consequences and push up demand for political risk cover.

David Anderson, credit and political risk head at Zurich, says he is already starting to receive Trump-related queries: "We are seeing some types of enquiries that we haven't seen before, [from] firms from outside the United States who are concerned about tariffs going up."

The problem is that it is hard to insure against a policy a politician has said they will carry out. As Anderson tells *Insider Quarterly*, insureds are "looking for loss of profitability coverage, in the event that the US would raise tariffs. That is not a product that we have and I'm not sure anyone has it".

## Front page news

Political risk and trade credit insurers work with banks, trading houses and corporations to mitigate against the consequences of revolutions, financial crises, insolvencies and wars.

But as soon as these events actually happen, it tends to be too late for the insurance market.

"Once a risk has hit the front pages of a newspaper it's going to be difficult to find coverage for it," says Anderson.

For Jeremy Shallow, Argo Global's credit and political risks class underwriter, the Brexit referendum and Trump's election present an opportunity for the market.

"Change brings concern over risk," Shallow argues. "Ultimately, when we are selling products which people don't have to buy, if there is more fear and there is more perception that risk exists, that should be good for us to sell insurance."

Shallow thinks that Brexit will push manufacturers in the UK to look to markets outside the EU. And UK companies venturing further afield will be a "positive thing" for trade credit insurance providers, he says.

With UK exporters lacking certainty about how reliable their new customers in emerging markets will prove to be, an increase in UK trade with the developing world "may push them to make the discretionary purchase

SECTOR PROFILE

– which is buying some cover from me", says Shallow.

### Different dynamics

Kade Spears, who heads The Channel Syndicate's political risk book, says he receives between 400 and 500 enquiries a month from brokers, compared to just a few a week when he started his career in the 1990s. However, he adds, in 2016 he underwrote less than 3 percent of the deals the syndicate saw.

"We are highly selective" he says. "Understanding credit is different to understanding political risk. You have to have the right models. You have to have the right support."

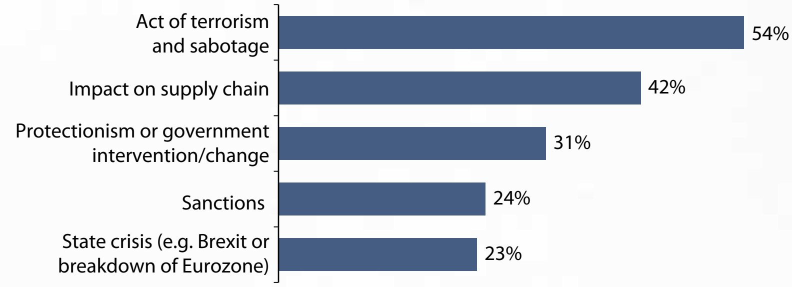
Underwriting capacity in the market has doubled since 2010, according to Anderson. The recent entrants include Sompo Canopius, which was reported in February to have taken on a duo of credit insurers from AIG, while three more hires to its fledgling trade credit team are said to be pending.

"A lot of people came into this market looking at the track record pre-2009, and in political risk in particular it was a very benign track record," recalls Anderson. "But, post-2010 there is much more claims activity, particularly in political violence and forced abandonment."

The Washington DC-based executive notes that pricing has been falling since 2010, but is now starting to stabilise.

Political risk and trade credit insurance has different pricing dynamics to other insurance lines, as political instability and economic turmoil push up the pricing for individual countries. In Turkey, for example, where the government survived an attempted coup in July 2016, the cost of political risk

## Most worrying business risks: political risks and violence




Source: Allianz Risk Barometer: Top business risks 2017

insurance is increasing.

"We have seen pricing tick up quite substantially in Turkey" says Argo's Shallow, a view echoed by other political risk underwriters *Insider Quarterly* spoke to.

Venezuela, meanwhile, is off risk for Argo. "It's just too hot for us," Shallow says.

### Trump card

While troubled areas such as Ukraine, Libya and Yemen have been the hotspots for political violence risks in recent years, the landscape is shifting as the first "Trump era" claims start to come in.

In January this year, in response to a hike in petrol prices, rioters in Mexico took to emptying supermarkets. While Donald Trump cannot be blamed for the Mexican government's decision to cut fuel subsidies on 27 December 2016, the US president's tweets – both before and after his inauguration in January this year – have led to currency market falls in the Mexican peso, in turn increasing the cost of living for the Mexican population.

The unrest in Mexico is expected to lead to claims of between $200mn and $250mn across all markets. Walmart, for instance, is understood to have put in a claim of $60mn-$70mn following the riots against its wide-ranging global political risk policy, which is led by QBE.

The claim demonstrates the depth of cover available for political events in the specialty insurance market. Cover for political violence, including strikes, riots and civil commotion, is often taken on by political risk underwriters, despite being the mainstay of the standalone political violence market.

### Regulatory push

More than half of the clients that use the global political risk and trade credit insurance market are banks. Since the financial crisis, there have been lending constraints imposed on banks, with the industry's version of Solvency II, known as Basel III, forcing firms to set a certain amount of capital aside for a rainy day.

Sophisticated lenders, such as HSBC and JP Morgan, have

Continued on page 26

All change
continued from page 25

the option of buying insurance to get capital relief. The regulatory changes imposed after the 2008 financial crisis pushed bankers, especially those in the world of trade finance and emerging market lending, into the arms of the political risk and trade credit insurance sector.

Business is also coming to the political risk and trade credit market from export credit agencies (ECAs). Zurich's Anderson says he has seen more of these government agencies turning to the insurance market. According to Anderson, state-run export finance lenders, such as UK Export Finance, are under pressure from governments to be more autonomous in managing their portfolios prudently for taxpayers. The ECAs buy big chunks of treaty reinsurance, as well as purchasing trade credit insurance for specific deals.

Other big customers include the commodity trading houses – companies like Glencore, Trafigura and Vitol. These big traders are now acting like banks themselves, using their vast balance sheets to finance commodity purchases.

The banks and trading houses are buyers of single situation trade credit. These are big ticket transactions that the insurance market gobbles up on a case by case basis.

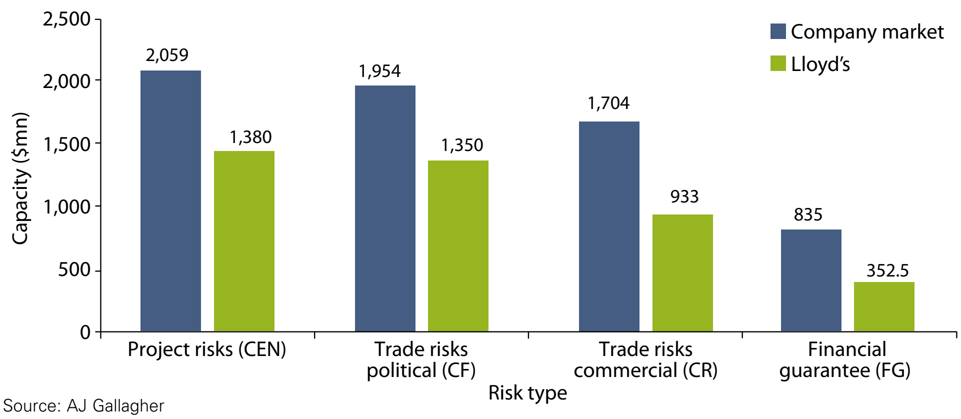
For instance, if a company is buying all of the oil in Angola one month to sell to the export market, or is financing a power station in Tunisia, it might tap into this market to alleviate the risk.

## Major claims

Companies with long supply chains are more likely to purchase a different kind of trade credit cover: insurance against suppliers not paying up, often due to insolvency.

## Available market capacity as of July 2016

Total possible maximum $mn per risk




Source: AJ Gallagher

Insurers are particularly worried about so-called "torpedo claims", where insolvencies come out of the blue. As Tim Fisher, managing director at AJ Gallagher, says, these claims concern "companies where one day they are creditworthy and they just fall over the next day".

After the mobile phone retailer Phones4U went bust in September 2014, for example, insurers had to cough up between £30mn and £35mn in claims.

And the collapse of Hanjin Shipping Co in 2016 is an example of where things can go wrong on a bigger scale. It isn't clear yet what the tab for the trade credit insurers will be following the shipping company's demise, but as one broker puts it: "Hanjin is huge."

The South Korean shipping firm was officially declared bankrupt on 17 February 2017 and trade credit insurers will now have to cover the losses to banks that financed the goods currently stuck on Hanjin vessels waylaid by the company's collapse.

Banks use letters of credit and extend trade receivables – ultra-short-term loans – to support trade around the world, which in turn are insured by carriers such as Euler Hermes, Coface and Atradius.

Trade finance defaults are rare, but costly. One spectacular example came in 2014, when metal that had been put up as collateral in Qingdao, China, for millions of dollars of lending was found not to exist. Banks and trading firms were hit hard by the resulting $3bn fraud.

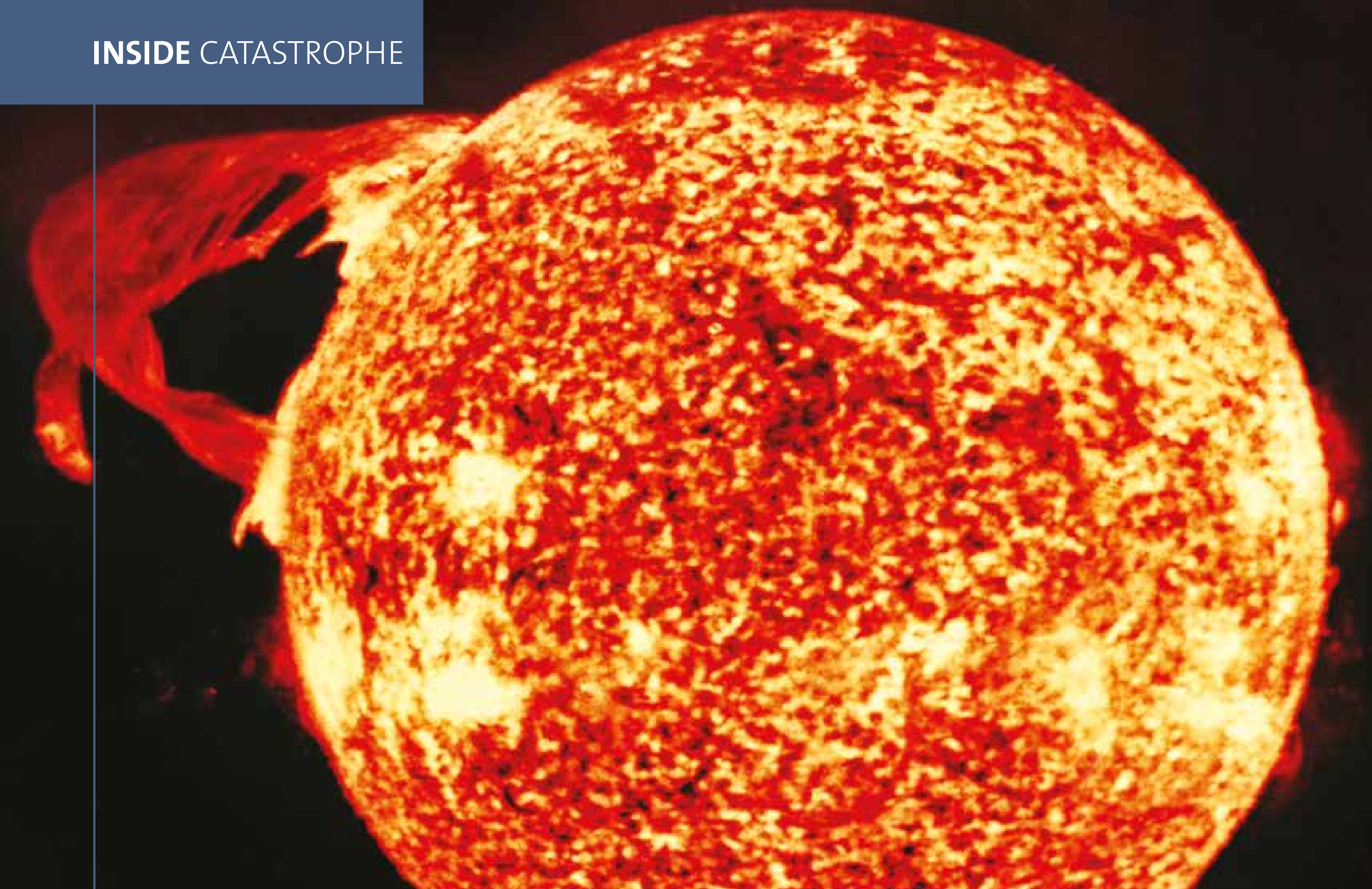
And insolvencies are on the rise. Euler Hermes, the massive Allianz-owned trade credit carrier, said it expects global bankruptcies to increase by 1 percent in 2017. An increase in insolvencies could lead to more trade credit claims, and put pressure on pricing.

Prices for both political risk and trade credit insurance are already starting to edge upwards. As Zurich's Anderson says: "With some of the dislocation we've seen recently in the market, you're starting to perceive a hardening of pricing, but on individual risks I think underwriters can still be quite aggressive." Shallow agrees that pricing is getting more disciplined in the political risk market.

As Trump's presidency gathers momentum, and the UK formulates its plans for leaving the EU, the political risk book presents a conundrum for carriers.

Should insurers invest resources in what promises to be a growth area? Or do they hold back, taking the hardening price environment and the chaotic geopolitical landscape as a signal to proceed with caution?


You don't
have to be
the biggest to
be The Best.



# Sun storm

An extreme space weather event could cause insured losses in the hundreds of billions, finds **Lucy Jones**, but the level of risk is still underappreciated

**What would happen if the biggest space weather storm ever recorded was to take place today?**

A repeat of the 1859 Carrington Event, which led to a geomagnetic disruption so forceful that US telegraph operators saw sparks fly from their apparatus, would have catastrophic consequences in today's high-tech world, according to AIG-funded research by the University of Cambridge's Centre for Risk Studies.

US insurance industry losses resulting from three variants of extreme space weather events, as detailed in the Cambridge study, "Helios Solar Storm Scenario", published last November, were estimated at between $55.0bn and $333.7bn.

The study estimates that just over 90 percent of this loss would be from property insurance policies for service interruption within those entities that lost power, while 1 percent would be from direct physical property damage.

Global supply chain disruptions were conservatively estimated to range from $0.5tn to $2.7tn across the three scenario variants.

To put this in perspective with regard to major property catastrophe losses, Swiss Re has estimated that insured losses from Hurricane Katrina and Superstorm Sandy were $45bn and $35bn, respectively.

"The real concerns for solar storm risks are the 'silent coverages' which could be triggered, related to power outages and business interruption," says Michelle Tuveson, executive director of the Centre for Risk Studies, who led the Helios Solar Storm Scenario study.

"Proactive measures that insurance companies can take include managing their accumulation risks more closely," she adds.

This might include, for example, monitoring concentrations across power grids around the world when considering potential power outages.

### Learning from Quebec

Extreme space weather events are now widely recognised as a realistic threat to electrical power grids by governments and power providers, but the art of quantifying the risk and insuring it is still very much in the early stages.

Part of the problem is that the Carrington Event, which is the largest recorded electromagnetic storm, is no longer in living memory.

The best known recent example is the solar disturbance that resulted in a nine-hour power outage in the Canadian province of Quebec in 1989.

An explosion on the surface of the sun resulted in a coronal mass ejection – the release of a cloud of electrically charged particles. After two days of travelling at a million miles per hour, the ejection collided with the earth's magnetic field, causing a geomagnetic storm that in turn induced a powerful electrical current in the soil of North America.

The fact that much of Quebec lies over the Canadian Shield, an extensive layer of bedrock that sits below a thin soil layer, meant the currents found a weakness in the electrical power grid operated by Hydro-Quebec, at around 2.44am on 13 March. In less than two minutes the entire network was down.

Thousands of people were left stranded in dark office buildings, underground pedestrian tunnels and lifts. Both the Montreal Metro and airport were closed for several hours. The Quebec outage was a 1-in-30-year occurrence, whereas the Helios solar storm scenario is a 1-in-100-year Carrington-scale event.

