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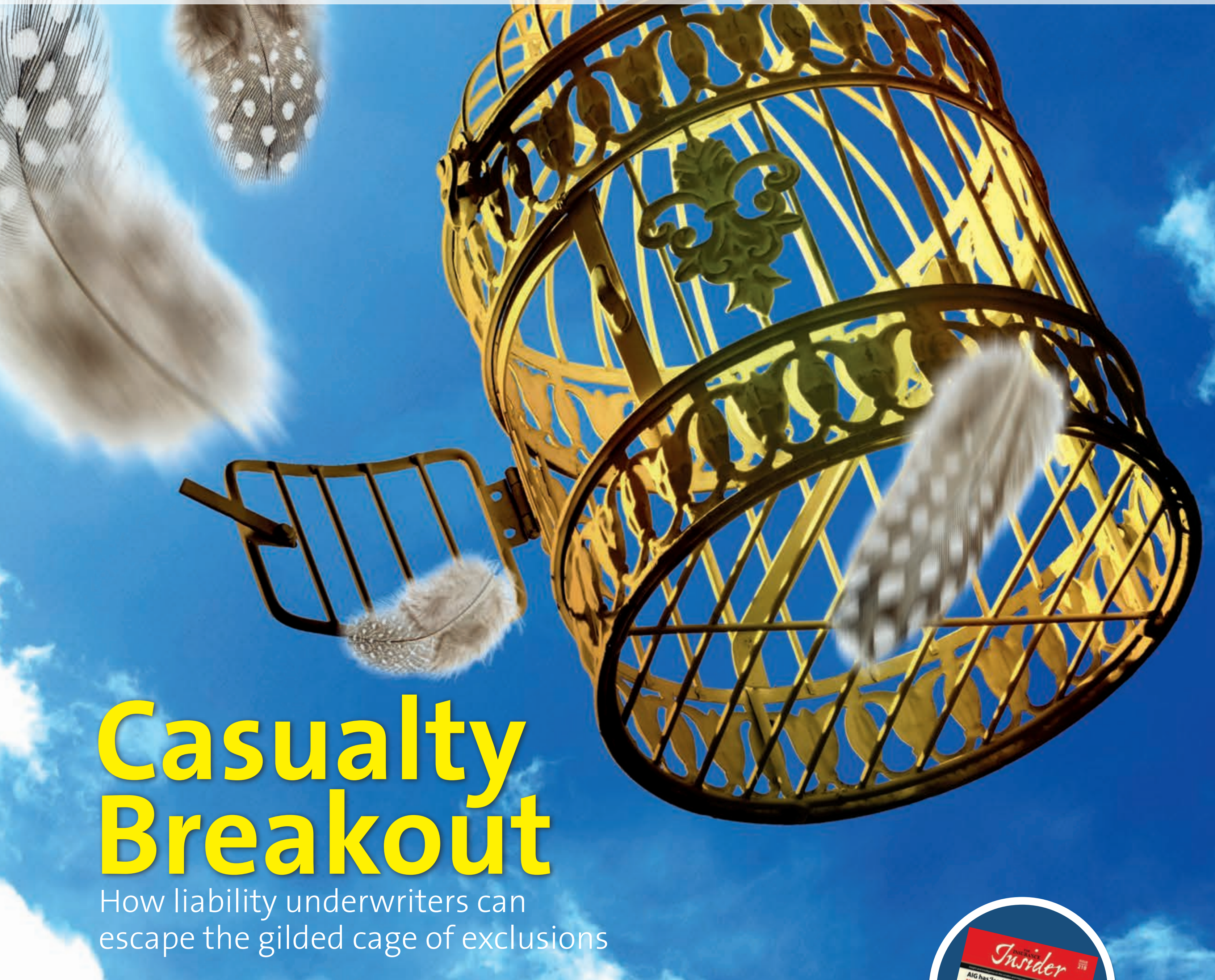

Casualty Breakout

How liability underwriters can escape the gilded cage of exclusions

The intelligent quarterly from the publishers of

If your name's not down you're not coming in

Dear Friend,

When I was a broker I never understood why so many liability underwriters looked down on their property brethren. After all, it was plain that the casualty world was far more likely to cause trouble than the plain vanilla, short-tail, tangible physical damage market.

In more lucid moments I often thought that third party liability insurance policies were just a very elaborate way of issuing someone with a blank cheque.

They start off straightforwardly enough, perhaps lulling the reader into a false sense of security. In Anglo-Saxon jurisdictions the neat and simply worded arrangement agrees to indemnify the insured for the legal liabilities that it may incur arising from the course of its activities.

The general principle is that if it isn't excluded, it is included.

Understandably, given the slant to inclusivity enshrined in the simple insuring clause, this opener is followed by a long list of exclusions borne from the near-death experiences of yesteryear. Asbestos, gradual pollution and various different forms of first party and pure financial loss are all out.

But effectively cover is on an "all risks-minus-the-nasty-ones-we-know-about" basis.

The problem is that because new perils only emerge slowly, underwriters have always been behind the curve. Look at the way wily lawyers shoehorned asbestos into decades of commercial package policies written on a losses-occurring basis.

But who could blame them? Great damage had been done and the insured was legally liable – coverage could hardly be in dispute.

Therefore the only way for a liability underwriter to get ahead of the curve is to be trigger-happy with exclusions. When market conditions did not allow this it was deemed far better for all simply to not name the perils one was worried about and stay "silent" (Y2K and electromagnetic fields immediately spring to mind).

Whenever I picked up a named perils property slip in our office I always had a laugh reading through the ridiculously exhaustive list of ways in which damage might be done to tangible assets.

Impact of vehicles, mysterious disappearance and even fall of objects from space all seemed to get a mention. What were these people worrying about I wondered? Why not bung in alien abduction while you were at it?

There are only a finite number of ways of damaging a building and I figured the ancient quartet of earth, wind, fire and water should cover just about everything. Indeed, I always wondered why more didn't just go more down the "all risks of physical loss or damage" route.

But then I also had a sneaking admiration for a group of underwriters sticking to their guns and refusing to give cover that wasn't specifically named.

The named peril property underwriter's logic was ceaseless. If you dare name it, presumably you must understand it. If you understand it, you must be able to price for it, and if you price for it you should be able to profit from it.

Naming it, aggregating it and making people pay for it has got to be the way forward for the casualty world.

Surely in the 21st century leaving the perils that you know that you don't know about lurking silently in a wording (for free) has got to become a thing of the past?

Have a look at page 11 for a fascinating cover feature on the latest developments in casualty modelling from our editor-in-chief, Adam McNestrie.

P.S. I hope to see you in Monte Carlo!

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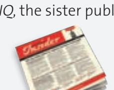

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AROUND THE WORLD

IQ's roundup of regional market developments

01 CANADA
McMurray estimates

PCS kept its second estimate of industry insured losses from the Canada wildfires largely steady at C$4.67bn ($3.63bn), up slightly from its initial projection of C$4.63bn ($3.60bn).

The average claim from the Fort McMurray disaster totalled C$120,159, according to the agency.

The cost of the disaster has far surpassed the previous largest catastrophe loss in Canada, a C$1.9bn storm that hit Alberta in 2013.

The PCS industry loss estimate came in just above the lower end of the modelled loss pick of between C$4.4bn and C$9.0bn ($3.4bn-$6.9bn) from AIR Worldwide.

In July, the Insurance Bureau of Canada pegged insured losses from the fires at C$3.58bn..

02 ITALY
Major earthquake

As *Insider Quarterly* was going to press central Italy had just been hit by a major earthquake. It struck at 01:36 GMT on 24 August, around 100km (65 miles) northeast of Rome, not far from Perugia.

The quake is reported to have had a magnitude of 6.2 and a relatively shallow depth of 10km.

To date, nearly 250 people are said to have been killed in the quake, with many more believed to be buried under the rubble, and the death toll is expected to rise.

Early reports have suggested towns near the epicentre such as Amatrice and Accumoli have been severely affected, with many of the dead reported to be in Accumoli.

03 USA
California wildfires

Modelling firm RMS has estimated that three wildfires that ravaged the US state of California in mid-August have destroyed at least 220 buildings.

The “Bluecut” blaze to the northeast of Los Angeles poses the most significant threat, the firm said. Around 82,640 people were thought to have been evacuated from the area. So far, the fire has burned 25,600 acres.

Elsewhere, a fire in Northern California has burned around 3,900 acres, damaged more than 175 buildings and threatens a further 380, according to RMS.

And a third fire in San Luis Obispo County has burned an estimated 8,000 acres to date, destroying 45 structures, RMS said.

04 INDIA
Mandatory listing?

The Insurance Regulatory and Development Authority of India (Irdai) has tabled the idea of mandatory listing for Indian insurance companies.

In a paper released on 11 August, Irdai said that it had discussed the idea at a meeting held on 15 April in Hyderabad.

The regulator said that general insurers and reinsurance companies should be publicly listed after eight years of operation, while life insurers should list after 10 years.

Listing provides a number of intrinsic advantages, Irdai said, including bringing shareholder participation into insurer decision making, enhanced disclosure requirements and greater transparency in operations.


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risk awareness
+
Our
CatNet® ability
=
Closing
the protection gap
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Energy

An "average" natural catastrophe year would erode all profits for energy offshore property risks in the Gulf of Mexico, according to PwC research.

In its 2016 review of London market pricing conditions, PwC said average risk-adjusted rate reductions for Gulf of Mexico offshore risks exceeded 25 percent last year. In this class of business, the market includes an average 30 percent catastrophe loss ratio within business plans, it added.

"In light of ongoing and double-digit rate reductions over recent years, in addition to the effect from falling oil prices, there are increasing concerns over rate adequacy, with the market average initial 2016 planned combined ratio being 100 percent after allowing for reinsurance," PwC wrote.

Marine

The Placing Platform Limited (PPL) board and London market governance groups have agreed that marine will be the next class of business to use the technology following the rollout of financial and professional (finpro) lines.

The International Underwriting Association, London & International Insurance Brokers' Association and the Lloyd's Market Association will be recruiting members for the PPL marine working group in preparation to commence work on the class in September, they announced in mid-August. The electronic placing platform is one of the priority initiatives in the London market's modernisation scheme, the Target Operating Model.

Workers' comp

Hundreds of US insurers have taken to the courts in Florida to seek a double-digit increase in workers' compensation rates in the state.

A dispute over workers' compensation pricing in Florida came before the state regulator in mid-August, as insurers looked to increase prices in the segment by 19.6 percent.

The raise, proposed by industry representative body the National Council on Compensation Insurance, was spurred by an April Florida Supreme Court Ruling, which held that limiting attorneys' compensation in workers' compensation cases was unconstitutional.

The effective date for the mooted change is 1 October.

Medical indemnity

Berkshire Hathaway Specialty Insurance (BHSI) has signed an underwriting agreement with medical indemnity specialist Tego Insurance to write business in Australia.

In a statement, the carrier said the product would be distributed by Tego and underwritten by BHSI on an exclusive basis. Tego provides professional indemnity coverage for individual medical practitioners, medical centres and day clinics.

BHSI first moved into the Australian market last year, initially writing P&C executive and professional and healthcare business, before moving into marine insurance, directors' and officers', professional indemnity and cyber liability.

Kidnap and ransom

International piracy activity has fallen to a 21-year low, as pirates increasingly seek ransoms by kidnapping crews instead of looting cargo, according to the International Maritime Bureau (IMB). The IMB's July report revealed there were 98 piracy incidents in the first half of 2016, compared with 134 in the same period of last year.

The IMB recorded 72 vessel boardings, five hijackings and a further 12 attempted attacks. Nine ships were fired upon. Sixty-four crew were taken hostage on board, down from 250 in the prior-year period.

However, some 44 crew were held for ransom in the first half of 2016, compared to just 10 in H1 2015.

Aviation

Lloyd's insurer ArgoGlobal is likely to discontinue its aviation book following the departure of head of aerospace Richard Bayman.

Bayman is understood to be moving to Chubb after six years at Argo. He had previously worked at legacy Ace, specialising in general aviation and hull war risks. Sources told sister publication *The Insurance Insider* that Bayman's exit had accelerated a review of Argo's participation in the aviation market, which has endured a tough few years following a number of medium-sized losses and successive rounds of brutal rate reductions.

The fate of the other three staff working on the aviation book is yet to be confirmed.

Market intelligence on the QT

Investing in people

Willis Towers Watson, not content with restructuring on a monthly basis, is also understood to have carried out a shakeup of working practices at its London office.

IQ PI has heard that Willis has introduced a new "free" working environment where employees can work from home, or dress how they feel comfortable in the office. Naturally, some folk at the broker have taken that to mean it's totally fine to wear shorts in the office which, *IQ* PI understands, the old guard at Willis has found a little unnerving. Much tutting has ensued.

That said, *The Insurance Insider* office has had its own share of wardrobe disasters. A certain journalist's fondness for wearing muscle vests prompted calls for a little more decorum to be exercised in the work environment...

Hell hath no fury...

It appears that someone at the National Oceanic and Atmospheric Administration (NOAA) has got it in for our colleagues at sister publication *Trading Risk*.

In its report on the developing Tropical Storm Fiona, NOAA warned hurricane followers to: "Watch for belligerence in days three and four", having already highlighted the fact that since forming on 16 August, by late on the afternoon of 18 August "it seemed that Fiona might lose all its deep convection".

"Fiona has a tough road ahead," NOAA uttered darkly, alluding to some probable "weakening" by day three, before concluding on 23 August that Fiona had "lost its organisation".

***Trading Risk* editor Fiona Robertson declined to comment...**

The party's over - before it's started!

Ahead of the annual reinsurance jamboree in Monte Carlo, news has come through that one global firm has already curbed its hospitality spend for the event – ditching the Saturday night dinner for early-arriving executives and their wives (gasp!), and even contemplating axing the obligatory cocktail reception (say it ain't so). Is nothing sacred!

Well if the free drinks are off, then delegates can always order a taxi to take them somewhere cheaper [like Nice]. "Certainly sir – that will be EUR130"...

Gilded cage

The casualty sector has historically caged itself behind exclusions, but new ways of modelling the 'unmodellable' could open the door to a wealth of underwriting opportunities, finds **Adam McNestrie**

Human beings like simplicity.

We like ideas that we can grasp without too much effort and tasks that we feel we can accomplish. And our perspective is skewed towards the dramatic, the short-term and the tangible. Things that are abstract and convoluted tend to be ignored, along with things which shift almost imperceptibly.

As such you could say that there is a natural bias in favour of the property market and against the casualty market. The (re)insurance press and the industry itself tend to focus their attention on the property market, drawn by the tangible nature of bricks and mortar and the shock and immediacy of hurricanes. Pulled too, perhaps, in the past by the disparity in returns between the two classes.

One of the upshots of this focus has been that the sector's understanding of casualty risk is far less sophisticated than its understanding of property risk.

"There is a chasm between the way the industry has looked at property cat and casualty risk," Willis Re co-president and global head of casualty Andrew Newman tells *Insider Quarterly*.

Mark Flower, a casualty actuary and broker at Aon Benfield, agrees. "In relative terms property is easy: you know what your portfolio is going to look like pretty much.

"The buildings don't tend to move around, you know roughly how resistant they are to earthquake or wind or fire. You know what the perils are and you have a pretty good idea of how likely they are to occur."

Newman stresses the relative ease with which the industry has been able to get its head around cat risk. "The nature of casualty risk is inherently, infinitely more complex than property. Property threats in the cat space are

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limited in time and space, geo-specific and known. Risk changes relatively slowly."

By contrast, casualty risk is all about human behaviour. The risk profile evolves under the influence of an almost illimitably complex concatenation of economic, social, legislative, judicial and technological forces, operating locally, regionally and globally.

"That is like writing a Midwest fire risk and in two years it's on the coast – and there is nothing you did externally to influence that," Newman explains. "It just changed, and you're still on risk."

Intuitive underwriting

With casualty risk in many quarters considered unmodellable, the industry has instead relied on its empirical experience combined with what Flower describes as its "great intuition" for the exposures.

"Just because it's difficult to get a robust actuarial model to quantify what your 1-in-100 looks like doesn't mean underwriters don't have a very good, workable sense of what their downsides are," he says.

"The best ones very well understand the risk that they're taking – it's just very hard to put it into a model with a nice neat number against it."

The industry may have, broadly speaking, gotten along well enough in recent years without casualty modelling, but in a period of enhanced regulatory and rating agency scrutiny, and with the sector's understanding of risk having improved across the board, it is an increasingly apparent blind spot.

Bob Reville, CEO of cutting-edge casualty modelling firm Praedicat, believes that the industry is in "dire need of more analytics to cover downside risk".

Newman agrees: "There is a big risk management deficit and it needs to be dealt with in and by the industry – by brokers as well as carriers."

He explains that the way in which risk management budgets are allocated would lead one to assume that 90 percent of all risk comes from cat events.

> "The industry may have gotten along well enough in recent years without casualty modelling, but in a period of enhanced regulatory and rating agency scrutiny it is an increasingly apparent blind spot"

In fact, an AM Best study found that half of all company failures stemmed from casualty risk, underlying the urgent imperative for the industry to get a grip on its liability exposures.

And, like a long-deferred assignment, the industry is now starting to get serious about quantifying and understanding casualty risk.

Property catastrophe modelling has pointed the way, as well as siphoning off the attention of boards nervously eyeing Floridian disasters or Californian cataclysms.

Andrew Newman – Co-president and global head of casualty, Willis Re

Filippo Salghetti-Drioli, head of casualty research and development at Swiss Re, one of the leaders in casualty modelling, stresses that about 30 years ago the perception was that cat was unmodellable.

In the early 1990s following a series of major catastrophes, the industry set out to change how it priced the risk, according to RMS chief research officer Robert Muir-Wood.

He explains that the industry set about creating "synthetic histories" of events across a 10,000-year sample period to understand the likelihood of a severity of event taking place in any particular year.

"You're then simply running these synthetic catastrophes across your portfolio to discover what losses they would cause you. And then if you want to find the average annual loss for pricing the risk, it's simply the average loss across all of those years."

Those companies that embraced modelling soon demonstrated that it provided them with a competitive advantage, which could help them avoid the surprises that tend to arise when you don't know what level of risk is on the books.

Casualty modelling

Willis Re is one of the firms that has turned its attention towards developing casualty models, including the industry's first cyber portfolio model.

The broker has chosen to focus on helping its clients to understand the downside they face if there is a major industry casualty loss.

With its Entail model, it is creating synthetic cat scenarios and looking to model the exposure of clients against such events.

"We're saying: if something

comparable hits your portfolio with your concentrations, this is where your probable maximum loss is," Newman notes. "It tells you where you have a big bet."

He explains that the concentrations within an industry or class that can be thrown up are akin to realising that you are the number one cat underwriter in Florida.

The Willis Re global casualty head believes that there is an inherent value for cedants and reinsurers in putting their books through this sort of exercise.

"The process is more important than the output," he opines. "The journey is more important than the destination."

Swiss Re too is well advanced in its own efforts to measure the casualty risk that it runs and that of its clients.

Salghetti-Drioli explains how the Swiss Re Liability Risk Drivers model works with the example of a chemical factory.

The global reinsurer starts by collecting the relevant information on the chemical factory – everything from what it produces, to employee numbers, geography and revenues.

It then selects a series of potential loss scenarios like explosions, harm to customers and product liability and attaches a distribution showing their likelihood based upon analysis of the empirical record and emerging risks.

Subsequently it adjusts this for the economic, social and litigation environment in the relevant jurisdiction and applies the relevant terms and conditions to produce an expected loss for a policy.

Underwriters will then take the model output and adjust it to reflect their knowledge of the particular insured and asset.

With its risk model already live, a casualty cat model is now under development.

"Even if we won't be able to answer the question on the overall accumulation of an entire portfolio yet, we will soon answer questions on the exposure of a portfolio towards specific named perils. It might be chemical substances, big explosions or accidents – it might also be things like the impact of a potential tort reform in a specific place or an inflation shock – these could also be considered as big events."

"The typical emerging [casualty] risks group was five senior executives who would meet quarterly and talk about the things they read in the newspaper"

Predictive modelling

The most ambitious protagonist in the casualty modelling space is Reville. The firm he leads, Praedicat, started as a research and development joint venture by US thinktank the Rand Corporation and RMS, and was spun out in 2012.

Reville and his team have launched a casualty model that is forward-looking and allows (re)insurers to assess their exposure to developing perils.

Carriers in the casualty space have always looked at emerging risk – the rating agencies require them to demonstrate that they are doing so – but the approach has historically been unsophisticated.

"The typical emerging risks group was five senior executives who would meet quarterly and talk about the things they read in the newspaper," he says. "Literally that was the state of the technology."

And the whole approach was dictated by the spectre of asbestos. "They just wanted to find the next asbestos, the next casualty cat so they could exclude it."

Reville wanted to use an altogether more sophisticated approach, employing computer searches and algorithms to harvest the internet and track potential perils identified in scientific literature.

"Scientists are the world's emerging risk group," he observes. "So if you can use their work and delegate this task not to five mid-level senior insurance executives, but to thousands of toxicologists, epidemiologists and environmental scientists you can transform the approach."

Praedicat then tracks the risk, building a database of potential loss events. This steadily improves the firm's understanding of how many potential issues mature as well as the period of latency between the flagging of harmful agents in scientific literature and the first claims.

Once identified the peril can then be run against a portfolio based upon databases of information about the number of impacted claimants and the size of awards in parallel past cases, allowing carriers not only to calculate their exposure to an event if it matures, but also to price in expected claims.

Reville's ultimate motivation here is not limiting the risk of an underwriting misstep through exclusions – it is the liberation of the casualty industry from fear and negativity.

"We are talking about an industry that is making itself irrelevant," he argues. "The underlying strategy here is exclusions, meaning casualty risk products are not really as effective for clients as they could be."

He goes on: "Turn it around and

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Gilded cage
continued from page 13

say it's not necessary to exclude it anymore. You can now use that information to manage your aggregations, or even to develop new products."

Reville argues that the current focus on cyber as a growth area misses the untapped potential presented by old-fashioned casualty business, if the product can be improved and priced correctly.

Robert Muir-Wood – Chief research officer, RMS

"We are talking about an industry that is making itself irrelevant. The underlying strategy here is exclusions, meaning casualty risk products are not really as effective for clients as they could be"

"It's a story about a huge growth opportunity about a part of the industry that unlike some others is not going anywhere," he concludes.

Muir-Wood, formerly a colleague of Reville's, agrees that this is as much about grasping a commercial opportunity as improving risk management frameworks.

"The market has existed on exclusions so far and exclusions are not very healthy – they don't really help society," he says.

The market took that approach after the San Francisco earthquake of 1906, he explains, by excluding fire after earthquake regardless of the changing risk profile.

"Outside Japan they would have made a lot of money if they hadn't put that exclusion in."

A sea change

Modelling casualty risk is clearly exponentially more difficult than modelling cat risk. And for there to be real progress and a change in the industry's approach to risk-taking requires board buy-in, investment and a willingness to assign top talent to an area that has traditionally been neglected.

That will be a challenge because it may prove more difficult to demonstrate either acute need from a risk management perspective or a clear competitive advantage coming from the improved understanding.

However, when surveying the sector there is an impression that a sea change may have started. After decades of scepticism, belief is growing that the industry and its service providers are up to the job of modelling human behaviour in all its infinite complexity, and that the sector is on the cusp of a breakthrough.

Micro modelling

Modelling across multiple casualty classes and identifying total exposures for clash events is a distant ambition.

RMS chief research officer Robert Muir-Wood talks about "hundreds of modellable problems".

"There is a composite of many, many potential things – many, many forces of injury," he says. "You can't treat it as a whole – you have to break it down into its component pieces. Once you do that they look much more tractable to being modelled."

RMS, for example, has created a model for casualty exposures relating to earthquakes generated by deep disposal of oil industry waste water in Oklahoma, which provides underwriters with solid numbers for expected casualty losses to the well operators.

Since 2009 there has been a massive increase in the number of quakes felt and recorded across the state. Before 2009 there was an annual average of around 21 earthquakes of magnitude 3 and greater across the whole eastern and central US. In 2015 there were more than 800 such quakes in Oklahoma alone.

The quakes in Oklahoma have reached magnitudes up to 5.6 so far, including an event in 2011 which caused a lot of damage to the town of Prague. The potential upper magnitude of such earthquakes is probably in the low magnitude 6 range. If such an earthquake occurred under a major urban centre like Oklahoma City the total economic damage and loss would cost billions of dollars.

By modelling the impacts of these potential quakes RMS has identified the likely annual cost to well operators of all the potential quakes they could trigger. This could be the amount the operator should set aside each year to pay for the impacts of the seismicity, or the annualised costs of this component of a liability insurance policy.

"I think that's the way forward," Muir-Wood argues, pointing to a future where risk carriers will run a range of different casualty models side by side for different portfolio niches.

Down but not out

Reports of the imminent demise of the cat bond market have been greatly exaggerated, says **Fiona Robertson**

Several years ago, industry commentators were pondering the supposed death of the traditional reinsurance model as they sat sipping their espressos at the Café de Paris in Monte Carlo.

As ILS fund managers were experiencing a boom in asset inflows, this allowed them to grab a bigger share of the property catastrophe market, eroding margins from a business that propped up traditional carrier income.

Ironically, in 2016 it is the health of the catastrophe bond market – a small but highly visible sub-sector of the ILS industry – that participants are anxiously keeping tabs on.

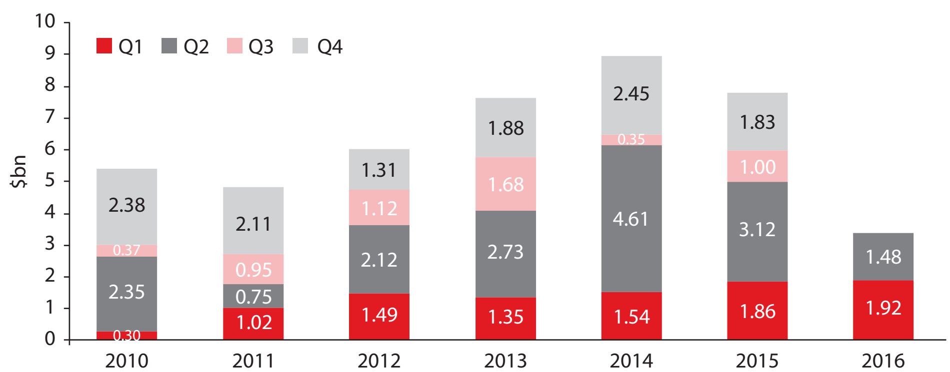
After a couple of years of record-setting new issuance, annual volumes this year have dropped back, as a number of key sponsors have chosen not to renew deals.

How significant will 2016's drop-off prove to be? The traditional reinsurance carriers have clearly proved that reports of their death were premature – so will this be the case for the cat bond market too?

Behind the 2016 slide

Oddly enough, a jumpy batch of cat bond statistics this year doesn't necessarily show why

H1 2016 issuance reaches $3.4bn



Source: *Trading Risk*

some participants are worried about the supply of new deals.

The first quarter actually set a new record for volumes, but this was followed by a slump in the second quarter, which saw issuance of $1.48bn – less than half the $3.12bn transacted a year earlier.

On a half-year basis, that makes 2016 only the sixth largest H1 for cat bond issuance since 1997, Swiss Re Capital Markets calculated.

