Autumn 2018

THE INSURANCE Insider

STATE OF THE MARKET ROUNDTABLE 2018

Agent of change

Technology will prove a useful tool for the (re)insurance industry, but its ability to disintermediate the market is exaggerated

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Don’t believe the hype

There has been plentiful talk in recent years about the technological renaissance currently under way in the global (re)insurance industry.

Significant moves have been made to revolutionise the back office, with straight-through processing, electronic placement and digital claims paying platforms increasingly being used.

Even London, for so long regarded as the dinosaur of the global (re)insurance industry, is getting in on the act.

The Corporation of Lloyd’s is pushing its market modernisation efforts by mandating managing agents to take on a certain percentage of business through electronic platforms.

At the same time, the very face of the wider market is changing with the advent of the so-called InsurTech industry – a term created to highlight the marriage between the insurance industry and its cohorts in the technology sector.

Back in October, *The Insurance Insider* partnered with software platform AdvantageGo to host a roundtable which considered the wider state of the (re)insurance industry, as well as the growing influence technology is having on the market.

Among the many talking points that arose, some of the most interesting centred on which technologies the participants felt were being over-hyped, as well as those proving to be a hit with the industry.

Interestingly, artificial intelligence (AI) – a system many believe will revolutionise the industry once companies work out how best to harness its power – was considered to be an over-hyped innovation. That is only the case now though, and once the (re)insurance industry gets a handle on AI’s capabilities, it will be able to use them.

The belief that technology will serve as an agent that will fundamentally change the way that the industry operates was also given short shrift by participants.

There is little doubt that the application of technology will prove to be a useful tool for the (re)insurance industry, but its ability to disintermediate the market is exaggerated.

> “Among the many talking points that arose, some of the most interesting centred on which technologies the participants felt were being over-hyped”

Technology will surely continue to push through progress on the consumer-facing side of the insurance sector.

But, in the more nuanced and specialist property and casualty space, technology will support the placing of risk rather than drastically overhaul it.

These topics, and a whole host of other interesting talking points, arose during the discussion, and over the coming pages we present the highlights of the debate.

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Christopher Gallagher
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Simon Hedley
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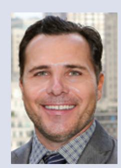

Adrien Robinson
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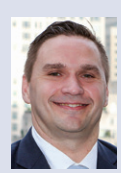

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State of the market
Roundtable 2018

Chris Munro
Bill Gates once said people overestimate the impact of technology in the near term but underestimate it for the long term. Which technologies are being overhyped in terms of their near-term impact on the insurance industry, and what changes are people not paying enough attention to that will transform the market over the next 10 years and beyond?

Greg Wolyniec
Which technologies to me feel a bit overhyped? A lot of the more recent platforms that really focus on the disintermediation of brokers or agents, especially in the commercial space, feel a bit early in the evolution of the industry.

I'm thinking about a lot of the direct-to-consumer, small commercial enterprises and platforms. Especially in the US, the role of the localised agent and broker is something that will continue to be a source of advice to localised clients for the next couple of decades.

"There are insurance companies which seem to be good at deploying data and technology because they have a flexible organisational structure"

Christopher Gallagher

Chris Munro
And which type of companies will own the future of insurance?

Greg Wolyniec
The platforms of the future will be ones that are very good at synthesising data from external sources, outside the very specific quote submission process – so outside the very standard agency or broker application to get a submission for a quote. That's data which will be really important. Platforms, either on the brokerage or the underwriting side, that could take all that data and translate it back into a better risk selection, a better price and, ultimately, better advice to the client or to the insured – that's really where the battle is going to be fought.

Yulanda Francis
I agree, data is very important. We hear about data collection and the implementation of privacy policies to ensure companies are handling the data responsibly, and therefore data collection and whoever owns the data hold an important source which can be used as a tool to assist in evaluating risk. Also, the use of technology can assist all channels in the distribution of data.