> "Global supply chain disruptions were conservatively estimated to range from $0.5tn to $2.7tn across the three Helios Solar Storm Scenario variants"

The Carrington Event was named after English astronomer Richard Carrington, who discovered the connection between activity on the sun and electrical disruptions on earth.

According to Catherine Burnett, manager of the space weather programme at the UK's Met Office, a Carrington-scale event is overdue.

"In terms of space weather, we could get a severe event at any point. They don't necessarily tie into periods when the sun is at its maximum activity – it can happen when the sun is relatively quiet, as it is at the moment," she says. "You only need one sun spot."

### Carrington-scale damage

Most modern technology has been developed while our sun has been going through this relatively quiet stage.

"We've developed lots of great technology but it has never had to withstand large solar events and it is not designed necessarily to deal with those. Potentially, we are making ourselves more vulnerable," says Burnett.

The UK government is most concerned about the effect of solar storms on the electricity grid. A Carrington-size event has been on the UK national risk register since 2012.

Meanwhile, the Met's Space Weather Operations Centre started operating 24/7 in 2014.

"In terms of transformer damage, we are better situated in the UK than potentially other parts of the globe," says Burnett. "We are quite a small country, so we don't have very long power lines, which helps us."

But solar storms could impact other areas, including global satellite navigation systems.

Space weather can damage the satellites themselves, while changes in the atmosphere can prevent satellite signals from reaching the ground.

"That could be critical because GPS-based timing systems have proliferated throughout our modern technology in ways that people are completely unaware of," says Burnett.

For example, many modern building management systems use

Continued on page 30

## Space weather events

**1847** – First recorded storm caused "anomalous currents" on UK telegraph lines
**1859** – Carrington Event caused telegraph systems to catch fire
**1882** – A storm caused disruption to US telegraph systems and interrupted trading on the Chicago Stock Market
**1921** – A storm similar in size to the Carrington Event caused fires at telegraph stations in Sweden
**1958** – Transatlantic communications were disrupted between Newfoundland and Scotland
**1989** – A storm caused the Quebec power grid to collapse
**2003** – Halloween Storms led to a one hour power cut in Sweden and disruption to GPS systems

Source: Cambridge Centre for Risk Studies

Sun storm
continued from page 29

Scada (supervisory control and data acquisition) systems, which rely on the GPS signal for time synchronisation – a service that could easily become disrupted during a solar event.

Electromagnetic disturbances can also disrupt railway signals and track operations and radio wave transmission, and cause cumulative damage to pipelines.

During a period of extreme space weather, aviation routes may need to be altered to avoid high latitude regions, due to the threat of disruption to communications. These routes include the New York to Tokyo and the Toronto to Hong Kong passages.

And radiation bursts can cause spacecraft drag, resulting in uncontrolled re-entry for satellites in low orbits.

## Assessing space weather risks

The level of insurance against space weather events is unclear and untested. In many standard insurance policy forms the power outage may be excluded by the fact that it was caused by something off-premises.

However, it has become very popular in the US, particularly with business insurance policies, to offer off-premises service interruption cover.

“The level of insurance against space weather events is unclear and untested. In many standard insurance policy forms the resultant power outage may be excluded”

“A space weather event is relatively without precedence in terms of it being tested against policy language, in a legal sense,” says Kyle Beatty, senior vice president of Verisk Insurance Solutions.

“There is some uncertainty to how it would be evaluated. What I can say is that it’s in the forefront of the minds of [executives] in many insurance companies.”

From a frequency perspective, he compares a space weather event to the large earthquakes that the New Madrid Fault Line is thought to have the potential to produce.

Running from Illinois, through Missouri to Arkansas, the zone had a series of three to five major earthquakes (believed to have been magnitude 7.0 or greater) between December 1811 and February 1812.

The New Madrid Fault Line does not produce earthquakes every year or even every few years in the way major active fault lines do. However, when considering activity over a few hundred years, there have been enormous events in the area covered by the fault line that have impacted large parts of the US, Canada and Mexico.

“If it affects a big part of the continent when it happens, but there isn’t a lot of recent experience. People can kind of discredit it because they haven’t had first-hand experience with it,” says Beatty.

“I think the same is true with space weather. It feels to many people not to be a real threat because they don’t have first-hand experience of it.”

## Space exposure

So what can insurers do?

Verisk has modelled space weather events and has undertaken portfolio-specific modelling for individual companies. It says demand for services in this area is on the rise.

“Insurance companies really need to take a quantitative look at the exposure their portfolios have associated with service interruption,” says Beatty.

“For the most part, I have observed that level of risk is underappreciated.”

According to Tuveson at the Centre for Risk Studies, insurers should also look at how prepared a country or region may be for space weather events, and how seriously the risk is taken by network operators and the government.

For example, if during a solar storm a transformer sustains damage and a spare is available, it could be brought in from a central storage facility within 14 days. However, the destruction of a transformer could equally take many months to resolve.

Securitisation of space risk will require further development of parametric triggers as well as structured price plans, Tuveson notes. That is one area where research on this subject needs to head next – as well as to making improvements in the modelling of transmission grids and empirical determination of the potential damage to transformers from an extreme space weather event.

In Tuveson’s view, considering the level of uncertainty which persists in our understanding of the impact of space weather on modern society, much more work needs to be done in this area.

## Potential impact of solar storms

- Power blackouts
- Cumulative pipeline damage
- Railway signal and track disruption
- Satellite transmission interruption, including those enabling GPS
- Spacecraft drag causing uncontrolled re-entry
- Radio communication disruption
- Distortion of timekeeping instruments

Source: Cambridge Centre for Risk Studies, Met Office

# Selling like hot cakes

(Re)insurance might not look like hot property currently, but interest in M&A remains strong. **Dan Ascher** untangles the complexities of consolidation in the sector

**If the insurance sector was a high street retail chain it would be a target for avaricious, asset-stripping vulture funds vying for the scraps of a wounded industry.**

With rates in a steady decline and profitability dwindling, the prospects for insurers seem fairly bleak.

Generally, industries with the outlook of the property and casualty insurance sector would attract none but the hardiest of investors, those interested only in turning around distressed businesses bought at a significant discount.

But this sector has never abided by the norms of other industries – and that extends to its merger and acquisition activity.

In 2015, deal values for P&C companies in the US and Bermuda topped $50bn, rounding off what Deloitte referred to as a record-setting year for insurance transactions. However, 2015 also saw net income for US and Bermudian insurers trail behind the levels reported previously.

Yet that same year, valuations in the insurance sector were close to a six-year high, with the average price-to-book multiple standing at around 1.5x.

## Oversupply

But of course insurers are not high street retailers – and they are hurting not from a dearth of demand but a glut in supply.

These complex financial institutions represent only a small portion of the wider macroeconomic environment in which they function, yet they are acutely sensitive to any changes in the global economic outlook.

The current rating environment, which has put pressure on profitability in recent decades, is itself a product of the global low interest rate – and that hampers earnings in two ways.

Firstly it puts pressure on the top line, as supply increases, with alternative capital pouring into the market in search of an uncorrelated investment offering profits that surpass the returns available from other channels.

And secondly, it compresses the investment income insurers used to depend on in order to smooth often lumpy quarterly underwriting results.

In recent years, those factors have worked in tandem to drive the M&A frenzy of 2015, when talk of low interest reached a crescendo as the rate languished at a more-than-three-decade low.

With investment floats effectively idle – struggling to earn a return and frequently even making a loss – insurers were sitting on significant capital that was just waiting to be deployed.

That combined with surplus capacity in the wider market putting pressure on rates – and thus on the denominator in the combined ratio calculation – set the stage for an M&A spectacular.

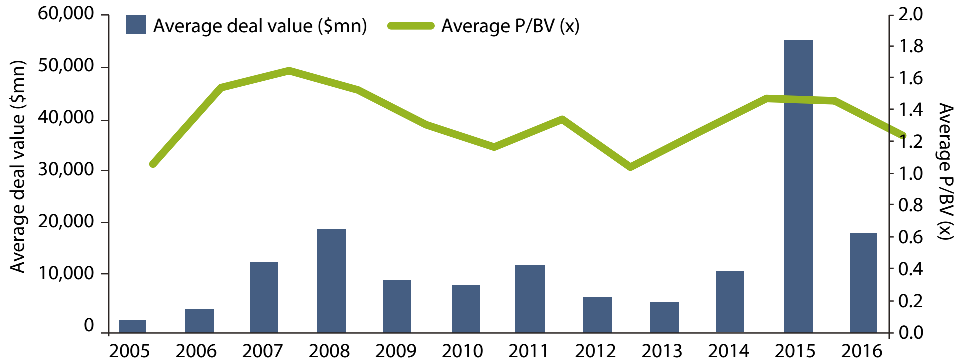
## Bottom line

That combination of factors forced insurers to look elsewhere for measures to protect the bottom line.

One option is to rationalise the expense base and leverage the benefits of M&A to grow and gain economies of scale – and insurers did that in their droves.

But it would appear that even among the investment bankers that are often initiating and structuring these deals, there is some disagreement over what overarching market trends are causing this phenomenon.

## M&A trends for property and casualty




Source: Deloitte, SNL Financial

> “With investment floats effectively idle and surplus capacity in the wider market putting pressure on rates, the stage was set for an M&A spectacular”

John Hendrix, managing director of investment banking at Sandler O’Neill, thinks RenaissanceRe’s $1.9bn deal to acquire fellow Bermudian Platinum in 2014 kicked off a busy period of M&A that has lasted more than two years.

Since then there has been a wave of deals including XL’s purchase of Catlin, Ace’s acquisition of Chubb and Italian investment house Exor’s deal to take PartnerRe private.

Hendrix believes there were three key drivers behind the increase in deals.

“The industry still feels significantly overcapitalised,” he says. “It is harder to grow the top line organically.”

He adds that expenses continue to plague the smaller carriers – which at the same time are expecting to face significant technological pressure, although Hendrix expresses doubts as to whether that additional problem will materialise.

## Building scale

Hendrix says all three factors have typically led small and medium-sized carriers to question whether it was better to remain independent or partner with a larger firm to leverage greater economies of scale.

He says companies were asking themselves: “Can I can I get paid today for what I’m going to be worth tomorrow?”

The executive adds: “The challenge for virtually all P&C companies right now is to grow their top line and to grow it in a safe and conservative way.”

“A lot of them see the opportunity to acquire smaller competitors or a smaller company in a market sector that they’re not in as a very sound and prudent way to build scale and to leverage their own capital base.”

Hendrix says that, looking at some of the most recent deals, pricing multiples had hovered between 1.3x and 1.6x of Gaap book value. “Those are very healthy multiples and probably at the higher end of what we’ve seen,” he explains.

Continued on page 34

Selling like hot cakes
continued from page 33

"I think it is a rational price range, particularly when buyers are sitting on significant levels of excess capital that are earning very low rates of return."

The investment banker continues: "The opportunity cost of that capital has come down and it really enables buyers to pay fuller prices," adding that the debt markets have been "pretty accommodating".

"When you get to those meaningful premiums to Gaap book value that's when you start to see sellers who don't have to sell starting to look at the potential of a sale on the merits and what it does for their ownership base," Hendrix explains.

But he says the prices being paid are "fully justifiable" in terms of pro forma earnings and impact on earnings per share and book value per share.

## Rate reversal

Discussing the relatively lofty public market multiples relative to the challenged P&C rating environment, Peter Babej, Citi's global head of financial institutions in its investment banking group, says there is a perception that the downward trend in pricing will reverse eventually.

"Historically, if you look over the cycle, whether it's because there's a large insured catastrophe or some other event in the market that depletes capital, rates tend to revert over time."

He adds: "People are also expecting interest rates to come up.

"While profitability near-term may not be at the level that you would like longer-term, interest rates look like they may recover, and while you can't predict the timing, at some point P&C pricing also will recover."

Babej says that while rates have continued to broadly decline across commercial, personal and specialty P&C lines, specialty areas such as some excess and surplus business have been relatively sheltered from pricing decreases.

"So you see some of those specialty players still trading at pretty healthy multiples because they're not subject to the same rate pressure as, for example, a property-catastrophe reinsurer."

"While profitability near-term may not be at the level that you would like longer-term, interest rates look like they may recover, and while you can't predict the timing, at some point P&C pricing also will recover"
Peter Babej, Citi

He adds that the strong bid speculation in the sector has also had the effect of driving up valuations.

"You have to pick your spots," he says.

## Dual wave thesis

Meanwhile, Deutsche Bank's chairman of insurance Paul Puleo thinks the swathe of M&A activity that has grabbed headlines in recent years falls into two distinct categories.

The first, he says, could be characterised as "cross-border acquisitions" where foreign buyers diversify away from their home market to balance currency risks and look to jurisdictions where higher returns are available.

## P&C transactions

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Number of deals** | 52 | 58 | 66 | 70 | 62 | 79 | 72 | 68 | 63 | 65 | 51 | 60 |
| **Size of deals ($mn)** | | | | | | | | | | | | |
| **Low** | 1.2 | 0.4 | 1.0 | 1.8 | 0.02 | 1.2 | 0.5 | 0.8 | 0.4 | 1.3 | 0.3 | 1.0 |
| **High** | 825.0 | 1,120.9 | 2,744.0 | 6,225.0 | 1,900.0 | 1,318.5 | 3,534.6 | 3,100.2 | 1,125.0 | 1,671.3 | 28,240.3 | 6,303.8 |
| **Average** | 78.3 | 95.1 | 230.6 | 323.5 | 196.9 | 145.7 | 266.8 | 148.5 | 110.3 | 199.4 | 1,636.1 | 612.5 |
| **Observed P/BV deal multiples** | | | | | | | | | | | | |
| **Low** | 0.87x | 0.92x | 1.23x | 0.48x | 0.77x | 0.55x | 0.73x | 0.57x | 0.68x | 0.14x | 0.99x | 0.92x |
| **High** | 1.15x | 6.19x | 2.34x | 2.81x | 2.98x | 1.70x | 2.69x | 1.52x | 4.11x | 2.83x | 2.53x | 1.45x |
| **Average** | 1.00x | 1.58x | 1.72x | 1.56x | 1.30x | 1.13x | 1.34x | 0.97x | 1.24x | 1.50x | 1.48x | 1.22x |
| **Median** | 0.97x | 1.66x | 1.73x | 1.51x | 0.99x | 1.06x | 1.16x | 0.90x | 1.38x | 1.43x | 1.29x | 1.26x |

Transactions represent US and Bermuda companies making acquisitions on a global basis and international buyers making acquisitions in US and Bermuda
Source: SNL Financial

The second, Puleo explains, are more strategic acquisitions where domestic trade buyers attempt to gain scale and leverage both capital and cost efficiencies through acquisition growth.

"I would say there's this dual thesis," the investment banker says.

"When you look at it all together it looks like an incredible wave, but it's a very different sort of a wave when you separate it."

Celeste Guth, Puleo's colleague and co-head of the German bank's financial institutions group, says US life insurance companies have been of particular interest to Asian buyers.

She says the investable assets relative to capital that insurance assets provide are attractive to buyers coming from countries with low domestic growth or with a high concentration of volatility.

Citi's Babej thinks the inbound interest from Asia has made a major change in the M&A landscape in recent years, which has seen Tokio Marine acquire Philadelphia Consolidated, Kiln and Delphi; Mitsui Sumitomo buy Amlin; and Sompo take on Endurance.

Babej says he expects further geographic diversification from the Japanese carriers, though there is unlikely to be a rapid succession of deals.

He says that low yields in Japan were a further factor behind their interest.

"Obviously, investment returns are a big part of the insurance business, and the fact that yields in Japan are so low is another impetus for looking overseas," he explains

"And [in] our market, even though we think our yields are low by historical standards – and they are – they're still relatively high compared to Japan."

## Specialty interest

Guth says another area where Deutsche Bank has heard a lot of interest on the P&C side is specialty business.

"But I think when you look at it there are relatively few targets out there, and for the most part I think many of them are not considered actionable," the investment banker warns.