The larger transactions that have not been renewed include the North Carolina residual insurers' $500mn Tar Heel Re deal and the Turkish Catastrophe Insurance Pool's $400mn Bosphorus I Re.

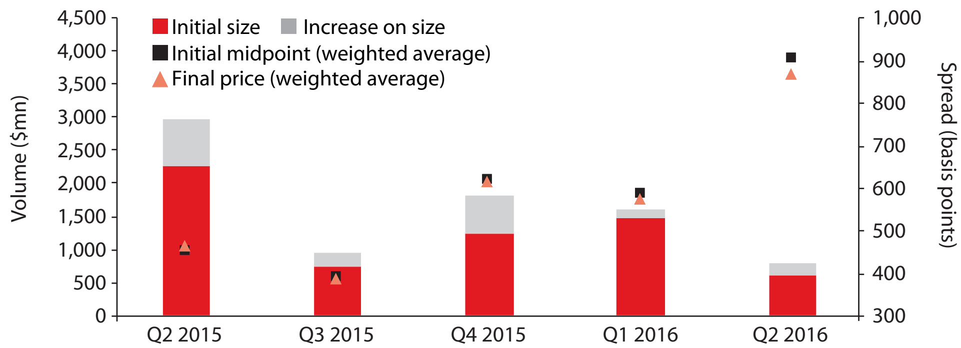
Notably, major primary carriers Allianz, Chubb and Zurich did not reissue their maturing deals – the $175mn Blue Danube, $150mn East Lane Re V and $270mn Lakeside Re III respectively – while a small tranche of AIG risk also expired. Reinsurers Hannover Re and Axis Capital did not return to the market either.

There are a number of reasons that carriers are deciding against renewing their deals. Price is of course a major one, as traditional rates have kept sliding over the past year while cat bond rates have held steady.

The rated carriers that several years ago might have argued that ILS market players were naive underwriters have long since decided that if they couldn't beat 'em, they would join 'em – loading up on retro and maintaining their place on the front lines of competitive underwriting.

There are also other softer factors at play, such as the familiarity of traditional reinsurance transactions, which might involve just a page or two of documentation compared to the more expensive legal requirements involved when issuing bonds.

Size/price change during cat bond marketing process



Source: *Trading Risk*

Trading Risk is the market-leading title covering the convergence of the (re)insurance industry with the capital markets www.trading-risk.com

This is part of what has enabled the collateralised reinsurance market to take off so significantly in the past few years.

Philipp Kusche, global head of ILS and capital solutions at TigerRisk Partners, says that the cat bond format provided the benefit of reaching a very large investor base if a reinsurance buyer wanted to raise a large volume of reinsurance cover and to distribute their risk widely. But if cat bond pricing was not cheaper than traditional reinsurance, it was hard to convince a sponsor to opt for that market.

"When we talk to a sponsor on how efficient a 144a transaction is compared to other options they have...when the price is the same...it's hard to ask sponsors to do the extra work which a 144a transaction requires," he says.

The collateralised reinsurance segment is also where Michael Stahel, partner and portfolio manager at LGT ILS Partners, expects future ILS growth to come from.

"Unfortunately, we don't expect the cat bond market to grow significantly," Stahel said earlier this year at the Convergence London conference hosted by sister publication *Trading Risk*.

The executive said that collateralised reinsurance had lower transaction costs and more flexibility compared to cat bonds, with the ability to control which counterparties are being dealt with.

"Some [cedants] are afraid of issuing cat bonds," he said, adding: "The problem is we like cat bonds."

The value of liquidity

Stahel's comment points to the ultimate question mark for the cat bond market at the moment: how far do investors prize the ability to trade a bond and how much premium would they be willing to give up to have a liquid ILS portfolio?

Stahel said that if the market shifted further to collateralised reinsurance this would not be an issue for LGT, which holds around $1bn of its $4.5bn of assets under management in cat bond funds.

"It doesn't change the way the majority of investors are looking at the industry," he said.

One factor that may undercut the value of the liquid cat bond for some investors is that private collateralised reinsurance contracts will generally renew on a yearly basis – not exactly a long-haul commitment for a fund with a multi-generation timeframe.

But what about other types of investors, such as mutual funds and European UCITS funds that do need liquidity?

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Down but not out
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According to Bill Dubinsky, head of ILS at Willis Capital Markets & Advisory, the ILS market is seeing a struggle between the two different viewpoints of pension funds with less appetite for liquidity, and the mutual funds which do require it.

As more mutual fund investors enter the market, demand for liquidity will increase, the executive says.

Where to from here?

Indeed, the cat bond market is already showing signs of being hungry for new deals after rates softened in April and May – inverting the usual seasonal increase that occurs as hurricane season approaches.

RMS data shows that risk-adjusted cat bond spreads were 2.56 percent by 30 June, compared to 3.18 percent at the same point last year.

As investor demand outpaced supply, the premiums on newly issued deals settled well below initial pricing targets throughout most of the second quarter.

This type of response has not been seen on the ILS market since the third quarter of 2014.

The exception was the final deal of the period, Blue Halo Re, which featured a risky three-year aggregate structure.

Before Blue Halo was issued, final spreads had come in 9 percent below initial midpoint pricing targets on a weighted average basis.

But the transaction reined in the overall average weighted fall to 4 percent below target – which was still a reduction that had not been seen before on the ILS market

Swiss Re Capital Markets described the Q2 tightening as "massive".

"The ILS market became almost entirely one-sided, with significant buy interest across the spectrum of risks and perils," it added.

According to Swiss Re's Jean-Louis Monnier, the US market has "played catch-up" in the last few months, with ILS spreads reducing after 18 months of stability.

In turn, the firm expects this to drive greater issuance activity before the 2017 hurricane season.

"We would expect a healthier issuance towards the end of the year and for the market to remain very well supported into next year by virtue of a more attractive pricing environment," he said to *Trading Risk* in July.

Meanwhile, the ILS market is also seeing more activity in what is loosely known as the "private cat bond" segment of the market.

The nature of the deals varies, but the underlying idea that many broker-dealers are chasing is to simplify the cat bond issuance process to entice more sponsors.

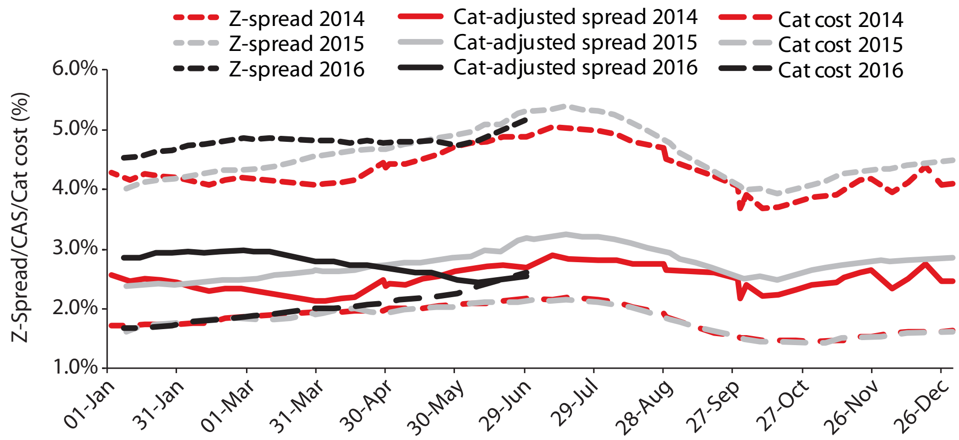
However, the challenge is of course ensuring that the bonds are still readily tradeable.

These deals may require investors to do more of their own modelling analysis, limiting it to a smaller target group – although the reality is that the market has not yet reached many more mainstream investors who would have relied on third-party modelled information anyway.

Ultimately, the cat bond format may evolve further but this is proof that for a corner of the market, delivering liquidity remains a prime concern.

The constant juggling between supply and demand forces has nudged the market to be more competitive – showing that just as reports of the traditional reinsurance model's death were exaggerated, so too are worries over the cat bond market's health.

ILS rates claw back some ground



Source: RMS

Michael Stahel – partner and portfolio manager, LGT ILS Partners

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Brexit blip

London-listed carriers' H1 results revealed a boost to bottom lines from investment returns – but how much of this was just a blip following the UK's Brexit vote? **Charlie Thomas** investigates...

The first half of this year has seen a number of carriers hit by increased natural catastrophe losses internationally, along with the continued erosion of reserve releases, but in London investment returns have helped to boost (re)insurers' bottom lines.

While many column inches have been dedicated to the potential problems caused by the UK's vote to leave the European Union (EU), in the short term at least there has been a positive impact on London-listed carriers' balance sheets.

The momentous decision by the UK electorate to leave the EU sent bond yields into decline in the second quarter, resulting in strong returns from Lancashire, Hiscox, Novae and Beazley's fixed income portfolios as bond carrying values appreciated.

Total investment income for the six months to 30 June increased 42 percent to $30mn for Lancashire, 8.9 percent to $62.7mn for Beazley and 12.7 percent to £39.9mn for Hiscox.

Novae, meanwhile, beat its H1 2015 result of £3.8mn by more than 647 percent, taking its total investment income to £28.4mn. This was attributed to its relatively new investment strategy, implemented last year, which is focused on "maximising long-term economic value by managing balance sheet assets and liabilities on a more holistic basis".

The London quotient's results were particularly significant given the polar opposite investment environment a year before, when rising government bond yields triggered a drop-off in fixed income returns.

Treasury and bond yields have declined in recent months, with investors predicting a period of low growth in developed economies. Interest rates in both the US and the UK are also expected to remain flat or even decrease if the macroeconomic situation deteriorates further.

UK government bond yields entered negative territory on 10 August, extending a historic rally after the Bank of England stressed its commitment to buying up gilts in a bid to stimulate the economy.

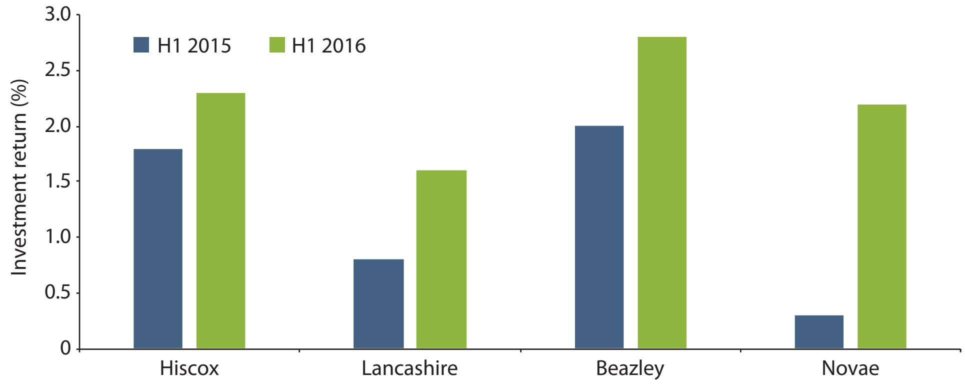
Demand was particularly high at the short end of the curve, with yields on government paper due in March 2019 and March 2020 falling to minus 0.017 percent and minus 0.015 percent, respectively. This means that investors are now paying to hold the debt to maturity.

There was a similar picture in the US, as 10-year Treasury notes fell to a yield of 1.53 percent ahead of an upcoming auction of $23bn in 10-year notes. Japanese and German note prices also rose, along with those of other Eurozone countries.

London calling

Looking in detail at the half-year results from Lancashire, Beazley, Novae and Hiscox, there are a couple of trends to note. Firstly,

Investment returns increase sharply



Source: Company reports, *Insider Quarterly*

there has been a shift from government, supranational and quasi-government bonds into corporate bonds, both investment grade and high yield.

Beazley noted that the proportion of its portfolio given to investment grade corporate bonds rose from 27.5 percent in H1 2015 to 43.9 percent. Its allocation to high yield bonds also increased over the period, from 2 percent to 2.7 percent. Illiquid credit strategies also rose from 1.8 percent of the portfolio to 2.9 percent.

By contrast, the allocation to government, quasi-government and supranationals fell from 40.6 percent of the portfolio to 24.4 percent.

Lancashire, meanwhile, increased its corporate bond holdings from 30.5 percent of its portfolio to 31.1 percent, although overall its allocation to fixed maturity assets fell 1.2 percentage points to 80.8 percent.

Instead, displaying a more bearish view of the future economy, Lancashire lifted its holdings in cash and cash equivalents from 9.1 percent of the portfolio to 11.7 percent.

Lancashire's more conservative standpoint was also evidenced by its annualised total return, which came in at 0.8 percent for the year to 30 June 2016, reflecting its shorter-tail underwriting portfolio.

This was some 0.7 points higher than in the same period last year, but was still below Beazley's figure of 1.4 percent, an increase of 0.3 percentage points on H1 2015, and Hiscox's comparatively high 2.3 percent, which was up 0.5 points.

Hiscox's investment growth was driven by a strong fixed income performance, with the yield from its debt and fixed income securities increasing from 1.3 percent in H1 2015 to 3.2 percent in H1 2016, offsetting the decline in risk assets and cash and cash equivalents.

The only carrier to buck the trend was Novae, which increased its holdings in government bonds, reduced holdings in corporate debt and increased its allocations to risk assets, such as its pooled equity fund and its "other" portfolio.

Novae's holdings in government debt escalated sharply from £190.5mn in H1 2015 to £575.2mn for the same period this year, while its corporate debt holdings shrank from £481.2mn to £307.4mn.

The pooled equity fund went from nothing to £73.7mn. Novae also allocated some £39.8mn to an emerging market mutual fund, another sector which had no investment in the prior-year period.

The second change evident in London was a slight elongation of the duration on the portfolios. Overall, Lancashire's duration ticked up from 1.6 years to 1.7 years, as it sought to obtain a better return.

Novae more than doubled its duration, moving from 1.1 years to 2.4 years.

And while Hiscox didn't give an overall figure, the duration of its bond portfolios increased by around four months to 22 months compared with the end of 2015, with the US book at 20 months, the UK at 29 months and Europe at 27 months.

No fear

Asset managers were unsurprised by the development, noting that several Lloyd's carriers were now no longer afraid of extending their duration.

"In some ways this has been a long time coming, there's been a lot of scepticism around government bond and corporate bond yields for a long time and there's more acceptance that [the situation] is not going to change any time soon, and therefore you don't need to be scared of duration," says Nigel Jenkins, principal and portfolio manager at Payden & Rygel.

"There's less fear now that there's going to be a nasty rise in yields."

Gareth Haslip, global head of strategy and analytics in the global insurance solutions team at JPMorgan Asset Management (JPMAM), adds that in the current economic environment with low yields at the short end of the curve, duration positioning is a key driver of investment performance.

"What you need to look at as a reinsurer is what's the duration of your liabilities and then have a view on whether you want

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Brexit blip
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to match assets and liability duration or if for accounting reasons you prefer to be short assets, versus liability duration," he says.

"If you're a listed insurance company and report to the stock exchange you can report under IFRS, which uses available to sell methodology, enabling them to focus on the income generated by their assets. The changes in the capital value from realised gains only become an issue if you sell the asset or it defaults. Many of the listed entities will try to match asset liability duration to make use of the accounting method and smooth volatility."

> "Asset managers were unsurprised by the development, noting that several Lloyd's carriers were now no longer afraid of extending their [bond portfolio] duration"

Portfolio planning

Looking ahead, it is difficult to predict what will happen to the London contingent's investment portfolios over the rest of the year.

On the strategic side, JPMAM's Haslip says moving away from holding too much in cash equivalents and gilts is important.

"Lloyd's entities are lucky in a sense as a lot of their exposures are in dollars, rather than sterling, but essentially clients have been minimising their exposures to negative yielding parts of the curve by going more into corporates," he goes on.

"Beyond that, they're also looking at non-core aspects of fixed income, such as taking on a higher exposure to high yield markets. We see some interest in hard currency emerging market debt. Outside of fixed income, we see some interest in liquid return-seeking assets – such as public market equities – and liquid alternatives, such as hedge-fund type strategies where you have similar exposures through a liquid UCITS fund. There's also interest in looking at absolute return funds in fixed income."

Central banks are going to continue to be key, according to JPMAM's managing director and head of international fixed income insurance Prashant Sharma, who adds that he expects the European Central Bank (ECB) to continue to be accommodative and ultimately extend its quantitative easing programme.

He goes on: "From a Federal Reserve perspective, the US economy looks in decent shape and approaching a stage where it has no spare capacity. But we think the Fed will be aware of global macro conditions before they raise interest rates. Our view is they do want to raise rates but the extent to which they can will be determined by the wider global macro environment.

"Where that leaves us is we think there's a ceiling to how much higher government bond yields can go. If you were to look at corporate bonds, and more importantly from the perspective of euro- and-sterling denominated corporate bonds, the purchase programmes announced by the ECB and Bank of England will be a strong technical supportive driver for corporate bond spreads."

Payden & Rygel's Jenkins is also an advocate for US high yield in the current climate.

"We like this area because you can get a reasonable amount of spread without taking much capital risk or duration risk," he says.

"You have the option of buying a two- or three-year high yield bond, and can put up with a bit of volatility as it has little impact on the price, and will mature at par in two or three years' time.

"It's attractive also because of the growing realisation that return and yield relative to risk is generally quite attractive at that sort of maturity but it also gives you quite pure exposure to the US economy, where there's clearly a growth premium, relative to just about everywhere else."

US Treasury 10-year bond yield

Source: Bloomberg


2000
1500
500
1000

Panama Confidential

The Panama Papers data leak heralds a sea change in the way (re)insurers should think about vicarious liability, finds **Catrin Shi**

In the midst of the media furore that erupted when the Mossack Fonseca data leak hit the headlines in April, few will have considered the implications of the event for the wider financial services sector.

The unprecedented leak of 11.5 million files, nicknamed the Panama Papers, from the database of the world's fourth biggest offshore law firm led to the exposure of a variety of methods used by the rich and famous to exploit secretive tax regimes.

Among the exposed were 143 politicians, including Russian president Vladimir Putin and Icelandic prime minister Sigmundur Davíð Gunnlaugsson, as well as their families, and multiple celebrities.

But while diving into the darkest offshore secrets of Simon Cowell and Jackie Chan, not many will have spared a thought for what leaks of this type mean for the (re)insurance industry.

History's largest data leak is a stark example of how (re)insurers' exposure is radically changing through what is known as "vicarious liability".

Vicarious liability is not, in itself, a new concept. Insurers have long been paying out for the financial consequences of actions or omissions of others – it's the single concept on which the whole directors' and officers' market has been built.

However, in a digital and more interconnected age, the nature of this risk has changed. With the use of cloud computing and data storage, it is quicker and easier than ever to cause serious reputational damage to both companies and individuals.

"Thirty years ago, if a criminal wanted to steal the volumes of info they can now, they would need to have a huge infrastructure around them," explains Scott Bailey, head of emerging risks at Markel International's professional and financial risks division.

Compared to 30 years ago, when if a criminal took a single cabinet drawer out of an office it might hold the equivalent of three gigabytes of information, data is now significantly more portable.

"These days, you can have a 1.5 terrabyte hard drive, which contains essentially the same volume of information as 465 filing cabinet drawers, and that can all be leaked in a split second," Bailey says.

In the case of the Panama Papers, one anonymous source leaked 2.6 terrabytes of data – relating to more than 200,000 Mossack Fonseca clients – to one newspaper, leading to global exposure.

Ultimate liability

In the UK, recent court rulings have determined that any liability arising from a data leak ultimately lies with the company that held the data. A landmark ruling was *Axon v Ministry of Defence* earlier this year.

The case relates to a commanding officer of a Royal Navy frigate, who in 2004 was summoned to London and relieved of his command following an investigation into his alleged bullying of officers on his ship. In that same month, UK daily newspaper *The Sun* published full details of the incident, leading the claimant to be censured by the navy and ultimately resign.

It later emerged *The Sun* had a Ministry of Defence (MoD) source, who had been prosecuted for leaking information to the newspaper. In 2014, the claimant brought claims against the MoD for the unauthorised disclosures of information about him which gave rise to *The Sun's* coverage.

In a judgment handed down on 11 April 2016, the judge dismissed the claim, but conceded that if it had been upheld, the employer would have been vicariously liable for the information leak.

"In this particular case the court did not find in favour of the claimant because he did not have a reasonable expectation of privacy – the claimant was performing a very public function and much of the information would have made its way to the public domain in any event," explains Hans Allnutt, a partner at City law firm DAC Beachcroft.

"But the judge did say if he had found in favour of the claimant, then the employer should be vicariously liable for the employee that had leaked the information."

This actually provides, therefore, that an employer will be vicariously liable for any loss of a third party's private data by an employee, even a rogue employee acting outside of their employment terms. As Allnutt says: "That in itself is remarkable, especially in the world of data breaches and cloud computing."

> "The single breach at Mossack Fonseca would have significant effects on multiple parties and individuals' data and private information. The liability escalation would be significant"
> **Hans Allnutt – partner, DAC Beachcroft**

Increased claims

In the UK, a number of legislative changes are combining to create an environment conducive to increased severity and frequency of claims arising from vicarious liability and data leaks.

The MoD ruling relates to the tort of the misuse of private information but similar claimant rights are to be enshrined into legislation, according to Allnutt.

Meanwhile, under the European Data Protection Regulation, which comes into force in late 2018, claimants will be entitled to seek compensation for non-material damage following data breaches.

In other words, an individual who has suffered due to an employee leaking data should be able to obtain compensation to the extent he or she has suffered distress, in addition to any financial loss the individual has suffered.

DAC Beachcroft also expects claims frequency to increase as a result of the European Data Protection Regulation. As part of an ongoing European study into data breach and privacy claims trends, the law firm canvassed data protection lawyers from each European Union member state.

"Our initial findings are that there is an expectation that compensation claims for data protection and privacy breaches will likely rise in almost every member state following the regulation coming into effect in 2018," Allnutt says.

These two changes come together with a compensation culture under privacy claims

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which can encourage claimants to come forward.

"Different parts of this jigsaw come together to create a potentially significant employer liability around data protection and privacy," says Allnutt. "You have the forthcoming legislation changes [and] judges interpreting existing law. Furthermore, it is still possible to obtain no-win-no-fee arrangements to pursue privacy claims. Any insurer of a liability class should be looking at these developments."

Liability escalation

In the case of the Panama Papers, the leaked data belonged to multiple clients, and may have also contained details of non-client third parties.

"The single breach at Mossack Fonseca would have significant effects on multiple parties and individuals' data and private information. The liability escalation would be significant," Allnutt warns.

The extent of a liability insurer's exposure depends on the nature of the data leaked. Exposed lines of business would include professional indemnity, to the extent there is personal data on the leaked files. The company could also have a direct liability to an individual, and could claim on a general liability policy, provided there is no exclusion.

If the data leaked contains employee data, claims could also come through on an employers' liability policy.

"Because of the multifaceted nature of the data, one breach can hit different liability policies," says Allnutt.

On this basis, a Panama Papers-style breach easily has the potential to escalate into a reinsurance loss, according to Bailey.

"Especially with cloud computing, there is scope for lots of policies to be triggered from the same problem at the same time," he said.

Under the skin

However, the evolution of vicarious liability is not necessarily being accounted for in the traditional liability classes, leaving them heavily exposed in the face of a large-scale data leak.

> "The insurance world is acutely aware of the fact that vicarious liability and aggregated risk like this is becoming more common, as global economies converge"
> **Scott Bailey – head of emerging risks for professional and financial lines, Markel International**

Cyber and technology underwriters look to explore the idea of interconnectedness as part of day-to-day underwriting, but this is not always replicated in other classes of business, Bailey says.

"When we consider the exposure, we are looking to learn how our clients are exposed to the wrongdoings of other companies and individuals, and trying to evaluate that through the application process," he explains.

Beyond that, cyber underwriters also examine the risk management of those relationships, such as the contractual indemnity between a firm and an outsourcer. "It's about getting under the skin of that risk," says Bailey.

However, it is unclear how liability underwriters go about this process, or whether this risk is priced into policies, Bailey adds.

"I would speculate that when you are considering 50 different types of exposure, that vicarious liability and aggregation aspect of the exposure might get lost in the application process."

He continues: "Of course in a soft market there are pressures for the breadth of cover to expand and the price point to reduce. We try to evaluate the risks we feel are worth underwriting for the premium and terms and conditions on offer.

"That is not always possible, but I think the insurance world is acutely aware of the fact that vicarious liability and aggregated risk like this is becoming more common, as global economies converge."

Portfolio view

Events like the Panama Papers breach demonstrate the need for (re)insurers to take a portfolio view of their contracts and deploy processes or technology that allow them to build up a picture more quickly.

"As we all know, an average reinsurance contract is up to 90 pages long and without a means to quickly review the relevant wordings contained across a portfolio it would be very difficult to provide an accurate response to the question 'How exposed are we?'," comments Laurie Davison, CEO of financial services software firm Adsensa.

"What (re)insurers need is a means to identify every relevant mention of exclusionary language, from detailed clause references and wordings down to the most peripheral type – perhaps where brokers have manually input a clause or clause reference rather than the full wording.

"Once these have been identified, the underwriter can apply its own judgement about how effective those exclusions will be against claims hitting its bottom line."


It's like working with your next-door neighbor...
if they were a leader in reinsuring global ag risks.

Containment strategy

Pandemic risk offers a new frontier for the ILS markets, which hope to offer a credible rapid response mechanism for both dealing with and anticipating outbreaks, says **Lucy Jones**

In the blockbuster film *Pandemic*, released earlier this year, the human race fights for survival in the face of a new virus that has wiped out most of the US population.

The survivors are starving and rampaging in gangs, while those who have reached "Stage 5" of the disease have become bloodied, hostile zombies.

If the film included a pandemic bond subplot, the storyline would have needed to take a considerably different course.

In fact, the premise of the film – a virus that knocks out a substantial proportion of the population – would be obsolete if architects of a new type of pandemic insurance had their way.

Containment strategy

The inventors of this new approach aim to create bonds that release money so diseases can be treated and contained – even before fatalities arise.

"It's really like a rapid response mechanism to help with preventing the pandemic from occurring," says Cory Anger, global head of ILS structuring at GC Securities.

"It's trying to capture when you have a very significant disease and trying to infuse money to get the facilities and laboratories that are needed, in order to educate people, deal with the medical needs of potentially afflicted people and manage the containment risk, as well as confirming whether people are afflicted," she adds.

Pandemic covers to date have been used primarily by life insurers as a way of managing the risk of a shock claims event where the buyer has no ability to contain or mitigate the impact, says Anger.

"This has been more a case of replenishing surplus following a major loss, as opposed to focusing on rapid response," she adds.

Learning from Ebola

The world has learned a lesson from the failure to act quickly in the recent Ebola outbreak.

In a remote village in Guinea on 28 December 2013, a two-year-old boy became the first victim of Ebola, which was to sweep across West Africa and land on the doorstep of the US. Some 11,310 people died during the outbreak, according to the World Health Organization (WHO).

In a push to prevent a similar emergency, the World Bank launched the Pandemic Emergency Financing Facility (PEF) in June, which plans to raise up to $500mn of insurance cover to respond to infectious diseases.

"While outbreaks are inevitable, pandemics, if addressed early, are for the most part preventable. Money and support delivered at the right time can save lives and economies," explains Michael Bennett, head of derivatives and structured finance at the World Bank.