Adrien Robinson
The one example I would give, particularly through the lens of a specialty insurer, would be artificial intelligence (AI). There's certainly a lot of hype, perhaps rightly so, given the long-term potential to transform the business, but the near term is more likely to be about 'augmented' intelligence as opposed to 'artificial' intelligence. If you attend an IT conference these days, you leave thinking there's going to be a computer in your chair doing all the underwriting when you return to work.

The practical reality, however, over the next three to five years, is technology will be used to make underwriters or claims handlers better and faster at decision-making. A technology-enabled or 'smart' work environment will prep accounts, pre-analyse risks and display multiple sources of data, leaving humans to spend more time making decisions and less time organising and gathering information – so it's not about a computer making the decision. Underwriters in the near term, bolstered by technology, will still be determinative on taking risk, but will become more accurate and efficient. I prefer the analogy of augmented intelligence as opposed to artificial intelligence. Relatedly, the companies that rule the future will feature organisational agility, which is the ability to readily absorb and find practical applications for the many new technologies that materialise.

Christopher Gallagher
There are insurance companies which are tech-savvy and are very successful. They seem to be good at deploying data and

technology. That's not because they're a good tech company; it's because they are good insurance companies with a flexible organisational structure. These companies are willing to try new things and they're constantly trying to improve. That ability is not limited to insurance and it's not limited to technology. It's being an organisation that is flexible and adaptive.

Simon Hedley

In all parts of the industry there will be some big winners. Essentially, they're going to be the incumbents who are already there, who are able to evolve their business model and make the most of the technology to support it, to Chris' point, their already good understanding of the insurance business.

Technology is such a broad subject and question. It goes to process and it can go to pricing and marketing. A particular example of technology, related to the cat ILS space – and that's really [due to] the growth of the models – has been automated pricing for cat business.

Martyn Sutton

There is still quite a big question mark when you get into the specialty and reinsurance space. With data, for example, we can throw masses of data at you, but how do you extract the value? How does that make a difference to how you assess risk or write it? So, from our perspective, on the technology side, there are enormous opportunities for us to deliver data. But you, as buyers of technology, would look at it and say: "Well, give me the value proposition.

It's all very well bringing data to me but how does that make a difference in terms of my top line, my bottom line and ultimately my profit?"

Matthew Dolan

Greg said it well. Technology's ability to act as a fundamental change agent to disintermediate is exaggerated. Especially where this relates to specialty business, the broker has a fundamental role in the transaction both in how they interface with their clients and how they interface with insurance companies.

When you think about the most recent transaction between Marsh and JLT, one of the major points that underpinned it is that Marsh sees it as the ability to have a bigger client base, more data and better analytics – which drives better outcomes, resulting in more clients. That's the virtuous circle they're trying to create.

John Racher

Echoing many of the sentiments around the table, data is going to be the key thing. It could, or probably will, lead to new business models, mitigation models that will, in the next five to 10 years, have quite a dramatic impact on the insurance market itself as we look to mitigate risk and we move into a risk control and risk management model.

Who will be the winners and losers? I agree with everybody around the table – we're all still going to be here. The main carriers, particularly in the commercial P&C specialty space, will absolutely be there. They have the advantage to do that. The danger, of course, is not moving your IT and your ability to react to this quickly enough to remain relevant and not become marginalised.

> "I was surprised to learn that 84 percent of the total value of firms within the S&P 500 is in non-physical assets. That's an amazing statistic"
>
> **Adrien Robinson**

Chris Munro

Moving on, if you look at many of the major businesses in the world these days, a lot of their actual assets are in the form of intellectual property. How can the industry stay relevant and grow in an economy increasingly dominated by intangible assets? What are the sources of growth and how will the changing economy separate winners and losers?

Christopher Gallagher

We've been asked if we want to be involved in insuring the value of intellectual property and we've said no. It is very difficult to assign values to intellectual property and therefore difficult to price. But as long as there is risk, there's going to be insurance. And as long as there's a gig economy, there is potential for growth. Rather than being a single entity buying insurance, there's going to be a lot of independent contractors who are going to need professional liability and other types of protections.