She says there has been a "huge" amount of activity that had whittled down the number of potential targets where the board or management team would be amenable to selling.

> "The investable assets relative to capital that insurance assets provide are attractive to buyers coming from countries with low domestic growth or with a high concentration of volatility"

"The board can always say no if they feel they can build a lot of value just by keeping the company independent and executing the business plan," she explains.

"Often times you will see that, where boards want to remain independent," the executive continues. "They feel good about the prospects that the company has on an independent basis and they don't necessarily want to take a 20-30 percent premium and get cashed out because they feel like there's more upside in the stock."

And the scarcity of available businesses has driven up the prices being demanded. Babej says one of the main obstacles to getting a deal over the line is balancing the pricing expectations of sellers and buyers.

"That's been heightened a little bit by the fact that we've seen certain trades at pretty high multiples," Babej explains.

He warns: "Different buyers are situated differently and willing to pay different types of prices, so it just depends on who's actually out there willing to do a deal, and whether you're going to have a match from a valuation perspective."

## Specialty interest

And the challenges don't end once a deal has finally been agreed.

Andy Wallin, group commercial director for Ed, has bought and integrated many broking businesses, but he admits: "I'd struggle to name you any businesses that have been perfectly integrated, given the constant change in all businesses."

He says the conversations acquirers should be having would go something like: "We are going to integrate your IT, your finance, your HR, your risk, your compliance, your legal and probably your premises and we're probably going to take your brand away.

"If you can deal with all of that, then we can have a conversation."

However, he adds, the dynamic is slightly different for portfolio businesses: "You want the assets, you want the portfolios [and] the people, and you want the renewal rights."

Integration is set to take centre stage in the months and years to come because, while there is little agreement as to exactly what is driving the increase in deals, the consensus view is that it will certainly continue.

# Talent spotting

**Carlos Pallordet** details the rationale and process behind *The Insurance Insider's* survey-based rankings of the (re)insurance market's top talent

**Ask industry leaders what makes their organisations great and one of the things you are likely to hear is that it's about their people.**

Company websites, annual reports, chairmen's statements, executive speeches – all reference talent as the key to success and will take pride in the efforts they put into promoting it. If you look at the (re)insurance industry – a trade predicated on the notion that it is a "people business" – you will see this trend widely amplified.

The (re)insurance industry values its workforce like no other industry and will go to any length to attract the best talent and protect it. But there is more to it than just having the best experts working for the firm.

Like no other industry, companies in the (re)insurance sector will continuously strive to understand who they are doing business with, who they could be partnering with in the future and how their competitors are perceived. There is paramount value in understanding the human network through which business flows.

The access to this intelligence is fragmented, however. Business leaders have the means to measure the performance of their own staff objectively, but are unable to replicate this beyond their own boundaries.

Views outside the firm are frequently informed by circumstantial exposure, personal accounts and subjective perceptions. And there is only so much that you can rely on from word-of-mouth to understand who's who in the industry, particularly when it comes to the newer generation. After all, it takes time to build a reputation.

So the subject continues to be mostly the territory of recruitment partners, who work individually with companies to help them to fill this void. With a discovery process that is subjective by nature, any practices that can tilt the balance towards impartial and measurable evidence are a positive addition.

## Mapping cyber

It is against this backdrop that last summer *The Insurance Insider* had a stab at the topic, launching a survey-based ranking of London market underwriters and brokers. The initiative was aimed at providing a quantitative measure of talent across the market that could complement the knowledge that companies have gathered through the usual channels, while also identifying and recognising hitherto hidden talent.

The line of business chosen to roll out the first pilot was cyber liability. The data collected provided the first comprehensive view of the cyber insurance talent map, uncovering the attributes of 165 professionals across 60 companies, as reported by 250 respondents active in that class.

Most importantly, it proved the feasibility of the research project and laid the foundations for a data product that could be scaled up to other classes of business, a journey on which *The Insurance Insider* has now fully embarked this year.

From the beginning, there was a determined attempt to lay the foundations of the rankings on solid ground, and two things were instrumental in achieving that purpose.

The first was the inspiration taken from *The Insurance Insider*'s sister publication *Institutional*

## 2016 Cyber Rankings*

**Total Positions Analysis: Brokers ranking**

| Overall Rank 2016 | Broker | Firm | Overall Score | Overall Vote Count | Top Choice | % of Top Choice | "Second Place" | % of Second Place | Third Place | % of Third Place |
|---|---|---|---|---|---|---|---|---|---|---|
| 1 | Jack Lyons | JLT Specialty | 31 | 14 | 5 | 36% | 7 | 50% | 2 | 14% |
| 2 | William Wright | Paragon | 29 | 12 | 5 | 42% | 7 | 58% | 0 | 0% |
| 3 | Tom Quy | Miller Insurance Services | 24 | 12 | 5 | 42% | 2 | 17% | 5 | 42% |
| 4 | Lyndsey Bauer | Paragon | 20 | 10 | 5 | 50% | 0 | 0% | 5 | 50% |
| 5 | Lucy Scott | Lockton | 16 | 6 | 4 | 67% | 2 | 33% | 0 | 0% |

*Top 5 of a total of 70 brokers shown for illustrative purposes

*Investor*, which started canvassing Wall Street 45 years ago. Now running more than 60 rankings across different geographies and areas of interest, *Institutional Investor* has continued to improve its methodology and research procedures over time and *The Insurance Insider* was able to tap into that body of expertise.

But the concept needed to be vetted and adapted to the (re)insurance market. For that purpose, *The Insurance Insider*'s research team took guidance from 22 prominent business leaders, comprising CEOs and non-executive directors, from the London market. Their advice was essential in identifying and defining the key attributes of good underwriting and broking, as well as understanding the idiosyncrasies of the market that needed to be addressed in correctly adapting the product.

The road-testing process also validated the need for objective and comprehensive assessment of London market talent, as well as the advantage conferred by *The Insurance Insider*'s independent status in collecting this intelligence.

### Ranking methodology

Following the cyber pilot, the 2017 Rankings initiative has begun with coverage of political risk and political violence. Surveys of both classes were launched simultaneously in early February.

While a few useful lessons were learnt from last year's cyber exercise, the initial rankings framework proved solid enough to make changes to the rankings formula in 2017 negligible.

Simplicity is the defining feature behind the model now being rolled out to other lines of business.

To begin with surveys are based on individuals, so respondents only nominate and score professionals – not companies – with brokers voting for underwriters and vice versa. Respondents are not prompted to vote on a pre-determined list of candidates, leaving them free instead to volunteer their own choices, reflecting top-of-mind awareness.

Respondents nominate their top three choices with three points assigned to the top professional, two points to the second position and one point to third place. This scoring method – known as the Borda count – provides consistent weighting to each vote while accounting for the voter's order of preference, hence providing the best representation of market preferences.

Apart from nominating the best professionals, respondents provide a score on a set of specifically defined attributes. These are based on the understanding of what defines a good underwriter and a good broker, and hence differ for each of these groups.

Underwriters, for example, are assessed on knowledge/experience, negotiating skills, work ethic, communication skills, creativity and consistency.

For both groups, respondents also have the option to freely express their main consideration behind each of their designations. Complete confidentiality is offered to all participants, allowing for honest and trustworthy scores and testimonials.

Surveys are mainly conducted online but the data collection process is complemented with phone calls to ensure the required levels of participation. Time and internet protocol tracking, paired with the analysts' validation of all individual records, ensures data integrity.

The guiding principle behind the survey design and data collection process is statistical significance. To that end, detailed lists of potential participants are screened and filled in preparation for each survey launch, so once the polls open the participation of all relevant market practitioners can be closely monitored.

The process is thoroughly managed to target a maximum error margin of 10 percent at a 95 percent confidence level, which translates into samples sizes that are large enough to ensure that ranking scores remain unchallenged if the surveys are run repeatedly.

### More than a ranking

Statistical significance aside, high participation rates also mean that a richer, denser body of information has been hauled out of the shadows.

Survey forms are deliberately designed to enable respondents to complete them in under five minutes but that still means – when the dust of polling activity

Continued on page 38

Talent spotting
continued from page 37

has settled – that the survey will have racked up some 20 to 30 hours' worth of interview time pertaining to the specific line of business surveyed.

The ranking of the top brokers and underwriters is the first thing that comes to mind when focusing on the survey results and is indeed what *The Insurance Insider*'s editorial team has commented on. As the backbone of the survey it is also valued by respondents, as individual scores and positions are confidentially reported back to every participant.

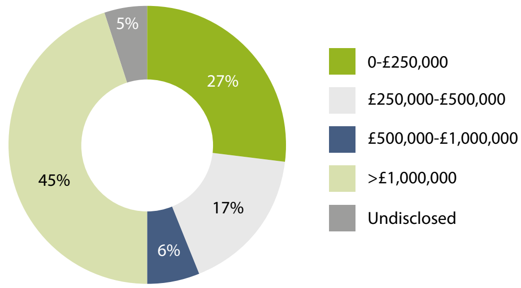
But a lot more information is tabulated from the surveys and compiled in the anonymised Excel-based Rankings Data package that *The Insurance Insider* makes available to companies.

First, individual brokers' and underwriters' scores from the main rankings of practitioners are regrouped as teams to create the ranking of companies. These broker and underwriter company league tables hence reflect the aggregate value of each firm's team members rather than straightforward brand awareness.

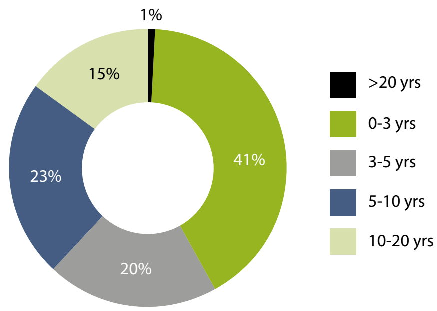
In the case of the Cyber Rankings for example, a total of 30 underwriting companies and 30 broking houses were ranked on the back of the individual scores of 165 practitioners.

A second set of outputs is given by the segmentation of rankings. Two of the survey's filtering questions allow for the segmentation of rankings by respondents' years of experience and the size of premiums underwritten or intermediated in the specific line of business.

## Gross premium brokered




## Years of experience in cyber insurance




These "sub-rankings" allow users to understand how practitioners across different companies rate with more or less experienced players and with bigger or smaller market players.

A third spin-off of the survey is the analysis of attribute scores at an individual level. This involves aggregating the marks given by respondents to each of the nominees' key traits.

The scores are not directly comparable across different practitioners (as the sets of respondents behind each individual average differ), but the results will objectively reveal what the relevant strengths (or weaknesses) for each nominee are. For example, it will show that a given practitioner is more valued for their knowledge or work ethic rather than their communication skills.

But it is the tabulation of all results at an individual level in the form of a "profile view" that provides perhaps the most eye-catching picture. Users of the data package can select all nominated practitioners and display individual profile pages including their basic information (such as job title and years of experience) and examine both the analysis and the testimonials about the practitioner – from being solid presenters in client meetings to having good humour or social standing – behind their specific accomplishments.

Overall, the Rankings data package allows for a comprehensive mapping of talent in each line of business. With the 2017 calendar extending the coverage to six new classes plus a repeat of the cyber rankings – and more classes set to follow thereafter – we fervently hope *The Insurance Insider*'s new Rankings make a powerful contribution to a topic that is of paramount importance to the market.

## 2016 Cyber Rankings*

**Company comparative Score, Rank and Vote Count: brokers**

| Overall Rank 2016 | Firm | Name | Overall Score | Overall Vote Count |
|---|---|---|---|---|
| **1** | Paragon | **Paragon brokers** | 67 | 34 |
| | | William Wright (2) | 29 | 12 |
| | | Lyndsey Bauer (4) | 20 | 10 |
| | | Jasper Goring (8) | 10 | 7 |
| | | Erica Constance (21) | 4 | 3 |
| | | JJ Kilmartin (25) | 3 | 1 |
| | | Sebastien Plummer (52) | 1 | 1 |
| **2** | JLT Specialty | **JLT Specialty brokers** | 39 | 18 |
| | | Jack Lyons (1) | 31 | 14 |
| | | Lauren Cisco (14) | 6 | 3 |
| | | Sarah Stephens (38) | 2 | 1 |
| **3** | Miller Insurance Services | **Miller Insurance Services brokers** | 33 | 16 |
| | | Tom Quy (3) | 24 | 12 |
| | | Simon Milner (21) | 4 | 2 |
| | | Daniel Leahy (25) | 3 | 1 |
| | | Nick Fearon (38) | 2 | 1 |

*Top 3 of a total of 30 companies shown for illustrative purposes


DOCOsoft
Documents
Real Time
Bespoke
Claims Management
One System
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# Smooth running

***Insider Quarterly*** takes a look under the bonnet to find how companies can diagnose and provision for operational risk

**A long time ago in a galaxy far, far away… there existed a bank on Wall Street called Bankers Trust.**

After a near-death experience following massive trading losses by one of its "star performers", Bankers Trust invented a system of relative risk/reward measurement called RARoC – risk-adjusted return on capital.

The underlying concept was that if a trader made huge profits by taking huge (possibly existence-threatening) gambles with the balance sheet, then those profits should be "downgraded" to reflect the risk/reward imbalance. Conversely, the trader who made less enormous profits by not betting the bank should be rewarded for getting the trade-off right.

Thus Bankers Trust gave us the first rudiments of market risk calculations.

At around the same time, JP Morgan published Credit Risk Metrics on the then-nascent internet – and founded the entire science of credit risk in financial institutions.

Not to be outdone, Bankers Trust soon came back with the first operational risk measurement and management framework.

Bankers Trust is long gone, but at the time it was well ahead of the curve in defining operational risk. Everyone can define credit risk: it's the danger that you won't get paid. But how do you define operational risk? You can't model "everything that isn't credit risk or market risk".

## Identifying operational risk

That early operational risk work has since found its way into the Basel II/III capital framework, which requires banks to hold capital against the risk. The risk itself is defined as "the risk of loss arising from inadequate or failed people, processes or systems, or from external events".

One could be forgiven for needing help to understand this definition, so to clarify, the risk arises when…

**People make mistakes:** sell 30,000 Coca Cola shares instead of 30; commit fraud (e.g. transfer money from clients to their own account); or mislead customers (e.g. regarding the riskiness of an investment product).

**Processes fail**, for example: a fraudster's mortgage application is accepted when it should be declined; or a bank transfers money for a sanctioned individual or company and is fined for the failure.

**Systems fail**, such as: a successful hack enables thieves to steal client identity and credit card information, with the result that customers complain that large amounts have been spent on their cards; or a computer glitch occurs – e.g. debiting bank customers three times for their monthly mortgage payments.

And **external events occur**: for example, severe flooding in the north of England damages bank premises, staff are unable to reach their workplaces and must be lodged and work in London until the waters recede, and the bank incurs significant extra expenses; or, perhaps terrorists attack the building where the bank's main trading activities are located, meaning the bank loses people and trading opportunities.

## Measuring the risk

Financial services firms are regulated in the UK by the Prudential Regulatory Authority. Banking regulation around operational risk is currently in flux, but the consideration and measurement of operational risk has long since moved beyond banks to insurance companies and asset managers.

Looking at insurance companies, the Solvency II capital rules require them to hold up to 30 percent of the calculated solvency capital requirement (SCR) against operational risk. Stock analysts have been critical of companies that cannot demonstrate high levels of capitalisation – 175-200 percent of statutory requirement (SCR) is approximately the number they like to see – so managing that potential 30 percent operational risk charge becomes important.

Underpinning operational risk with capital also focuses the corporate mind on managing it, which in turn requires a robust framework and model, so as to help: identify key risks (establish a taxonomy); collect internal loss data, preferably including near misses; and develop scenario analysis to provide a comprehensive view and valuation of existing and emerging threats.

Ultimately, the goal is to understand how much enterprise value could be destroyed by operational risk.

## Managing the number

After much internal strife, the capital model will produce a £ value of capital at risk from operational risk. In practice, most insurance companies have calculated that their operational risk SCR is between 8 and 12 percent of the total SCR.