Cory Anger – global head of ILS structuring, GC Securities

"Yet as we saw in the recent Ebola crisis in West Africa, there is currently no fast-disbursing financial mechanism to make available significant funds to resource-constrained countries early enough to help them fight an epidemic outbreak that is escalating," he adds.

Made up of pandemic cat bonds, as well as reinsurance funding, the PEF would provide three-year cover for outbreaks of infectious diseases most likely to cause major epidemics, such as influenza, Sars, Mers, Ebola and Lassa fever.

Parametric triggers would be set using publicly available data based on the size, severity and spread of the outbreak. Funds would be disbursed quickly to governments and international agencies when an epidemic hit.

Bennett continues: "If the PEF had existed in 2014 during the Ebola outbreak, the world could have mobilised $100mn as early as July to accelerate the emergency response.

"Instead, relying on 'pass-the-hat financing' meant that money at that scale did not begin to flow until three months later – during which Ebola cases increased tenfold."

"Donors ended up committing more than $7bn for Ebola response," he adds.

Collective failure

The facility addresses "a long, collective failure in dealing with pandemics," admits Jim Yong Kim, president of the World Bank Group.

However, the World Bank initiative, which will be up and running by the end of the year, is not the only pandemic bond of this type on the drawing board at present.

African Risk Capacity (ARC), which provides African countries with insurance policies for climate-related emergencies, is also structuring a pandemic risk bond due to be offered within two years.

"It will be based on similar principles for what we do for nat cat risk," says Dr Simon Young, CEO of African Risk Capacity Insurance Company, an ARC affiliate.

"It will be an investment insurance policy, purchased by a government, which will trigger to fund very early response by that government, tied to an agreed response plan."

Triggers are likely to use a combination of independent and government data.

"We would be looking at numbers which were available and could be verified more quickly than the significant mechanism that the WHO has to go through to get to a declaration of international concern," says Young.

He says confirmed infections are likely to be the criteria used – as opposed to a body count.

"It would be great if we could do something before there are deaths," Young adds. "We are looking at what's practical and what the market will accept as a verifiable index number."

There are also opportunities for corporations to take out pandemic insurance, according to Julian Roberts, managing director of alternative risk transfer solutions at Willis Towers Watson.

Simon Young – CEO, African Risk Capacity Insurance Company

Those with multinational exposure may incur costs in repatriating employees based abroad in the event of an epidemic, he notes.

"However, it is even more likely that a pan- or epidemic outbreak will result in reduced revenue – in effect, a type of non-damage business interruption," he adds.

Modelling pandemics

ILS investors typically see mortality risk as a diversifier to their main natural catastrophe risk exposure, but there are some challenges in adapting a pre-emptive pandemic bond for this market.

Deciding when a pandemic bond triggers is a bone of contention among investors, for example. Transmission rates, mortality ratios – the rate of death among those infected – as well as confirmed infections are all possible trigger types.

But one source told *Insider Quarterly* that if a WHO declaration of a pandemic phase was used, then triggering the bond would immediately become a political decision.

Some investors view a total of verified deaths as a more dependable metric. And information on the countries to be covered is also under scrutiny.

AIR Worldwide pandemic expert Doug Fullam admits getting information about outbreaks in general is challenging, as incidences of disease are usually under-reported. However, that under-reporting can be estimated and accounted for, he says.

After an event has run its course, epidemiologists can track down all the people that seemed to be sick in a small community.

"You can go to a town of a few thousand people and knock on a lot of doors and say: 'Hey, during this time period did any of your family members have any of the following symptoms?' Then you ask who they came into contact with. That can give you a sense of how big the actual event was, not just the [numbers] who came through the hospital doors," says Fullam.

Investors in the PEF scheme have also questioned which countries will be covered by the Word Bank bond and how those countries will be grouped.

Fullam says country characteristics can be identified: number of doctors per capita, hospital beds per capita, and interconnectivities between one country and the next.

"We can start to understand the response these countries can have to outbreaks and their ability to fight them, even from countries that have never experienced them," he says.

Preventing deaths

But according to the emergency aid organisation Médecins Sans Frontières (MSF), which was at the forefront of providing care during the Ebola crisis, poor epidemic response is not just related to the lack of available cash.

"Political will is the main blockage, especially at the onset," says operations health adviser Dr Monica Rull.

"For national governments, fear of declaring a deadly disease outbreak and its negative effects on trade, tourism and

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Containment strategy continued from page 29

international presence is a major factor that delays proper response," she adds.

MSF says that during the Ebola crisis it had adequate funds but lacked experienced human resources and diagnostic tools, as well as vaccines needed to fight the disease.

"More cash is not a guarantee of better response if this is not coupled with political willingness to tackle all the aspects that prevent effective epidemic response," Rull continues.

Maria Guevara, regional humanitarian representative at MSF, says the World Bank needs to have the emergency organisation "closely tied to the concept" while continuing work on the PEF in order for it to be a success.

Fending for yourself

There is also widespread concern that if countries sign up for pandemic insurance they will invest less in measures to reduce the threat of disease outbreak in the first place.

"There is the moral hazard of not paying and just waiting for the international community to respond," says ARC's Young.

"We're trying to work to make a very compelling case that African countries can fend for themselves and give themselves more control over how things play out," he adds.

Rapid funding has value too, he notes. In crises, foreign assistance can take months to arrive.

There is also the question of whether pandemic insurance is affordable – the governments of regions where epidemics hit hardest are usually least able to afford protection, even though it makes sense.

"It is often exceptionally difficult for countries with limited resources to tackle the numerous health challenges around pandemic risk when it is not the most pressing need, and often it is all but too late when it becomes a direct issue," says Kevin Noone, executive director of International Medical Corps UK.

Doug Fullam – pandemic expert, AIR Worldwide

"It is, however, affordable for emerging countries if there are initial subsidies to put programmes in place," he adds.

It is also essential that the international community helps these countries build resilience so they have strong platforms from which to tackle epidemics, Noone continues.

According to Willis Towers Watson's Roberts, affordability is essentially a function of product design.

"As with all index-based or parametric contracts, cost can be customised to requirement and budget by adjusting the trigger, limit and payout characteristics," he says.

Roberts adds that, as with other sovereign protection mechanisms such as the ARC and Caribbean Catastrophe Risk Insurance Facility programmes, there may be external funds and mechanisms made available to support their purchase.

Investor appetite

Given the low interest environment and drop in cat bond issuance – transactions in the second quarter totalled \$1.48bn, half the \$3.12bn transacted in Q2 last year (see *Trading Risk* feature on page 16) – interest in pandemic bonds is growing.

Charlotte Acton, head of risk transfer advisory at RMS, points out that excess mortality catastrophe bonds have existed within the market for more than 10 years and that most of the risk in these transactions is typically pandemic risk.

Examples include Vita Capital IV (2010), Kortis Capital (2010), Mythen Re (2012) and Atlas IX Capital Limited (2013).

"Recent transactions have seen continued innovation in trigger mechanisms and more risky layers placed successfully into the market, demonstrating the appetite investors have for taking on pandemic risk and their comfort with the modelling that supports that," she says, adding that pandemic catastrophe bonds offer diversification,

The bonds also provide a destination for socially responsible capital held by pension funds.

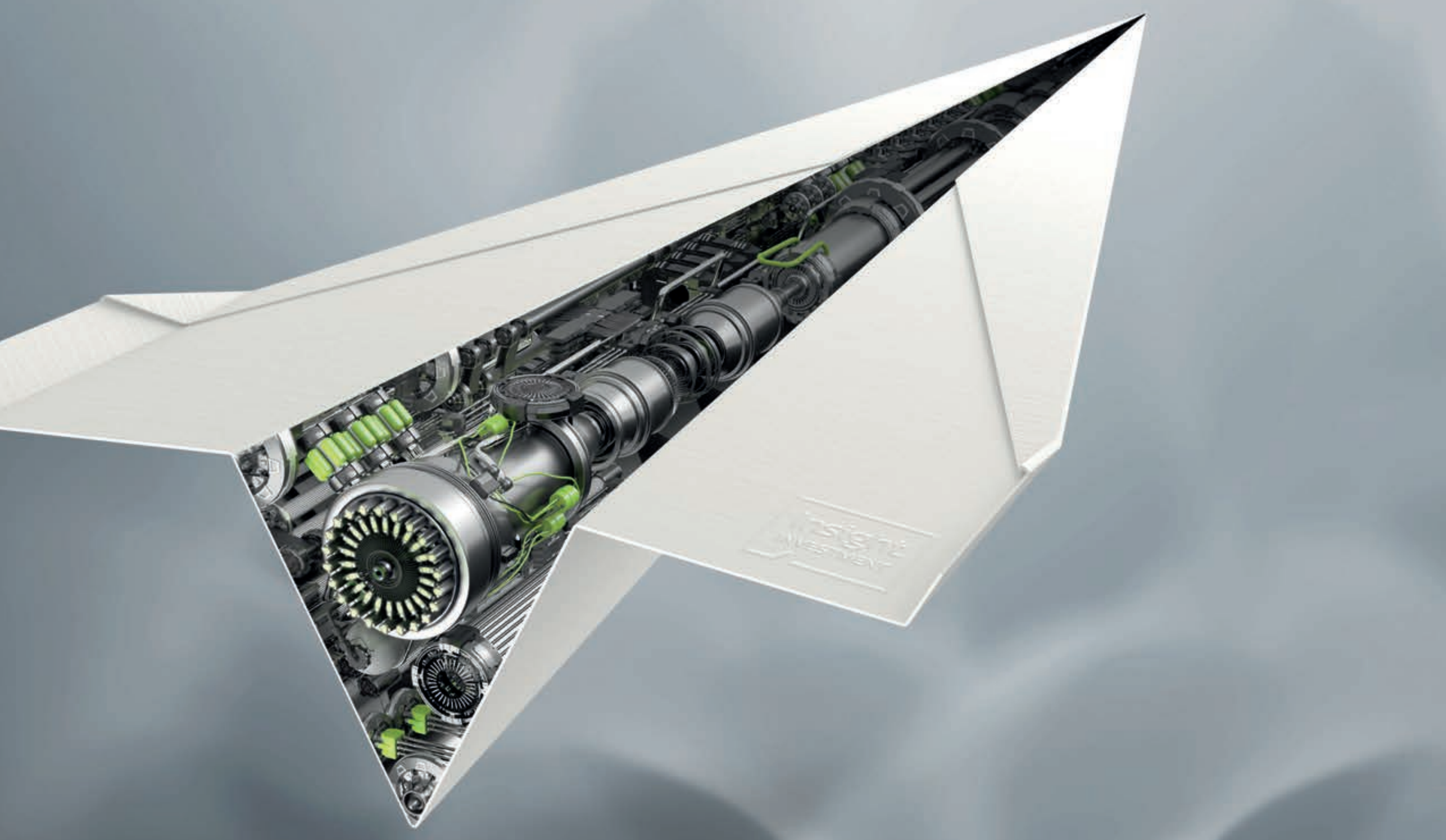
However, many investors expect the bonds to be risky, especially at the outset.

GC Securities' Anger says that as investors have not been tested in broadening out this niche of the market before, pandemic risk should be presented with as much transparency and data as possible.

But most in the sector agree that pandemic bonds offer the chance for substantial returns.

Dr Gordon Woo of RMS recently wrote in a blog post that some insiders believe this new segment has the potential to become bigger than the natural catastrophe bond market. That level of popularity may be some way off yet, but if the World Bank's PEF is well received it might start the ball rolling for similar transactions.

If pandemic risk insurance eventually becomes commonplace, then thousands of lives could be saved – and a sequel to *Pandemic* in the cinema would be unlikely.



Running dry

Warnings about excess reserves drying out have been a regular feature of the (re)insurance industry in recent years, but the reserving cycle could be changing, says **Iulia Ciutina**

The issue of reserve redundancies drying out has been an ongoing topic for many years, with carriers, analysts and the media all warning that the moment of truth is approaching, but it has yet to happen.

"How much longer the gift of prior-year reserve releases can keep giving will no doubt be a factor for if or when conditions change, at which point differences in individual companies' historic reserving practices will be exposed," argued Willis Re's global CEO John Cavanagh in a 1 July report from the broker.

Indeed, everyone is waiting for the expiry date to be unveiled, but of particular interest is the situation in which companies would find themselves without the cushion of reserves to lower loss ratios.

With pricing on the floor, excess capital pouring in through the roof and strong competitors knocking at the door, would the lack of excess reserves be the final blow for carriers with shaky underwriting foundations?

(Re)insurers have still been actively releasing reserves every quarter, with a few minor exceptions in certain underperforming classes of business. These reserves contribute to the companies' overall underwriting results and, in turn, their profitability.

In a note released on 10 August, Morgan Stanley analyst Kai Pan said that reserve releases had accounted for approximately 27 percent of P&C industry earnings in the past seven years.

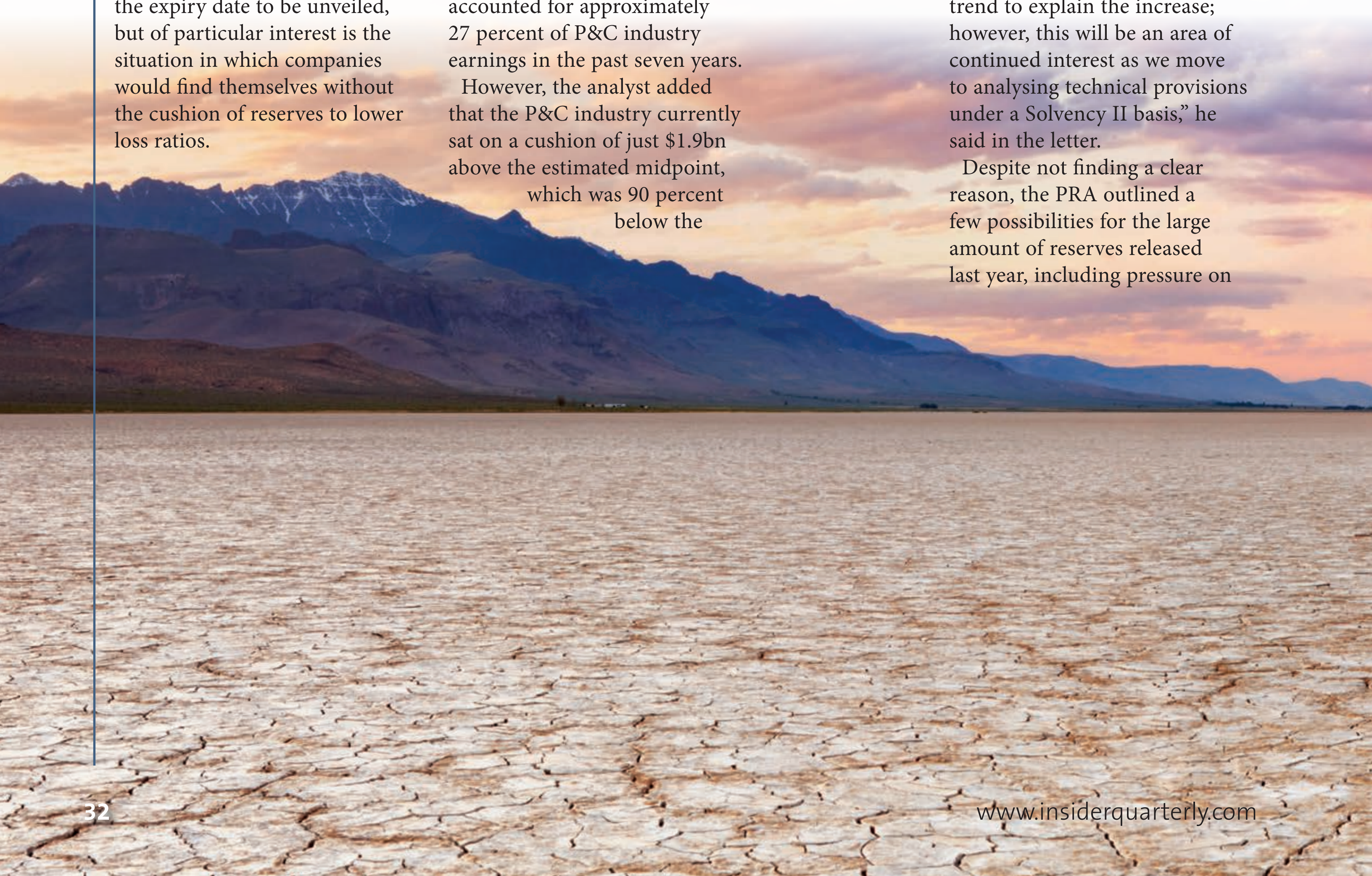
However, the analyst added that the P&C industry currently sat on a cushion of just $1.9bn above the estimated midpoint, which was 90 percent below the same metric back in 2009, when he identified $20bn of excess reserves.

Meanwhile, Chris Moulder, director of general insurance at the Prudential Regulation Authority (PRA) in the UK, published a letter to general insurance firms on 18 July 2016 warning on the industry's reserve trends.

Moulder questioned the sustainability of UK carriers' high positive prior-year developments given that in 2015 the percentage of reserves brought forward was the highest for more than 30 years.

"We have not identified a single trend to explain the increase; however, this will be an area of continued interest as we move to analysing technical provisions under a Solvency II basis," he said in the letter.

Despite not finding a clear reason, the PRA outlined a few possibilities for the large amount of reserves released last year, including pressure on



(re)insurers to maintain a certain level of profitability.

Reserve cycle

Looking back at the late 1990s and early 2000s, companies underestimated reserve requirements, and in the context of a soft market environment, they were forced to carry significant adverse prior-year developments.

Then the mid-2000s saw a spike in pricing following a series of outsized loss events, allowing carriers to set aside larger amounts of reserves, which have later proven to be redundant.

If we look at prior-year developments at sister publication *The Insurance Insider*'s Bermuda composite, the ratio of aggregate reserve releases to net earned premiums has been decreasing in the past year and a half.

In 2011, the full-year ratio stood at 8.2 percent, before falling to 6.8 percent in 2015.

On a half-year basis, the ratio had consistently stood at around 7.4 percent, but dropped to 5.7 percent for the first six months of this year, indicating that the downward trend is accelerating.

Commenting on the reserving situation in the wider (re)insurance industry, Axis CFO Joseph Henry notes that most of the releases, particularly on longer tail lines, have been coming from accident years 2007 and prior.

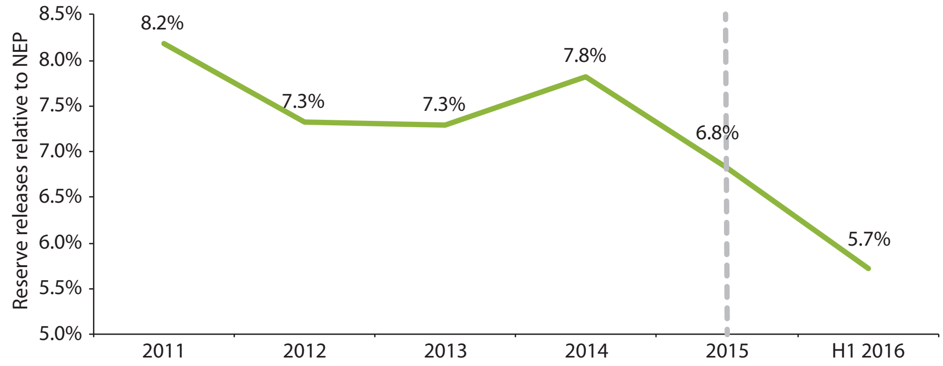
"Subsequent years have generally performed more in line with expectations, so I wouldn't anticipate the same level of reserve releases that you see from older accident years to recur with more recent years," he says.

This view is shared by Jeff Sangster, CFO at Validus, who argues that there has been a decade of reserve releases coming from the early 2000s.

However, he believes those reserve releases lasted for a longer period than expected, but are now coming to an end.

"We think we are soon at the end of the casualty lines releasing reserves from those years. I think we are in the last year or two."

Reserve releases ratio decreases for Bermudians



Bermuda composite includes: Allied World, Arch, Aspen, Axis, Endurance, RenaissanceRe, Validus, XL Catlin
Source: Company reports, *The Insurance Insider*

Soft market

Henry suggests a few of reasons why (re)insurers have been releasing less and less relative to earned premiums – the first being the difficult pricing environment, as "the rate scenario that was in existence at the beginning of the 2000s is not here today".

Morgan Stanley's Pan also found that the decline in P&C pricing and the thin reserve cushion could challenge the sustainability of large reserve releases.

Among the P&C carriers he covers, the analyst concluded that Bermudians Axis and Arch

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benefited the most from reserve releases, which constituted 56 percent and 45 percent of their respective 2015 operating earnings.

However, Pan warned that the two carriers would be the most impacted "if the reserve release tail were to slow".

The second argument is that the market has been facing a benign claims environment for the past 10 to 15 years, representing a fundamental change in the reserving cycle.

"The expectation of larger losses that was originally factored into the reserving has largely failed to materialise," Henry adds.

Inflation and interest rates

The final explanation Henry gives for reserve releases slowing down is related to inflation and interest rates, which have been running at very low levels.

> "The 'cheating phase' of a market occurs when reserve releases are used to mask poor results, mainly in periods of very low rates"

Carriers' assumptions of claims inflation are critical to the reserving process. If (re)insurers estimate their loss picks and reserve using an inflation figure that proves to be too low, then they would be faced with insufficient reserves in the future.

However, the degree of sensitivity to these macroeconomic issues depends on the tail length of each line of business, as longer-tailed lines are more exposed to changes in inflation.

But looking at the opposite end of the spectrum, Pan warned that the sustainability of large reserve releases from short-tail lines and more recent accident years could be challenged by a potential uptick in loss cost inflation.

The analyst continued to say that "subdued inflation has kept a lid on loss cost trends", as a rise in inflation could reduce the reserve cushion or even cause reserve charges.

The PRA also analysed the impact of inflation on reserves, diving more into the assumptions (re)insurers implied when estimating future claims inflation.

The analysis highlighted that, in an extreme case, should inflation increase to 5 percent, in line with levels implied by the historical data, booked reserves would need to be 25 percent higher than currently assumed.

Cheating phase

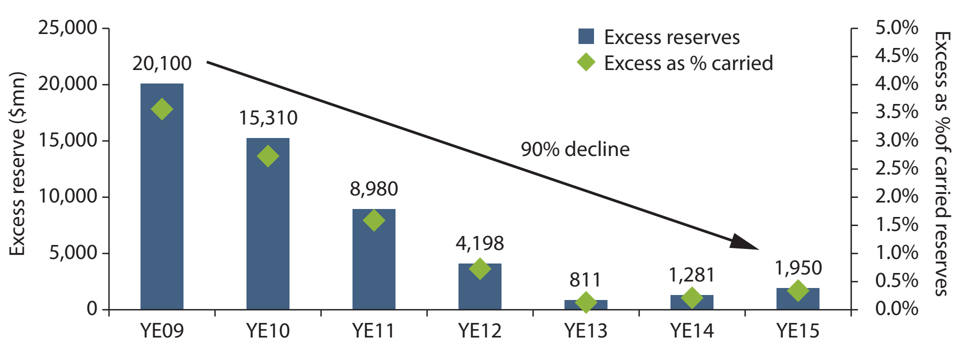
Commenting on the industry's current position in the reserve cycle, Sangster says he does not see a change in the cycle, as a softer market brings times when reserves may not be replenished as much as when the market is harder.

"One of the key analysts in the industry calls it 'the cheating phase', where companies are either taking down reserves more quickly or don't replenish them enough or as fast," he continues.

The "cheating phase" of a market occurs when reserve releases are used to mask poor results, mainly in periods of very low rates as companies are not able to afford to reserve as much as they did before.

"That's happened throughout the history of cycles. It tends to be the natural way things go," Sangster concludes.

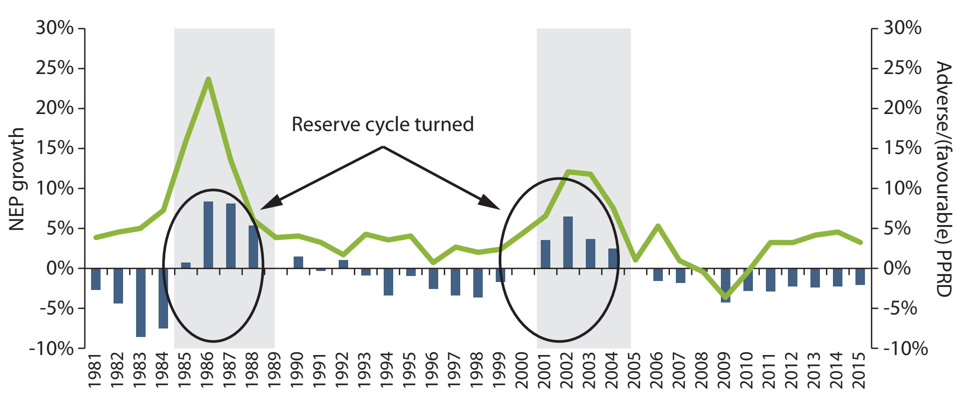
P&C industry excess reserves 2009-2015



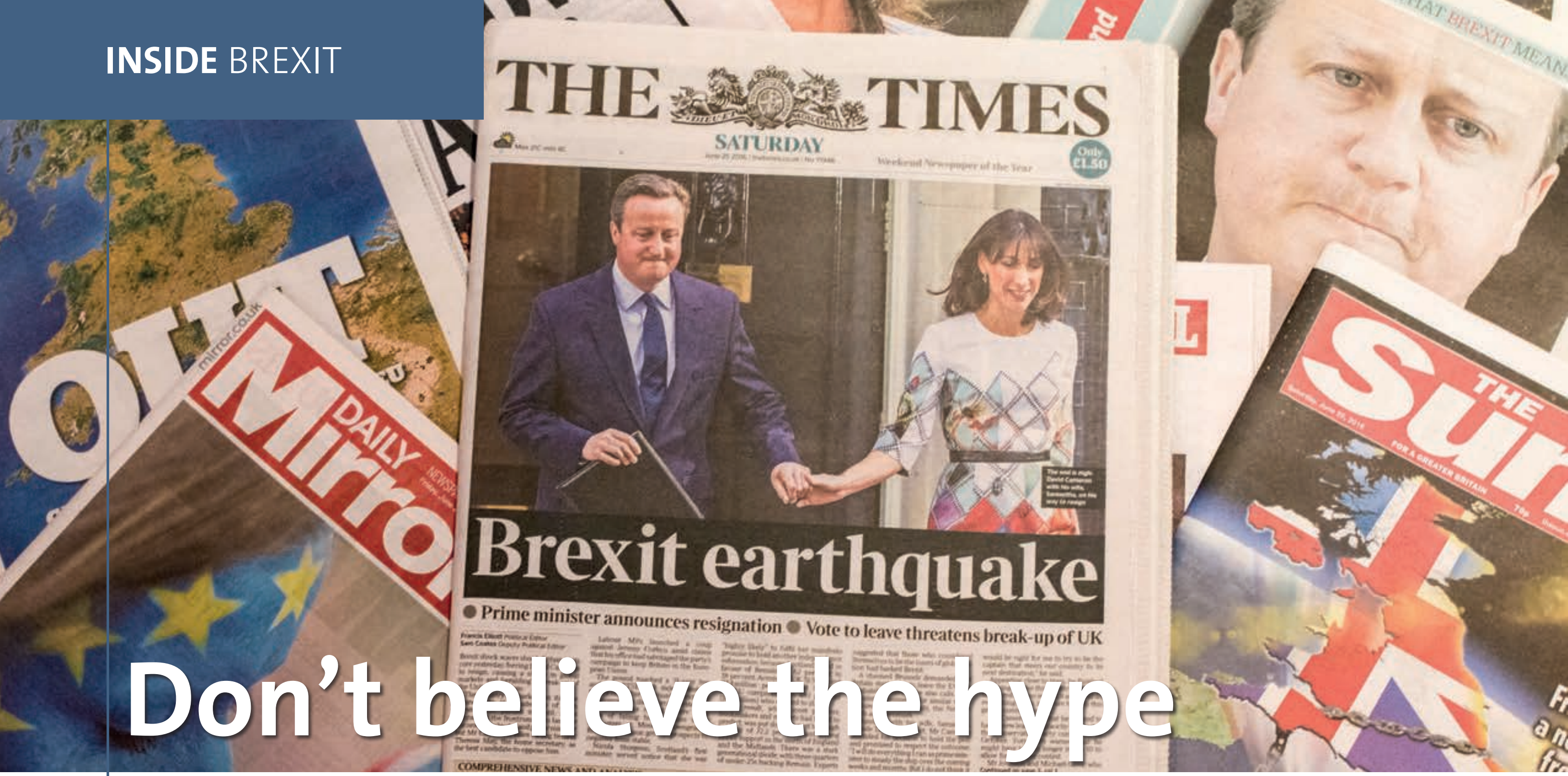
Industry carried reserves: $564bn (YE09), $562bn (YE10), $567bn (YE11), $575bn (YE12), $575bn (YE13), $577bn (YE14), $585bn (YE15)

Source: SNL, Company data, Morgan Stanley research

Prior year reserve development vs. premium growth



Source: SNL, Company data, Morgan Stanley research



Don't believe the hype

Is the UK's prospective departure from the European Union really that big a deal for the (re)insurance industry? asks **Winifred Okocha**

Some things are totally overhyped. The Millennium Bug. Downton Abbey. Sushi.