Adrien Robinson

I was surprised to learn that 84 percent of the total value of firms within the S&P 500 is in non-physical assets as opposed to physical assets. That's an amazing statistic and a clear trend of the information and service-dominated economies of the future. So, to answer the question of how does the insurance industry stay relevant, we must solve real problems and there's clearly an emerging predicament – or opportunity depending on how one looks at it – surrounding the rise of intangible assets: intellectual property, patents, computer programs, customer databases, and algorithms on

"It might take 20 years to transition from the first autonomous car to where there's an 80 percent or whatever the market share is going to be"

Simon Hedley

how one monetises those databases. As an industry, we've historically had tangible property as a core component of our product offering. However, at some point in the future we're going to need to shift toward a more cohesive solution to insuring intangibles other than the somewhat piecemeal approach today, which generally entails stitching together component parts of a number of policies, such as property and cyber coverages, in order to begin to create a holistic risk-transfer solution.

Chris Munro
Matthew, you work on the underwriting side, what are your thoughts?

Matthew Dolan
The insurance industry, in different ways, is accustomed to dealing with intangibility and things that may be conventionally described, to Adrien's point, as a bit amorphous or evolving behaviours. Insuring against the behaviours of people within an organisation, whether that be various kinds of professional liability or D&O insurance, that's an intangible that the insurance community has done a reasonably good job of figuring out how to quantify and provide product for.

Greg Wolyniec
The insurance industry is starting to sit on some real mispriced business potentially. Sometimes it's better to be lucky than good, and it's nice to sidestep a hurricane or a big cyber exposure. But as the economy develops into being much more interconnected through technology interfaces and data reliance, you start to get these cloud platforms that are really aggregating huge amounts of data. Then you start to think about all the ripple effects in the insurance products: very standard product sets and specialty commercial reinsurance sectors like business interruption [BI], where a data server going down in Singapore may trigger a BI claim in Canada now. Those sorts of interdependencies have never existed in the insurance industry and they're starting to surface.

Matthew Dolan
This idea of interdependencies and things presenting in ways that don't have a really well-established historical precedent or historical patterns is one of the great challenges of our industry right now. We are by definition inductive. We look to the past as a pretty good predictor of the present and the future.

John Racher
Do you think maybe that's a threat to the industry itself? Because outside the industry, companies are coming in and seeing this brand-new risk, and they're not encumbered with the history of old risk exposures, old books of business etc. They can take a very fresh view of risk.

Matthew Dolan
They could. It doesn't mean that they'll do it any better. The lack of that history doesn't necessarily provide them with an advantage. It may present them with a different perspective but the one thing we have learnt traditionally is that new entrants, disrupters in the industry, typically underestimate risk and how it presents, how it aggregates and how it impacts.

Greg Wolyniec
The challenge for the incumbent carriers is to get smarter, quite frankly, to try to figure out how the new-age data helps to inform the traditional assessment of risk and pricing. So, typically, your underwriters go through a process of "Well, if I could get a 20 percent rate increase, I could do this". For some of these exposures the right answer may be I need a 1,000 percent rate increase to truly take this on my balance sheet and fully indemnify what the policy form says I need to indemnify financially for that exposure to that client base. So the incumbents are in the driver's seat and we need to get smarter.

Simon Hedley
Looking at growth threats coming down the road literally, there is the transition to autonomous cars, which is going to take longer than people probably thought, but it is going to happen. Globally, roughly half of the world's premium is personal and commercial auto. Take out 50 percent of premium in the total global system, and you've got a different business at that point. It might take 20 years to transition from the first autonomous car to where there's an 80 percent or whatever the market share is going to be. We'll probably figure it out at that time, the industry typically does.

Greg Wolyniec
It's a space which is obviously dominated by personal lines carriers, but as that evolution happens, does the form of

coverage turn into a commercial product? Which would be opening up a new growth opportunity for commercial carriers and commercial brokers, as opposed to retail agents and retail personal lines carriers.

Yulanda Francis

My response from the ILS space, admittedly not being up to date with technology, is that I do realise that over the years it has evolved quite quickly and I understand that we have to move with it, otherwise we'll get left behind. For example, when I first heard about Uber I was thinking "Okay, what is this?" but now find it very convenient. Any technology enhancements to provide convenience should be looked at as we evolve.