Compared with the much larger capital blocks they are required to set against underwriting, market and counterparty risk, the operational risk number appears modest. But capital is expensive. So the thinking finance director suggests that the capital need not be his own – he could just as easily rent someone else's capital, i.e. buy an insurance policy.

The capital rules specifically state that, in calculating their operational risk SCR, insurance companies may take into account any appropriate insurance or reinsurance. So it's tempting to look at the company's property, crime, professional indemnity and general liability policies and simply subtract those policy limits from the capital requirement as calculated.

Unfortunately, it's not that easy. The regulator expects firms to demonstrate that there is a consistent, robust, transparent and repeatable process for mapping the insurances they buy to the operational risks they have identified.

Achieving that goal may require some external expertise to help with: mapping insurance policies to the operational risk taxonomy; establishing the mitigation effect of insurance (how much is the policy likely to pay out?); estimating the likely timeframe (how long will it take to get the money?); and modelling a pre- and post-mitigation figure for economic capital at risk from operational risk.

> "Operational risk itself is defined as 'the risk of loss arising from inadequate or failed people, processes or systems, or from external events'"

## Stakeholder buy-in

Oddly enough, getting regulatory clearance may not be the biggest hurdle. The keepers of most companies' capital models are the actuaries.

Actuaries deal in hard numbers and binary responses to questions:

Is the scenario set out here covered under the insurance policy [Y/N]?

If [N], move on to the next scenario.

If [Y], what percent of the loss would be covered and how soon will the policy pay out?

Insurance practitioners know that insurance policy response is seldom that clear. The policy is likely to respond under certain circumstances but…

Thus, the insurance buying team cannot provide simple [Y/N] answers, and the actuaries are inclined to bin the whole possibility of insurance mitigation for the operational risk charge.

Even where insurance exists that might respond for operational risk scenarios, that response is so equivocal that the actuaries will likely ignore its existence. This means that capital is set aside for a specific risk that might be insured – thus creating a double provision for the same risk. When this is pointed out to them, their immediate reaction is that their job is to model the risk, not manage the capital charge.

## Taking ownership

If our thinking CFO wishes to avoid double-provisioning for operational risk, he needs to take a strategic decision regarding the company insurances. Namely, should these be: as broad as possible, acknowledging that any claim is likely to be the subject of a lengthy court case before payout is negotiated; or narrow policies that respond for specific top risk scenarios and are worded in such a way that coverage is narrow but policy performance is certain.

Once this decision is implemented, the CFO then needs to take ownership of incorporating those policies into the capital calculation.

This might require some confrontation with the actuaries and will almost certainly require external expertise to: review the breadth of insurance coverage as compared to the risk scenarios; document coverage conclusions (why do we think it's covered?); and ensure results are consistent, logical and repeatable.

The outputs from this review can then generate a "post-mitigation" model for operational risk.

Properly executed, documented and presented to the regulator, the exercise may also help the insurer to achieve that all-important 175-200 percent of SCR.

# The strongest link?

As index-linked securities trading becomes more efficient, **William Dubinsky** examines the resilience of such instruments and what it means for ceding companies

**Trading and liquidity are imperative to growing the insurance-linked securities (ILS) market and delivering competitive pricing and terms for reinsurance backed by ILS. Yet ILS trading is typically not well understood, except by market insiders.**

ILS proceeds provide collateral to back reinsurance contracts. Traditional reinsurance balance sheets are also backed by securities including the surplus notes of a mutual or the common equity of a reinsurer. What is different with ILS is the "linked" part.

ILS is typically linked to the performance of a specific reinsurance contract rather than the performance of the entity as a whole. This means that when ILS trades, the traded value in part reflects the value of the associated contract. If the contract pays a claim because of a hurricane, the linked hurricane ILS drops in value.

## Basic ILS structure

Stepping back, it is important to understand a typical ILS set-up. The most important thing to know is that an ILS deal is not one transaction but two, as shown in the diagram.

This is the case regardless of whether the risk transfer is proportional or non-proportional and regardless of whether the deal has a single investor or multiple investors. For convenience, we call the single investor deals where the investors might purchase a security from a segregated account in a segregated account company "collateralised re" and the multiple investor transactions "catastrophe bonds".

Nonetheless, both single and multiple investor ILS deals follow this same basic pattern because the investors are not licensed reinsurers and cannot write "collateralised re" directly from a regulatory standpoint. They can only make investments and cannot bind reinsurance contracts. A transforming reinsurer must sit in the middle if the ceding company seeks legal form reinsurance.

While this set-up covers most situations, the range of potential structures is vast. For example, some corporates will transact via derivative rather than by insurance or reinsurance of a captive. In other situations, entities besides the transforming reinsurer provide fronting services so the protection buyer faces a rated and regulated "promise to pay" insurer or reinsurer.

There have also been a number of attempts to establish exchange-traded contracts, albeit with limited success. As ILS grows in importance, these and other structures could become increasingly important.

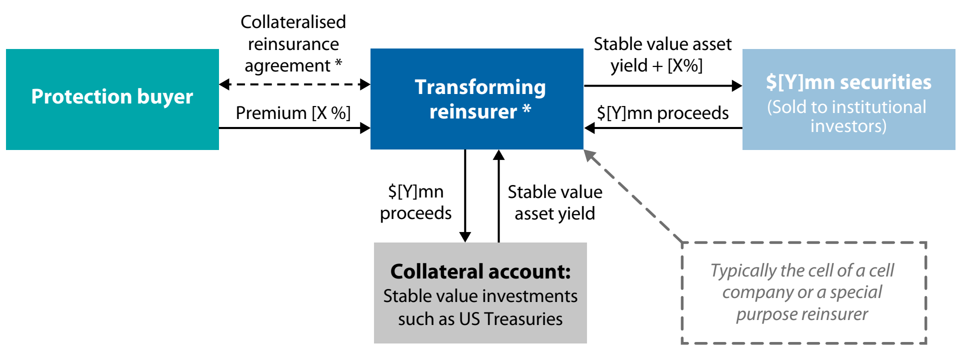
## Why does ILS trading matter?

Do ILS investors value liquidity? The short answer is yes. And they do so for several reasons.

Firstly, some of the investors themselves need liquidity. For example, a specialist ILS fund may need to fund redemptions or want the flexibility to change their ILS investment mix over time. With an illiquid investment, their capital is trapped until released. With a liquid investment, they can sell and then redeploy the cash as necessary.

Other investors require liquidity such as European UCITS funds (Undertakings for Collective Investment in Transferable Securities – essentially a type of

## Structure to transform reinsurance to ILS




*Note: sometimes other risk transfer alternatives are used and the transformer is not technically a reinsurer
Source: Willis Capital Markets & Advisory

mutual fund).

Liquid ILS also facilitates leverage on the investor side by allowing investors to effectively borrow against the value of their positions. This is similar to an individual investor buying common stock of a public company on margin.

Here, the ceding company is no more impacted by the borrowing than the public company would be in the stock margin situation. As with ILS trading, the ceding company's rights and obligations are essentially unaffected by leverage on the investor side.

Consider loss development following an earthquake. With liquid ILS, an investor may be able to exit a position with a loss. With illiquid ILS, the investor's capital may be trapped regardless of whether a loss ultimately occurs. In contrast with traditional reinsurance, only the balance sheet is "trapped" and the risk is shared with the ceding company.

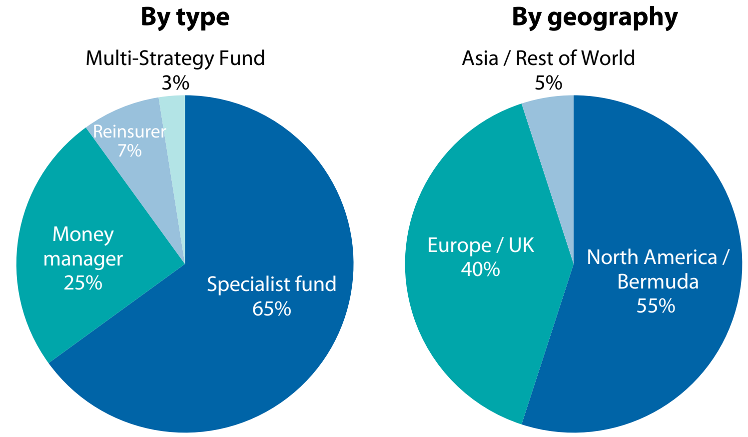
Secondly, traded products are easier to value accurately. Where trading occurs, the trading price provides a quantifiable indication of value – something more difficult to come by with either illiquid ILS or traditional reinsurance. Investors also receive price indications on a periodic basis from securities broker-dealers, reflecting the current market valuations of liquid ILS through so called "pricing sheets".

Liquid ILS trading enhances price discovery more generally. A traditional reinsurance contract may only renew once a year but trading of related ILS can inform potential renewal pricing by providing an early warning of any forthcoming price drops or rises.

Price indications for liquid ILS can also supplement "mark-to-model" valuations for illiquid ILS with similar characteristics. Even end investors who do not need access to cash want accurate

**William Dubinsky** is managing director and head of ILS at Willis Capital Markets & Advisory

## ILS investor breakdown




Source: Willis Capital Markets & Advisory

valuations on illiquid ILS from their ILS funds.

### How much trading occurs?

Today, we estimate there is about $75bn of non-life ILS capital. Of this, about one-third is in the most liquid form of ILS, catastrophe bonds. A rapidly growing portion, but still under $5bn, is in ILS of intermediate liquidity. In these cases, trading is possible but more difficult and with fewer potential buyers.

The remaining ILS investments are illiquid. In recent years, the market share for illiquid ILS has grown quite a bit. However, in the second half of 2016 this trend began to reverse.

Illiquid ILS grew because liquid ILS involves extra costs to create the liquidity. These include out-of-pocket costs to arrange the deal as well as some different requirements in ongoing transaction management.

Where these costs outweigh the benefits, illiquid ILS done on a single investor basis, with or without fronting, provides an easy-to-execute alternative.

Even with liquid ILS, many investors take mainly a buy-and-hold approach, so the total amount of trading without a catalysing event such as a large hurricane or a financial market meltdown is modest compared with many other fixed income markets.

That said, the margins broker-dealers charge for trading are modest versus other similar asset classes and there are a healthy number of broker-dealers that intermediate ILS. As such, practical liquidity is very good, as reflected in our experience, as well as the limited data available from the Financial Industry Regulatory Authority's Trace (Trade Reporting and Compliance Engine) system.

Furthermore, large reinsurers can invest in ILS and, as a group, effectively provide a backstop on the market as natural investors of last resort. This may partially explain the resiliency of liquid ILS in the face of the Long-Term Capital Management meltdown in 1998 as well as the financial crisis 10 years later and in other periods of volatility, both financial and reinsurance-related.

We anticipate liquid ILS and trading will remain important and that ILS of intermediate liquidity will continue to evolve. For the foreseeable future both liquid and illiquid ILS will coexist.

As ILS trading becomes more efficient and ceding companies and others more comfortable with ILS liquidity, ILS capacity will become an even more important source of capital for the industry.

# Open door policy

Millennials are knocking at the door of the insurance sector, says **Keith Wolfe**, and the industry should be doing more to let them in

**Millennials who are sceptical about an insurance career should take this short quiz: Are you inquisitive? Are you attracted to limitless challenges? Do you want to do good for society? I believe a majority of people under age 34 would answer "yes" to those questions.**

Millennials – those who are currently between the ages of 18 and 34 – number more than 75.4 million, surpassing the 74.9 million baby boomers, according to the US-based "fact tank" the Pew Research Center.

Millennials and insurance are a perfect match. First, let's dispense with the usual arguments against millennials pursuing insurance careers. Arguments like: "Insurance is boring and stale. Millennials are not." "Insurance is stuck in the dark ages. Millennials live in the moment and are looking ahead." And "Insurance is all about profit. Millennials are altruistic."

Anyone who works in insurance knows it is definitely not boring and stale, what with a barrage of perpetually emerging and changing risks.

Anyone who works in insurance knows it is not stuck in the dark ages, but forward-thinking – imagining the future and quantifying the risk using solid science.

And anyone who works in insurance knows that yes, it is about profit, but it's also about protecting lives and livelihoods, and about providing the means to carry on in the face of adversity.

My company, Swiss Re, is taking risk protection into some of the most vulnerable regions of the world. It is shielding Chinese farmers from financial risk, post-catastrophe, with parametric insurance, and helping Guatemalan business owners recover lost income after a hurricane, landslide or volcanic eruption.

Helping people is a guiding principle of insurance. It's a timeless concept. Yet the methods of execution are changing and we must accept the change.

Our industry will look different in the coming years because of the disruptors, and millennials are largely the ones doing the disrupting. Technology is the great enabler, creating demand for younger professionals and their skill sets.

## The future is today

For all the assertions that insurance is a follower, our industry deserves some credit for stepping boldly into the future and embracing the unknown.

(Re)insurers are always scouting for new ideas. Swiss Re sponsors hackathons, partners with IBM's Watson (its computer system capable of answering questions in natural language) to harness the power of "big data" for life and health underwriting, and recently launched an InsurTech accelerator in India.

(Re)insurers are investing in start-ups. Swiss Re is backing Cuvva, which sells pay-as-you-drive auto insurance, while Munich Re and HSB invested in Bought By Many, a members-only insurance marketplace.

And carriers are always thinking about the next big societal development and the risk it brings – for example emerging market instability, internet fragmentation and human-induced earthquakes from hydrofracking.

Disruption is creating opportunities to reimagine insurance. As branding strategist Leonard Kim wrote in an October 2016 article on emerging business trends for *Inc* magazine: "As baby boomers seek to retire in the next few years, you will see many businesses being sold, taken apart and reinvented by the millennials."

InsurTech entrepreneurs are changing the norm – from marketing and origination to underwriting to claims management and finance. We're pioneering ways to source and analyse data from an individual's everyday activities for better risk selection and underwriting.

Your toothbrush tells your dental insurer if you've been brushing regularly. A telematics device tells your motor insurer if you've been driving safely. A wearable device can tell your health or life insurer more about your cardio health than you can disclose on an application.

This level of specificity will help deliver the right product at the right price, because no one wants to subsidise the risky behaviour of others.

Speaking as a non-millennial who's worked in this industry for nearly 20 years, I welcome this influx of innovation. It is absolutely necessary to ensure we can meet our obligation to extend protection to a rapidly changing world.

## Help wanted

The insurance industry will need to fill 400,000 positions by 2020, yet eight out of 10 millennials admit to having limited knowledge and understanding of the employment opportunities available.

Just making insurance appealing to the 34-and-under crowd won't be enough; we need to seduce them with the prospect of changing the world through technology and innovation. That starts with a compelling job description, so let's make a list of the qualities and competencies we're seeking.

*Ability to bring technology to bear on insurance*. Lemonade is processing claims in seconds, aided by artificial intelligence. The new Swiss Re Institute will further strengthen and steer R&D activities across my company. Our job applicants are the digital natives, so they should be jumping at the chance to make their mark in this realm where there's no limit to what can be accomplished.

*Understanding of emerging risks*. A generation that grew up Xbox, Nintendo and PlayStation should have no trouble grasping the boundless possibilities of cyber risk and big data.

*Ability to work with evolving distribution models*. This is the generation that grew up in a mobile society – where access to everything is direct and easy. All of our frustrated attempts at understanding how to reach and sell to this consumer will be moot because soon this generation will be calling the shots.

*Fluency in the language and application of automation*. Many financial services companies are leveraging robotics to perform previously manual tasks. We are also a founding partner of the B3i initiative, a group of global insurers exploring the use of blockchain to revolutionise the handling of transactions across companies and jurisdictions.

> "Our industry will look different in the coming years because of the disruptors, and millennials are largely the ones doing the disrupting"

*An understanding of the importance of the insurance value chain*. This is a concept that should actually resonate with millennials because insurance is less like manufactured goods and more like Uber. Take Lemonade, for example, a peer-to-peer model where participants contribute premiums and share the risk, with money left over after claims going to charity. Like Uber, Lemonade brings like-minded people together to access a common utility.

The insurance jobs of the future may look somewhat different from current positions. Yet we will still need underwriters and claims professionals, which begs the question: "Are the schools doing enough to attract and train the best?"