Like most obsessions that have the masses going gaga, Brexit was for a time the only thing on people's lips. Forecasts of economic doom and gloom were projected and the arguments posed by the "Leave" and "Remain" camps grew increasingly vicious.

But three months on, and with the problems that plagued the (re)insurance industry before the vote still present, is Brexit really that much of a game changer for the London market?

Article 50 '101'

The Lisbon Treaty was signed by the heads of state and government of the 27 EU Member States on 13 December 2007, and the formal mechanism for leaving Europe is found within Article 50 of the treaty.

Roger Matthews, senior lawyer at global law firm Dechert, explains that there are two negotiations to be had regarding the UK's separation from the EU: the terms of leaving, which consist of a two-year framework; and the question of what the UK's post-Brexit agreement will be.

Article 50, with its two-year timescale, relates only to the first of these, although it requires that the arrangements for withdrawal must take account of the framework for the UK's future relationship with the EU. There may be debate about what this means in practice.

"The UK wants those two negotiations to happen in tandem; the EU may not want that," he says.

"The expectation is that [UK prime minister] Theresa May will not launch Article 50 until the New Year, or possibly later."

Matthews says that there is talk of the UK trying to negotiate third country trade agreements on its own, but argues that this cannot be done while it is still part of the EU.

There is an issue too as to the content of third country trade agreements. "You've also got to remember that the UK's business interest is not just in getting a free trade agreement, but getting a good free trade agreement. There's a risk of the UK doing deals that aren't very good for UK businesses just to get agreements done quickly," he says.

Matthews outlines three discernible phases in the process of invoking Article 50 and withdrawing from EU membership. "From now until Article 50 triggered, the negotiation period from the point of activating Article 50 until we leave the EU, and the period after we leave the EU, are the time periods which can be distinguished in terms of the nature of the uncertainty and the potential for actual legal changes," he says.

Matthews adds that many parts of the civil service would be overstretched now and during the negotiation period. This means that potential changes around EU-related insurance regulation as it currently applies in the UK – such as Solvency II – would probably be put on the backburner (i.e. until the third of these phases) as far as possible.

"The government probably won't have time to work through the detail of Solvency II during the second phase, but they will probably have to make some changes immediately on exit and/or negotiate a transitional arrangement," Matthews says. He continues that later on, at the UK's leisure post-Brexit, the industry can consider with the government whether the country really needs Solvency II.

"Insurers may want to push for a commitment from the UK to align with Solvency II law and demand an immediate formal recognition from the EU that the UK is an equivalent third country. I would expect the UK to seek, as a minimum, for this status to be guaranteed for a five- to 10-year period after Brexit to allow for a decent time to adjust," he says.

Likely effects

Graeme Trudgill, executive director of the British Insurance Brokers' Association, says that the organisation has made its position clear to all relevant parts of government, including the new department for exiting the European Union and with HM Treasury. He says members have raised a number of issues.

"These include single market access and passporting, equivalence regimes, the need for the Financial Conduct Authority (FCA) to be given a statutory objective to consider the international competitiveness of the UK financial markets, European staff working in UK offices, UK staff working in European offices, and Northern Ireland," he says, adding that there are many more.

However, the CEO of the Lloyd's Market Association (LMA), David Gittings, says that it is possible for the market to survive Brexit.

"Clearly there will be an effect, but Lloyd's has quantified the affected premium income at around £800mn, which is about 4 percent of our GWP – not unmanageable," he argues.

> "Ireland has been calling attention to itself as an attractive alternative jurisdiction for insurance companies wanting to passport into the EU"

The Ireland alternative

In the wake of the vote, Ireland has been calling attention to itself as an attractive alternative jurisdiction for insurance companies wanting to passport into the EU.

Speaking to sister publication *The Insurance Insider* in August, IDA Ireland's Denis Curran, who runs the inward investment agency's international financial services division, said that the agency talked to companies "all the time" before the Brexit vote.

"But we have seen companies post-Brexit carrying out an evaluation of their European footprint and how best to serve the European marketplace on a passporting basis outside of the UK," he added.

"I wouldn't say that carriers aren't looking at other European jurisdictions. Any good company that's carrying out due diligence is probably looking at multiple jurisdictions outside the UK that are within the EU, but Ireland would be one and that's for a couple of reasons."

He said that Ireland had a number of strengths that made it an obvious choice.

"We already have international expertise in insurance and have global leaders within the (re)insurance industry, such as Zurich, Allianz, Munich Re, and Beazley Re.

"Married with that is the commitment to membership of the EU as we've been a member since 1973, and we're English-speaking. That combination of factors makes Ireland a very competitive location for companies when they're considering other jurisdictions across Europe."

Curran said that any preparations by insurance firms were likely to be in their infancy.

"What a lot of companies are doing at the moment is establishing Brexit teams within their own organisations and they're commencing internal projects to do some scenario planning around the uncertainty that Brexit has created," he said.

Gittings echoes these sentiments.

"We have up to two years to adjust to Brexit following the Article 50 notification and I'm sure firms are considering their options right now in order to position themselves for the future," he says. "I see a number of options being pursued, with the government seeking to maintain passporting rights at national level being the first."

Another option is the possibility of Lloyd's either determining which European community countries to apply for licences in or, alternatively, establishing a company model, says Gittings.

"The third option is individual firms deciding their own strategy," he adds. "These are unlikely to be mutually exclusive and I would anticipate all three being explored at the same time. There will be a cost/benefit equation to be done in each case."

However, Matthews advises against carriers making hasty decisions.

"Rightly, every insurance company should consider the option of locating certain

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functions in an EU country such as Ireland. But it would not seem sensible for any insurer to rush to move, especially if there is likely to be a substantial period of the UK being recognised as Solvency II-equivalent. I would be surprised if many firms do full-scale moves at this early stage."

Existing challenges

The London and global insurance industry has been fighting a number of battles in recent years and Gittings says that many of those issues remain at the top of the agenda for insurers trying to operate in a tough environment.

"I believe that increased international competition, excess capital and the soft market remain the greatest current challenges, together with the resulting pressure on costs and increased regulatory demands," he says.

Paul Merrey, partner in the global strategy group at KPMG, says that there is no doubt that Brexit could have a big impact on insurers, particularly in terms of market access. However, he emphasises that it creates other problems too.

"One of the immediate difficulties that insurers have been dealing with is the macroeconomic uncertainty and adjusting to the changes in interest rates and exchange rates," he says.

Merrey argues that the other big point is market access, in terms of the structure and the licences that insurers have.

"Outside that, the third impact is people. As a market that employs 34,000 people, protecting the protection of access to international talent is going to be an important factor in whatever comes out of these Brexit talks," he adds.

Meanwhile, Trudgill says that what tops the list of intermediaries' worries will differ from business to business.

"You may have motor brokers stating FCA issues are most pressing, but commercial brokers may say the Insurance Act, while international brokers may say Brexit," he says.

Trudgill names various challenges facing the broker community and says that the cumulative effect of these pressures is enormous, adding that it is difficult to pinpoint if one issue, including Brexit, is bigger than another.

"Flood Re, the FCA's new requirements relating to add-ons from September, the Insurance Distribution Directive with its accompanying systems changes – all of this breeds cost," he says.

"But commercial premiums are soft and therefore a broker's income remains flat at the same time their costs are increasing – particularly paying for all of these system and regulatory changes."

Dechert's Matthews says that another thing insurers and brokers should consider is the fact that there are a small number of very large players in the industry, so its negotiating power with government should be very strong.

"Coordinating a coherent message from the sector is important," he emphasises.

With the vote in favour of leaving the EU coming as a shock to many, Prime Minister Theresa May was keen to stress that "Brexit means Brexit". However, what Brexit actually means remains a mystery.

And however the negotiations turn out, the London market will have to adapt as it always has done, while being careful not take its eye off the myriad of difficulties it already faces. This belief is best encapsulated by the LMA's David Gittings: "Brexit is a 'new normal' that firms will find various ways of dealing with – maintaining London's international competitiveness and attractiveness to business is the greater long-term challenge."

The message from many in the industry is that the market has bigger fish to fry.

"With the vote in favour of leaving the EU coming as a shock to many, UK prime minister Theresa May was keen to stress that 'Brexit means Brexit'. However, what Brexit actually means remains a mystery"

The Insurance Act

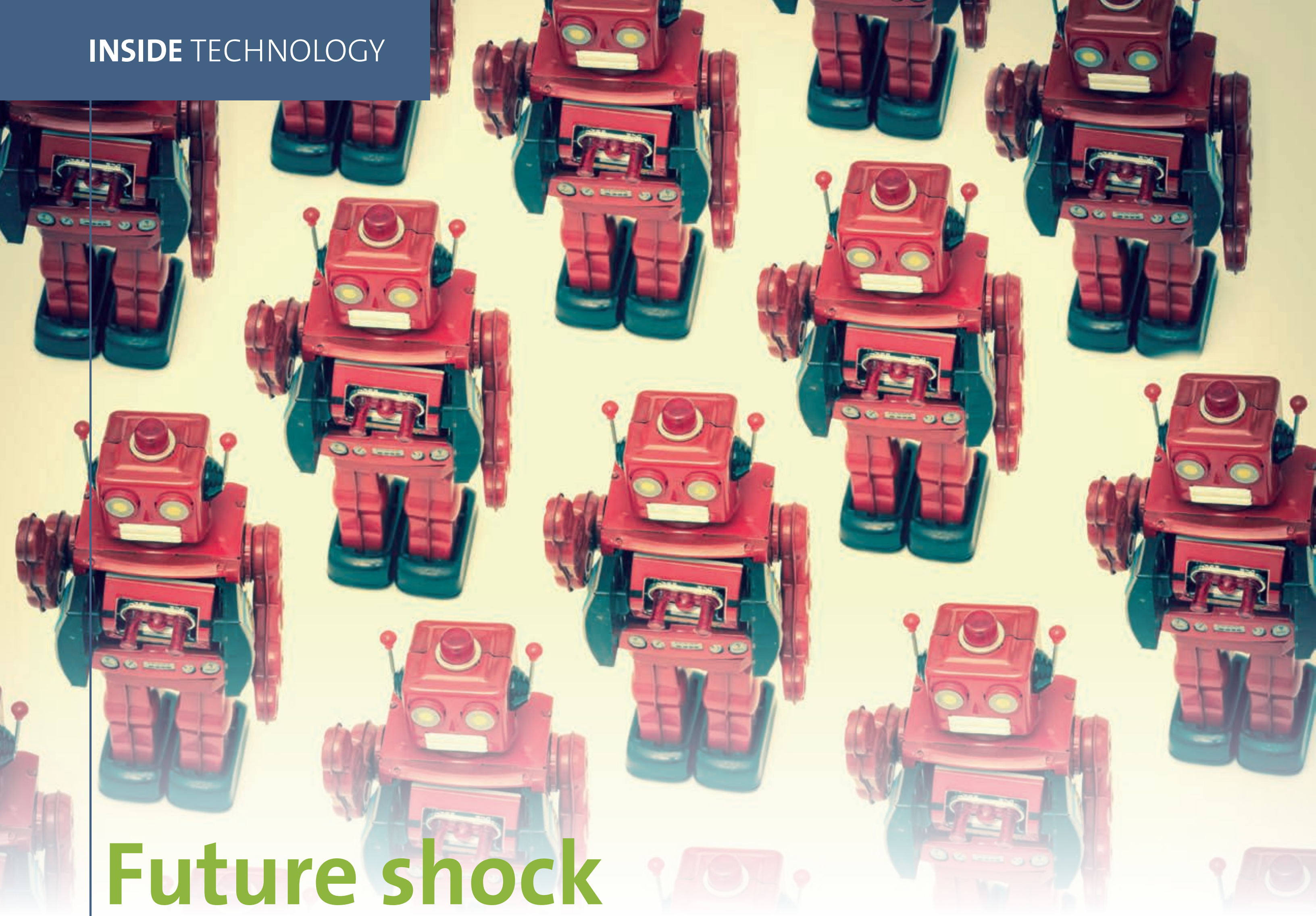
The UK's Insurance Act came into effect on 12 August.

The reform of UK insurance commercial contract law replaced some parts of the 1906 Marine Insurance Act, which underpins much English insurance law.

A survey conducted by law firm BLM in January found that more than two-thirds of UK brokers felt insurers hadn't provided them with enough guidance on implementation of the act.

Some 70 percent of the 60 respondents felt that underwriters had not provided them with sufficient information to enable them to assist customers on the duty of fair presentation and on issues concerning the knowledge of the insured, including the brokers as their agents.

BLM explained that the duty of fair presentation includes the disclosure of every material circumstance known, but brokers are still unclear about what will be deemed sufficient information under the new legislation – over and above what they currently provide – to put an insurer on notice.



Future shock

Watch out Lime Street – insurance technologies are coming, ready or not, warns **Matthew Neill**

The inevitability of change is beginning to seduce the insurance industry. Executives have started to perk up as whispered cures for the sector's ills brush past their ears on a walk down Lime Street: blockchain, telematics, cloud computing.

Technology has finally trickled down from the foothills of the banking and investment space into the parched uplands and yellowing pastures of the global insurance market.

This new arrival has duly been christened as both a saviour and a threat to the industry; at once a panacea for the soft market and stagnant work-flow management practices, and a harbinger of death for traditional insurance.

Its name: InsurTech. Or InsTech. Or "insurance technology solutions".

Whatever your preferred title, the phenomenon has begun to flex its (potential) muscles within the last year, with a host of companies either investing in, acquiring or partnering with start-ups, and venture capital funds pouring money into companies trying to farm once-fertile financial lands.

Sowing the seed

While the current proliferation of start-ups related to insurance is mostly focused on health and personal lines coverage, entrepreneurs – and increasingly those within the industry – have begun to explore opportunities within commercial insurance.

A number of major players are now emerging from the pack with the potential to significantly change the way commercial insurance works.

Late last year the self-styled world's first peer-to-peer insurer Lemonade secured $13mn in seed funding from venture capital firms Aleph and Sequoia Capital. Munich Re was also among the backers.

Sequoia is one of the best known venture capital firms in the world, and the fact that the Lemonade offering marked one of the largest seed rounds in its history demonstrates the perceived growth potential for start-ups within relatively uncharted territory.

And the company is not alone. According to consultancy KPMG, InsurTech funding in the first half of 2016 topped $1bn, despite a 50 percent drop in funding to wider financial technology (fintech) firms in the second quarter of the year.

This comes on the heels of approximately $2.5bn of backing given to nascent companies in the sector in 2015.

Venture capital database company CB Insights predicts the level of funding given to InsurTech start-ups will exceed last year's total by 42 percent if the volume of deals remains steady.

In a statement announcing the funding, Lemonade CEO Daniel Schreiber pinpointed the area where he thought traditional insurers were at a disadvantage to new players.

"As a fintech insurance company, Lemonade is designing around the bureaucracy and conflict that haunt the industry, replacing them with technology and transparency. What makes this exciting is that it requires reinventing the very structure and business model of insurance in ways not available to the legacy insurance carriers," he said

Pre-existing problems

Matt Miller, CEO of San Francisco-based digital broker start-up Embroker, says the point of the InsurTech industry is not to deliver a completely new concept, but to solve pre-existing issues that companies have failed to address.

He says insurers have previously relied on trust in the absence of transparency about their operations. However, customers will no longer accept simple trust on the basis of long-standing relationships as the foundation of a business decision, and expect more transparency from companies.

"How some people use the trust that they have is to operate in a way that is not transparent. Not everyone does it, but the industry overall lacks transparency and trust is sometimes used as a replacement for that," he says.

"We think that is a bad approach, we think that the way to build trust is to be transparent and by being good at what you do."

What is clear is the start-ups seeking to disrupt the industry have no qualms about targeting the broadly poor perception of some aspects of insurance.

> "The gulf of understanding [between insurers and buyers] has not escaped InsurTech start-ups, which have made improved customer engagement one of the pillars of their organisations"

Bad reputation

It's no secret that insurance has an image problem. There are constant discussions surrounding how to make the industry more palatable and appealing to buyers. To demonstrate the true value of the product and deliver it in a manner more in tune with what those purchasing now expect of it.

The gulf of understanding has not escaped InsurTech start-ups, which have made improved customer engagement one of the pillars of their organisations.

Companies within the industry understand the threat all too well. Whether they are capable of staving off the wolves at the gate remains to be seen, but a number of companies are beginning to take the first steps towards controlling the phenomenon for their own gain.

Reinsurers have been leading the charge, with several big players including Munich Re and Swiss Re not just partnering with start-ups, but allowing them space to grow in their own backyards.

In May, Swiss Re launched an InsurTech "accelerator" in Bangalore, India, in a bid to plant its flag firmly in the country's burgeoning fintech start-up ecosystem. The initiative offers fixed-term programmes to provide nascent companies with advice and funding.

The project was geared towards supporting companies focused on Swiss Re's key technology development objectives – including the Internet of Things, smart analytics and systems of engagement including innovative distribution channels, models and digital assistants.

And in July, Munich Re launched its Digital Partners initiative, which aims to create partnerships between the reinsurer and growing start-ups.

Concurrently the company announced it had paired with New York-based start-up Slice Labs to distribute its on-demand cover in the US.

The business model – which sees Slice Labs retain control of servicing and processing claims and the platform's automated underwriting rules chosen by Munich Re – serves as a benchmark for the types of relationships that established and nascent companies can forge.

Barriers to entry

Despite the continued hype surrounding InsurTech start-ups and how they may radically transform the way the industry works, there are a plethora of issues to contest with in the space that are not present in other sectors, and which pose significant barriers to companies looking to enter the market.

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Future shock
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Regulatory and capital demands, the need to acquire solid credit ratings and access to markets are all mountains to climb for small start-ups.

But with the backing of an established player, young companies can quickly and easily gain access to markets, crucial infrastructure and expertise, which would otherwise be obtained at a slow pace, if at all.

Slice Labs CEO Tim Attia said Munich Re's credit rating and global reach would be a critical element of the company's growth strategy.

PwC insurance director Steve Gough says that while regulatory issues are not insurmountable for the ambitious InsurTech start-up, the influx of genuine competitors in insurance will not happen to the same degree as in other industries such as banking.

He says: "I don't believe we will see a challenger insurer in the way we see challenger banks. So I don't think we'll see a start-up setting up a standalone insurer."

"Because of the complexity and the capital demands in insurance, I think you will see more partnering happening."

PwC senior associate Kasia Kirkland agrees that partnerships between existing companies and start-ups are the more likely route to success.

"While regulatory issues are not insurmountable for the ambitious InsurTech start-up, the influx of genuine competitors in insurance will not happen to the same degree as in other industries"

"Most of the start-ups are focused on one part of the value chain, so they can't really provide without partnering with the insurers," she says.

"They are not doing the underwriting, so they need to partner with insurers, not only for the cash flow but also for the other core processes you need for insurance policies."

Technophobia

While it is too early to predict the scale of the impact InsurTech will have on the traditional pillars of the industry, what is certain is that it is likely to play a role of some sort in the development of insurance in the coming years.

Whether the industry is ready and willing to accept the coming changes is an entirely different matter.

The reticence to quickly adopt new technologies has been a feature of the industry for some time.

The face-to-face dealing at Lloyd's and elsewhere is passionately advocated by those who say the system presents the best method of handling the complex and specialist coverages required by clients.

Several technology-based platforms have tried unsuccessfully to break the model, epitomised by the expensive failure of the Lloyd's-led Kinnect system.

Placing Platform Limited is the latest challenger to try its luck, recently adding marine lines to its initial trial following the successful rollout of the financial and professional lines services earlier this year.

However, Charles Taylor chief operating officer and co-founder of InsTech London, Paolo Cuomo, believes the problem stems from a lack of knowledge about current developments rather than a fear of change.

"The majority of people within the London market space are still broadly unaware of the quantum of change that technology is likely to bring," he says.

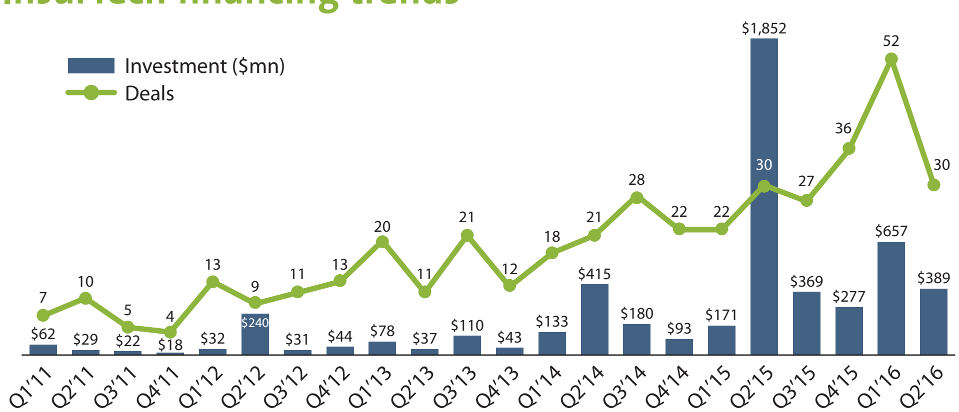
"It's not like people are being Luddite, they are just simply unaware."

Educating the insurance market at large on the potential benefits technology could bring to the industry will be difficult. But insurance has proved its resilience in the face of change before.

For advocates of InsurTech the challenge will be to properly articulate the value it can bring to the industry, rather than just adding to the noise.

If that is achieved, insurers will be the very first to reap the benefits.

InsurTech financing trends



Source: CB Insights

Legal assets

A new derivative market is forming where, instead of stocks and commodities, the underlying asset class is legal disputes. **Dan Ascher** delves into the world of third party litigation funding

Private equity houses and hedge funds have found a new investment vehicle and it could have a significant impact on insurers.

The practice of third party litigation funding or TPLF sees investors bet on legal disputes in a bid to earn a return that can be as high as 300 percent – on top of getting their money back.

It effectively creates a secondary marketplace around the judiciary as investment funds back claimants that they expect to win their legal challenges or, ideally, reach a profit-making settlement.

And one of the most important assessments the funders make is to look at the liquidity of defendants – and that can include their insurance coverage.

In that instance a marketplace is established that transforms the civil judiciary into a trading platform.

Such cases reduce claimants to a vehicle for investors looking to earn a healthy return from the deep pockets of insurers backing the defendants.

Yet little is known about the inner workings of the litigation funding industry, which remains largely in the shadows because claimants aren't required to reveal if a case is backed by investor capital.

That dynamic has frustrated insurers because the presence of an insurance policy sitting behind a defendant is discoverable during legal proceedings. And that could make insured defendants a more attractive target for litigation financiers.

> "The presence of an insurance policy sitting behind a defendant is discoverable during legal proceedings. And that could make insured defendants a more attractive target for litigation financiers"

Recruiting claimants

Last year, we were offered a rare glimpse into the world of TPLF after a disgruntled worker filed a complaint against his former employee, a US claimant law firm that had benefited from a sizable investment from litigation funding giant Gerchen Keller.

The complaint was sealed by a Texas district court judge shortly after it was filed in late September.

But sister publication *The Insurance Insider* managed to get a copy of the document before it was made private.

It accused the plaintiff law firm AkinMears of using the third party capital to amass "tens of thousands" of mesothelioma claims in a bid to leverage the scale of the potential litigation to force a settlement.

The complaint, which was filed by former AkinMears chief business development officer Amir Shenaq, alleged that the firm was using its private equity funding to buy books of claims for up to $50mn from rival law firms, with the expectation of making up to $200mn from settlement fees.

But that wasn't the only way AkinMears was alleged to be recruiting potential claimants.

"The firm is in the business of purchasing generic television spots, running a call centre stocked with script-reading [toll-free] operators, signing up clients and bundling the claims, and then sending them en masse to other lawyers who will hopefully settle them," the complaint alleged.

In return, it said that AkinMears charged a "robust" 40 percent contingency fee, which was then divided between its financial backers.

And the trend wasn't expected to slow down. Research by the US Chamber of Commerce's Institute for Legal Reform (ILR) revealed that AkinMears had spent over $25mn a year – more than any other firm – on television commercials targeting people harmed by asbestos.

It was part of a wider study which found that law firms harvesting asbestos victims through online advertising were paying up to $390 for each and every click they received on Google, making it one of the top 20 most expensive search terms in the US.

Gerchen Keller did not respond to a request for an interview and it is not known how many of these claims are brought with the help of third party funding because disclosure of how cases are financed is not required.

Access to justice

However, it is perhaps too easy to dismiss this kind of investment out of hand. In a world where court fees are increasing annually, it can provide financially challenged and unsophisticated claimants with access to justice that may otherwise have been out of reach.

Third party litigation funders provided the tools for individuals and entities "that are never able to see the courthouse door finally get their time of day", says Eric Blinderman – the newly appointed US CEO of Therium, which invests in suits on both sides of the Atlantic.

He argues that many people were shut out of the court system because it is simply too expensive.

"Courts are fundamentally designed to ensure that difficult problems that individuals and entities have against one another are resolved appropriately in a fair and neutral and transparent manner," the lawyer explains.

He says the judiciary ensures "predictability of outcomes and results", which prevents people resolving disputes "at the point of a gun", as in other parts of the world.