Efforts should be made to make processes more efficient for the players in the market. If we look at what we've been doing to date, there is still a lot of growth available through the alternative capital markets and the use of enhanced technology to assist in making transactions more efficient.

Matthew Dolan

That's a good example of the industry's capacity, sometimes slowly and sometimes grudgingly, to evolve in a relationship with alternative capital. ILS is viewed as a disrupter for conventional insurance carriers.

Markel and its acquisition of Nephila is a great example of how they're thinking about capabilities existing in a complementary way.

Evolving insurance is in the business of originating risk and then figuring out how to most effectively manage that on behalf of their brokers and insureds. By keeping it, by keeping it with reinsurance, or by keeping it and utilising third-party capital as part of the overall solution – that's how the industry needs to evolve.

Simon Hedley

That's a great point about that particular transaction, because they're building a business for the future. Nephila could have been bought by all sorts of different people. It could have gone to another fund manager, it could have gone to an intermediary, it could have stayed with private equity-type backing.

But they both chose to come together. And that's the power, back to incumbents. They're managing capital of about $30bn now. And while it is a different business model, most of that capital is in Catco and Nephila.

Adrien Robinson

Maybe technology sometimes does a disservice to the industry by too often promoting itself as a disrupter. In many cases, that's a little sensationalised where in reality, for the near term, it's really about a transformational journey and it's about partnerships between technology firms and industry, similar to the impact of insurance-linked securities (ILS) in insurance.

For industry, if you come at technology thinking: "I'm going to be disrupted," this creates an antagonistic stance from the beginning.

However, it goes back to the organisational agility that I previously mentioned, organisations that are forward-thinking and can say: "That's not really a disruption, that's transformational, I'm going to try and deploy that in some accretive manner."

These companies can really thrive in a world engrossed in technological advances. The word 'disrupter' is kind of overblown and an unproductive framework in many instances.

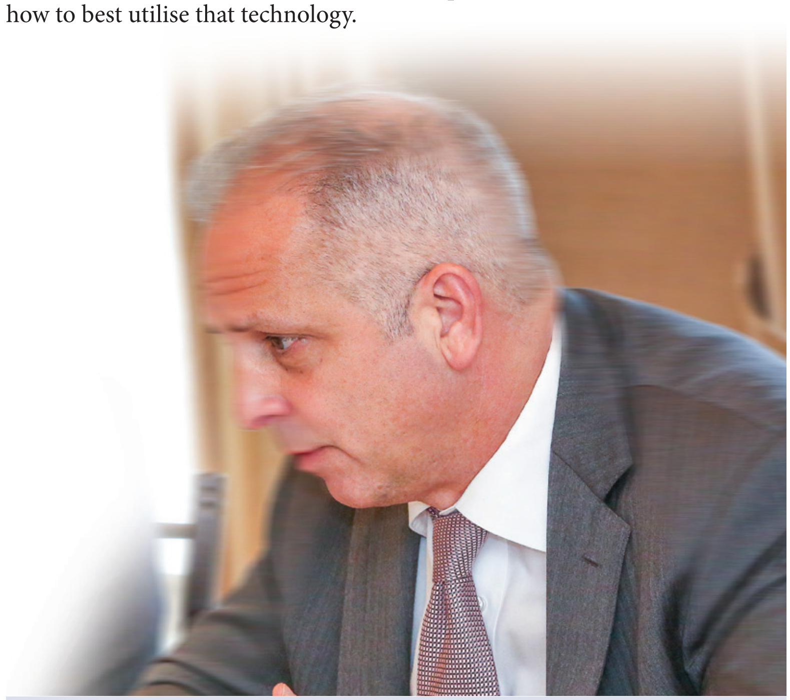
Matthew Dolan

It doesn't always have to be viewed as fundamentally in opposition. Our strength is information and our ability to bring information to bear, and to make informed risk-transfer decisions to help insure and manage their risk with the benefit of a broader and more global lens. We bring something to the equation that perhaps alternative capital doesn't.