While education isn't our core capability, insurers can help. We can partner with and help fund educational institutions, mentor students and create more early careers programmes that usher the best and brightest through the door and fast-track their careers.

**Keith Wolfe** is president of US P&C – Regional & National, at Swiss Re

## Failure is an option

Risk-taking is calculated in the insurance world, but the growing millennial influence must work to discourage paralysis from risk aversion, and change the notion that perfection is the only option and failure is bad. Failure is common and accepted in entrepreneurial circles inhabited by younger professionals.

Jeff Stibel, vice chairman of data services company Dun & Bradstreet, famously installed a giant whiteboard in the breakroom for employees to write down their failures and what they learned from them. The insurance workplace could use more of this type of validation.

By 2030, nearly half of the current insurance workforce will have retired, and understandably it's unnerving to envision insurance veterans handing over to the millennial generation. So how can we set the table for a successful transition?

A new study by business membership and research association The Conference Board entitled "Divergent Views/Common Ground: The Leadership Perspectives of C-Suite Executives and Millennial Leaders", published in January 2017, compares the values and preferences of two generations of business leaders – basically older and younger.

In talking to people at 14 organisations, researchers found differences as well as similarities between the two age groups. Perhaps the most important point the two groups agree on is this: "leading through transformation" is the most important work experience that shapes leadership competence and motivation.

The commitment to transformation – leading teams through transformative periods and invoking transformation to build winning organisations – is a catalyst for the success and sustainability of our industry.

The millennials are at the door, eager to seize the opportunity of transformation. Let them in.

# Steaming ahead

As the American Club celebrates its centenary, **Joe Hughes** reflects on the past history and future prospects of P&I clubs

**The first protection and indemnity (P&I) clubs were set up over 160 years ago in the United Kingdom.**

They were created to address a need for insurance against newly emerging shipowner liabilities that had arisen out of recent decisions in the English courts and new acts of Parliament. These placed growing responsibilities on the maritime community.

Traditional marine insurers were reluctant to embrace these new exposures. In consequence, shipowners turned to the principle of mutuality to form new associations to cover these risks.

Mutuality has been at the core of P&I insurance ever since. Most current members of the International Group of P&I Clubs were formed in the closing decades of the 19th century and the opening years of the 20th. The American Club was founded in February 1917. As a mere centenarian, it is relatively youthful by comparison with some of its colleagues elsewhere in the group!

## Pooling mechanism

What is now the International Group of P&I Clubs had its origins in an 1899 agreement between six clubs that set up a simple claims pooling mechanism among themselves. This has since grown into a collective of 13 clubs that cooperate over the broadest range of interests.

The clubs have had an exceptional impact on both the shipping and marine insurance industries over the years. Some 90-95 percent of the world's merchant marine is covered by International Group clubs. The group itself cooperates by way of pooling large losses and collectively arranging reinsurance to the highest limits of liability. It is also an active voice on behalf of the maritime community on a wide variety of issues.

The benefits created by the clubs are without peer. They occupy a special place within the universe of marine insurance and have, over the years, created an environment that supports other sectors of the industry. These include the diversification of some clubs into other areas, notably fixed premium P&I, hull, energy and other insurance. The clubs' reinsurance arrangements also have a major influence on that specialist market.

The scope of liability cover offered by clubs is designed to meet all the requirements of the global maritime community. Clubs are owned by their members, with the proprietary model underpinning the mutual principle. For this reason, club cover has always been responsive to the needs of shipowners as liability risks have evolved over time.

There is no broader catalogue of liability cover than that provided by International Group clubs, nor any higher limits of protection. This, coupled with the extraordinary financial reliability of the group system, has, among other things, supported the development of international regimes for providing compensation to the victims of marine accidents.

## Facilitating commerce

The deep engagement of P&I in the day-to-day realities of shipowning facilitates global commerce, from the arrangement of letters of undertaking by the clubs to provide security for claims against ships, to the issuance of certificates of financial responsibility for oil pollution and other exposures.

The emergence of Asia as a major polarity in the maritime industry has had a great impact on world shipping over the last 30 years. In addition to Japan, the rise of other Asian nations has given strength to the entire region in recent decades. For example, China, Korea, Singapore, Taiwan, Indonesia and India are now significant shipping powers in their own right and are gaining an ever larger share of global seaborne trade.

Asian shipping will continue to expand over the next three years. This will be driven not just by the maritime needs of major nations such as China and India, but also by the growing development of smaller countries such as Vietnam, Myanmar, Bangladesh and others.

Endogenous GDP growth in Asia is equivalent to the creation of one new economy the size of Germany every three years. This statistic alone will continue to drive local markets – and their concomitant P&I needs – for years to come. Asia will continue to be an important part of the global P&I scene and attract ever-larger resources from the clubs.

Nevertheless, over-commitment to a particular sector can create problems. Regional downturns can be challenging for clubs that are disproportionately committed to a particular regional constituency of members.

A well-balanced marine insurer will have representation from all the major polarities of world maritime commerce – the Americas, Europe and Asia – as well as a healthy diversification of tonnage by reference to vessel type and trade.

## Diversification

As to diversification, P&I insurers have themselves entered into new business sectors in recent times. Indeed, some clubs have for years offered hull cover in parallel with their P&I business, while others have branched out into other sectors, for example fixed premium P&I, specialist inland waterway business and so on.

The main issue for any P&I club in considering diversification into other areas of marine insurance is the interest of existing members. No club should diversify simply for the sake of diversification in the absence of a clear benefit for the membership as a whole.

The tempo of diversification has increased over the last five years. Two clubs now operate Lloyd's syndicates and most clubs now offer a fixed premium P&I product. In the case of the American Club, an investment in a Solvency II-accredited hull insurer was recently made in Cyprus in the form of American Hellenic Hull Insurance Company Limited, while its fixed premium Eagle Ocean Marine facility has been operating successfully for nearly six years.

Fixed premium facilities, and the provision of hull cover, represent suitable diversification since they are germane to the core business of the clubs and offer cross-selling and other benefits.

## Mega-claims

Market commentators have recently expressed apprehension as to where mega-claims on mega-ships might be going. However, the effect of such claims has, in fact, been relatively subdued.

The *Costa Concordia* loss created an increase in market reinsurance rates for passenger ships but so far it has not been considered necessary to isolate very large container ships, for example, for special treatment in reinsurance terms, notwithstanding the *MOL Comfort*, *Rena*, *MSC Flaminia* and other claims.

This speaks positively to the ability of the reinsurance markets to absorb these losses, and to the resilience of group clubs generally, to provide the extent of cover required and the financial wherewithal to accommodate them.

Were there to be any further concentration of claims in the mega-ship area these circumstances might change, but current trends are encouraging and no major change seems likely in this respect for the foreseeable future.

> "The *Costa Concordia* loss created an increase in market reinsurance rates for passenger ships but so far there it has not been considered necessary to isolate very large container ships, for example, for special treatment in reinsurance terms"

Looking ahead towards the next three to five years, the P&I sector will largely feature more of the same. The clubs have recently experienced a relatively benign period for both attritional and catastrophe exposure, part of which may be related to the downturn in freight rates, lower ship utilisation, slower steaming, and so on.

Although world trade is expected to develop at a comparatively modest pace during the next few years, rising commodity prices, as well as geopolitical and trade uncertainties, could have an inflationary effect on claims over time.

Club diversification will likely continue, but not in a way very different from the pattern of the last five years. The underlying shape of the International Group is also likely to remain much as it is at present. This is not to say that the landscape might not change over the years ahead, but there are no obvious signs of it at the moment.

**Joe Hughes** is chairman and CEO of the American Club's managers, Shipowners Claims Bureau, Inc


# Fast forward

In the period spanning Betamax videos to the 'Internet of Things' the insurance industry has seen many transformations, says **Aidan O'Neill**, but the time has come to tame the innovation beast

**Everyone of a certain age will remember the "video wars" between the Betamax and VHS video cassette recorder formats of the 1980s.**

Betamax was a consumer-level, analogue recording format for video, in the form of a magnetic tape cassette. It was developed by Sony and was released in Japan in 1975. The defeat of Betamax by the VHS format, developed by Japanese rival JVC, became a classic marketing case study.

Within a decade, however, both formats had been supplanted by laser-based technology. Technological progress is inexorable.

Fast forward 30 years – probably on your Sky Box now – and it is little surprise that Japan remains at the forefront of technological transformation. And the country's insurance companies have already been lined up in the cross hairs of that transformation.

The news from Japan is that an insurance company called Fukoku Mutual Life Insurance is to invest in IBM's Watson Explorer question answering software, which it believes can help automate new efficiencies in its claims team.

The upfront cost to the insurance company is reportedly an outlay of $1.7mn to set up Watson, with annual running costs of $128,000, which would result in savings of more than $1mn a year, according to a report in Japanese news daily *The Mainichi*.

Japan has always celebrated its technological prowess as well as its cultural traditions, seeming to find an accommodation between the new and the old. The question is can insurance companies today do the same?

Lloyd's and the London bureau market are in the process of adapting to the great technology transformation of the 21st century, which will be remembered 150 years from now as having been as disruptive as the Industrial Revolution of the 18th to 19th centuries.

Human progress as expressed through culture or the economy is less easy to measure, but the fact is that the world of "Industry 4.0" – the trend for automation and data exchange we are currently experiencing – appears to be accelerating transformation across all levels of society, including insurance.

The "Internet of Things", the connected economy, smart devices, social media – all of these innovations are changing the way that insurance companies interact with their customers and sell to them.

The Lloyd's Target Operating Model innovation streams recognise that a technological earthquake is shaking the foundations of EC3. The natural inclination of some carriers may be to put their hands over the ears and to cry out for somebody to make it stop! There is a fine line: one man's disruption is another man's innovation. The London market winners of tomorrow, however, will recognise that if the innovation horse has bolted, it is time to re-capture and tame the beast, then put it to work.

## Technological transformation

If the likes of Swiss Re are to be believed, we may not recognise the insurer of tomorrow. According to a blog posting by Charles Marshall and Karsten Rimestad on Swiss Re's Open Minds platform: "The customer of the past is not the same as the customer of the future, and the technology frontier in insurance is incredibly vast and constantly changing. At the forefront of this technological frontier is the consumer. People today want more digital interactions at their fingertips."

So far, so interesting, but what really caught the eye of Docosoft is a later reference in the same piece which asks us to imagine how "smart devices will reduce insurance claims (the extent of reduction varies by line of business), which leads to an interesting concept: insurance companies becoming less of an insurance provider and more of a service provider".

This is a very important point, because only now is it beginning to be understood that technology innovation can be about so much more than reducing costs, overheads and people count. The real benefits will be seen by those organisations that have the foresight to investigate opportunities that increase customer value and offer new sales touchpoints.

## Investing in IPAs

For example, there is the prospect of technology that hums in the background, waiting for spoken commands, before carrying out instructions. At the latest Consumer Electronics Show, which was widely covered in the news, it was reported that the dominant theme was artificial intelligence (AI)-enabled intelligent personal assistants (IPAs).

Manufacturers and suppliers of connected cars and homes are investing heavily in IPAs: the clear frontrunner at the moment is Amazon Alexa. As a recent Celent blog posting by Donald Light explains: "There is a deeper potential benefit for the connected car and connected home sellers: developing context-rich data and information about the connected home occupants and the connected car drivers and passengers."

Meanwhile, blockchain, machine learning and AI are being tapped as new technological disrupters that might help insurers to connect better with consumers, create added value and improve transparency. One of the biggest technologies to come along in a while is deep learning, which is essentially a way to automate predictive analytics.

Over the last 12 months, this deepening understanding of machine learning has taken off as part of the new technology tsunami being surfed by proponents of AI. Google, Facebook, Twitter and Yahoo are reportedly using deep learning to classify images, decode human speech and develop computer vision, according to tech media company TechTarget.

## Holy Grail

What does it all mean for insurance claims technology? It almost certainly means that consumers are going to be a lot more connected to their claims. We might even envisage a time when risk transfer and claims management becomes more democratised.

As another Celent blog by Nicolas Michellod says: "In our open world where information is so easily accessible and transferrable and where transparency is important, insurers need to make insurance more palpable, and digitisation is a great opportunity to democratise the knowledge of insurance and risk among the public."

It is the same for claims management. From a claims perspective, it seems likely that emerging technologies will add value to customers' experience by placing power back into their hands by enabling swift claims resolution, empowering consumers and delivering the service quality they expect.

Evolving customer expectations and digital transformation are changing financial services as we know it. This transformation is accelerating the growth of the sharing economy and the demand for new customer value, hence the rise of Uber and Airbnb, to take two commonly used examples.

In the insurance market, InsurTech start up Lemonade is probably the closest that we have to an Uber-style disruptor. As Lemonade's website says: "Maya, our charming artificial intelligence bot will craft the perfect insurance for you." How very *2001: A Space Odyssey*!

Docosoft is currently conducting research on robotic process automation for enterprise claims management as a way of providing integrated, end-to-end automated solutions. The claims Holy Grail is to integrate all applications and legacy systems to avoid disruption, with 100 percent AI accuracy.

As far as Docosoft is concerned, the future is today and our Write Back-enabled claims management system already frees up "value-adding time" that allows adjusters to be more creative, more focused and therefore better equipped to deal with complexity.

Other potential opportunities can be foreseen that will help the underwriting team and their actuaries to have a more accurate view on future claims exposures, thus connecting claims and underwriting together in an aesthetically pleasing one-stop-shop of insurance tranquillity.

The concept of aesthetics in Japan is seen as an integral part of daily life, defined as wabi-sabi. At Docosoft, we firmly believe in the power of claims wabi-sabi!

"Blockchain, machine learning and AI are being tapped as new technological disrupters that might help insurers to connect better with consumers, create added value and improve transparency"

**Aidan O'Neill** is CEO of Docosoft


# What a drag

In the third of RPC's series of articles on M&A, **James Mee** and **David Wallis** outline some of the issues involved in selling companies with a large employee shareholder base

**Picture the scene. It's early Friday evening at a fictional insurance broker. The overworked in-house lawyer is looking at her long "to do" list and working out what documents she should take home to review over the weekend.**

Her concentration is broken, though, by the sound of fast footsteps coming her way. Only one person walks that fast – the CEO.

The CEO steps into our lawyer's office with a big smile. Oh dear. He talks even faster than he walks and our lawyer is just about able to follow his monologue: "We're selling the company to my favourite private equity fund…I have agreed price and key terms… obviously I will be staying on as CEO… management are on board and we need to sign at the end of next week at the latest… all of the employee shareholders will be selling their shares. That's ok, though, we have a drag in our articles."

However, our lawyer is anxious. She has a gnawing doubt about whether so-called "drag clauses" really work…

## Employee shareholders

Many insurance companies and brokers have a wide employee shareholder base. Shares are often issued rather than options (for tax and other reasons). This can give rise to a number of problems when the company comes to be sold – particularly if former employees hold shares and/or some shares are issued partly paid.

The simplest way to effect a sale is for all shareholders of the target company to enter into a share purchase agreement (SPA) with the buyer, which sounds simple until one realises that there could be dozens or even hundreds of shareholders!

Corralling this number of people and persuading them to enter into a lengthy legal document, all the while maintaining deal secrecy, is not an easy task. Shareholders may need to take independent advice on the terms of a deal that has already been struck with the buyer. At the very least this causes delays and uncertainty. And tax issues can really complicate this process.

The next simplest approach is to use a "drag along" provision. In simple terms, a typical drag right allows a third party buyer to acquire all of the shares in a company once shareholders holding a specified majority of the value have accepted the deal. As such, this can involve most of the shareholders by number being forced to sell their shares, whether they want to or not, normally at the same time and on the same terms agreed by those majority shareholders.

A drag provision can be found in a company's articles of association (articles) or in a separate shareholders' agreement.

## Problem 1: Equal treatment

Most drag provisions rely upon a dragged shareholder being required to sell shares on the same terms as the majority shareholders. However, in practice, it is rare for every single shareholder to end up selling shares on exactly the same terms.