"From my perspective there has to be a healthy balance between the two and I think litigation finance does that because what you're really doing is providing access to justice," he continues.

He explains that Therium tends to shy away from the type of class action disputes that would typically trigger insurance coverage, and that very few of the damages awards or settlements that Therium has a stake in were funded by insurers.

However, he is fond of direct cases against an insurer where a declaratory judgement is sought by an insured.

"It's a strict breach of contract claim like any other except the contract is your insurance policy," Blinderman says. However, he emphasises that the vast majority of Therium's claims don't involve any insurance coverage whatsoever.

Market failure

Jonathan Molot, the chief investment officer of London-listed litigation financier Burford Capital, says investment fund backing addresses a market failure in the legal system.

"It doesn't pay to pay for

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Legal assets
continued from page 45

litigation," he says, as until a successful verdict is delivered money spent on bringing a claim represents a dollar-for-dollar loss to a firm.

The executive, who taught insurance law before founding Burford, says: "There aren't that many people that straddle doing both litigation and the financing and risk management."

His firm invests in individual cases or portfolios of litigation for large corporate clients. Again, very few of Burford's cases involve insurers and the firm does not have much appetite for class action disputes.

"We like to invest in what we understand, which is disputes between companies over contract problems," he says, adding that the firm would never touch mass tort claims. "[It's] just not our way."

"We're not really in the business of suing companies that are going to get insurance coverage to pay the result," he adds.

"In fact, we have done cases where major law firms were litigating on behalf of major insurance companies on the claimant side, but we haven't done the bread and butter suit against a defendant that's insured," he goes on.

"These are business suits," he explains. "There's definitely not insurance coverage for intentional breach of contract."

Molot says the firm's investment philosophy boils down to three things. Firstly, the claimant has to be significantly more likely to win than to not win. Secondly, the expected recovery has to be large enough to justify the cost of getting a case off the ground and, finally: "It also has to be really about money and not other things.

"We don't like cases that are about some principle – whether it's a noble principle, somebody suing to change the law for the better on something, or an ignoble principle like a divorce or a family matter.

"We don't like to get involved in things that aren't about money."

> "In a world where court fees are increasing annually, [TPLF] can provide financially challenged and unsophisticated claimants with access to justice that may otherwise have been out of reach"

Appropriate usage

Quality lawyers that have used TPLF speak highly of it because the partnership structure of a firm doesn't always allow them to accept risk.

Joel Heap, national head of commercial litigation for DWF, says that in the right case "it can be a very useful tool in the armoury" for claimants and their solicitors.

"It's all about there being enough fat or enough headroom in the dispute to afford to sacrifice some of your settlement or winnings if you go to trial in return for the funding."

He warns, however: "The claimant solicitors need to know where and how to use third party litigation funding."

"Where it gets a bad reputation and where it goes wrong is where third party funding is taken in the wrong circumstances. Because all it does is apply pressure on the pot and really… the person that loses out is the claimant.

"You've got to know how to use it because as much as it can be very helpful, if you get it wrong it adds another layer, another party to the dispute and – you might say – another snout in the trough."

But, he explains: "Our experience of the funders is actually I think they see themselves as responsible lenders, in that they also see that it will only work in a certain kind of case.

"And I don't think they want to be in that place where their fee becomes a barrier to settlement or turns into a big bunfight at the end because they're taking a massive slice of the pie."

He says that "as expensive as it can be" third party funding is a useful tool in high-value litigation.

The lawyer also argues that the presence of third party backing can reassure a claimant because it provides a second opinion on the merits of a case.

"For a funder to tell you: 'You know what, we're in this with you, we'll fund this; yes, we'll want a decent return but what we'll do with the money is give us the best opportunity to win. We'll get ourselves the best leading counsel, we'll get ourselves a brilliant expert, get witness training – if we've got to go to trial then let's at least go in the best possible shape we can go in.' There's some comfort for a claimant in a funder deciding to back your horse because they're not doing it for charity."

He concludes: "Let's be right about this – they do make a good return."

Staying in control

However, Heap says that while funders were "interested" in the course of litigation, "I don't ever feel that it's something where you lose control – because you might say that would be a downside, it's another person with a hand on the tiller.

"But in the main they will tell

you, having decided to back you and fund you whatever the strategic decisions are at any given time, yes there will be discussion and a collegiate approach."

Heap's colleague Jeremy Irving, who serves in DWF's insurance practice, says that TPLF is likely to increase access to justice.

"That is more likely to mean that there will be claims brought against parties that are known to be insured because ultimately there is a deep pocket there that will guarantee a payout," he says.

After speaking to clients, issues around litigation financing are not a major area of concern for insurers at the moment, he says.

However, Irving adds it has the potential to generate more interest and more concern over the next few years.

JLT Specialty's chief legal officer Steve Shappell agrees. He says that while, so far, the industry has not felt the effects of the new funding stream, we must assume that it will have an impact at some point.

"Suits that would not have been pursued previously because of the cost associated in litigating will be brought and will likely result in some larger settlements if the funding is adequate to eliminate the motivation to settle earlier due to escalating costs," he says.

The executive explains that the logical impact of the increase in third party funding would be a rise in the number of lawsuits faced by insureds, which are likely to cost more to defend and ultimately settle.

Lacking merit

This is one of the reasons that the ILR argues there should be more transparency and oversight in the market for litigation funding, which remains mostly unregulated.

"Certainly [insurers] will be defending more suits because our courtrooms will be clogged with lots of new cases lacking merit," says Page Faulk, vice president of legal reform initiatives at the ILR.

She is concerned that third party funders could file suits that lack merit and then abandon the plaintiff if the case appears to flounder.

"[The ILR's] Bryan Quigley casts doubt on the argument that litigation financing genuinely provides access to justice. He says that the presence of litigation financing is 'absolutely' a case of 'who has the biggest gun'"

"If they're involved in a case they need to be acting in the best interests of a claimant or plaintiff," she says.

"Clearly, if they're pulling out that does not sound like it's in the best interest, and again it raises a whole host of ethical issues and problems with this industry altogether."

And the institute's senior vice president of communications, Bryan Quigley, casts doubt on the argument that litigation financing genuinely provides access to justice.

"Show me a case where somehow or another they're really helping the genuine little guy get into the legal system that otherwise could not have gotten in there," he says.

"And the answer is that virtually none of the cases are that way, really. This is not an industry built on helping the genuinely downtrodden who otherwise don't have access to justice."

Quigley argues that there is already a regulated mechanism to prevent these kind of barriers to entry and that the presence of litigation financing is "absolutely" a case of "who has the biggest gun".

"This is an industry that really seems to be built on leveraging a settlement by their presence."

Axes to grind

But all of this may be ignoring the most pressing ethical dilemma posed when outside interests use the judicial process for something other than its primary purpose.

And that dilemma was brought to the fore lately in an unlikely dispute between former pro wrestler Hulk Hogan and online gossip magazine Gawker.

Hogan sued the site for invasion of privacy after it published a sex tape featuring the retired wrestler.

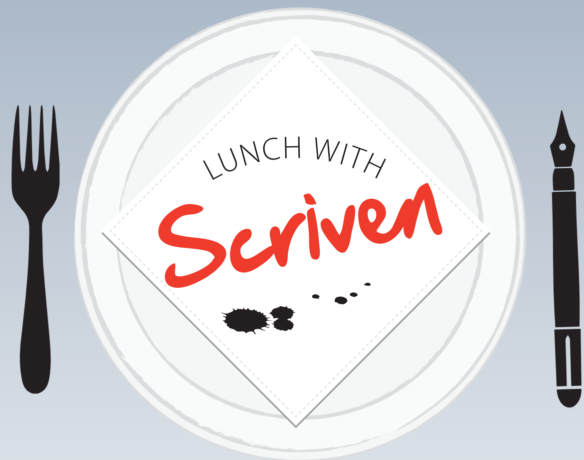
And earlier this year, after a two-week trial that attracted the attention of media across the world, Gawker was bankrupted when a Florida jury awarded Hogan $140mn in damages.

But a month later it transpired that Hogan's claim had been funded by tech billionaire Peter Thiel, who almost 10 years earlier had been outed as gay by Gawker and had an axe to grind.

While the court ultimately found that Hogan had been wronged by Gawker's coverage, the real motivations for the case were not on trial. Some would argue that Thiel facilitated a legitimate lawsuit to settle a private score and obscured the transparency of justice as a consequence.

It could also be argued that this is what third party litigation funders are doing when they treat a claimant's grievance as a derivative investment for the purpose of earning a return.

But as long as those investors hide in the shadows, questions will continue to be raised about the legitimacy of their business model.



Marcus Scriven returns in a new section for *Insider Quarterly*. In this issue Ian Posgate, aka Goldfinger, at the Ladbroke Arms in Notting Hill, muses on the power of prayer

"That is the power of prayer. Don't you understand the power of prayer?"

The voice sounds as though it's been unlocked from a monochrome clip of 1940s or 1950s cinema, quite possibly of a Rattigan play; it emerges, instead, at lunchtime in the Ladbroke Arms, Notting Hill, from a figure of flesh and blood, the tight epidermal corrugations around his cheek-bones indicative not of duelling scars (plausible though that might almost be) but of a life fully lived.

Still, at 84, strong in the shoulder, and dressed today in a shirt of sky-blue poplin, open at the neck, and a coat – as it would have unhesitatingly been called by members of the London market when he first arrived there, bowler-hatted, in 1954 – of charcoal grey, his is, in fact, a soubriquet born of the Technicolor age: Goldfinger.

It was conferred on Ian Posgate in (often begrudging) acknowledgement of market domination that saw him consistently write up to 20 percent of Lloyd's marine business, an accomplishment achieved by nerve, ability – and appetite: "fearless and greedy", in the awed and appreciative opinion of one of the broking multitude who queued to do business with

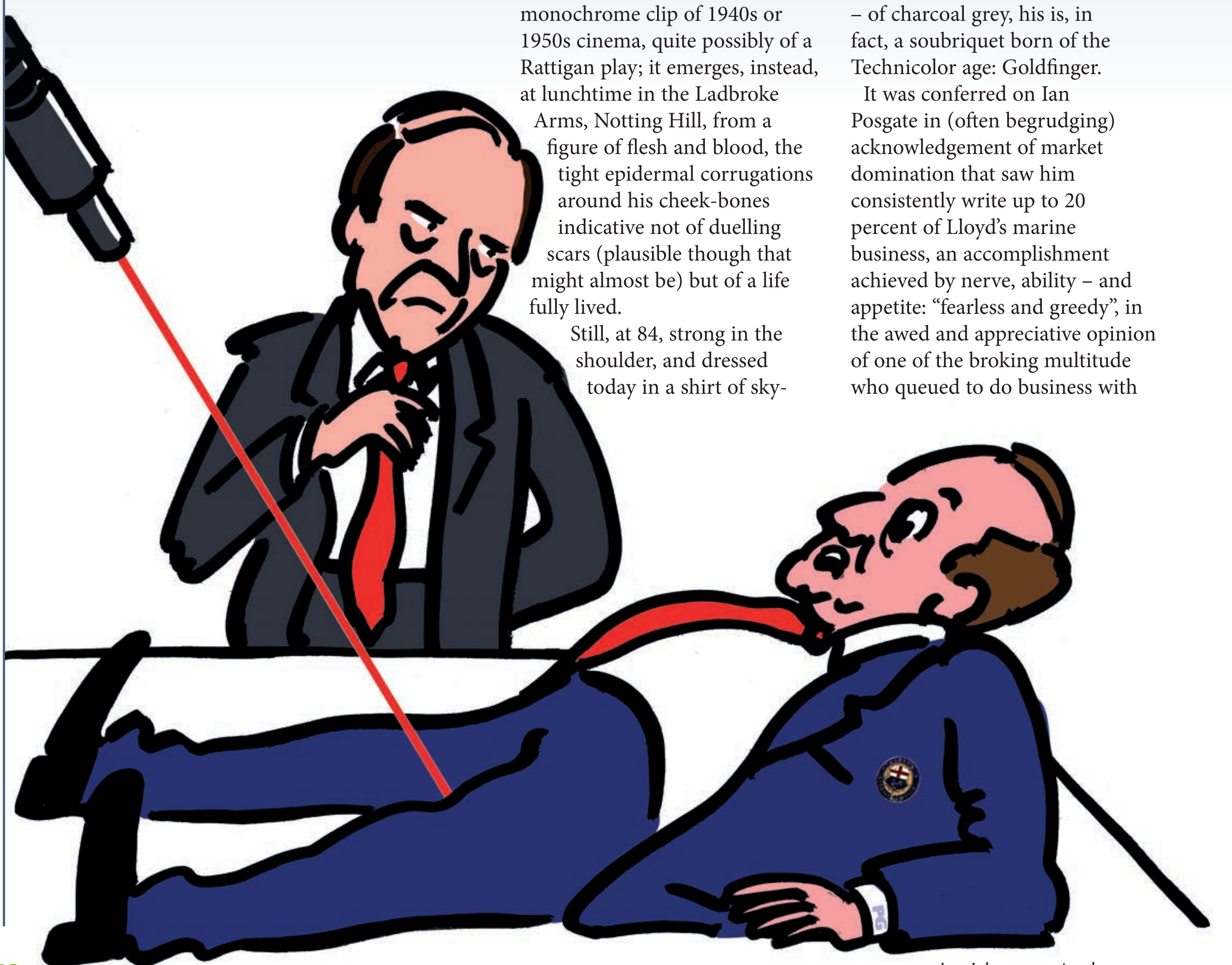


Illustration: Mark Long

him at Box 137.

Success necessarily came at the expense of fellow underwriters, the mention of one of whom by name – Stephen Merrett – causes Posgate, refreshed by a pint of Truman's and a glass or two of sauvignon blanc, to comment on the potency of prayer, on hearing that Mr Merrett's health is perhaps less robust than once it was ("that is a perfect example").

The lack of inhibition, the allergy to insipid comment of the sort expected by contemporary convention, the theatricality of delivery – metal-rimmed glasses pinioned, skywards, halfway across the top of his head, left index finger raised in emphasis, thumb planted on lapel – all seem authentic expressions of the character within.

Yet it's difficult to envisage Posgate failing to appreciate that overt flamboyance was a trait to be cultivated, a vital tool in an arena that he immediately identified as a market rather than the incestuous old boys' club – headed by a confederacy of amateurs, or dunces – which most of its members preferred it to be.

Joining Frank Davey's syndicate – one of the smallest of the 400 then in operation, with annual premium income of just over £100,000 – he noted that the box was equipped with copies of T*he Field* magazine, and that Davey arrived each day at 10.15 am and departed at 4.15 pm.

"His is a soubriquet born of the Technicolor age: Goldfinger… conferred on Ian Posgate in acknowledgement of market domination that saw him consistently write up to 20 percent of Lloyd's marine business"

The young Posgate soon also became familiar with "Colonel Roylance" (Lt Col Robert Walker Roylance). "Nice fellow, quite incompetent, lost his Names a lot of money. The view was taken that, as he'd been chairman, they shouldn't ask anyone for money: that we'd all make a contribution. Extraordinary."

Going with the herd had never been the Posgate way. At Merchant Taylors' School, where he endured the winter of 1947 when snow was piled either side of the drive, "6ft high", for week after week and rationing intensified (bread, never rationed during the war, went "on the ration" in summer 1946), he was in the First XV for two years – "wing-forward: had to flatten the opposition" – and excelled at maths, brilliantly taught by three masters, all with Oxbridge double firsts. But he truncated his time reading maths at Cambridge well before graduation. "I hated it; I read poetry."

Worse might have followed. "God, I nearly became an actuary." The words emerge against the downward flow of lemon and basil gnocchi, plaice and buttered spinach, the ingestive process made more perilous by contemplation of a less richly textured life than the one he subsequently experienced.

Fortunately, his father, who had his own modest business ("my mother was more ambitious"), facilitated an introduction to Lloyd's, where the novitiate speedily sized up the opportunities offered by the Davey regime. "Lunch was 1pm till 2pm, so you might hang on for five minutes; equally, you got back a little early; by the time he got back from the Captain's Room it would be half-past two." Then it was agreed that Posgate could come in on alternate Saturdays; the syndicate's premium income "rapidly increased".

He became a Name in 1957, but never settled for the passive comfort of "clubbable" Lloyd's; flattening the opposition was infinitely more rewarding. Although, he claims, "not particularly good as a

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Lunch with Scriven
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mathematician", he was "very quick on arithmetic", assimilating figures on a slip in a heartbeat. "I could look down and say: 'that doesn't add up.'"

War whetted his appetite. "The only money…" he pauses; lowers his voice an octave… "is out of war." The Six-Day War was "good money"; Vietnam was in a league of its own. More exactly, the Mekong River was. Whenever claims came in, as each year they did, Posgate hiked the premium to 10 percent of the cargo value per month; when they abated – as, again, each year they did – he dropped it to 5 percent.

Only much later did he learn what caused the annual fluctuations. "Half the year you could put a bazooka through a porthole, because the river was 30 yards wide; the other half of the year, in the rainy season, it was three miles wide – out of bazooka [range]. If we'd known either or both of those facts, I would not have made the millions that I made out of it. Millions," he repeats, his tone joyous and gently exclamatory.

The legend swelled commensurately. There was, for instance, the occasion when, walking to lunch with a broker, he was said to have remarked: "I don't like you, you don't like me. Buy me a shirt, and we'll skip lunch." ("True," says Posgate. "We got on rather better after that.")

Or, when striding along beside his late friend Reid Wilson, they were greeted by a gentleman heading the other way; Wilson reciprocated while Posgate remained silent. Wilson to Posgate: "Why didn't you say good morning?" Posgate: "I don't speak to him." Wilson: "Why not?" Posgate: "I can't remember. But I don't speak to him." ("Probably true.") Or the encounter with Peter Green and

"He became a Name in 1957, but never settled for the passive comfort of 'clubbable' Lloyd's; flattening the opposition was infinitely more rewarding"

Stephen Merrett, who reputedly went over to him to "have a word", only for Posgate to look up and say: "I don't talk to unsuccessful sons of successful fathers." ("Not true; they never had the courage to come and see me.")

As the capacity of Posgate's syndicates grew to £250mn, he increasingly fell foul of Green, a less inspired underwriter but an adroit politician who, by 1980, had become chairman of Lloyd's – en route to receiving Lloyd's Gold Medal, followed by disgrace via partial exposure for corrupt practices.

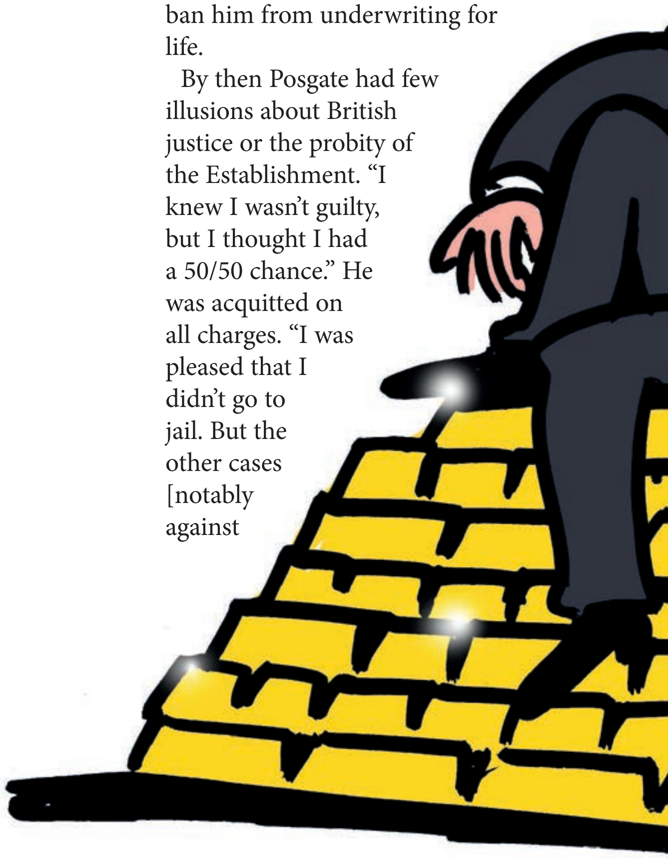
Before then, however, Green had helped ensure that Posgate was forbidden from being an underwriting agent, and was instead yoked to "the Grobfather", Ken Grob, chairman of Alexander Howden, and his ally Ron Comery.

Grob's war service had been as a rear-gunner in a Lancaster; in peacetime, says Posgate, he was less impressive. "He and Comery persuaded Lloyd's they would be sensible; they were a couple of crooks. Green had the same accountants as Grob and Comery; [Peter] Cameron-Webb had the same accountant too. Some of the accountants had their wives on the syndicates. Accountants played a very important part, because in those days easily the majority of the syndicates were losing money and were just growing to cover the previous year. The accountants permitted them. Quite disgraceful."

In 1981 Howden was acquired by the Americans, in the form of Alexander & Alexander, whose due diligence disclosed that millions had gone missing. Posgate, a director of Howden, was accused by Lloyd's of false accounting and misappropriation of funds. "Green wanted to get at me; the insurance world wanted to get at Grob and Comery." Acquitted of the primary charges by a Lloyd's committee, Posgate was found guilty of accepting a Pissarro painting as a bribe; he did little to diminish his legend by reflecting that the Pissarro was "not that good, not that expensive".

He managed a similar display of insouciant candour at his trial in 1989 on charges of fraud and conspiracy ("if you are in love", he pointed out, "you do foolish things"), a case that was the culmination of a decade of hostilities between Posgate and a Lloyd's hierarchy determined to ban him from underwriting for life.

By then Posgate had few illusions about British justice or the probity of the Establishment. "I knew I wasn't guilty, but I thought I had a 50/50 chance." He was acquitted on all charges. "I was pleased that I didn't go to jail. But the other cases [notably against



Grob] were then dropped. It was grossly unfair."

He abandoned the attempt to resume underwriting, contenting himself instead by securing a last victory – permission to continue as a Name – and in immersing himself in various commercial and philanthropic interests, and recreational pleasures, and by offering insights into the challenges faced by Lloyd's as it lurched through the 1990s, to those wise enough to seek him out ("My family and my cattle are out of bounds, Mr Jones," he pointed out to one documentary maker, opaquely alluding to agricultural endeavours at Badgemore, his Oxfordshire residence).

The pattern continues to this day, his time and energies variously engaged by the theatre ("we saw *Richard III* the other night: Ralph Fiennes and Vanessa Redgrave. Very good"), the opera (especially Glyndebourne: "*Figaro* and *Barber of Seville*, and we're going to see *Midsummer Night's Dream*"), variegated business opportunities ("I'm involved [this emerges, in Posgatian manner, as 'in-vole-v'd'] in a pharmaceutical company being taken over") and, always, the reassuring pleasures of the south of France ("Cap Ferrat in June").

The fascination in others is unabated: "the Essex cricketer" (Novae CEO Matthew Fosh), "the boxer's daughter" (Sarah Spencer, formerly Milford Haven, née Walker, whose late father George was once British amateur heavyweight champion before he progressed to other fields of endeavour), the Greenbergs ("Hank would ring me up at 25 to seven and say 'Why haven't you paid me something?' God, we'd only had the claim a week… Evan's good; a bit of a shit") and "that very odd woman: very odd" (Lloyd's CEO Inga Beale).

The market still engages him. Sanguine about collateralised capital and its ability to withstand apocalypse ("if it goes bust, it wasn't enough; that's the test"), and Bermuda's capacity for attracting capital and talent ("a little island in a small world"), he is less equable when addressing homegrown deficiencies ("Royal Sun Alliance is a crap firm. Aviva – Commercial Union – is a crap firm. These people don't deserve the money"). Lloyd's, he feels, is especially vulnerable. "When I came to Lloyd's, you had 25 percent of the world's shipping on the Clyde. America didn't know really about insurance. They considered it a rather lowly job. Now America has caught up. Aon, Marsh… they're much more powerful than we are." So, he adds, are the Japanese, citing their acquisition of Kiln and Canopius.

By now, he has dealt with the chocolate fondant (and banana ice cream). "I've got until 3.30. 2pm is it? 3pm? Oh, godfathers! We'll have some coffee. Black."

He concludes with advice for "the goons" in charge at Lloyd's, particularly those who would lock the market into an actuarial straitjacket. "Underwriting is not a science," he says, explaining that it is amidst the shadows and uncertainties that those with entrepreneurial spirit can make money – or should be free to do so. "That was its advantage. That stands."

Conversely, the market, he argues, needs a manager rather than an entrepreneur as chairman – someone who will slash Lloyd's costs ("still the highest"). "I would be horrified if it was Catlin because he was the underwriter. I would accept Philipps – a managing director. Enormous difference."

It's a view informed by experience. "I would have hoped to have had a managing director who could deal with people like Peter Green. We'd still have been there if we'd had [Andrew] Houghton as the boss or someone similar. We'd have made some money."

> "He abandoned the attempt to resume underwriting, contenting himself instead by securing a last victory – permission to continue as a Name"

Guns for hire

With carriers' balance sheets effectively for hire in mitigating operational risk, can the facultative market foster the development of these new insurance products? **Marcus Alcock** takes a peek

As a market, you would have thought that (re)insurers would by now have had pretty much every area of risk covered, codified and packaged into suitable products, backed by ample capacity and distributed by clued-up brokers.

Yet there's one potentially huge area that remains, to a great extent, uncharted waters for the direct and facultative (D&F) market in particular: operational risk.

Operational risk in the insurance world refers to the risk of loss arising from inadequate or failed internal processes, people, systems or external events (see boxout right).

As a consequence of Solvency II, European insurers must include these risks within their risk-based capital models. And this is not exactly small beer. According to the Institute of Risk Management (IRM), capital requirements in respect of operational risk could range from 2 percent to more than 25 percent of the overall funds an insurer must hold, amounting to hundreds of millions of pounds for major insurers.

Of course, the management of operational risk is not limited to insurers themselves, and is a major regulatory topic for the entire financial services sector, as banks, asset management companies and the like seek to address the issue of better management of capital head on.

And one can see why – currently, the evidence is that upwards of 12-15 percent of a bank's regulatory capital is deployed in addressing operational risk, according to a senior London market lawyer. He adds that in addition to operational risk, insurance products have been incorporated in banking institutions' risk buying for a number of years, with the appetite for these products increasing, as well as the use of them to arbitrage capital and insurance premiums.

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Balance sheets for rent

"Prior to Basel II 'operational risk' was not subject to capital adequacy requirements," says Mark Hardinge, a pioneer of the management liability market and now director of specialist insurance intermediary Wiredback.

"Formerly operational risk was implicitly covered through the treatment of credit and market risks for credit institutions. Now minimum capital requirements need to be calculated and provisioned for credit risk, operational risk and market risk."

Hardinge says the willingness of regulators to acknowledge the renewed financial strength of major insurers to mitigate these risks has created the opportunity to rent carrier balance sheets to replace elements of regulatory capital.

"Capital haircuts of up to 20 percent can be achieved and the purchase of insurance products has been boosted by the arbitrage between the cost of capital and insurance premiums," he explains.

"Whilst insurance has been traditionally seen as a defensive risk mitigation strategy for operational risk, credit risk, and market risk, recent regulatory developments and a change of approach by some enlightened insurers has opened the way to use a new generation of insurance policies," Hardinge adds.

In his opinion these "extremely powerful tools" can underpin innovative corporate finance and treasury stratagems for both financial institutions and their corporate customers.