They bring vast amounts of capital, we bring capital as well as vast amounts of information. Those things in combination are tremendously compelling. In isolation, they don't have the same kind of value.

John Racher

You're absolutely right. That partnership that you referred to is definitely something that we're hearing more people talk about. A lot of the new start-ups, with great new tech ideas, don't have the insurance and reinsurance experience to know how to best utilise that technology.



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Matthew Dolan

"I always look at the ILS space as being very creative, so there is always room for further growth and to think outside of the box and see what mechanisms can fit together"

Yulanda Francis

On the other side of the fence, a lot of the primary carriers and reinsurers don't have the technical expertise to know how best to utilise the new tech. Bring the two together and you've suddenly got quite a powerful team. You're right, disruption is not the right word – partnership is probably the right word.

Christopher Gallagher

I was talking with a colleague from Greece about the recent wildfires and he related to me that only about 20 percent of the homes destroyed had homeowner's insurance – so when you look outside the United States, there are vast opportunities for growth.

But in the US, the only way you're going to grow fundamentally is to grow your share of the pie, because the pie isn't getting bigger as a percentage of the total economy. I came into the business in 1986.

You see companies come and go, and you see companies that have had a long track record stumble. If you maintain organisational agility, you can take advantage of those opportunities to grow your market share.

Chris Munro

Moving on to M&A – have we reached the peak of deal-making in terms of both volume of transactions and multiples? In particular, how will future transactions differ from the type we've seen over the past few years?

Greg Wolyniec

On the one hand, consolidation will absolutely continue – so the volume and the equation of M&A will continue to be robust or will potentially continue to increase. The multiples, the valuation of that consolidation, feels a bit toppy to me at least.

The multiples are starting to reach a level where a lot of people are modelling the past as being a predictor of the future in terms of interest rates and in terms of cost efficiency gains – and Excel spreadsheets are dangerous.

Yulanda Francis

I do agree with you, Greg – there is still more room to grow and advantages to gaining scale, and I also agree when you say it has to be focused. The Markel/Nephila transaction opened up everyone's eyes to something new for the market. For the ILS space, structures are always evolving. For example, the set-up of rated vehicles like Lumen Re. I always look at the ILS space as being very creative, so there is always room for further growth and to think outside the box and see what mechanisms can fit together.

Martyn Sutton

We're currently in a soft cycle and, as we know, everyone is speculating about how that will end or if it will ever end. Certainly, if you look at the press, you're seeing Scor, you're seeing RenRe, you're seeing Maiden, so the obvious answer is yes, M&A activity is likely to continue.

Chris Munro

One of the things we're looking at is the emphasis on catastrophe losses. How much stress is there on non-cat lines right now and what do you think it would take for these to spill over into a broader market problem?

Adrien Robinson

It's hard to be prescriptive about how much actual stress there is, but there's certainly stress.

What do we know? One example would be the general liability product line within the US marketplace, which has been running a combined ratio of more than 100 percent over the last four years. The combined ratio of product liability has been more than 100 for the past 10 years running, and we all know about the struggles within commercial auto.

Couple that with the reserving position of the industry, which has been steadily yielding lower releases over the last six to eight years. Morgan Stanley and other industry analysts will tell you that US P&C industry overall is probably slightly under-reserved, maybe several billion dollars on a total reserve position of roughly $650bn.

So the point is, there's not much more reserve releasing left to do and, combined with the recent performance of the lines I've mentioned, I would say there's definitely stress there.

While the industry in total remains highly capitalised and very healthy, I could see micro- or niche-hard markets developing, such as is the present case with commercial auto for transportation risks or casualty for wildfire exposures.

Simon Hedley

The fact that reserves have been released says someone thinks they are making some money. That's slowed up and we shouldn't lose sight of that. If you sit down with a big casualty reinsurer in the US, and look at their releases over the last 10 years, it's a lot. But there is absolutely stress in certain segments of the market. And you can add public D&O to the list that you mentioned. And we definitely see clients addressing it.