For instance, an institutional investor in a company (such as a private equity fund) will most likely require other shareholders to provide business warranties in the SPA, but will not provide this level of cover itself.

In addition, key management may be asked to accept a mix of cash, shares and loan notes in exchange for selling their shares, and may also receive sale bonuses, so their consideration may be different to the dragged shareholders.

All these terms of the deal can mean that shareholders are not being treated equally. This complicates the analysis of whether the drag works.

Many buyers won't want to take the risk of shareholders refusing to be dragged. It may be possible to amend the drag provisions to make clear, for example, that different groups of shareholders can be offered a different mix of consideration. But this needs to be looked at carefully, and the buyer ultimately needs to agree that this works.

### Problem 2: A spanner in the works

Traditionally, drag provisions in articles provide that a minority shareholder who does not sell his shares – typically referred to as a defaulting shareholder – was deemed to have appointed a director of the target company as his attorney, giving that director the right to sign documents on his behalf.

A power of attorney must however be granted by way of a deed – a document that says it is a deed, and which is signed in a particular manner in front of a witness (or in the case of signature by a company following certain other rules).

The Companies Act 1985 made clear that articles were deemed to be a deed, and so a power of attorney included in articles would be effective. However, for some unknown reason, this approach was not included in the Companies Act 2006 and, therefore, power of attorney provisions in articles no longer work.

This problem is not present where the drag is included in a shareholders' agreement executed as a deed. But where there is a diverse shareholder base, with some shareholders holding only a small interest, sometimes not all shareholders will have signed the shareholders' agreement.

One solution may be a provision

> "A typical drag right allows a third party buyer to acquire all of the shares in a company once shareholders holding a specified majority of the value have accepted the deal"

**James Mee** is head of corporate insurance and financial services at RPC

**David Wallis** leads RPC's private equity work in the financial services sector

appointing a director of the target company as a defaulting shareholders' agent, rather than attorney – but this only works if the dragged shareholder is not being asked to sign any documents as a deed (as a power of attorney would be required to do so).

### Help! My drag doesn't work

As each drag provision is different, a buyer – and the target company – will need to examine its terms carefully and consider whether it fits the proposed sale.

A drag is a limitation on the property rights of a shareholder – because a shareholder's assets, the shares, may be taken from him – and so any ambiguities and uncertainties are likely to be construed by a court against the majority shareholders trying to force the minority shareholders to sell.

It is best practice to include a well drafted drag provision from the outset – a court is more likely to object to the inclusion of a new drag-along provision, given that it affects the property rights of a shareholder, than to the subsequent amendment of an existing provision. Many drag provisions are, though, not as well drafted as they might be…

The courts have shown themselves willing to give the directors of target companies scope to propose amendments to articles, particularly where those amendments are "tidying up" changes that help give effect to the operation of the drag and do not change the overall commercial bargain.

The courts will also look at whether amendments to articles have been put forward for a proper purpose – that is, the courts will not look kindly on changes that are designed to affect minority shareholders in an adverse fashion.

In essence, if a change doesn't "feel right" when all shareholders' interests are taken into account, the change probably doesn't work and may be at real risk of challenge.

We have seen too many companies that hand out shares at different prices, with different amounts unpaid, and that don't take shares back when shareholders leave employment; and too many companies that don't have well drafted articles and shareholder agreements.

Not taking care of the share capital of a company and the key documents can make a sale much more difficult and expensive than it might otherwise be.

# Cyber or crime?

With crime insurers now offering coverage for certain deceptive fund transfers, **Vince Vitkowsky** assesses the limits of cyber insurance for cyber deception and social engineering risks

**Businesses face an endless stream of attempted deceptive fund transfers, many of which are successful.**

Although insureds instinctively think of these as "cyber losses," they have not been covered by most cyber insurance policies. Rather, they most often involve interpretation of commercial crime policies and financial institution bonds.

There are at least seven potential scenarios to consider:

- The transfer is effected entirely by a hacker independently penetrating a computer system, and making the transfer;
- The hack and transfer are enabled by employee negligence;
- The fraudster convinces an employee to reveal credentials, enters the network by using them, and then transfers funds;
- The fraudster gets an employee to open an attachment or click on a link, thereby allowing the network to be penetrated, and allowing the transfer of funds;
- The fraudster, through emails or telephone calls or both, poses as a company's executives, vendors or customers and convinces an employee to transfer funds;
- An employee enters data believed to be accurate, but which in fact is fraudulent; and
- A rogue employee makes an improper transfer or enters fraudulent data.

Numbers three, four and five are variants of "social engineering", a term used to describe the manipulation of people into performing acts or divulging confidential information.

The application of computer fraud and funds transfer fraud coverages to deceptive fund transfers involving computers has arisen in several recent cases, and courts have reached various results.

The main issues have been whether the policy applies to the activities of authorised users or only to the activities of outside hackers, and whether there is causation when the deception involves multiple elements, such as emails, telephone calls and employee acts or negligence.

The leading recent US cases are discussed below.

## Authorised user analysis

*Universal American Corp vs Nat'l Union Fire Ins Co of Pittsburgh, PA, 25 NY 3d 675 (2015)*: The New York Court of Appeals (New York's highest court) held that there was no coverage under a financial institutions bond for losses arising when healthcare providers who were allowed to submit claims directly into the computer system of a health insurer (the insured) submitted over $18mn in fraudulent claims.

The bond excluded "losses resulting directly or indirectly from fraudulent instruments which are used as source documentation in the preparation of Electronic Data, or manually keyed into a data terminal".

The court found that the bond provided coverage for losses incurred through unauthorised access to the computer system, i.e. the deceitful and dishonest acts of outside hackers, but not to fraudulent information entered by authorised users.

*Pestmaster Services Inc vs Travelers Cas and Surety Co of America, 2016 WL 4056068 (9th Cir 29 July, 2016):* Applying California law, the court affirmed a district court holding that there was no coverage for lost funds transferred by the insured to a payroll company that failed to remit the portion representing payroll taxes to the Inland Revenue Service.

It found that neither the computer fraud nor the funds transfer fraud insuring agreements apply where the transfer is made by an

employee who was an authorised user of the system.

Also, it found: "Because computers are used in almost every business transaction, reading [the Computer Fraud] provision to cover all transfers that involve both a computer and fraud at some point in the transaction would convert this Crime Policy into a 'General Fraud' Policy."

## Causation analysis

*Apache Corp vs Great American Ins Co, 2016 WL 6090901 (5th Cir 18 Oct 2016)*: Applying Texas law, the Fifth Circuit found no coverage for a social engineering-induced transfer of funds under a crime protection policy. The computer fraud provision insured against "loss… resulting directly from the use of any computer to fraudulently cause a transfer of [money] from inside the premises".

The fraudster made a telephone call to an oil production company claiming to be an actual vendor, and requested that future payments be sent to a new bank account. Upon being told the request had to be made in writing, the fraudster sent an email from an email address that was similar to the vendor's, attaching a letter purportedly on the vendor's letterhead providing both the old bank account transfer number and the new one.

An Apache employee called the telephone number on the letter, and spoke with a person using the name of the individual who usually dealt with invoices for the vendor. The Apache employee concluded the requested change was legitimate. A different Apache employee approved and implemented the change, and in response to invoices from the actual vendor, transferred millions of dollars to the fraudster's account.

In finding there was no coverage, the court concluded that although the email was part of a scheme, it was merely incidental to the occurrence of the authorised transfer of funds. If Apache had conducted a more thorough investigation, such as calling the correct telephone number known from past communications, it would not have changed the account information.

*The State Bank of Bellingham vs BancInsure, Inc, 2016 WL 2943161 (8th Cir 20 May 2016)*: The court found there was coverage under a financial institution bond when a hacker broke into a network and performed fraudulent wire transfers, notwithstanding that the hack was enabled by employee negligence.

> "Cyber deception and social engineering losses provide a fertile ground for dispute within the context of a rapidly evolving insurance market"

Employees left computers on overnight with tokens still inserted, giving access to the Federal Reserve's FedLine Advantage Plus system.

Applying Minnesota law and the concurrent causation doctrine, the court held that the "efficient and proximate cause" of the loss was the transfer by the hacker, not the negligence of the employees.

*Principle Solutions Group, LLC vs Ironshore Indemnity, Inc, 2016 WL 4618761 (ND Ga 30 Aug 2016)*: This case found coverage when an employee of the insured transferred $1.7mn as a result of a scheme in which a fraudster posing as an executive sent an email to the employee instructing her to make the transfer, but the specifics as to where to wire the funds were provided in a subsequent telephone call.

The insurer argued that because of the intervening telephone call and the company employee's actions in setting up and approving the transfer, the loss was not covered.

The policy provided coverage for loss "resulting directly from a 'fraudulent instruction' directing a 'financial institution' to debit [the insured's] 'transfer account' and transfer pay, or deliver 'money' or 'securities' from that account".

The court found that this provision was ambiguous and should be construed in favour of the insured.

## Industry reaction

Some crime insurers now offer crime policies that expressly provide coverage for certain deceptive funds transfers, including those effected through social engineering. They tend to be subject to sub-limits, which are frequently $250,000.

Also, an increasing number of cyber insurers now expressly provide coverage for some of these risks. According to The Betterley Report's June 2016 "Cyber/Privacy Insurance Market Survey", of 31 cyber insurers surveyed, 13 offer some coverage for various types of deceptive funds transfers.

Coverage is most often afforded with sub-limits of $250,000, although some insurers have sub-limits of $500,000 or $1mn, and possibly more, "subject to underwriting".

In conclusion, cyber deception and social engineering losses provide a fertile ground for dispute within the context of a rapidly evolving insurance market. They will continue to present coverage issues for resolution by the courts.

**Vince Vitkowsky** is a partner at Seiger Gfeller Laurie LLP, offering litigation, counselling, and product development to (re)insurance companies for classes including cyber, E&O, D&O and CGL

# Cutting the ILGS link

Following the change in the UK personal injury discount rate, the method for assessing it should reflect the reality of how damages are actually invested, says **Andrew Hibbert**

**The headlines last month were dominated by the UK government's personal injury discount rate announcement. On 27 February, Lord Chancellor Liz Truss bit the bullet and set the discount rate at minus 0.75 percent, to apply from 20 March. The news was issued via a statement to the stock exchange.**

As a matter of process, Truss should be congratulated for not ducking a very awkward decision – even if the financial implications of the move are of huge importance. As to substance, views will inevitably differ hugely.

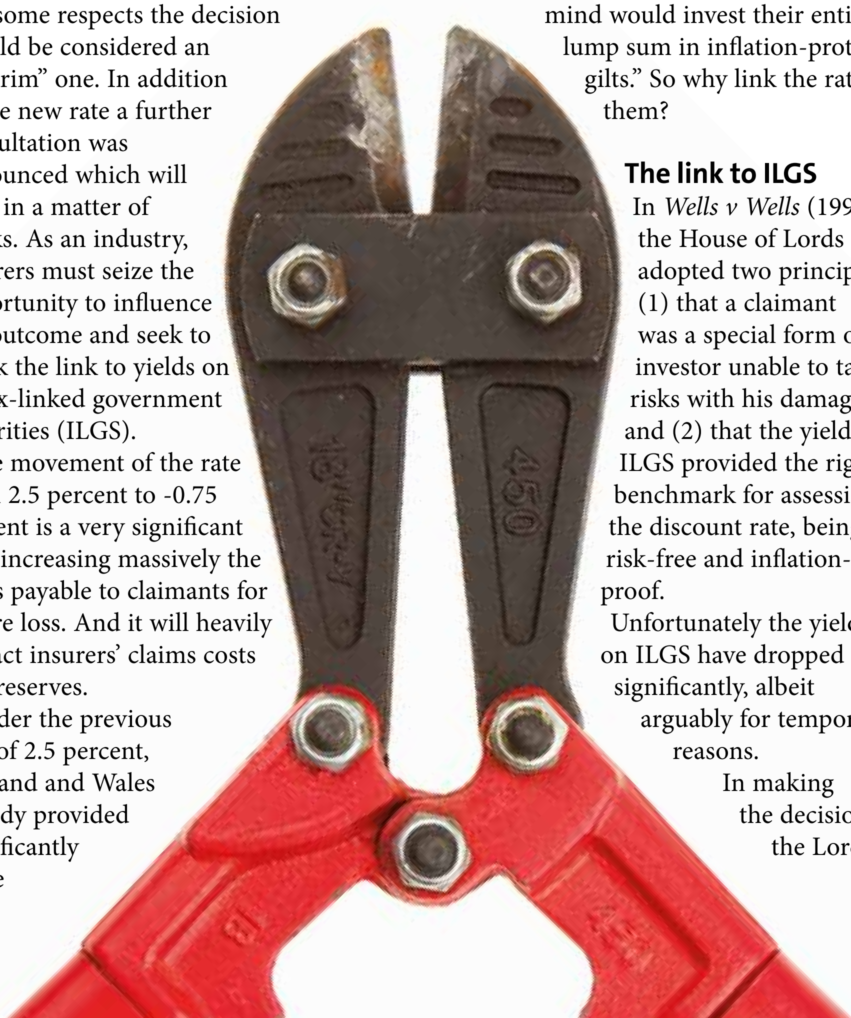
In some respects the decision should be considered an "interim" one. In addition to the new rate a further consultation was announced which will start in a matter of weeks. As an industry, insurers must seize the opportunity to influence the outcome and seek to break the link to yields on index-linked government securities (ILGS).

The movement of the rate from 2.5 percent to -0.75 percent is a very significant one, increasing massively the sums payable to claimants for future loss. And it will heavily impact insurers' claims costs and reserves.

Under the previous rate of 2.5 percent, England and Wales already provided significantly more compensation to seriously injured claimants than the next most generous country in Europe. Now, with the rate set at -0.75 percent, the gap becomes an ugly chasm and might even increase the risk of forum shopping.

The real challenge must be to ensure that responses to the imminent consultation make an irresistible case for breaking the ILGS link so that the calculation of awards properly reflects how they'll be invested – doing anything else is a very expensive fantasy.

As *The Times*' financial editor Patrick Hosking put it: "No accident victim in their right mind would invest their entire lump sum in inflation-protected gilts." So why link the rate to them?



## The link to ILGS

In *Wells v Wells* (1998) the House of Lords adopted two principles: (1) that a claimant was a special form of investor unable to take risks with his damages; and (2) that the yield on ILGS provided the right benchmark for assessing the discount rate, being risk-free and inflation-proof.

Unfortunately the yields on ILGS have dropped significantly, albeit arguably for temporary reasons.

In making the decision the Lord Chancellor said the following were relevant.

The principles in *Wells v Wells* (full, but no more, compensation and risk-free investment) led her to base a decision on a portfolio of 100 percent index-linked gilts.

She was not persuaded by arguments that ILGS were not the "realistic or appropriate" basis, and maintained that ILGS were the best way to ensure availability of money. Use of mixed portfolios incorporated an element of risk.

Effective management of an ILGS portfolio would allow funds to be matched to needs, and any risk here was outweighed by risks of alternative investment models.

She also chose to follow the one rate approach based on weighting towards long-dated stocks and excluding stocks with less than five years to maturity.

Taking into account a three-year simple average gross real redemption as at December 2016 of -0.83 percent, the Lord Chancellor's decision was to round the rate to -0.75 percent.

There are some immediate responses to those reasons though, in fairness, they may be ones that are influential in the coming consultation.

ILGS yields are currently suppressed, and in awarding compensation to last decades into the future experts' views as to how yields will recover ought to have been taken into account.

ILGS are not an appropriate form of investment through which to meet the cash-flow needs of a claimant. Claimants do not use them, independent financial advisers do not recommend them and the comment quoted above is not unique.

Claimants do invest in other ways and there are types of portfolios which provide higher returns for comparable risk. Yet we now have a situation where claimants are awarded damages based on an investment vehicle they never use, while investing their damages in a way that delivers higher returns.

The last point is worth dwelling upon and raises some important issues about our compensation system.

Modelling that has been undertaken suggests that with claimants being awarded damages based on a discount rate of -0.75 percent, they do not have to achieve much by way of a positive return (1 percent or 2 percent only) to end up at the end of the loss period, or on death, with a fund higher than they were awarded in the first place.