"Receivable and payable portfolios are an asset which when enhanced by insurance wraps become an asset class that can be used to secure innovative programmes to improve liquidity and even reduce pension fund deficits," he comments.

Hardinge notes that given the current imbalance of capital supply and muted demand from insurers for traditional insurance protection, some industry leaders are looking hard at other ways to rent their substantial balance sheets on a non-traditional basis and to address broader areas of risk.

One of the companies to stick its head over the parapet last year was XL Catlin, with the launch of a bespoke operational insurance product. As the insurer said at the time of the launch: "These highly tailored and specific solutions are designed to provide absolute clarity of coverage, giving operational risk practitioners and regulators the confidence that they will work as intended when needed." Available capacity per operational risk product is in the $100mn-$300mn range.

D&O expansion

At present the market that most closely correlates with operational risk insurance is the directors' and officers' (D&O) insurance space, which is understandable given its wider focus on management liability. At present a number of underwriters in the D&O stable are looking keenly at what can be achieved, according to one senior London market underwriter.

"Broadening the scope of what D&O underwriters can do by effectively moving into the wider operational risk arena is something that a number of people have been trying to do for some time, and it's definitely something I've been banging on about for ages, but like all these things it's a game of softly, softly, catchee monkey," he says.

"That said, I can understand why actuaries and their ilk are loath to come on board here and put their full weight behind new products – it's potentially an inherently more volatile product than bread and butter D&O, which the market has been extremely comfortable with for some time.

"As you might suspect, it's a matter of finding the right pricing point, and that's not going to happen overnight."

Indeed, in the preface to a report published by the IRM last year on the subject, Michael

Continued on page 54

Operational risk in brief

The use of the term operational risk first came to prominence in the mid-1990s, and is defined by the Basel Committee on Banking Supervision as "the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputational risk".

The Basel Committee subsequently issued a paper, "Sound Practices for the Management and Supervision of Operational Risk", which defined the following seven types of operational risk loss events:

Internal fraud – Acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or company policy, excluding diversity/discrimination events, which involve at least one internal party.

External fraud – Acts by a third party, of a type intended to defraud, misappropriate property or circumvent the law.

Employment practices and workplace safety – Acts inconsistent with employment, health or safety laws or agreements, or which result in payment of personal injury claims, or claims relating to diversity/discrimination issues.

Clients, products and business practices – Unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from the nature or design of a product.

Damage to physical assets – Loss or damage to physical assets from natural disaster or other events. Examples include terrorism, vandalism, earthquakes, fires and floods.

Business disruption and system failures – Disruption of business or system failures. Examples include hardware and software failures, telecommunication problems and utility outages.

Guns for hire
Continued from page 53

Sicsic, international chairman of operational risk consortium Oric International, highlighted the problems currently faced in this area, with keeping an accurate tally of potential risks a major issue.

"Operational risk management is still a relatively new discipline – and quantification appears to be the cornerstone of raising the bar for both operational risk practitioners, and more importantly for senior management in their decision-making processes," says Sicsic.

"Indeed, the quantification of operational risk is a critical milestone in the journey of achieving the same maturity level in managing operational risk, as is regarded to be the case in the other more established areas of enterprise risk management, such as credit, market and insurance risk."

Fac support

Given the bespoke nature of the product, this is potentially very fertile territory for the fac market, according to one London market player.

"Certainly for mid-market syndicates and the like there will always be a bit of fac bought around the margins by decent D&O underwriters, whatever people tell you. Looking at operational risk, it's difficult to say as there really isn't a mature market to speak of, but I can definitely see the potential for fac at some point down the line. It's a bespoke product, after all, but this will all come down to capacity and whether reinsurers have the stomach for it."

> "The willingness of regulators to acknowledge the renewed financial strength of major insurers to mitigate these risks has created the opportunity to rent carrier balance sheets to replace elements of regulatory capital"

To what extent operational risk insurance will develop to become a properly mature market, with several products on the table and sensible pricing, is the key question.

It's far too early to tell at the moment, but what one can say with some confidence is that any growth will be dependent on the willingness of the (re)insurance market to underpin new products with sufficient capacity. And here it's a safe bet to assume that an important part of that capacity will almost certainly be provided by the facultative reinsurance market – helping financial institutions steer a clear course through choppy regulatory waters.

As Hardinge muses: "There has never been a better time for both financial institutions and corporate clients to talk to experienced brokers to explore how insurance can help not only protect but reduce regulatory capital requirements, and perhaps even more importantly to grow new business."

Mitigating other key risks for FIs

According to Paul Beard of financial institutions risk specialist Transaction Mercantile, external factors such as credit risk and political risk can also be mitigated by insurance, resulting in even greater rates of return on capital.

New types of credit risk insurance policies are increasingly being employed to not only reduce capital requirements, but also to enable profitable financing transactions with a far broader spectrum of corporate customers.

In Beard's opinion, banks and financial institutions have traditionally been attracted to trade financing as a short-term, self-liquidating and recurring source of revenue. However, he argues, regulators' capital adequacy requirements have progressively attached higher risk weightings to all but investment-grade borrowers.

"In practice most trading portfolios are made up of asymmetric transactions between small and medium-sized companies selling to larger enterprises. Here again insurance can provide enabling solutions," he says.

"In reality these inherent conflicting approaches all distil into a common shared outcome – certainty of payment. Ultimately all successful commercial trades are reduced to invoices and remittances. We therefore focus on perfecting both receivables and payables being two sides of the same financial transaction. Trade credit insurance is used to enhance the underlying obligation to become an asset class which can be taken onto a funder balance sheet."

He adds that where the obligor in a transaction has a less than investment-grade credit rating, the same debt when wrapped by an A-rated insurer's balance sheet substitutes this credit rating for the purposes of calculating the amount of risk-weighted capital that a funder has to provision to fund it, with tangible results.

"Using the now familiar 8 percent capital adequacy provision requirement this means that the same £10mn trade finance portfolio enhanced by a qualifying insurance wrap might require £160,000 in regulatory capital instead of £800,000 to support it. The cost of the premium to support this portfolio enhancement may well range from 1.2 to 1.6 percent of the total value."

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Capturing profitable reinsurance opportunities in trying markets

The Qatar Re story

Succeeding under market adversity

Within just three years of its strategic repositioning Qatar Re has developed into a Global Top 35 reinsurer. This expansion was accompanied by sound profitability – defying inexorably eroding rates and margins in the global reinsurance space coupled and increased volatility in the global economic and political environment.

Successfully operating under adversity, in brief, has been challenge for any reinsurance operation over the past few years.

Qatar Re has been advantaged by its still young and legacy-free operation, which has enabled it to maintain a strong focus.

The company's team has shaped the strategy mix and operating model around a series of value drivers that Qatar Re believes make it a truly modern reinsurer: proximity to clients and brokers; a firm commitment to excellent financial security; the most advanced capture and integration of data; the development of knowledge-intense products; and the support of innovative entrepreneurship among its clients.

Entrepreneurship in insurance – A challenging notion

Insurance is not exactly the industry that springs to mind when seeking examples of outstanding entrepreneurship and spectacular, "game-changing" innovation.

The downside generally features more prominently on most insurers' minds than the upside. Risk aversion all too often has served as surrogate for excellent management and control of risk.

In addition, in the pre-digital age, economies of scale in areas such as capitalisation, availability and quality of underwriting data or administrative and acquisition expenses tended to favour incumbent players with their long-established business models.

Digitisation as a potential game changer

The advent of the digital age, however, is likely to render irrelevant what now appears as yesterday's internal and external barriers and disincentives for innovation and entrepreneurial behaviour in insurance.

➤The company will continue to enhance its internal process across its global operation platform and further broaden its geographical footprint through the establishment of a branch in Singapore.

Data is the most striking example. Digitally enabled insurers no longer need to amass lots of policies to control volatility as suggested by the venerable law of large numbers. In the digital world the paradigm has shifted and talk of the "law of precise data" is a telling pointer to the new direction of travel.

Thanks to technology such as telematics, the mushrooming variety of enabling big-data applications, and the revolutionary concept and now available capability of "machine learning", insurers, including smaller market participants, can access unprecedented efficiencies benefitting general operations, marketing and indeed underwriting.

Therefore, one can argue that the data revolution makes innovative and entrepreneurial behaviour in insurance not only a possibility but an imperative. It will put a premium on nimble and agile players whereas the competitive edge of large incumbents sitting on huge amounts of historical underwriting data is under threat.

Promoting 'creative destruction'

New insurance entrepreneurs stand the chance of making disruptive visions happen, contributing to what economist and political scientist Joseph Schumpeter coined "creative destruction".

These individuals epitomise the "non-replicative" version of entrepreneurship which nurtures both additional demand and supply in insurance. Meeting their needs is a major opportunity for reinsurers to revive their traditional role as incubators of insurance entrepreneurs, a role which may have been neglected recently in light of the industry's focus on - or even obsession with – the supply side of the business.

Small- and mid-sized reinsurers such as Qatar Re are well positioned to capture this potential: They enjoy "natural" advantages in terms of agility, speed and accessibility. These qualities matter greatly to aspiring insurance entrepreneurs.

No need for Qatar Re to track a declining market

Of course, Qatar Re is not immune or sheltered from fierce and increasingly irresponsible price competition. But the company's rather unique focus on entrepreneurial and knowledge-intense areas and client segments has yielded a low dependency on highly commoditised lines of business, where business is "traded" rather than "underwritten".

"The downside generally features more prominently on most insurers' minds than the upside. Risk aversion all too often has served as surrogate for excellent management and control of risk"

Furthermore, the firm's teams have systematically integrated technically informed capital assessment and management into the underwriting process in order to achieve both enhanced capital efficiency for clients and optimised, capital-efficient portfolio "behaviour" for Qatar Re.

This approach positions the firm to deliver robust performance even under the prevailing conditions of a generally declining market environment.

Substantial premium growth and strong underwriting performance

Qatar Re's gross written premiums more than doubled to $1.16bn in 2015. We took advantage of specific project-based opportunities. Net profit for 2015 rose by 57 percent to $25mn, primarily driven by significant improvement in net underwriting results. The loss and administrative expense ratios on net earned premiums decreased considerably.

Despite being a start-up on a trajectory of high growth, Qatar Re's costs have been well controlled, with major investments channelled towards analytical, convergence, specialist underwriting and enterprise risk management skills.

Overall, Qatar Re's combined ratio improved from 108 percent to 94 percent in 2015, based on net premiums earned. This is a strong performance given the fact that the firm's still young portfolio did not enjoy any tailwinds from positive prior-year reserve developments which, for the industry as a whole, accounted for a relief of more than 5 combined ratio percentage points in the 2015 results.

On the contrary, as a relatively young and growing company, in agreement with its parent Qatar Insurance Company (QIC), Qatar Re further strengthened reserves in 2015, committed to a very conservative and prudent reserving philosophy.

In addition, the company's investment yield continues to outperform most of its peers in Bermuda or London.

Continued on page 58

Continued premium and profitability growth in the first half of 2016

In the first half of 2016 Qatar Re remained firmly on track to growing both its top and bottom line. Year-on year, gross premiums written have increased by 41 percent to $654mn, from $464mn in the first half of 2015. Net premiums earned have doubled from $82mn to $164mn.

Qatar Re currently cedes 70 percent of its business via a quota share agreement to its parent Qatar Insurance Company (QIC). Fuelled by the strength of the company's long-term client and broker relationships as well as its enhanced recognition as a Bermuda Class 4 (re)insurer Qatar Re's portfolio continued to expand in the first half of 2016.

Moreover, a number of new major client relationships were successfully established, a testimony to the Company's growing franchise.

Qatar Re's growth is supported by a parental guarantee from QIC. As at 30 June 2016 Qatar Re's shareholders' equity stood at $561mn, almost double the amount of the previous year. This capital base is supported by QIC's shareholders' equity of $2.2bn and a market capitalisation of $5.4bn, as at 30 June 2016.

Qatar Re's first-half 2016 net combined ratio improved to 95.8 percent, compared with 97.7 percent in the same period of the previous year. The net loss ratio increased from 63.6 percent to 71.7 percent, reflecting the evolving portfolio structure, above-average global catastrophe activity in the second quarter, higher net losses in facultative business where the Company is running higher deductibles and a further prudent strengthening of prior-year loss reserves.

The increase in the net loss ratio was more than offset by a significant reduction of the administrative expense ratio, from 31 percent in the first half of 2015 to 15.9 percent in the first six months of 2016. The first half of 2015 incurred some exceptional investment cost to enable the business to grow.

The results of that investment are now showing through in increased business flow and an acceleration of earnings. On a gross basis, the administrative expense ratio improved to a market-beating 4 percent, versus 5.5 percent in the previous year.

Outlook and summary

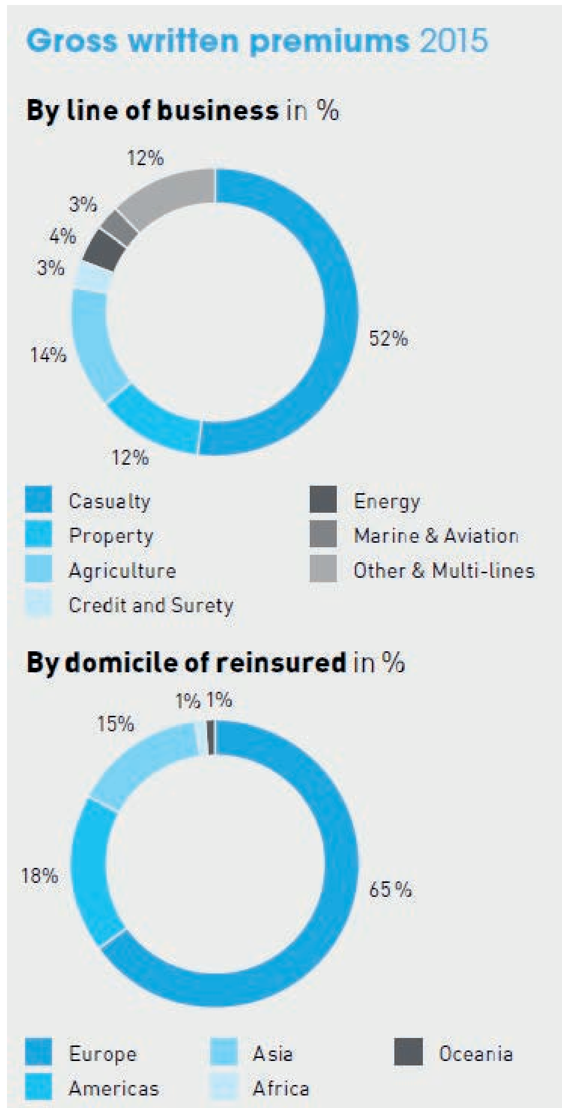
For the near future Qatar Re will continue to focus on deepening its current book of business on the back of what has developed into a robust franchise. In addition, the Company will continue to enhance its internal processes across its global operating platform and further broaden its geographical footprint through the establishment of a branch in Singapore. Qatar Re's financial results testify to its robust positioning in an environment of continued economic volatility and reinsurance market softness, exacerbated by rising global catastrophe losses.

Qatar Re's relative resilience reflects the increasing depth and diversification of its portfolio. The firm's franchise continues to grow on the back of its status as a Bermuda Class 4 (re)insurer and distinct strengths such as a class intimacy and a particular focus on insurance entrepreneurs. These capabilities enable Qatar Re to expand its book of business without tracking the market.

Qatar Re has every reason to believe that its franchise, supported by clients and in-house talent, will continue to grow.

The company's increasingly robust global operating platform will enable a further organic portfolio expansion. Having said this, with global reinsurance markets expected to remain challenging, niches of profitable growth will be harder to come by and to exploit.

> "The data revolution makes innovative and entrepreneurial behaviour in insurance not only a possibility but an imperative. It will put a premium on nimble and agile players"



That Kodak moment

Technology is rewriting the rule book in many industries, including insurance. **Rafal Walkiewicz** wonders how companies will overcome ‘insurtech inertia’ to thrive in the face of disruptive innovation

Disruptive innovation. It happened in photography, destroying Kodak when the company downplayed its own innovations in digital technology and clung on to then-profitable film; and it happened in movie rentals, when online streaming made Blockbuster’s business model of video and DVD hire obsolete.

These are just a couple of examples of how innovation has disrupted even the most established markets and the most powerful of companies. And it will happen in insurance too.

Flag bearer

Indeed, we’re already seeing it happen in motor insurance, with potential knock-on effects for reinsurance and capital.

The spread of technology such as proximity sensors, reversing cameras and collision avoidance systems into vehicles has already contributed to fewer small-scale “fender benders” and a 40 percent reduction in US highway fatalities since the 1970s.

So, the premium pool is falling – by as much as 30 percent in the next 10 years, according to some analysts – and that in a market that accounts for as much as 80 percent of the total premiums written by some personal lines companies.

Then there is telematics, which is putting downward pressure on some premiums by facilitating more precise underwriting and encouraging safer driving. Around 12 million telematics policies are already in force around the world, with the UK and the US leading the way in terms of technology. It is predicted that around half of all cars in the US will be equipped with driving monitors by 2020.

And then, of course, there is the further threat to motor insurance premium from driverless cars. Their effect will be to move the affected insurance need from a personal motor policy to product and public liability covers.

Volvo, for example, has already said it will accept liability when vehicles equipped with its self-driving systems that are currently on trial in Sweden – and soon to be on trial in the UK – are operating in autonomous mode.

This type of liability would be covered in the commercial market. And therein lies a further threat. With so much third party capital having come into the insurance market in recent years, what’s to stop car manufacturers or software providers from bypassing insurers and going straight to the capital market?

These examples show how technology is shifting the pockets of value. It's eating away at the traditional business model, whereby insurers create value from offering loss protection, and is building a new model that focuses on mitigating risk.

For example, outside the motor sector take connected homes, which allow everything from our heating and hot water systems to our toilets to be monitored for signs of malfunction, leak risk or health warnings. Or take occupancy sensors, used in conjunction with smoke detectors, that help assess the risk of fire.

Such devices not only make homes more comfortable and save energy, they also lower risk. Following a similar pattern as auto insurance, home insurance can eventually be sold to manufacturers of intelligent homes rather than homeowners.

A mind boggling 30 billion objects in total are expected to be connected to the Internet of Things by 2020, all embedded with electronics, software and sensors that enable the collection, storage and analysis of data.

And it's this data that will increasingly hold the key to generating risk-related value from connected cars, homes or whatever else you care to think of. Sources of value creation will typically break down into three components – devices that collect data, the data itself and the analysis of that data to create business insights.

New value networks

So, where do insurers fit in?

Most aren't obvious candidates to manufacture or distribute devices, with many having faced difficulties in getting people to accept devices in their cars as part of a telematics offer.

Then there is the problem that

> “Technology is shifting the pockets of value. It's eating away at the traditional business model, whereby insurers create value from offering loss protection, and is building a new model that focuses on mitigating risk”

Rafal Walkiewicz is CEO of Willis Capital Markets & Advisory

if insurers haven't generated and collected the data, do they have access to it? The growth in connected cars and homes, along with innovations such as wearable technologies, are likely to mean that insurers are relegated down the data supply chain and forced into new relationships with data owners, some of whom might be tempted into becoming de facto insurers. Insurers will need to find partners if they are to remain relevant in this new value network.

Where insurers do have the advantage is in using data and analytics to understand and underwrite risk. But for how long? Insurers need to make bold moves while there is still a window of opportunity.

New data is being generated by the distributors of things, but insurers have valuable historic data that can be married with risk analysis expertise. Access to enhanced analytics should also help make underwriting the more intangible risks, such as reputation and contingent business interruption, more sustainable.

Similarly, in capital markets most third party capital is invested in property catastrophe risk, but enhanced data pools will make different types of risk increasingly suitable for securitisation and potentially attractive to investors.

Be bold

With so much pressure on companies to deliver short-term profitability, such bold decisions will be hard to make. But history is full of companies that stumbled because they made only small, incremental changes in the face of disruptive innovation. Spare a thought for Kodak the next time you pose for a "selfie".

Right now, motor insurance is providing a window on the future of how technology can disrupt established value networks in the sector. It illustrates how, even in the simplest of policies, insurers won't necessarily only be concerned with loss protection, but will also need to compete on the basis of offering customers wider risk mitigation benefits.

If you apply the same principles to a more complex product, like life insurance, with the potential intervention of not only wearable technologies but advances in treatment and the ethical questions of a more personalised approach to risk assessment, the sources of future risk-related value become even more ethereal and liable to disruption.

In the past personal lines insurers interacted with insureds twice: when they sold a policy and when they paid a claim. With the underlying function of the industry shifting from volatility management and loss paying to risk mitigation, insurers have an opportunity to build a real-time, continuous relationship with customers that can facilitate delivery of products we cannot even imagine today.

Those who thrive will learn to ride the wave of disruption to capture the available opportunities – although whether they will still be known as insurance companies remains to be seen. Some may face having to reinvent themselves entirely.

Future vision

In his Monte Carlo *Rendez-Vous* preview, **Aidan O'Neill** looks at what lies ahead for claims and insurance analytics

Looking forward to Monte Carlo, what can we expect to be debated at this year's *Rendez-Vous* in relation to claims?

The major theme for this year's *Rendez-Vous* is "Insurance, Reinsurance – Trends, Cycles and Disruptions". Claims tend not to feature highly on the agenda as the delicious canapes are consumed and copious amounts of bubbly are quaffed, but at Docosoft we intend to put that right this year. That's why we have drawn up our own list of trends in claims that relate to the theme of disruption that this year's *Rendez-Vous* seeks to highlight.

Disruption is the word of the day in (re)insurance circles. Claims teams can help to minimise that disruption but it often needs investment and support from the C-suite – in fact just the sort of people who attend the *Rendez-Vous*. That's why we have drawn up four common features of effective claims IT initiatives, including support from senior leadership, which can play their part in helping (re)insurers to obtain a competitive edge in today's challenging market conditions.

Docosoft has been involved in a number of claims management system implementations this year and it has been interesting to observe some commonalities emerge that reflect the changing state of claims systems in the insurance industry. In particular, speed of implementation and delivery in such a rapidly evolving environment is of paramount importance.

Competitive edge

A consistent factor in successful projects has been support from executive leaders. It has been our experience that strong executive support ensures the coordination and communication required to deliver and implement complex cross-departmental projects. The vision of executive leaders is also vital in clearly defining project goals and benefits for all claims practitioners within a particular carrier.

A key component of many projects is ensuring that employees receive the necessary training. In some cases this can be practical: users need to know how to use a new feature effectively. However, sometimes projects need to overcome resistance from prevailing corporate culture and an often understandable reluctance to embrace change.

In order to overcome internal resistance and ensure cross-departmental coordination, clear communication is essential to many projects. In many cases, demonstrating the benefits of new claims management technology has been a key factor in overcoming reluctance to change. Many projects also require interfacing between multiple internal departments, as well as frequent coordination with external units.

Claims management teams whose projects use agile development methodologies can often achieve significant gains in time to delivery, project costs, transparency and in improved communication between IT and business units. Being agile has helped many teams manage large projects while staying flexible.

In particular, always striving to build intuitive technology can help to keep multi-part projects on schedule, as distinct project components could be completed in parallel. Speed is the key to success in today's rapidly evolving insurance claims environment – so helping claims management teams adapt to changing requirements during the development process is essential.

Future of claims analytics

Looking ahead, sophisticated artificial intelligence (AI) and big data look set to underpin future insurance and claims solutions – such as when and how to proactively manage the customer claims experience or how to enhance retention of the most profitable customers, for example.

Risk carriers that are able to effectively utilise big data and advanced AI, along the lines of IBM's Watson technology, could develop substantial competitive advantages.

Google has also made several moves that suggest it could be entering the insurance market. It's applying the Internet of Things to human health by developing glucose-measuring contact lenses, and it's moved into the space of remote sensing and control of residential and commercial environments.

It is also likely that insurers will employ telematics and other emerging "real-time data" technologies, where the potential use of telematics in risk management and controlling losses will become possible. We will then see technology move from the operational to the strategic.

A variety of advanced statistical, analytical and visualisation techniques are being employed to extract commercial value from the available data, and this can be applied across a wide range of business issues to give organisations significant competitive advantage.

The need for advanced analytics solutions has been driven by globalised competition, data overload, more stringent risk and compliance requirements, new regulations and changing consumer behaviours. In such an environment, these are testing times for insurers.

Many London market carriers are therefore turning to analytics to gain insight and enhance performance. Weaving analytics into the organisational fabric can position managing agents for strategic, competitive and cost advantages.

Data harvest

Insurance companies collect and retain a large amount of data on their customers. For example, their processes fold in items such as telephone recordings, customer feedback, market prices and even socioeconomic information. As a recent Deloitte one-pager noted: "Companies that can remove the noise from this potentially overwhelming data set, whilst creating insight through new linkages between data items, are able to gain a competitive advantage."

These days, significant quantities of public data ranging from census information to social media data, as well as third party data – ranging from lifestyle information to shopping data – are now available and accessible. Overlaying these added inputs to enhance internal company data could allow London market operators to gain deeper insights into their customers' behaviour and preferences.

At the personal and commercial lines end of the scale, claims team data and analytics could help carriers to mitigate risk. For example, data analysis could be an effective way of reducing road risk by enabling a targeted approach to reducing accidents.

Major carriers such as Allianz have pioneered approaches that pinpoint the cause of accidents and assist with the assessment of claims data. Is it possible to visualise similar approaches by the "big ticket" London market players? Certainly.

The claims core services initiative, which forms part of the London market Target Operating Model (Tom), aims to enhance customer experience, service and accessibility to the London market, using technology, central shared services and the provision of rich and structured data for all. The Tom seeks to be a catalyst for innovation and effective business transformation.

That's why Docosoft has become a member of the Centre for Applied Data Analytics Research (Ceadar). Ceadar is an industry-led centre that brings together analytics researchers from leading Irish universities and innovation companies. Through cooperating with Ceadar partners Docosoft will develop tools that extract actionable insights from claims data.

Write Back-enhanced analytics

Docosoft sees new opportunities for enhanced data analytics solutions that can be provided by Write Back, for example. Within Write Back the claims workflow triggers (CWTs) will contain enriched data that will fill almost 300 data fields as opposed to the 60 – or thereabouts – that we currently receive. Our clients are already finding that the level of data coming through is more granular and detailed in comparison to what we saw in the past.

At the moment, we have barely scratched the surface of what new information can be analysed, but we will have a more detailed view and complete picture thanks to the "fat CWTs" with all the data analytics opportunities that they entail.

These are just some of the lessons we will be taking to Monte Carlo this year and we are sure these messages will be digested with as much pleasure as a bottle of 2005 Louis Roederer Cristal. Cheers! Or as they say in Monaco *à la vôtre*!

Aidan O'Neill is CEO of Docosoft

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Connected risk

Suki Basi leads the charge in highlighting the future of connected exposure management

The global (re)insurance sector urgently needs to consider ways of sharing risk information to enable better knowledge of its connected risk exposures.

It has been 20 years since the "Reconstruction and Renewal" initiative at Lloyd's and the big question now is whether we are on the cusp of a new London market excess-of-loss spiral of "extremely connected" risk.

Or are we about to enter a new age – even a technological inflection – where the relationship between risk and reward is more accurately reflected?