Christopher Gallagher
I would second the notion that there are some pockets of the market that are hardening and have hardened. And there are others that are atrocious. We were writing $150mn of medical malpractice, now we're writing $50mn. D&O is also competitive. That's where there has been continuing rate drops, yet class action suits are increasing – so how is that possible? But it continues.

Matthew Dolan
What is happening is that some of the masking agents are being pulled away. Tax reform has acted as a masking agent to eclipse or obstruct some of the real financial vulnerabilities in the risk portfolio of companies.

And social inflation is the fundamental challenge and the more pernicious of all of them in that it doesn't typically follow a very linear trajectory. It can manifest itself in plateau shifts, and they can be very destructive in revealing the overall position of your existing claim inventory and its ultimate value and impact.

Chris Munro
The reinsurance market has been mentioned a couple of times now. What do you think the market has learnt from the 2017 losses and the market's response that it didn't already know? What are the strategic implications for incumbent reinsurers?

Simon Hedley
It's simple. We didn't learn anything we didn't already know coming out of 2017. Put aside that it could have been very different if Irma had hit Miami – that would have been a different scenario. But the transition or evolution of business models, insurance and reinsurance to diversify their reliance on cat margins was well and truly under way and that just continues. I don't think it altered the course at all, so I'm not sure we found out anything we didn't already know.

Christopher Gallagher
Unless it was that people are not going to buy flood insurance, no matter what.

Chris Munro
Yulanda, there are still naysayers declaring that if cat is hit, then investors will run for the hills and they won't return.

Yulanda Francis
Well, they definitely did not run for the hills! The investors have enjoyed years of no losses, and were able to earn good returns. But investors knew that losses were to come at some point and they would have to pay out, so there were no problems from the investor side.

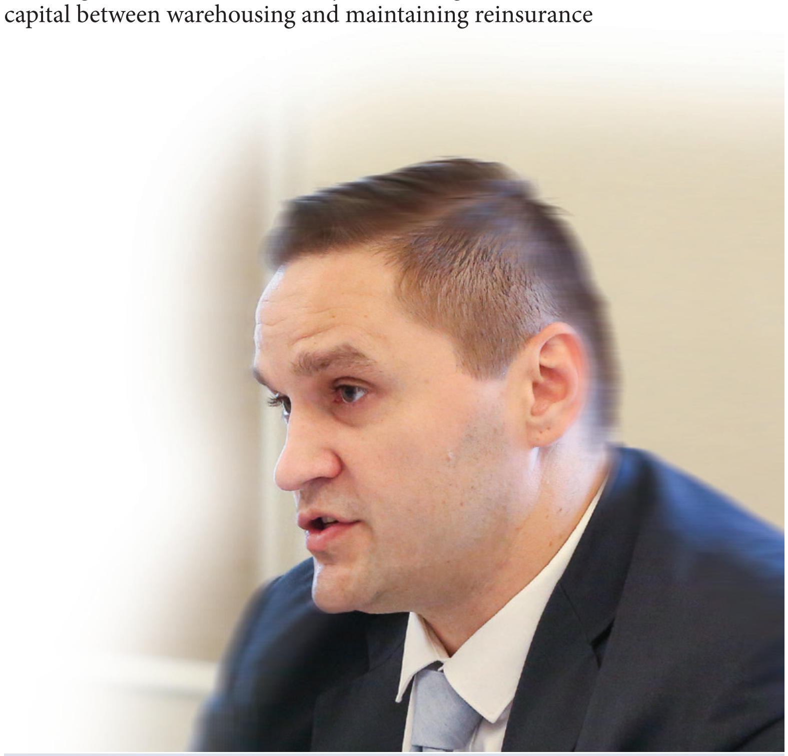
They are definitely committed to stay and many did reload, even with trapped collateral. Also since the big losses, there have been new funds set up to participate. But no one is running. Everyone is here and committed to take the industry forward.

John Racher
You can see the reloads in the capital market are significant; it means that ILS is definitely here to stay. There is still talk of what is going to happen at the end of this hurricane season. Two years on the bounce, will that impact the market? It's an over-capitalised space anyway, there's certainly abundance of capital. Will that remain?