Can that possibly be a feature of any sensible compensation system?

So the focus now must be on the next consultation and ensuring that claimants are compensated in such a way that the notional method for assessing the discount rate reflects the reality of how damages are actually invested.

## The situation for now...

Here are some points to consider leading up to implementation.

*Inevitably claims costs and multipliers will increase enormously*: We are now into 100+ multipliers for young claimants. Very substantial shifts will be seen in reserves and pleaded claims with no doubt a great deal of schedule re-writing taking place.

The size of the changes probably needs little dwelling upon, but in the table below we show for male lifetime losses the change for every £100,000 of future loss.

The new level of claims costs may have implications for policy limits as well as reinsurer retentions. With multipliers featuring in cases, say, above £100,000, they may also cause some cases to move over any planned limit for the extension of fixed costs into multi-track cases.

*Defendants need to review offers*: As time goes by it is unlikely that claimant "2.5 percent" offers will still be on the table but if they are, they may now seem attractive.

"The real challenge must be to ensure that responses to the imminent consultation make an irresistible case for breaking the ILGS link so that the calculation of awards properly reflects how they'll be invested"

*The* Roberts v Johnstone *formula, where there are claims for alternative property purchase, will be the subject of much debate*: Claims that the formula is "dead" have been heard. How do negative rates sit with the formula?

Of course, it must be remembered that the formula is to compensate for loss of risk-free investment return on capital tied up in the property. So rather than negative returns on risk-free investments meaning the formula does not work, it actually means the loss disappears.

**Andrew Hibbert** is head of the catastrophic injury practice group at insurance and risk law firm BLM

*Part of the consultation was to look at ways to encourage periodical payment orders*: Massive lump sums are not the way! Insurers and claimants will possibly be rethinking their strategies.

*As the multipliers are so large, defendants need to take every opportunity to keep the overall claim and particularly the multiplicand as low as possible*: It means using all reasonable means to investigate and adjust the annual amount, making sure reduction factors are adjusted (0.1 of the larger multipliers means a lot!). In addition multiplier calculation needs to be exact.

*Keep a watch on costs by claimants using the rate change to justify excessive additional work or the increased value, setting a new context for proportionality*: Does the substitution of a multiplier involve much additional work, and does the higher value necessarily affect the issue of proportionality?

*An updated version of the Ogden tables is anticipated in short order*.

The government will carefully consider all evidence and arguments submitted as part of the consultation. What we can be clear on, however, is that Truss has now set in train a very clear process for legislative change to the overall approach and because of the "significant implications" for those paying claims (insurers in particular) that process already looks very difficult indeed to derail.

## Male life – impact for each £100,000 per annum future loss

| | Discount rate multiplier | | Multiplier change | Cost (£mn) | | |
|---|---|---|---|---|---|---|
| Age | 2.50% | -0.75% | % | 2.5% cost | 0.75% cost | Extra cost |
| 10 | 34.08 | 108.32 | 317.84 | 3.408 | 10.832 | 7.424 |
| 20 | 32.1 | 88.96 | 277.13 | 3.21 | 8.896 | 5.686 |
| 30 | 29.6 | 71.43 | 241.32 | 2.96 | 7.143 | 4.183 |
| 40 | 26.52 | 55.66 | 209.88 | 2.652 | 5.566 | 2.914 |
| 50 | 22.69 | 41.44 | 182.64 | 2.269 | 4.144 | 1.875 |
| 60 | 18.3 | 29.2 | 159.56 | 1.83 | 2.92 | 1.09 |

# Pandemic protection

## **Kimber Lantry** outlines the thinking behind Axis' pandemic cover for hospitals

***Insider Quarterly (IQ)*: What prompted Axis' decision to launch a pandemic cover for hospitals?**

**Kimber Lantry:** Following the recent worldwide Ebola crisis, several brokers that represent hospitals and healthcare systems approached Axis and asked us to develop an insurance product that would address the financial losses and extra expenses that hospitals can incur due to the interruption to their business caused by the outbreak of a pandemic.

After consulting with our distribution partners, clients and hospital risk managers, we launched an innovative new medical catastrophe business interruption (BI) product in early 2016 for hospitals in the US to protect against loss of revenue caused by the outbreak of a contagious disease.

The Axis Healthcare Medical Catastrophe Business Interruption and Extra Expense product includes coverage for any disease that is transmitted by direct or indirect contact. This first-of-its-kind product also provides coverage for diseases that have not yet been discovered by science, or a disease that could mutate into a pandemic at some point in the future.

***IQ:* Are pandemics still largely an unmodelled risk, or is there a growing bank of data and analysis relating to this peril?**

**Kimber Lantry:** The dilemma facing hospital risk managers, and the brokers that work with them, is that there is only so much pandemics data available due to the relatively limited occurrence of such outbreaks. Therefore, it is difficult to predict with a high level of certainty when, where and to what extent a pandemic outbreak will impact a particular region.

In our discussions with hospital executives, hospital risk managers and our distribution partners, we quickly determined that the high level of uncertainty around pandemics is a major factor in causing BI losses to these facilities, if and when an outbreak occurs.

How the public reacts in the hours and days immediately following a pandemic outbreak is often out of a hospital's control. But what is in hospitals' control is how they manage the potential losses to their operations and to their business.

Axis provides expertise and support on a BI and extra expense basis to help hospitals quickly recover from what can be significant financial losses and reputational impact due to the outbreak of a pandemic.

***IQ:* What would you identify as the key factors involved in increasing the spread of pandemics?**

**Kimber Lantry:** The global spread of pandemics can't be blamed on any single cause. Rather, it's a combination of factors.

These include: changing land use and global migration patterns, which allow humans to explore and live on land never before inhabited; the spread of the global transportation system, which enables disease to quickly spread across both cultures and regions in ways that previously were not possible; and climate change and resource extraction and the ongoing impact each is having on how diseases spread, mutate and eventually are eradicated.

In addition, better surveillance, data collection and analysis by scientists and governments around the world are making people more aware of the growing financial impact of pandemic outbreaks.

**IQ: What, specifically, is covered by the Axis pandemic policy, and how is it triggered?**

**Kimber Lantry:** Axis Healthcare Medical Catastrophe Business Interruption and Extra Expense insurance covers any transmittable disease.

This insurance, with limits up to $50mn, protects a hospital's revenues through a BI policy, which also includes coverage for extra expenses, including a $1mn sub-limit for disposal of hazardous waste and a $100,000 sub-limit for public relations professionals to help the hospital communicate with the public and the media in the immediate aftermath of a pandemic outbreak (subject to the terms and conditions of the policy).

The policy responds when the contagion directly results in any one of four triggers: a governmental quarantine of a hospital; if 25 percent or more of the medical personnel do not come to work; a 25 percent or more reduction in inpatient stays; or a 25 percent or more reduction in emergency room visits.

**IQ: Has the product changed since it was first launched and, if so, how?**

**Kimber Lantry:** The biggest change we made is advancements to the data analysis and actuarial approach of the product. We made these changes following input from clients and our distribution partners to better meet their needs surrounding BI and extra expenses associated with pandemic outbreaks.

In doing so, we were able to lower the overall cost of the product to ensure we are better able to provide hospitals with the coverage they need to effectively manage this unpredictable – and potentially catastrophic – risk.

**IQ: You currently offer the product in the United States. Do you have plans to roll it out across other geographies?**

**Kimber Lantry:** We are exploring the expansion of this product into a number of international markets, including those in which the government provides either nationalised or highly subsidised healthcare or hospital services.

In such countries, the product can be customised so that it can offer more robust extra expense coverage to manage the additional unplanned expenses that can occur following the outbreak of a pandemic.

We are also looking at ways we can expand our BI and extra expense coverage to begin offering it to physicians and medical groups.

**IQ: What plans, if any, do you have for increasing limits and/or for expanding the scope of coverage?**

**Kimber Lantry:** We continue to work with our distribution partners, hospital risk managers and other relevant parties to evaluate the coverage limits of this insurance and make adjustments where necessary

**IQ: Do hospitals face greater risks from pandemics than the public in general? If so, what are those risks?**

**Kimber Lantry:** Hospitals are absolutely at a greater risk from pandemics than the general public. During the SARS epidemic in 2003, 22 percent of the cases in Hong Kong were healthcare workers. The same pattern emerged in South Korea in 2015 during the MERS epidemic – 18 percent of the cases were healthcare workers.

Even if healthcare workers avoid contracting a disease during an outbreak, they are often quarantined, which can have a serious impact on a hospital's operations and ability to generate revenue. The typical quarantine for a healthcare worker during an outbreak is two weeks, for Ebola it's three weeks. That's weeks' worth of lost labour, which significantly increases costs for hospitals.

Axis covers the financial losses that result from the interruption to business activities as a result of a pandemic outbreak. Considering how susceptible healthcare and hospital employees are to getting sick during such incidents, hospitals need to manage this growing risk to their financial health.

> "It is difficult to predict with a high level of certainty when, where and to what extent a pandemic outbreak will impact a particular region"

**Kimber Lantry** is executive vice president, Axis Insurance and head of Axis Healthcare

# Blurred lines

As distribution models change, the distinction between facultative and treaty reinsurance – and between reinsurance and insurance – will blur into a single risk financing continuum, **Igor Best-Devereux** tells *IQ*

**eReinsure has a well-established track record for being both an innovator and leader in the development of electronic placing for reinsurance. The company was founded in 1999 and was later acquired by specialty insurance distributor AmWins Group in 2013.**

In an interview with *Insider Quarterly*, eReinsure president and CEO Igor Best-Devereux explains how initiatives such as e-placement are breaking down the barriers of (re)insurance distribution.

***Insider Quarterly (IQ):*** **How did you come to be involved with both the reinsurance market and the technology sector?**

**Igor Best-Devereux:** I joined Sedgwick Group Special Services in 1982 and was fortunate to work in a team that was combining risk analysis, financial modelling and self-insurance. Many of the analytical methods are familiar today – but in the 1980s it could take days to run a simulation model! Many of the challenges, data quality in particular, are still with us.

From Sedgwick I moved to Alexander Howden and spent some time running a unit called Anistics, providing risk analysis and risk management systems; then to a management role in marine and energy broking.

In the early 1990s I moved from London to work in the nascent securitisation market in New York and then by complete chance I fell in with a company developing data networking technology. I ran that company's Asia Pacific business until 1999, when I started eReinsure.

***IQ:*** **What was the genesis of eReinsure?**

**Igor Best-Devereux:** It was 1999 and starting a B2B dotcom was all the rage. There wasn't InsurTech or FinTech at the time, just anything that you could start and put "dot com" on the end of the name. Fortunately, we identified a real business need and eReinsure ended up being one of the few dotcom companies to make it past 2000!

The competition was, really, standalone portals specific to one reinsurer's product offering. Otherwise it was use of email, which is a terrible way to manage business processes and try to collect structured information. Our approach was focused on providing a web platform for a reinsurance buyer (or broker) to engage with multiple parties to place reinsurance.

We received early support from some of the largest insurance carriers. These major cedants enabled us to achieve a critical mass of business and encouraged the brokers and reinsurers to participate. Staying focused on the needs of these companies was really critical to our success.

Some other e-placing initiatives that came along later, including Inreon, Ri3K and Kinnect, had bold plans but eventually failed to get traction.

***IQ:*** **Tell us a little bit about how eReinsure works and what differentiates it from other e-placing platforms.**

**Igor Best-Devereux:** eReinsure is a market engagement platform. Once a company has access, an underwriter or broker can log into the system via a web browser to use the negotiation workflow. The network of reinsurers and brokers is already in place to receive requests for reinsurance. There's no requirement for additional internal systems to be developed and reinsurers and brokers can benefit from one system feeding them business from multiple sources.

We developed proprietary technology combining a "one-to-many" distribution of reinsurance requests sent from the cedant to multiple markets; negotiation workflow to enable the parties to work out a deal; an audit trail; and a record of the final reinsurance agreement. We were granted two business process patents for our approach to e-placing and capturing digital provenance of the transaction.

The greatest differentiator is experience and adoption! The first mover advantage enabled us to continually update and improve the technology based on user input and to become experienced at delivering it as "software as a service".

Being early to the market also enabled us to form relationships with hundreds of companies encompassing thousands of users. This network effect is very powerful. Over the past 16 years we've learned a lot about the practicalities of electronic placing and handled over 450,000 reinsurance submissions.

***IQ:*** **How has the platform evolved since it was first developed?**

**Igor Best-Devereux:** We started in the facultative market because we saw the problems cedants had managing fac purchasing. This was a burning platform. But the technology has wider application and so we have expanded into distribution solutions for facilities, treaty reinsurance and other areas such as multinational accounts.

Our customers' needs have also evolved. They've chosen to integrate systems to feed data to and from eReinsure; and we've introduced features to support compliance tracking, regulatory requirements, market security controls and certificate production.

In all cases the fundamentals are the same: capture data in a controlled way; keep it available through the lifecycle of a transaction, allowing for queries and integration with other systems that need this data; keep an audit trail of the transactions to support non-repudiation; store data securely; and control actions and information access via defined "roles and permissions".

***IQ:*** **Where do platforms like eReinsure fit into smoothing the path of distribution and reducing costs?**

**Igor Best-Devereux:** To manage cost you have to have controls and eReinsure helps companies to get control over their reinsurance purchasing.

For the buyer, interacting with reinsurers and brokers becomes easier with one common interface rather than multiple channels and proprietary systems. Even where a reinsurer has its own portal to help automate underwriting and back-office activities, the ceding company wants the simplicity of one interface for all markets.

Passing information through multiple hands is also a large part of the distribution problem. Our approach has been to tackle those areas that traditionally multiply effort – enabling customers to simultaneously distribute a submission to multiple parties and build up an electronic file of each deal.

***IQ:*** **Why aren't more cedants complaining about distribution costs – and what can be done to accommodate their concerns?**

**Igor Best-Devereux:** They are complaining about it – both the buyers and the sellers. Some cedants are buying less reinsurance and finding alternatives to drive down cost. Reinsurers are also concerned about returns. When you can't do much more to lower the cost of reinsurance capital and when the market has priced risk at a very competitive level the focus turns to distribution cost – hence all the interest in InsurTech. This means simplifying the distribution channel, standardising information collection and processes, and getting closer to the original buyer.

Technology is eating away at costly processes and providing market intelligence that used to be the purview of the specialist. The ever-present cost pressures will continue to reshape the (re) insurance workforce.

***IQ:*** **What do you see as the future of reinsurance, particularly facultative, distribution? Are there simply too many brokers for the product?**

**Igor Best-Devereux:** Distribution throughout the (re)insurance value chain will become more streamlined – just as we have seen in other industries. Brokers will utilise their creativity, specialist expertise and market clout to remain relevant, but will face some of the greatest disruption to their traditional business model. There will continue to be consolidation and size and resources, especially technology, will matter.

The distinction between fac and treaty will blur and reinsurance will be a continuum of risk financing alternatives, from specialist individual risk underwriting to capital markets solutions. Insurance and reinsurance will converge, as we are already seeing.

The journey of risk to capital will be shorter and faster with less duplication of underwriting effort and less manual intervention in the overall process. Data carried along through the deal lifecycle will be reused from initial underwriting to ultimate securitisation.

It has been a long time coming in the (re)insurance market but I do believe that the focus of the venture community on InsurTech means that capital will flow to disruptive ideas. Most of these will be reliant on technology to change the cost structure of the market.

# Dress code: smart

Are market events a business opportunity or dead money? **Emma Charrington** gives some tips on how companies can get 'smart' about their objectives

**Conferences, exhibitions, awards ceremonies, receptions, corporate hospitality, networking events, dinners, parties...there are a lot of events happening across the insurance industry at any given time, but are they worth the enormous bill and inevitable hangover the next day?**

Some say not, it's just a bit of fun and frivolity and a chance to have a drink on someone else's tab, but there's more to it than that.

Traditionally, the insurance industry is very much based on face-to-face contact, although gone are the days when a gentleman's handshake secured the deal in place of a signature.