Connected risk

(Re)insurers are increasingly starting to understand the connected risk problem, and recognise that hitherto unknown exposures need to be quantified for complete exposure management and true pricing.

We recently researched the 2015 annual reports of the top 50 (re)insurers by premium income. Our research revealed that delivering enhanced analytics solutions looks set to become an increasingly important part of companies' 2016 investment priorities, according to letters from many chairmen and CEOs outlining their forward-thinking strategies.

Until recently, data analytics has been considered a tactic but its importance is increasingly strategic as data becomes more available as well as more valuable.

The industry needs to consider ways of sharing risk information to enable better knowledge of connected risk exposures. The ideal solution for the sector is to share terminology so that the market is all on the same page.

Easier said than done, of course, but the market needs to know the name of its risks so it can piece together the right portions of exposure. The market can do that if it has a kind of uniform or stringent naming convention. Once risks are named the market may choose to come up with a format that it is happy to exchange exposures with.

Companies should name and know their risks in order to aggregate across different underwriting units and product lines, on a facultative and reinsurance basis. Once this has been done underlying risk data can be integrated to analyse systemic risk.

> "A cyber-attack could threaten multiple assureds and multiple insurance product lines in the same event"

Know your risks

In parallel with this approach it is vital that underwriters and their CEOs know and are able to name their risks. To help launch the naming and knowing of risks, Russell Group has organised a number of closed (re)insurance working groups across multiple classes, with the stated aim of defining a universe of companies and their potential exposures to risk.

It is now time to bring the C-suite into the conversation, so that we can begin to work on a strategy that builds a market-wide insurance data value chain or data conveyor belt. The C-suite is becoming more aware of the concept of connected risks and the nature in which they can accumulate across product classes in an event to give significant exposure.

Continued on page 66

Connected risk
continued from page 65

A cyber-attack, for example, could threaten multiple assureds and multiple insurance product lines in the same event. Once we start talking about the same companies we can start thinking about how to aggregate the exposures.

The Volkswagen emissions scandal, for example, impacted directors' and officers' liability, product recall, product liability, unemployment insurance, employers' liability and environmental liability.

Managing accumulation

At the same time, the increased interdependency of the world as a result of globalisation, new technology, regulation and macroeconomic factors is making it more challenging for the (re)insurance industry to detect and manage accumulation residing within portfolios.

With supply chains spanning countries and companies, and new technologies developing, accumulation risk is growing apace.

We are now in a (re)insurance environment where different lines of business are writing on the same risk and paying the same claim. That is the accumulation that reinsurers with global programmes – which may have built up from different office units around the world writing the same policy – need to circumvent.

Policies and treaties written out of Munich and Madrid or Zurich and Milan may be on the same risk. Accumulation is therefore an issue for the insurer as well as for the reinsurer.

Inflection point

Russell Group has been saying for some time that the (re)insurance sector has reached a new technological inflection point.

Demand for new (re)insurance products is ever growing – from traditional life and health insurance to protection against natural disasters and cyber-attacks.

CEOs have rarely engaged with analytics directly but they should be comfortable delegating the analytics responsibilities of their direct reports in the C-suite. Unfortunately, many CEOs are missing out on the opportunity to set the strategic direction for their organisations' analytics investments – and to measure their progress.

> "(Re)insurers are increasingly starting to understand the connected risk problem, and recognise that hitherto unknown exposures need to be quantified for complete exposure management and true pricing"

From a (re)insurance CEO's perspective, data analytics could play a vital role in determining connected risk exposures – not just for their business but also that of their major corporate client accounts.

CEOs need to ask how the sector can improve the efficiency of its supply chain without becoming exposed to excessive risks. What advantages should the industry expect from the ability to make real-time adjustments to business operations using analytics insights?

Some (re)insurance CEOs are already asking these questions and taking an analytical risk-based scenario approach to underwriting. If we ally that approach with an algorithmic methodology that can be applied to (re)insurance risk management, it becomes much easier to model complex threats.

Suki Basi is managing director of Russell Group

Riskier world

In our 2015 review of CEO perceptions it became clear that the senior leadership of the (re)insurance companies surveyed were of the view that today's world is a riskier place and that the environment is "challenging".

As a recent European Insurance and Occupational Pensions Authority report noted: "High volatility and increasing risk in combination with low risk-free rates makes the (re)insurance industry prone to the so-called double-hit scenario. In addition to the traditional risks, two other emerging elements represent both a threat and an opportunity for the (re)insurance sector: the cyber risk and the InsurTech wave. Whilst posing a severe and increasing threat to the financial system, cyber risk also offers new business opportunities for insurers at the same time."

The need for modernisation is imminent and crucial for (re)insurance companies, as recent work in London towards the Target Operating Model has shown. As the market migrates towards highly integrated systems, it is evident that companies are becoming increasingly exposed to cyber-attacks. Yet many (re)insurers have focused on optimising existing tools while ignoring the need to review and transform their business models.

So, to conclude, specialty classes – which include aviation, space, energy, marine, engineering, casualty and property – are threatened by traditional hazards such as fire, storm and flood, but they also overlap and connect to each other by virtue of existing in today's more connected world, which is in turn exposed to other risk "connectors" such as political violence, supply chain, cyber and credit risks.

Rhode Island run-off

Rhode Island is set to transform the US run-off market, says **Mory Katz**

Recently it has not been uncommon to hear that run-off is undergoing something of a renaissance, having often been thought of as the least active part of the insurance industry.

However, the sector has changed significantly since the highest profile run-off operation ever, Equitas, was established by Lloyd's over 20 years ago.

While many people talk about innovation in insurance, it could be argued that run-off is the part of the insurance sector that really is the most pioneering.

This can be seen in areas such as risk transfer, portfolio types, capital structuring and the use of new territories with varying regulations.

Pro has a solid track record in this innovation, having managed the first UK insurance solvent scheme of arrangement in 1997 (by Chiltington, a subsidiary) and also the first cross-border transfer, for a German reinsurer, which used what was then the latest EU legislation to successfully create a scheme of arrangement.

Run-off growth

Look at the numbers and you can clearly see the growth of the run-off sector. A 2015 PwC study placed the value of European non-life legacy portfolios at $275.5bn, having grown by 20 percent between 2008 and 2015, and with most of that growth occurring in the later years.

So what is actually driving this growth and, in particular, the recent pick-up in activity?

Sector M&A is one of the main causes, with Solvency II often cited as a principal factor.

> "New changes to what is known as Regulation 68 in Rhode Island have created an exciting opportunity for innovation that could build a similar market for run-off business in the US [as exists in Europe]"

Increased standards for capital resources mean that entire lines of business are now being examined in terms of reserves to premium ratios. Run-off is often seen as an efficient method for disposing of liabilities with a low return and releasing additional capital.

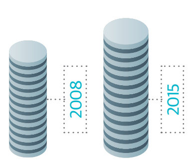
Many insurers, scrutinising operations in the light of Solvency II, are increasingly reluctant to leave large amounts of capital tied into run-off areas that typically pay a small return. Capital might well be relatively cheap, however, most businesses are keener to deploy it where there could be better returns.

Run-off: a growing sector

European non-life run-off portfolios are valued at...

$275.5BN

...having grown by 20% since 2008



Source: Pro Global, PwC

In addition to this, many firms are also now considering disposing of a single (typically, less profitable) class of business, or retreating from certain territories or jurisdictions. Many run-off aggregation businesses are keen to take on niche run-off disposals of this type.

US restrictions

Most of these varying options, however, have only been available to businesses outside the US where, notoriously, insurance regulation varies from state to state. To date, run-off solutions as a whole have been limited in the US insurance industry.

The US market has lacked the type of business transfer mechanism seen in Europe, where the sale of run-off portfolios to third parties has become an accepted practice and an efficient capital management tool.

However, new changes to what is known as Regulation 68 in the US east coast state of Rhode Island have created an exciting opportunity for innovation that could build a similar market for run-off business in the US.

Drawing on UK solvent schemes of arrangement laws, Rhode Island introduced legislation in 2002 that enabled solvent commutations by state-domiciled insurers for certain commercial lines.

Amendments in 2007 allowed Rhode Island carriers to assume closed books of non-life business from entities outside the state, setting the stage for so-called Rhode Island Regulation 68 business transfers.

The legislation was then further refined in August 2015 to create a more comprehensive framework that allows commercial insurers to transfer closed books to Rhode Island carriers, including protected cell companies.

Pro Global is the first business to file a new company application under this new amended legislation. Called ProTucket, the facility will enable insurers to “lift and drop” legacy books into the Rhode Island insurer’s protected cells.

Rhode Island 68

Regulation 68 opens up a far greater range of options and tools for carriers when managing legacy business, including the potential transfer of run-off portfolios to third parties.

The clearest attraction of Rhode Island 68 is that it provides true finality for legacy liabilities. Significantly, the amendments to Regulation 68 allow the novation of transferred insurance and reinsurance contracts, releasing the original insurer from its contractual obligations to policyholders.

By transferring legacy business to a Rhode Island run-off company like ProTucket, the original insurer no longer bears any liability for that business. Added to this, once approved by the court, all policyholders are bound by the transfer and individuals are not able to opt out.

Regulation 68 is likely to appeal to US direct admitted commercial property/casualty insurance and reinsurance carriers, but a wide range of companies could consider transferring portfolios to a Rhode Island company.

Not only can Regulation 68 be used by carriers to transfer legacy business to a third party and achieve true finality, it can help carriers unlock capital and resources, as well as seek more efficient operating structures.

The transfer mechanism could, for example, be used to restructure insurance operations by combining business from separate companies into one entity. In the case of captives, it should prove to be a useful tool for owners wanting to restructure or consolidate their activities.

Regulation 68 could also be used by carriers outside the US. Once up and running, it will be possible for insurers outside the country to transfer legacy business to ProTucket.

Run-off legislation in the UK, known as a Part VII Transfer under the Financial Services and Markets Act 2000, has already created a healthy legacy run-off sector in the UK, and increasingly in Europe.

The process has been shown to be fair to policyholders, reinsurers and stakeholders, while the insurance industry has benefited from more efficient capital allocation.

These benefits are now open to the US insurance industry under Regulation 68 and we would expect the market for legacy business in the US to develop in a similar way as it has in Europe.

Opportunity

The opportunity is huge. Estimates vary, but it is generally accepted that half the run-off in the world is located in the US, where legacy liabilities are estimated to be around $100bn.

The introduction of business transfer legislation in Rhode Island has already sparked interest from several US carriers. ProTucket has deals in the pipeline and we anticipate that there will be at least one Regulation 68 business transfer launched by the end of this year, potentially closing in 2017.

Over the next five to 10 years we expect the business transfer process to become standard accepted industry practice in the US. This should mean that insurance business transfers into vehicles such as ProTucket run into the billions of dollars over the next decade.

Pro Global has been handling legacy transactions for over 25 years, with a proven track record in managing legacy portfolios and business transfers, including the absorption of staff.

We are confident that the development of a professional run-off sector in the US is in the public interest. It should lead to a more efficient insurance industry, improved earnings and greater safety for policyholders.

Using a dedicated partner that is innovative in creating solutions as well as opportunities, and that is also experienced in proactively managing run-off portfolios, will maximise the value of previously trapped assets and serve the interests of policyholders, insurers and cedants.

Changes in legislation

2002
The first Rhode Island legislation enabling solvent commutations by state-domiciled insurers for certain commercial lines.

2007
Rhode Island carriers can now assume closed books of non-life business from entities outside the state.

2015
Commercial insurers can now transfer closed books to Rhode Island carriers, including protected cell companies.

Source: Pro Global

Mory Katz is managing director, US at Pro Global

Gilt-edged liquidity

Heneg Parthenay and **Simon Richards** detail a new approach to managing liquidity and counterparty risk in an evolving regulatory environment

Liquidity management is at the heart of insurers' balance sheet management. Insurers do not have the stringent liquidity constraints of banks, but depending on the exact nature of their liabilities, they usually hold material liquidity reserves to fund claims payments and more traditional operating expenses.

Recent insurance regulations have brought more attention to liquidity management, which is considered to form a key part of the overall asset/liability management framework of an insurer.

Historically, insurers' liquidity reserves have been placed with banks and, more recently, invested in money market funds (MMFs). However, with bank credit ratings having deteriorated and potential regulatory developments putting pressure on traditional MMFs, many insurers are seeking alternative ways to invest their liquidity reserves, paying more attention to counterparty risks.

This has brought attention to the repo market, which can potentially offer greater security for cash investors. The repo market itself faces challenges, but new approaches are being developed to offer attractive cash-investment alternatives that are secure, highly liquid and offer the potential for yield in some currencies.

> "The challenges facing banks have led many insurers to invest a significant portion of their liquidity assets in MMFs rather than through cash deposits"

Bank challenges

Basel III, developed by the Basel Committee on Banking Supervision, is a package of standards that aims to reform how banks approach capital and liquidity. It is set for full implementation in 2019, but some regulations have already taken effect and many banks have decided to follow the new rules sooner than required. This is having a significant impact on how banks consider investors wishing to place cash with them.

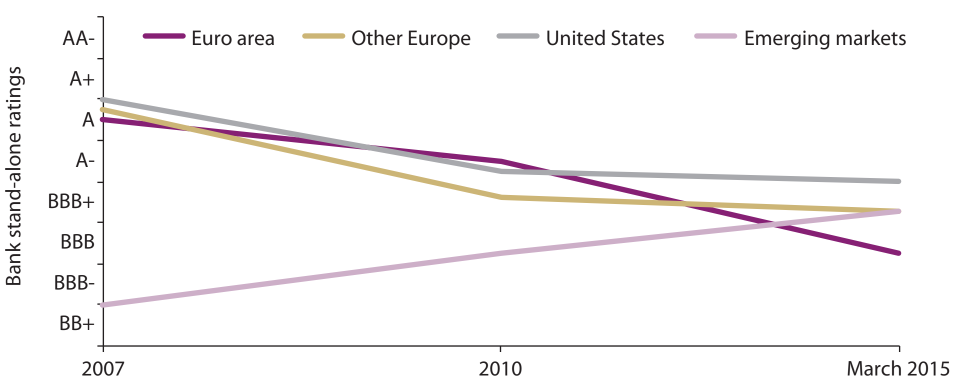
As a result of Basel III, banks are less willing to take on cash deposits with maturities of less than three months as they incur higher capital charges, preferring instead to offer three-month maturities or longer. Where banks are accepting short-term cash deposits, they are likely to offer lower yields to cover the additional cost of capital triggered by Basel III.

On top of regulatory pressure, many bank credit ratings have deteriorated in recent years (see chart). This has put pressure on the ability of insurers to diversify counterparty risk, which in turn is reflected in the overall capital that insurers have to put aside to cover this risk.

MMF challenges

The challenges facing banks have led many insurers to invest a significant portion of their liquidity assets in MMFs rather than through cash deposits. In Europe, the Solvency II regulations require insurers to "look through" MMFs at the underlying exposures being taken. This allows insurers to reflect the diversification usually embedded

Weakening credit ratings of banks since the global financial crisis



Source: Asset-weighted median based on Moody's financial strength ratings in MMFs in their solvency capital requirements.

However, MMFs are also facing headwinds. MMFs have historically offered a stable or constant net asset value (NAV) with daily access. However, during the global financial crisis in 2008, some US MMFs saw the value of their holdings fall significantly, and had to seek external financial support to maintain their constant NAV.

This led to the development of new regulations, due to be implemented in the US later this year, which will lead prime MMFs to adopt variable NAV status and apply liquidity thresholds that could limit investor withdrawals in a stressed environment and trigger redemption fees.

Only funds exclusively invested in treasuries would be permitted to maintain constant NAV status. These expected changes have already triggered outflows from US prime MMFs.

European regulations for MMFs are currently under review and are expected to follow a similar model to the US approach. If MMFs are required to apply liquidity thresholds, redemption fees or convert to variable NAV, insurers may have to reassess whether they are suitable vehicles in which to invest their liquidity reserves.

However, there is an attractive alternative available, in the UK at least, which may be developed in other markets in due course.

Collateralised deposits (Repo)

A collateralised deposit or "repo" is a bilateral trade. One party sells an asset to another party and agrees to buy the asset back in the future with interest. For the party buying the asset and selling it back on a future date, the transaction is known as a "reverse repo". The interest rate they receive is known as the reverse repo rate.

> "Insight's solution involves conducting reverse repo transactions with non-bank counterparties...which use gilt repos as part of their investment strategy"

In practice, reverse repos are a form of short-term lending to a counterparty that provides collateral as security. If the counterparty defaults, the investor retains the collateral and can sell it immediately. This materially reduces the counterparty risk for the party lending cash. Historically, repo transactions were intermediated by banks, which received a fee (spread) for the service (see diagram).

Unfortunately, reverse repos are also in the scope of Basel III and banks have been raising their intermediation costs materially in recent years to reflect higher capital costs.

Against this backdrop, some cash investors have started to trade repo and reverse repo directly with repo counterparties. This approach is typically limited to larger investors, which are resourced to analyse the credit quality of counterparties and to manage the legal infrastructure that lies at the heart of repo transactions.

Heneg Parthenay is head of insurance at Insight Investment

Simon Richards is head of insurance solutions at Insight Investment

A new approach

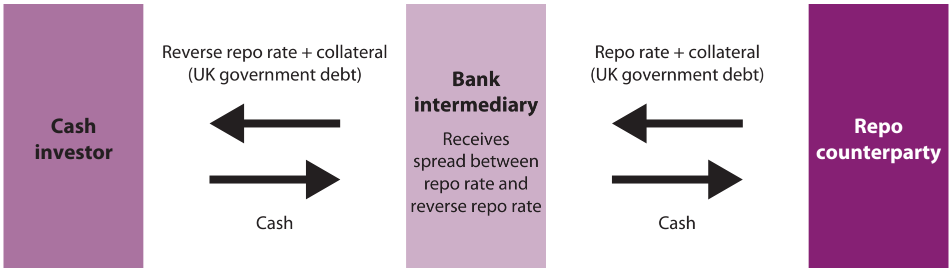
In order to broaden access to reverse repo trades to smaller investors, Insight has developed a solution that invests cash in reverse repos secured exclusively against UK government bonds. This aims to significantly mitigate counterparty risk and allow better solvency capital treatment for some insurers.

Insight's solution involves conducting reverse repo transactions with non-bank counterparties, specifically UK defined benefit pension schemes, which use gilt repos as part of their investment strategy.

It is possible to use this approach within a pooled fund to offer cash investors daily liquidity, with a broader range of counterparties than traditional MMFs, whilst still complying with certain forthcoming money market regulations.

By dealing with non-bank counterparties, it is possible to generate a gross yield broadly equivalent to prime MMF yields, but the increased use of repo gives greater security given the underlying gilt collateral. This is because if a counterparty defaults, it is possible to sell the gilt collateral to cover their cash investment.

Repo/reverse-repo using UK government bonds as collateral



Source: Insight Investment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Just right

Esther Law explains why the current economic and political landscape is a 'Goldilocks' environment for emerging market debt

Economic and (geo) political uncertainties have created a very challenging backdrop for emerging markets (EM) in the past few years but since the beginning of 2016 these challenges seem to have abated, with emerging market debt (EMD) staging a strong economic recovery.

The recovery is particularly impressive in local currency debt, with a total return of almost 15 percent in US dollar terms as at the end of July, reversing the entire weak performance in 2015.

This has not gone unnoticed by yield-seeking investors, with EMD attracting strong inflows of $25bn as at the end of July – the highest since 2012.

In this article we explain why we think this "Goldilocks" environment for EMD is likely to continue and that EMD will continue to be an attractive source of diversification for global fixed income (GFI) portfolios.

Improved fundamentals

Many EM economies have undergone substantial economic adjustments, especially on the external vulnerability front via currency depreciation. This is noticeable in the improvement in the average of EM current account balances from a recent low of -0.5 percent in 2013 to around +1.7 percent at present.

Short-term external financing needs have also fallen to around 20 percent in 2015 from over 24 percent back in 2011 as EM countries actively cut their short-term foreign borrowing needs in order to reduce their exposure to FX movements.

Brazil has shown one of the most remarkable improvements on this front, which has helped in the recent appreciation of the Brazilian real. Meanwhile, the heavy election agenda of 2015 means that we expect less political noise in EM in the medium term, especially compared with the developed world, which should be supportive for EMD.

On the growth front, in the International Monetary Fund (IMF's) latest World Economic Outlook (19 July 2016), the fund is forecasting global growth to be 3 percent and 3.4 percent in its baseline scenario for 2016 and 2017 respectively, while the forecast for EM growth stands at 4.1 percent and 4.6 percent for 2016 and 2017 respectively.

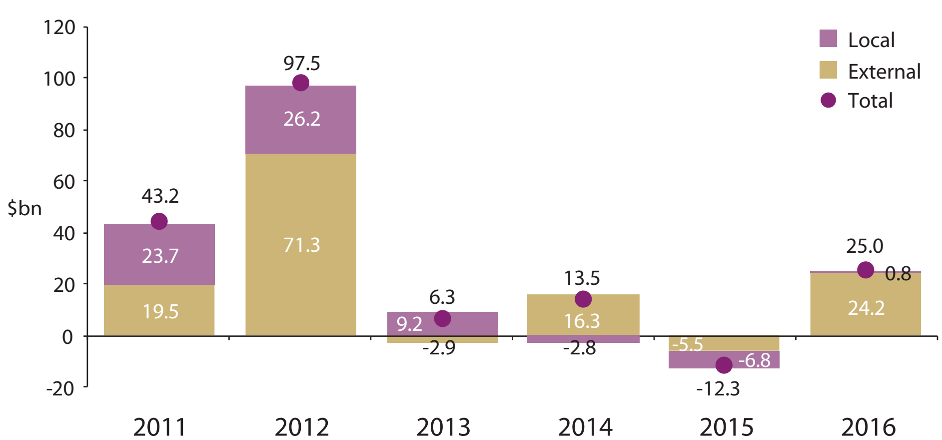
We believe that this favourable backdrop, together with improving fundamentals, should allow economic growth in EM countries to continue to recover at around 4-6 percent per year over the next five years.

Yield enhancement

Dovish world central banks and benign global inflation are also positive for EMD, with key global central banks (especially the US Federal Reserve, the European Central Bank and the Bank of Japan) likely to remain very accommodating for the

Continued on page 74

Flows into emerging market debt funds



Source: EPFR, Amundi, JP Morgan, Bloomberg

Just right
continued from page 73

foreseeable future in order to stimulate growth.

As long as we are not heading into a recession scenario, which is not our base case, and there is no further collapse in commodity prices nor a hard landing in China, we believe the external backdrop now offers a Goldilocks environment for EMD.

As at the end of July, the average yield of the JP Morgan Hard Currency Bond Index was around 5 percent, which offers a yield pick-up of over 350 basis points over US Treasury.

The yield enhancement offered by local currency debt is even more impressive, with a carry of over 6 percent and an average rating of BBB.

Underinvested asset class

We think EM is still an underinvested asset class and will continue to grow its share of the GFI portfolio. According to the Institute of International Finance's EM debt monitor for March 2016, total global debt across all sectors (i.e. including private debt) was around 26 percent of total debt in the world.

EM growth is contributing to 57 percent of global growth, and yet only 10 percent of total debt portfolio is allocated to EMD.

With the inclusion of the Chinese yuan in the SDR basket, we believe EM currencies' share in global foreign reserves can only increase from here. These all point to higher demand for EMD in the future.

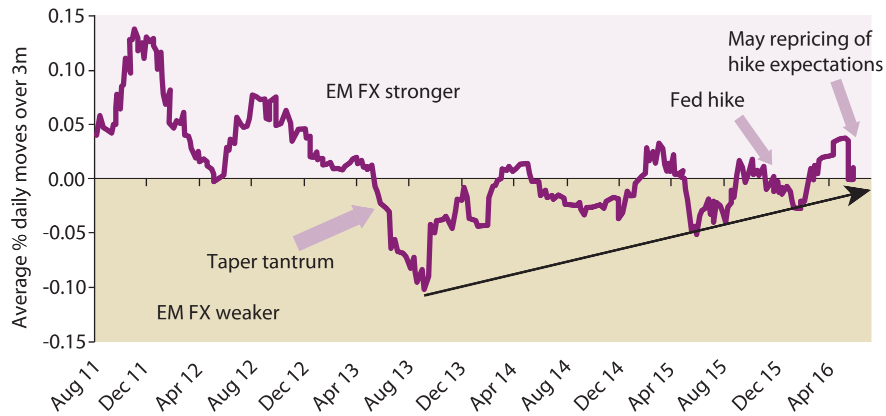
Investible universe

EMD also offers a rich diversity of countries with differing characteristics beyond the "Bric" nations.

The total investable EM debt universe is vast (roughly $15tn, which is around 15 percent of the world debt).

Emerging market foreign exchange reactions to US rate events

Average % daily moves over 3mn



Source: Bloomberg, Amundi as at 15 Aug

Hard currency debt versus local currency debt

	Hard currency debt	Hard currency corporate debt	Local currency debt
Yield (%)	5.2	4.7	6.2
Duration (years)	6.9	4.58	5.00
Average rating*	Ba1/BB+/BB+	Baa3/BBB-/BBB	Baa2/BBB/BBB
Total debt stock ($bn)	827	1,759	7,367

*All ratings included in this report illustrate Moody's/S&P/Fitch
Sources: JP Morgan Benchmark EMD Indices as at 29 July 2016

Geographically speaking, there are up to 60 countries with diverse economic cycles and around 500 corporates. As such, this asset class offers opportunities for portfolio diversification and reduced concentration risk.

Hard currency debt vs local

In addition to geographical diversity, EMD also offers the diversity of hard currency sovereign (i.e. EMD issued mostly in G4 currencies), hard currency corporate bonds and local currency sovereign bonds.

The outlook on EM forex markets is an important factor when allocating between hard currency and local currency debt.

While our strongest conviction remains on the hard currency debt for now (especially the high-yielding countries with an improving credit matrix such as Brazil, Russia, Indonesia and Argentina), we also hold a very positive view on local bond duration.

We expect to still see some volatility in currencies, but given the improving fundamentals and positive environment we think the more violent adjustment is behind us. Indeed, currency volatility has also been falling compared with developed market peers, and the ratio between the two is currently the lowest since 2013.

Another encouraging factor is that emerging currencies are becoming less sensitive to any hawkish Fed surprises, which increases the potential for local debt to perform over the medium term as emerging market growth slowly recovers.

With low yields in developed markets set to stay, further emerging market diversification of global fixed income portfolios over the long term seems almost certain.

Emerging market debt is surely an opportunity for insurance companies to exploit while keeping in mind that careful allocation among this diverse range of asset classes and countries will yield the most worthwhile results. Results are likely to exceed what can be achieved in developed market debt at the moment.

Esther Law is Emerging Markets Debt Fund manager at Amundi Asset Management

From constraint to opportunity

Martin Foden and **Emmanuel Archampong** look at how Solvency II can create opportunities for fixed-income investors

Fixed income is one of the most important asset classes for insurance companies, but the relentless fall in achievable returns has exacerbated a structural income squeeze in the sector from lower premiums and the burden of increased regulatory costs – in particular those relating to Solvency II.

Against this backdrop, asset owners need to make sure their bond investments are working as hard as possible.

In this article, we assess the impact of the Solvency II regulations on corporate bond returns for insurance firms and how it creates opportunities for investors by perpetuating market inefficiencies.