Christopher Gallagher
I'm not in that marketplace, but when you read about assignment of benefits in Florida and its impact on ultimate losses, the question is: what impact will it have going forward? It doesn't seem to be going away and I'm not sure how that fits into cat modelling, because assignment of benefits appears to throw a whole other variable in there.

Chris Munro
With more companies now focused on M&A and organic growth than capital return, is the era of capital discipline over and what are the implications for the cycle, relative to 2011 and 2013? Does the market have the necessary leadership in place?

Greg Wolyniec
What you'll see on the reinsurers' side is a lot more people thinking about more creative ways to arbitrage the cost of capital between warehousing and maintaining reinsurance



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Greg Wolyniec

"We're seeing new tech systems built around the outside of the core system. This will attract younger people who expect modern interfaces"

John Racher

on their own balance sheet – versus laying off at least a portion of the risk through the ILS marketplace, the retro marketplace, the ILW marketplace or more structured ILS vehicles.

You'll also see a lot more capital management strategies, in the more traditional insurer/reinsurer players, where they really start to fuel the next leg of the ILS market growth through laying off risk to them and really arbitraging their capital structure. And you start seeing a lot of traditional players create their own ILS platforms.

Adrien Robinson

I'll touch briefly on leadership in the industry. In general, yes, even though transformational forces are impacting the business at a record pace, I believe we have the right leadership for the foreseeable future.

A lot of the current leadership has been through the casualty challenge of the 1980s, those posed by asbestos and environmental risk.

And now that cyber threats have emerged as new exposures, the industry has responded in kind with cyber coverage as a major line of insurance. So, having that historical perspective, even though a lot of the dynamics of the future will be new, it is so important to have that history of continually seeing and solving new risk challenges within present-day society.

Yulanda Francis

To follow from Adrien's comments about the industry using old systems and being unable to attract young people – most companies, if they are on the cutting edge, look to hire young talent to enhance systems through the use of new technology.

Simon Hedley

To Adrien's point, we were talking around the context of capital and technology. A lot of that capital is going into some form of start-up. And in round numbers, if $2bn went into InsurTech in 2017, it's probably five times that in 2018. But of that $10bn, $9bn of that will go up in smoke. And that's the deal. But with whatever sticks and makes it through, at some point the incumbents will end up buying the business. And it's just easier, it just works better, growing it outside most of the time.

Martyn Sutton

I would echo the thoughts that have just been expressed by Adrien and Simon. Attracting young talent to the industry is an age-old problem, whether it be in IT or insurance itself. There's a lot of people talking about the fact that the generation that's running the insurance industry at the moment is going over the hill in the next 10 years, and what's coming next?

Christopher Gallagher

From our perspective, our focus would be underwriting agencies. If it involves a balance sheet, Fairfax will handle that transaction. But when we, as a buyer, look at an agency, an MGA or other administrator, the multiples on those types of transactions have gotten to levels that do not fit our appetite. That's driven very heavily by private equity where people are putting some money in and they're leveraging it four, five, six or seven to one. They'll pay a huge multiple compared to our valuation.

John Racher

It's probably fair to say that most of the carriers around the table have a big historic investment in infrastructure and technology, and it's pretty difficult to take a proposal for a large system transformation to the board – particularly in a soft market where growth is so difficult. We're seeing new tech systems built around the outside of the core system. This new technology will attract younger people who expect modern interfaces, new ways of interacting with data and dealing with technology devices.

Greg Wolyniec

I completely agree, John. It's very relevant for my daily life, building up a platform here in the US. From a system infrastructure perspective, we looked at all the incumbent software applications, system stacks, and we ultimately decided to go with a three-year-old start-up that we have a small minority equity ownership interest in and board representation.

And we're sort of incubating a fully integrated systems infrastructure in a silo, with the expectation that we'll just onboard the full stack into our insurance company when the time comes, as opposed to trying to build it within the insurance company outright.

Chris Munro

That's a good point to bring it to a close.

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further speakers to be announced shortly