In increasingly digital times, it's more important than ever to maintain face-to-face contact with clients as part of your overall communications strategy.

A well-timed, well-managed event can bring numerous benefits to a company such as: increased brand recognition; improved knowledge of your business and staff capability; better-developed and more loyal client relations; and improved knowledge of the market.

The key is to decide the aim of the event at the outset. What, as a business, are you trying to achieve?

We need to set "Smart" (i.e. specific, measurable, achievable, result-oriented and timely) objectives which are aligned with your strategic plan. Events should help your business to achieve its plan, not just show people a good time along the way.

Once the objectives are set, don't pop them in a drawer never to be seen again, keep referring back to them and make sure each aspect of the event relates to the objectives.

We often struggle with the "measurement" part of a Smart objective when it comes to events as it can seem intangible, but that's not to say it's impossible.

For example, has the awareness of your brand increased as a result – are people talking about it on social media/in the pub/in the press? Has traffic to your website increased?

Did guests find the event useful and informative? Would they come again? What was their feedback, and was it better than at previous events?

Tangible measurements could include how many people attended, who the key guests were and whether they attended, how many of the new contacts extended into new relationships, whether any guests arranged follow-up meetings, and whether any new business was written as a result of the event.

Once you know what you would like to achieve and why, keep a tight rein on your guestlist and choose your audience wisely. You'll be paying for each and every one of them to attend, so you want them to be the people who can help you to achieve your goals.

In order to get the right guests to say yes the event needs to be enticing. Put yourself in their shoes – is it compelling enough? Are you offering a solution to a business need, new contacts, market information or access to "hard to reach" people? If guests feel they won't get anything out of it then they are unlikely to come.

The event will reinforce your brand and market position so ensure the venue, invitations, branding, catering, entertainment, speeches and people representing the company reflect that.

If the event is a success, repeat it. Your guests will become your PR team, talking about it in the market and bringing potential new clients to the next event.

Extend the reach of the event by writing about it and publishing online and in your next newsletter to your database.

If you don't have the in-house resource to plan and organise events, bring in the experts. They can save time, money and offer a laser-sharp focus on goals and outcomes and how to achieve them.

**Emma Charrington** is managing director at 361 Events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# The inclusion factor

**Angela Peacock** explains how an inclusive culture can help risk reduction in insurance

**Having spent many years working with the insurance profession, driving conversations from the original "ABC of diversity" and "We have to do this!" through to deeper inclusion discussions, it is encouraging that I am now encountering increasing numbers of senior teams who truly see creating an inclusive environment as a key lever in achieving their strategic goals.**

Initially, the link was understood purely in the sense of matching customers – if we don't do this we won't be able to sell to "them". Thankfully, today we are seeing such a different approach. But have we all missed a crucially important piece?

Management committees and executive teams are now making the critical link between creating an inclusive environment and the success of specific products, distribution approaches and geographies.

Ensuring, ahead of the need to do so, that the internal culture really does welcome difference and is geared towards ensuring that difference can flourish over the longer term makes sense at every level.

As competition to enter new markets continues to increase, the awareness of combining all manner of talented people and ensuring we get the best from all of them becomes business-critical.

More recently we have been exploring that very bedrock of insurance – risk – and seeing parallels and lessons from other sectors that the profession might learn from; not only in terms of their clients, but their corporate and individual approach.

To understand the importance, we first need to appreciate that an inclusive environment cannot be made to happen because of an edict from above. Senior team buy-in is essential, however, an organisational understanding about one of the key levers is even more vital; insurance organisations attempting to create environments ready to welcome the next artificial intelligence or deep learning rock stars must first recognise the impact of bias within everyone.

## Flawed decisions

Recent global projects have taken us into the realms of health and safety and I believe there is much that the risk profession can learn from this work.

QBE's Issues Forum paper, "Behavioural Safety in Construction" (August 2015), cites disasters such as the West Fertilizer Company explosion (2013), The King's Cross fire and the Herald of Free Enterprise capsizing (1987), the Space Shuttle Challenger explosion (1986), the Piper Alpha fire (1988) and the Chernobyl nuclear accident (1986) all as being attributable, at least in part, to flawed decisions, driven by individual perceptions.

The report comments: "When considered within the wider context of a particular culture, it becomes apparent that individuals' behaviours, and the perceptions that drive those behaviours, are key to determining the safety performance of an organisation."

Joshua Howgego, who reported on BP's 2010 *Deepwater Horizon* disaster in *New Scientist*, says that rig staff had tested the concrete seal on the excavated well before removing the drilling column. The results indicated that the seal was not secure and that removing the column might result in a catastrophic blowout. So why were the signs ignored?

Disaster analyst Andrew Hopkins of the Australian National University in Canberra says that workers viewed the test as a means of confirming that the well was sealed, rather than approaching it with a view to finding out whether it was sealed or not.

So the same part of our brain that can count someone out of running for a job because they trigger some unconscious negative associations can also prevent us from properly assessing risk – leading to some very tragic outcomes.

In short, not only do our preconceptions appear to us as truths, we are also scuppered when a shot of dopamine acting as a reward signal in our thinking brain makes us ignore certain truths.

## Macho mistakes

QBE's "Issues Forum" recognises that underpinning behavioural safety is a belief cycle linking beliefs, feelings, behaviours and results in a self-affirming loop. If we believe that something is lower-risk than is really the case, our confidence and bravado will drive positive behaviours that may (with a measure of good fortune) carry us through. Our perception is then reinforced and confidence increased.

But how does this play out in a group situation where differing opinions and assumptions should make us look more deeply and assess risk more honestly?

Truly inclusive working cultures enable everyone in the organisation and drive the strategy, but if the culture is undermined by bias that restricts who or what we include it can severely affect safety and risk management.

Robin Ely, along with Debra Meyerson, highlighted the impact of inclusion on safety in their 15-year study of oil rigs ("Unmasking Manly Men", July-August 2008 issue, *Harvard Business Review*). She identified how macho cultures exacerbated poor, often unconscious, decision-making contributing to safety issues.

Ely found that: "Men who work in dangerous places often act invulnerable to prove their merit as workers and as men – objectives that can lead to decreased safety and efficiency.

> "In an industry such as insurance there has to be a widely understood personal and business case for inclusion driven by very real and measurable benefits to business strategy"

In dangerous, male-dominated work settings, men's tendency to gain respect by demonstrating and defending their masculinity is costly."

The research revealed that macho cultures place high value on the need to prove oneself and a perception that revealing one's weaknesses exposes incapability. The "macho" culture engendered an atmosphere that stifled speaking out, the ability to question or point out flawed decision-making and, worse still, the capacity to highlight hazards or accident risks.

Consider what this means in the insurance profession today. We have to ensure that the cultures we create differ from the "macho"-dominated ones of the past to ensure we hear from everyone. The very business of risk needs now, more than ever, to have input from not just the usual suspects.

**Angela Peacock** is the chair of global diversity and inclusion training specialist at The People Development Team (pdtglobal.com)

## Inclusion in insurance

In an industry such as insurance there has to be a widely understood personal and business case for inclusion driven by very real and measurable benefits to business strategy. Such a culture shift has to be seen to come from the top and authentically practiced by leaders while, at the same time, driving wider engagement and opening discussions across the organisation.

Michael Bartholomeusz, chief risk officer at flood insurance pool Flood Re, concludes: "A strong organisational risk culture requires more than easily apparent dimensions of diversity based on factors such as gender, colour, age and professional background.

"Essential is a strong and deliberate 'tone from the top' which welcomes constructive dialogue with all employees about how the organisation is keeping true to its purpose and, crucially, how it behaves in doing that."

As we continue to partner with insurance organisations across the globe, our top-line strategy rarely changes. There needs to be a deep realisation that it will be the organisation which creates an inclusive environment, where all individuals at every level of the business can be appreciated, respected and, above all, heard in order to help their, and the company's, growth and development.

That change can only start with individual recognition of our own behaviours and biases, and leaders who take responsibility for building their own and then others' awareness – supporting them and enabling a safe psychological space in which to thrive.

# Regulation and disruption

Shepherd Compello's **Steve Hart** tells *Insider Quarterly* about the challenges facing the delegated authority market and its opportunities

***Insider Quarterly:*** **Although you have recently joined Shepherd Compello, you have a vast experience of the delegated authority market. Tell us more.**

**Steve Hart:** Yes, I am new to Shepherd Compello and I will take describing me as having "vast experience" as a compliment! The opportunity to join the team was exciting for two reasons: primarily because Shepherd Compello already has a strong book, built up by the current team led by Chris Hatt. I have been working closely with Chris before he relocates with his family to the United States.

That leads me onto the second, and in many ways, most important, reason – the family culture at Shepherd Compello. I already feel part of that family and, on behalf of everyone in the business, we wish Chris every success in the future.

***Insider Quarterly:*** **Regulation is a hot topic in the market. What are the key issues and how should the industry face them?**

**Steve Hart:** There is certainly a lot of talk in the market, and for that matter around the world, about high levels of regulation. For some, particularly in the broking market, it is a source of frustration as it can feel like regulators are tripping over one another in a compliance land grab. This situation can then be exacerbated by different regulation in local markets and the potential for mixed messages and misunderstandings.

**Steve Hart** is divisional director responsible for delegated authority business at Shepherd Compello

> "I see some blurred lines in the delegated authority chain which can lead to antagonism rather than collaboration. This need not be the case and it is in everyone's interests to collaborate for the benefit of the end client"

Personally, while I empathise, I do not share this view. I think we need to embrace regulation and create a clear, positive message for clients. Professionalism and integrity are core pillars of the Shepherd Compello proposition. I feel we need to use this to our advantage, especially if we are serious about treating customers fairly.

In the long term everyone benefits as we can foster and develop mutually beneficial relationships. My belief is that we need to understand regulation and make the customer experience a positive one. You can then allow clients to focus on business in the knowledge that they have a fit-for-purpose product.

***Insider Quarterly:*** **Disrupters, blockchain and online dealing are also hot topics – what do these issues mean for you?**

**Steve Hart:** We have seen how disrupters like Uber and Airbnb have revolutionised the taxi and hotel markets. So being in denial that the insurance industry is in some kind of safety bubble is short-sighted at best and dangerous at worst.

As for blockchain, this is already happening – this year, one consortium has just increased their insurance base to 15. Blockchain will ask questions of our current business model, supply chain and efficiencies. You can view this as a threat, or as a driver to look at the way we work and make improvements that benefit our clients.

For example, if we turn to online trading, this may be right for some, but not necessarily all. An online rating for flood risks near the coast may by default create a soft market, driving down prices that may not be sustainable.

A face-to-face meeting with an underwriter can still be quick and, crucially, deliver cover and a rate that is better for the customer in the long term.

***Insider Quarterly:*** **So how should the market deal with these threats?**

**Steve Hart:** There is no doubt that in every sphere, not just insurance, we are facing rapid change.

As the well-known quotation – often wrongly attributed to Charles Darwin, but apparently referencing his famous work on evolutionary biology, *On the Origin of Species* – goes: "it's not the strongest who survive, but those most adaptable to change".

We all need to adapt, change and add value. I see some blurred lines in the delegated authority chain which can lead to antagonism rather than collaboration.

This need not be the case, and it is certainly in everyone's interests to collaborate for the benefit of the end client.

I have benefited from working on both the underwriting and broking side, so I feel I can understand the different standpoints. If you look at the stakeholders as three points of a triangle; carrier, broker and coverholder, the tripartite arrangement should allow each to add value.

The broker is the conduit to facilitate a mutually beneficial relationship. If the broker considers the pressures at every point of the triangle I feel that we can mitigate them and utilise the London market's ability to be agile and act quickly for the end client.

***Insider Quarterly:*** **One of the areas you are focusing on is high net worth homeowners. What are your views on this market?**

"Blockchain will ask questions of our current business model, supply chain and efficiencies. You can view this as a threat, or as a driver to look at the way we work and make improvements"

**Steve Hart:** I think it is a buoyant market which demands the specialist attention Shepherd Compello can provide. In terms of both cover and pricing this is a niche market where insight and knowledge are crucial. For example, the North American market is one that can benefit from the catastrophe capacity available in London.

The need for capacity is reinforced by the recent World Economic Forum Risk report which stated that extreme weather events are now the number one risk.

Add to this that flooding and wind damage were the most destructive natural hazards in the USA in 2016 and you can see that these are immediate threats that require a robust approach to underwriting.

"Our market is the oldest in the world because it has adapted, changed and improved. Yes, we face new challenges, but we have the skills and experience"

For some time there have been questions about the ability of insurers based in states like Florida to provide sustainable pricing.

We are now starting to see some reaction from ratings agencies. One of these, Demotech, has suspended ratings for 57 Florida-based insurers because of "an uncertain operating environment in the state".

For any insured this news will be alarming, and I feel that the greater certainty that the London market can offer will be of keen interest to high-value homeowners in the region.

***Insider Quarterly:*** **How would you summarise your thoughts on the future?**

**Steve Hart:** Another popular quote, which is often attributed to Einstein, but whose provenance is uncertain, is that: "insanity is doing the same thing over and over again and expecting different results".

It is clear to me that anyone in the insurance market who is complacent enough to think it is fine to "do the same thing" should heed these words. However, in the London market I am confident that this is not, nor will it be, the case.

Our market is the oldest in the world because it has adapted, changed and improved. Yes, we face new challenges, but we have the skills and experience which mean we are uniquely placed to offer innovative insurance solutions.

# Executive moves

Lloyd's confirmed in February that former Marsh Europe CEO **Bruce Carnegie-Brown** will succeed John Nelson as chairman. The Moneysupermarket Group chairman and Banco Santander vice-chairman will take on the role in June, pending regulatory approval. Carnegie-Brown's appointment was approved unanimously by the Council of Lloyd's and the Lloyd's Franchise Board, the Corporation said.

Aon group president **Steve McGill** is set to leave the business, it was revealed in January. It is understood that Aon will not appoint a direct replacement. Aon Risk Solutions and Aon Benfield CEOs Mike O'Connor and Eric Andersen will continue to oversee their respective segments, reporting directly to Aon CEO Greg Case.

**Arndt Gossmann**, CEO of European run-off specialist Darag, has stepped down after eight years in the role. A new leadership team including chief financial officer Simon Minshall, chief liability officer Zsolt Szalkai and chief operating officer Tim Braasch will form the executive committee, while Gossmann will remain with the carrier during the transition period.

**John Berger** stepped down as Third Point Re CEO with effect from 1 March, but will remain as chairman of the carrier's board and its underwriting committee. Berger, who launched Third Point Re in 2012, will be replaced by the hedge fund reinsurer's current president and COO Rob Bredahl.

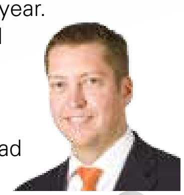
Axis Re CEO **Jay Nichols** has stepped down from his role, while agreeing to remain with the carrier in a transitional capacity until 31 March. Axis Re Europe president and chief underwriting officer Jan Ekberg has been named as Nichols' successor on an interim basis.

**Jeremy Goodman** has been appointed global head of broking strategies at Aon Benfield, based in New York and reporting to CEO Eric Andersen. Goodman was previously executive managing director at the reinsurance broker. In his new role, he will be responsible for building relationships and networks with Aon Benfield's reinsurance trading partners.

Airmic CEO **John Hurrell** is to step down after nine years in the post. The association said Hurrell would remain in his position until his successor has been named. Prior to joining Airmic, Hurrell was at Marsh & McLennan for nearly 30 years.

**Stuart Davies**, who stepped down as CEO of Sompo Canopius in November, has joined private equity house Disruptive Capital as a partner. Following Davies' departure from Sompo Canopius, Michael Watson, founder and former non-executive chairman, became executive chairman, supported by chief underwriting officer Mike Duffy and chief financial and operating officer Paul Cooper.

Brit Insurance group CEO Mark Cloutier stepped down from the role in December and became executive chairman at the end of last year. **Matthew Wilson**, Brit deputy CEO and Cloutier's long-term heir presumptive, was appointed as his successor while Richard Ward, Brit's non-executive chairman, was appointed lead independent non-executive director.



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