The case for credit

The "standard formula" under Solvency II distils capital calculations down to two characteristics: credit rating, and the sensitivity of the bond to movements in interest rates (duration). On this basis, it is a simple exercise to calculate the capital required for an insurance company to access the extra return from corporate bonds (spread), and the impact of this additional capital on overall returns.

As shown in the chart (right), although spread returns on capital to insurance investors (gold bars) are reduced in comparison with investors that are not required to hold Solvency II capital (purple bars), and the advantage of moving along the risk spectrum is moderated, there is still a clear incentive for insurance companies to consider boosting returns by buying corporate bonds.

The relative size of the additional return is brought into the sharpest focus when compared to the very thin income available from "risk-free" assets. Another benefit of corporate bonds for long-term investors is that a proportion of the excess spread earned is for perceived illiquidity versus gilts. For insurance investors able to invest over a long time horizon, this provides an additional source of potential return relative to the fundamental risk. Credit undoubtedly still has a role to play in insurance portfolios.

Over-rated?

Credit rating agencies (CRAs) are firmly embedded in the capital allocation process. This is despite their dubious role during the financial crisis. The US government's official investigation, published in 2011, suggested that CRAs were "essential cogs in the wheel of financial destruction". Nevertheless, just five years later, they are firmly entrenched as essential components in the machinery of Solvency II. That is some resurrection.

A more benevolent interpretation is that credit ratings are misapplied by many investors. While financial analysts love to wallow in a sea of complexity, the greatest insight often comes from the most basic of questions. So, what exactly do the CRAs assess?

Specifically, CRAs tell us about the risk of not receiving interest and principal from companies in full and on time – or in other words, "the probability of default".

Investors, however, should be concerned about both the probability of default and the losses that arise from default. With credit ratings typically focusing only on the former, they cannot provide a full picture.

As a consequence, protective credit enhancements that minimise losses are often undervalued – a distortion that is perpetuated by Solvency II.

Solvency II and security

This distortion is extended by Solvency II's counterintuitive treatment of secured bonds.

Securitisation, the process of packaging and ring-fencing a pool of assets and issuing bonds with a claim over the pool, is, alongside CRAs, another "poster boy" for the financial crisis.

However, the regulator's response to securitisation has been far more draconian than its treatment of CRAs, with capital charges imposed for securitised assets set at materially higher levels than for typical unsecured corporate bonds.

This is hard to rationalise. While

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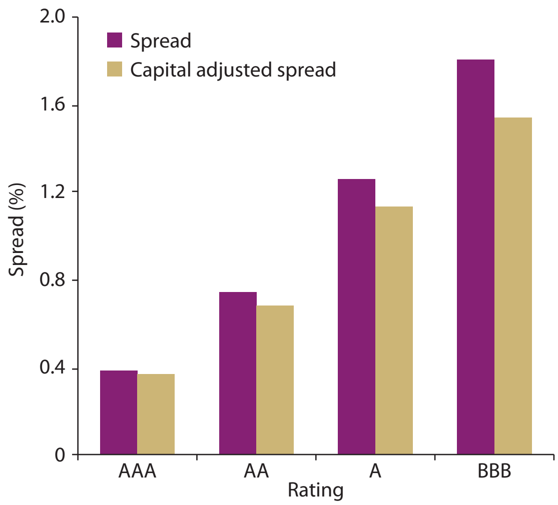
Impact of Solvency II capital charges on credit spreads



Source: RLAM, August 2016

From constraint to opportunity
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securitisation did allow nefarious writers of loans to pass on risk to somnambulant third parties, and contributed to a mushrooming of economic leverage, it should be kept in mind that, as with credit ratings, it was often the application, rather than the concept, that was at fault.

Logically, investors should prefer the certainty of collateral, lending structure and gearing, when offered through appropriately structured securitisations, compared with the vagaries of lending on an unsecured basis.

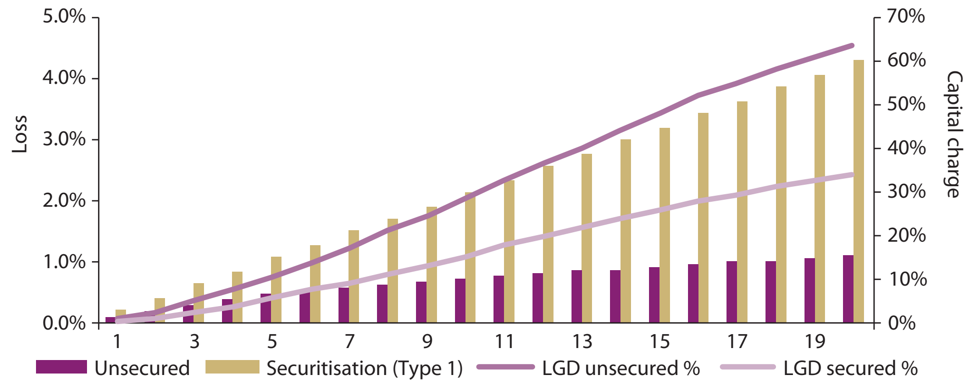
As demonstrated by the chart (right), the broad-brush classification of securitised assets means that investors are likely to be driven towards lending structures with higher potential losses, on account of their lower capital charge, rather than well-chosen, secured debt.

This potentially jarring regulatory treatment of secured versus unsecured bonds has a number of important consequences. The first is that it accentuates the inefficient treatment of security by the market, creating further opportunities for active investors. Secondly, it places significant emphasis on asset owners and their managers to allocate bonds correctly.

The European Insurance and Occupational Pensions Authority's Delegated Acts make it clear that the existence of security in isolation does not automatically infer securitisation or the contingent capital charges. And yet, it is equally clear from observing market behaviour that certain secured bonds, which are not "securitised", are being dealt with on a "sell first, ask questions later" basis.

This indiscriminate approach offers a clear window for insurance investors to buy better bonds at elevated yields. Expert credit analysis can distinguish such opportunities, which can be purchased at attractive prices, dampening credit losses without resulting in prohibitive capital requirements.

Solvency II capital charges versus historical loss given default (A rated bond)



Source: Moody's/RLAM, as at 21 June 2016

LGD = Loss Given Default

Diversification

Investors in corporate bonds are compensated for fundamental credit risk, as the return earned above "risk-free" assets is more than that required to offset the comparable likelihood of default and loss.

While this is undoubtedly true, based on historical data, the skewed return profile of credit – a small, fixed upside gain versus a larger potential downside loss – means that this theory is only borne out if the idiosyncratic risk of each individual bond is smoothed out.

In practice, this is managed by building a portfolio of diversified assets. While many credit investors understand the concept of excess returns, they often fail to build enough diversification into portfolios to capture the benefit.

Active credit investors, with a focus on exploiting market inefficiencies, are primed to identify investments from across a broad universe, without being constrained by arbitrary classifications. As illustrated above, the stringent, rules-based approach of Solvency II is helping to create further opportunities. Investors need to be prepared to look for them.

Martin Foden is head of credit research at Royal London Asset Management

Emmanuel Archampong is business development manager, insurance solutions, at Royal London Asset Management

Necessary antidote

In many ways, Solvency II is a necessary antidote to the causes of the global financial crisis. While the temptation may be to rely upon the "quick fix" of a high-level, ratings-based investment model, this runs the risk of sacrificing returns on the altar of convenience.

The regulations' clunky treatment of corporate bonds provides real opportunities for focused, active investors. In fact, the more other investors choose to delegate portfolio construction to a model, the greater the potential rewards for those prepared to adopt a more precise, asset-by-asset approach with expert credit research.

Indeed, with falling interest rates and premiums, what insurance company can afford to walk away from high quality excess returns?

A step closer

In the third of RPC's series of articles, **Matthew Griffith** and **Neil Brown** explore Lloyd's SPAs as an alternative for new market entrants to standalone syndicate formations and M&A

The use of Lloyd's special purpose syndicates, or special purpose arrangements (SPAs), to give them their up-to-date terminology, continues to evolve.

Whatever the underlying rationale – increasing underwriting capacity or taking advantage of growth opportunities mid-year – the first generation SPAs were, in many cases, an innovative way for an existing Lloyd's carrier to leverage third-party capital. Early SPAs mostly provided reinsurance capacity, while new businesses setting up in Lloyd's generally looked to establish a new standalone syndicate, often managed by an experienced managing agency or turnkey operator, or to execute an M&A deal.

But fast-forward a few years from the early days of SPAs, the achievement of broader and longer-term strategic goals – and Lloyd's market entry for new capital providers – is often at the heart of SPA transactions.

Stepping stones

Using an SPA as a stepping-stone – an interim step for a capital provider or non-Lloyd's carrier towards establishing a standalone syndicate – to gain exposure to, and experience of, the Lloyd's market has become more prevalent.

Acappella, China Re and Credit Suisse all followed this route, setting up SPAs and transitioning them to standalone syndicates, each within a relatively short period after their initial launch.

But longer-term partnering has been a theme in some of the more recent transactions. Chaucer's recent alliance with Axa has both the stepping stone and the strategic aspect, combining the global insurance giant's local distribution network with Chaucer's Lloyd's underwriting expertise for the development of African specialty business and the parties continuing to work together developing Axa's ability to establish its own Lloyd's business in the future.

But this is not always at the centre of the strategic thinking, as illustrated by Novae's recent US property excess and surplus lines SPA backed by major insurance-linked securities fund manager Securis. The deal provides significant commercial benefits to both parties with seemingly with no current intention for Securis to set up its own syndicate down the line.

Why choose SPAs?

Establishing a standalone syndicate would enable a new capital provider to underwrite its own business plan but it can be a time-consuming process, taking on average 12-18 months to pass through the application process (according to Lloyd's) and requiring significant resources to be deployed.

The process can be simplified, and significantly de-risked, by utilising the services of a turnkey managing agent, but it will rarely be advisable for a new entrant with limited experience of Lloyd's to move straight to the simultaneous formation of a syndicate and a newly authorised managing agent.

If an appropriate target were available, M&A may also be an option, though the cost of buying a Lloyd's platform, with everything already in place, can be significant, as can the risks of acquiring and integrating an existing business.

Setting up an SPA – a vehicle that writes a single quota share reinsurance contract of its host syndicate and is managed by the host's managing agent – is potentially a faster route to access Lloyd's business. The requirements that Lloyd's applies to SPA applications are less wide-ranging, so the timetable can be shorter, and the dates within it are generally more flexible.

Unlike providing capital to support an existing syndicate, where underwriting by a new capital provider can start only at the beginning of an underwriting year of account, SPAs can commence mid-year, giving significant flexibility for host syndicates and capital providers to pursue business opportunities as and when they arise.

SPAs may also be used as an alternative option in the event that plans to launch a standalone syndicate run into difficulties or delays, ensuring that capital is deployed into the market, albeit in a different way.

Supporting a syndicate directly exposes a capital provider to all classes of business underwritten. In some cases, this may take the investment outside the capital provider's risk appetite. SPAs are considerably less rigid in that they need not reinsure all of the host's business.

The underlying quota share reinsurance contract may, for example, be limited to cover only specified lines of business rather than a broad whole account quota share (again, the Novae/Securis deal is a good example of a class-specific SPA) and also to apply only to one or more defined years of account. Exposure to the host syndicate's previous underwriting years can be excluded from the reinsurance coverage.

Key legal documents

In addition to customary items required to establish a new Lloyd's-approved corporate member and certain standard Lloyd's documents, such as the managing agent's agreement with the corporate member and agreements for the provision of its underwriting capital, the key items will include business plans for the SPA and the host syndicate, the reinsurance agreement and, typically, a framework agreement between the managing agent and the corporate member – particularly in an SPA involving a longer-term strategic partnership.

Matthew Griffith is a partner in the corporate insurance and financial services team at RPC

Neil Brown is a partner in the corporate insurance and financial services team at RPC

The reinsurance agreement will set out clearly the business to be reinsured by the SPA. Lloyd's has helpfully developed a standard form SPA reinsurance contract that, if used as the basis of the arrangement with modifications clearly identified, will help expedite the Lloyd's review.

As to key commercial terms, Lloyd's would generally expect the host syndicate to retain a sizeable proportion of the business. Its current guidance states that this should be at least 20 percent to ensure alignment.

The framework agreement, if there is one, will supplement the standard Lloyd's managing agent's agreement and govern the parties' SPA relationship.

This may detail, for example, the business to be ceded to the SPA, budget and financial provisions for the venture, and arrangements for the cross-secondment of staff between the managing agent and the capital provider's group. It may also include exclusivity provisions to ensure that business is channelled to the host syndicate and to limit the parties' involvement in competing businesses, the use of the parties' brands and the ownership of key business assets such as customer data. And, as in most "joint venture" type agreements, the framework agreement may contain termination rights specifying when the arrangement may come to an end (for example, on a change of control).

Where it is a feature of the deal, the process and timetable for converting the SPA into a standalone syndicate should also be documented.

Assessment criteria

Lloyd's assesses the viability of the proposal and how it will add value to the market. Proposals that, for example, develop new specialist business, introduce market-leading underwriters, source business from new territories – in line with Lloyd's own Vision 2025 – or add global diversification to the market's capital base may be viewed as accretive.

The Lloyd's application process broadly comprises initial stages involving preliminary discussions and presentations leading to "in principle" approval, followed by further reviews culminating in formal approval.

The main elements Lloyd's will look at include, among other things: the nature and quality of the syndicate business plan and the rationale behind the SPA business plan; the classes of business and geographies involved; how new business or premium will be derived; and any impact on compliance with Lloyd's franchise guidelines.

Lloyd's is currently working on a new guide for setting up an SPA which, when it becomes available, will provide useful insights into its requirements and expectations and the decision-making process for SPA formations. But for now, and perhaps even more importantly pending the release of the new guidance, the first key step is to engage in early informal discussions about any new SPA with Lloyd's.

These discussions are held on a confidential basis within a dedicated group within Lloyd's and will help the parties to explore the proposal, its benefits and any potential stumbling blocks with Lloyd's before significant time and resources are incurred on the project.

This article is provided for educational and information purposes only and is not intended and should not be construed as legal advice.

Symbiotic relationship

Insider Quarterly speaks to **Alice G Vaidyan**, GIC Re's chairman-cum-managing director, about the company's international expansion plans

***Insider Quarterly* (*IQ*): How is the General Insurance Corporation of India (GIC Re) preparing for the opening up of the Indian domestic reinsurance market to international players?**

Alice G Vaidyan: The Indian domestic insurance market has always been open to international players! The only difference now is that they will have their direct physical presence in the Indian market.

We have always had to compete for business with them in the domestic market and that will continue even now. Competition in the Indian reinsurance space will not be something new.

Today GIC Re commands more than a 50 percent share of the reinsurance premium in the country. We are confident of not only maintaining this level but also growing it further. Last year (2015-16) we grew our top line by 21.4 percent.

We have grown and developed with the Indian market since inception, and having been the sole Indian reinsurer for more than 45 years are now well placed to capitalise on this as the domestic market opens up and grows further!

The entry of foreign reinsurers will in fact benefit the Indian market in terms of capacity, newer products, price realignment and talent/skills infusion – it's a sort of symbiotic relationship. There is ample space for everyone to grow and the long-term picture is quite optimistic.

***IQ*: What are the other key elements of your strategy for GIC Re over the next few years?**

Alice G Vaidyan: We have set our sights on being amongst the top 10 global reinsurers in the next couple of years. That is our current and long-term strategy. The plateau phase of growth in developed markets and slowing expansion in the emerging markets will be a challenge. However, we are geared up for these. Today we are focusing on newer classes of business like agriculture, life, liability and cyber. GIC Re is one of the largest agricultural reinsurers globally. We are scaling up our operations in life reinsurance as well. Our liability class of business grew 30 percent during 2015-16.

Currently our business split between domestic and overseas is 55/45 and we want to bring it to par.

The slowdown in the emerging markets is also an opportunity for prudent M&A activity and to grow inorganically. Thus we are confident of maintaining a healthy top line and bottom line growth as well as moving in to the global top 10.

***IQ*: How would you describe your appetite for catastrophe risk following some of the recent natural disasters in the region – e.g. the Chennai floods, the Nepalese earthquake etc.? Are such risks adequately modelled in your view?**

Alice G Vaidyan: The Chennai floods in November-December 2015 were a major natural catastrophe for India. Heavy catastrophic rains broke a 100-year-old record. Other civic factors also contributed to disastrous flooding of the city.

Economic losses from the event are estimated at upwards of $2bn with insured losses of $0.8bn. A significant part of the losses came from commercial lines.

The Nepal earthquake in April 2015 was also equally devastating – and earlier the Mumbai floods in 2005 and the Uttarakhand floods in 2013 also tested our cat risk appetite. We are, however, adequately capitalised and also our exposures are adequately protected.

Yes, such risks in the emerging markets are not adequately modelled. This is primarily because of the poor quality of data available. A lot needs to be done in this direction. However, with the impact of climate change and global warming it is difficult to model for such catastrophic events.

***IQ*: Given India's relatively low take-up rate for insurance amongst the wider population, where do you see the greatest potential for both insurance and reinsurance growth amongst emerging lines of business?**

Alice G Vaidyan: The government of India over the last two years has launched several universal insurance policies and also very simple social security schemes. These have created a perfect ecosystem that works on the principle that India needs insurance, Indian people need insurance, only we need to provide them this in the most acceptable form. Hence, the success of these simple social insurance schemes should spur some out-of-the-box innovative solutions to bridge this gap. GIC Re is providing support to such universal social-insurance schemes.

Also, retail commercial lines like health, motor and personal accident have been leading the growth story of the Indian non-life insurance industry ever since the sector was opened up for private players about a decade and a half ago.

***IQ*: How would you describe the talent pool for reinsurance currently? As you expand the business are you able to recruit for senior positions wholly at a domestic level?**

Alice G Vaidyan: The Indian insurance industry has an excellent talent pool both for the insurance and reinsurance sectors. As a matter of fact several of our compatriots are today occupying positions of responsibility in the reinsurance sector in several overseas and emerging markets. At this juncture, GIC Re is the sole reinsurer in the Indian market and it is a government of India company, so current regulations do not allow lateral entry into any cadre of employment. The intake happens at the most junior entry level, but our own cadres have served us well thus far.

***IQ*: As a seasoned (re)insurance professional yourself, how would say the sector has changed during your working life, and how do you anticipate the Indian market changing in the years ahead?**

Alice G Vaidyan: I joined the industry as a greenhorn in 1983 and the changes since then have been monumental both domestically and in the international market.

During my initial years the Indian market was under a tariff, which subsequently changed. The domestic market itself underwent a sea change as it opened up to private players and GIC emerged in its new avatar as a pure reinsurer. Soon thereafter, 9/11 happened and nothing was the same again.

As the market matured, it became more specific to its requirements as customers and consequently cedants became more demanding.

The Indian market has also witnessed the presence of almost every major global player in the market and with the reinsurers also coming in, the chain is complete. The growth levels are astounding, especially when you compare it with the markets of the west, and the best for the country is yet to come.

The government is playing a major role in bringing insurance to Indian households by way of medical cover, agriculture and crop cover and disaster cover. This will remarkably increase the penetration from current levels and once the juggernaut is set in motion, the subsequent years will have tremendous returns for market players.

***IQ*: What plans do you have currently for expanding your international business?**

Alice G Vaidyan: Asia and Africa have been our traditional markets. We have grown in these markets via M&A (with GIC Re South Africa Ltd), via joint ventures (GIC Re Bhutan) and also through organic growth across all our areas of operations.

We are now looking to expand our footprint further in Asia, which would include China and Myanmar to begin with. We are also likely to upgrade our presence in Russia from a representative office to either a branch or a 100-percent-owned subsidiary.

Plans are also afoot to upgrade our eventual reinsurer status to admitted reinsurer status in Brazil.

Earlier, USA and Canada were not areas of focus for us but now we are prudently writing in these markets as well.

Open the floodgates

Insider Quarterly speaks to Shepherd Compello's **Chris Hatt** about why London is best placed to take advantage of opportunities in the North American flood insurance market

Chris Hatt, director, Shepherd Compello

***Insider Quarterly (IQ)*: Why is the North American flood market so interesting?**

Chris Hatt: This market has been available to us for many years, but it was after Hurricane Katrina in 2005 that the market really came into sharp focus and interest grew.

There had, of course, been huge storms in the past and there have been many since – with the latest being wreaked in Louisiana – but it was Katrina that caused a shake-up. It made us all look at how we could sustainably underwrite risk and provide wordings which could meet needs; the primary need being that homeowners could buy cover which satisfied their lenders.

For me this was the opportunity for London to show its strength by proactively stepping in, looking at the challenges and providing solutions. London acted swiftly to satisfy mortgage lenders with tight wordings, supported by large capacity.

Add to this a niche underwriting approach and there was in a short space of time a credible, viable alternative.

***IQ:* Can you give us a brief history of the flood market in North America?**

Chris Hatt: Yes, whilst it is a long and complex story, with a great deal of politics involved, there are three key milestones.

Firstly, the National Flood Insurance Program (NFIP) was set up by the federal government in 1968. It was this programme which allowed property owners in participating communities to gain access to affordable cover.

The second milestone was the Biggert-Waters Act in 2012. By this date the NFIP was in debt to the tune of $17bn. Biggert-Waters sought to solve this by "allowing premiums to rise to reflect the true risk of living in high-flood areas".

Thirdly, the Homeowner Flood Insurance Affordability Act (2014) delayed the provisions of Biggert-Waters because of the economic and political backlash. Essentially, this has put off risk-based pricing for insurance.

At the end of this there are some stark facts for the North American flood market to face. The NFIP is insolvent and $527bn worth of property is in the coastal flood plain – some 40 percent of the US population lives in coastal cities subject to flooding.

At present there are approximately 5.5 million properties covered by the NFIP, with 20 percent receiving discounts of over 50 percent on those [policies] available in the open market. Congress legislated that premiums need to increase tenfold over a five-year period, but this is yet to happen.

IQ: So, in what is essentially a closed market, are there really any opportunities?

Chris Hatt: Well that's a very good question. Maybe we should start by turning it around and looking at the market itself and its size. Tapping into the $3.3bn in premiums paid each year to the NFIP by policyholders represents a huge potential growth opportunity in the property and casualty market.

In addition, for the vast majority of its existence the programme has collected more in premiums than it has paid out in claims.

However, a string of massive insured losses in 2004, 2005, 2008 and 2012, primarily due to catastrophic events such as hurricanes Katrina, Rita and Sandy, left the programme over $30bn in debt. Of course you can't take these spikes out, but they do make a massive difference, as do the subsidised rates available via the NFIP.

IQ: What does the future hold?

Chris Hatt: This is where things get interesting. In 2012 Congress reauthorised the NFIP for an additional five years, but required that a number of changes be implemented.

> "Compare London to the state of Florida, where there are 50-plus undercapitalised insurers that simply could not handle a major loss"

One was to start increasing rates over time to risk-based levels, by as much as 18 percent per year. Also, premium levels would be rated against updated flood maps and loss experience.

Congress also mandated that the NFIP consider greater private market participation, going beyond the role insurers already play in the distribution of policies and administration of the programme to assume more of the actual risk.

Whilst there are still massive political pressures on both sides – to maintain the status quo, or open up the market – the clock is ticking.

IQ: What happens now?

Chris Hatt: NFIP authorisation from Congress will again be required next year in 2017. In addition, new flood risk maps have just been released, which could mean increased rates. Add to this the latest losses in Louisiana and together these represent the most immediate staging posts as to what will happen with the market.

Whilst we cannot predict what will happen we should not overlook the here and now. There are areas of the market which have fallen through the legislation net and are not subject to the benefits of delayed NFIP reforms. Three types of property do not benefit from subsidies.

First, there are those properties subject to multiple claims. Yes, they may not be attractive to underwriters. However, it is the niche and often distressed risks where London has been able to help.

For example, if a property had been subject to numerous flood claims but is now raised on stilts the risk has changed. Could there be attractive, distressed risks which do not fit a standardised insurance approach?

Second, commercial properties could be right next door to residential risks under the NFIP, yet do not benefit from subsidised premiums. Again, a nimble approach with sound, risk-based underwriting could deliver an overlooked market. For example, Miami is enjoying a real estate boom. As of June 2015, more than 355 new towers have been proposed in South Florida.

Third, subsidised rates for second properties are not allowed – another niche market which is open to an agile underwriter.

IQ: What should London be doing?

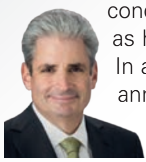
Chris Hatt: Whilst there is still a lot of manoeuvring going on as to what will happen with the NFIP, business can and is being written in London now.

Compare London to the state of Florida, where there are 50-plus undercapitalised insurers that simply could not handle a major loss.

We have the capability and knowledge to write both primary and surplus lines risks with a greater deal of expertise and capacity than available elsewhere. That is why I believe with a considered and strategic approach there is a viable and sustainable flood market available to us here in London.

Executive moves

Willis Re has hired **Chris McDowell** as Bermuda CEO with effect from 1 January 2017. He succeeds Michael Harden, who is returning to the Asia Pacific region as president of Willis Re Asia Pacific. McDowell joins from Aon Benfield, where he was CEO of Global ReSpecialty in Bermuda.



Travelers executive chairman and former CEO **Jay Fishman** has died after battling a neuromuscular condition that forced him to step down as head of the US-listed insurer last year. In a statement on 19 August, Travelers announced "with great sorrow" that Fishman had passed away, crediting him with transforming the company.

Arch chairman and CEO **Dinos Iordanou** will step down in March 2018, he announced during an analyst call. Iordanou confirmed that current president and chief operating officer Marc Grandisson would take over the reins as CEO. Iordanou will remain as chairman and take on an advisory role at Arch.

PartnerRe's head of direct and facultative (D&F) business **Dom Tobey** is set to leave the company following a broader management restructure. Tobey, who is based in Zurich, had been with PartnerRe since 2001. Sources said that following the restructure, PartnerRe would no longer run its D&F book out of a central unit.

Marsh has named **Martin South** as the new president of its US and Canada operations. He succeeds Rob Bentley, who takes on a new role working on "strategic initiatives". South will officially take the reins on 1 September, moving over from his current position as CEO of Marsh's Asia Pacific region.

Lockton has named **Glenn Spencer** as its next president and CEO, effective from 1 May 2017. He will succeed John Lumelleau, who will continue to serve the broker as a special adviser after his retirement. Spencer currently serves as Lockton's global COO and president of US operations.

Cooper Gay has hired **Kieran Angelini-Hurll** from Miller to become CEO of its reinsurance arm. He is currently head of sales and business development for programmes at Miller and head of non-marine reinsurance. The last CEO of Cooper Gay Re, Peter Gorman, left when Swett & Crawford was sold to BB&T.

Long-serving Miller CEO **Graham Clarke** will relinquish the role in 2017 and step up to become chairman of the broker. Clarke will be succeeded as CEO by current chief operating officer Greg Collins, who will become deputy CEO as of 1 July. The changes are subject to regulatory approval.

Kara Raiguel, a senior executive from Berkshire Hathaway's reinsurance division, is to replace Tad Montross as CEO of Gen Re, according to an internal memo seen by sister publication *The Insurance Insider*. Raiguel has worked with Berkshire Hathaway reinsurance chief Ajit Jain in the reinsurance division for 15 years.