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THE INSURANCE Insider

MONTE CARLO ROUNDTABLE 2019

Existential angst

As climate change threatens ever-wilder weather patterns and higher loss events and retro prices soar, is the reinsurance sector facing extinction?

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The price is right… for some

It seems like a long time since the reinsurance market was the lanky kid in the playground, looming over its developmentally challenged peers.

The sector experienced a growth spurt as it capitalised on an ultra-hard market for catastrophe exposures in the wake of major catastrophe events like Hurricane Andrew, 9/11 and hurricanes Katrina, Rita and Wilma – launching the careers of a phalanx of new reinsurance carriers in a series of 'Classes' that now seem like the stuff of legend.

However, having once snatched the ball out of the air – only agreeing to give it back after its lower-layer, primary-market playmates accepted hefty rate increases for loss-affected and cat-exposed accounts – the reinsurance market seems to be caught between two classmates who have experienced their own growth spurt.

To put it less allegorically, primary rates are increasing all the time – betokening a hardening if not resolutely hard market for the underlying business – and retro rates are also up, leaving reinsurers feeling squeezed.

There have been reinsurance rate rises for sure – particularly on loss-affected business – but the sector is coming from such a low base that it has a long way to go before it can recover the stature of its youth.

That said, as the participants in *The Insurance Insider*'s flagship Monte Carlo Roundtable relate, insurance pricing momentum is increasing, and with the increase in retro costs acting as a "natural floor" under cat reinsurance pricing, the catalyst is there for further reinsurance price increases in future.

The problem with the market currently is that the dynamic in the risk-financing playground is a little confused. The new kid on the block – the "new normal" of Cat 3 to Cat 5 windstorms – threatens to erode already thin margins.

At the same time, while reinsurance demand is apparently at an "all-time high", so is supply.

The question is: are we beyond the point of the "Groundhog Day market", as Hyperion X's David Flandro terms it? Is the current hardening market a temporary correction, following some of the largest insured catastrophe losses ever in 2017 and 2018?

With reinsurance combined ratios still hovering around or above 100 percent, the market still has to reach higher to prevent cedants snatching the ball out of its hands, bringing back another era of perma-soft rates and dwindling premium income to set against burgeoning cat losses.

And with many brokers and underwriters inexperienced in terms of selling rate increases in a hard market, articulating the value proposition of reinsurance may be harder than ever.

Hamilton Re's Kathleen Reardon wonders whether this reinsurance squeeze means the sector is threatened with extinction.

And Axa XL CEO Greg Hendrick ponders the "inverted rating curve" – where the insurance and retro sectors could "collapse right on top of each other".

Read on to discover how innovative new vehicles, technological change and data management could help the industry save itself.

It won't be child's play, but don't worry – these kids know what they're doing.

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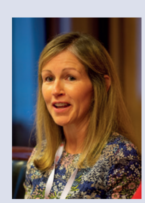

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Monte Carlo Roundtable 2019

Mark Geoghegan
Let's start with the state of the market. Greg, is the pricing momentum going to continue? That is the big question.

Greg Hendrick
It's great that rates are finally going up, but I don't think things are improving all that much. Mark's team did a good job the other day pointing out that you're at about 100 percent combined ratio still in reinsurance when you normalise for catastrophes.

So that's not making any money and it's just not acceptable given that, as insurers and reinsurers, we assume the tail of our client's risk curve. If anything, 2017/18, Hurricane Dorian, Typhoon Faxai and manmade losses all remind us that's what we do and we need to rebuild the uncertainty margin that's been beaten out of the system by all the modelling and competition. For reinsurance prices in particular we are in an "inverted rating curve" where you've got insurance pricing going up and accelerating, you've got retro costs going up and accelerating, and yet reinsurance is just bobbing around with small rate increases.

"We also have the question of whether there is now a norm of Cat 3s to Cat 5s every wind season, which could be due to climate change"

Kathleen Reardon

It seems like that's a natural floor under reinsurance pricing going forward and likely will be a catalyst for greater increases in the future. We see the insurance pricing momentum continuing across all lines and regions for some time.

Kathleen Reardon
You have to get paid for the risk you take and it's multi-line this time round, it's not just cat leading the way. We tend to have the short-term losses, and short memories go with those, but the longer term losses emerge more slowly so we react for a longer time. And then we also have the question of whether there is now a norm of Cat 3s to Cat 5s every wind season, which could be due to climate change. That needs to be priced in.

Rod Fox
Yesterday, when Greg and I were talking about this inversion, I said there seemed to be some unspoken words around cat reinsurance pricing. So yes, primary rates are going up, retro plus 15 to 25 maybe on aggregate, but nobody is talking about that as an example on the original reinsurance. It's just not being discussed. Meanwhile, I think Dorian will be an $8bn-plus event. Faxai has just hit and there are a million people in Japan without power.

Steve Arora
Rates will need to continue to move in the right direction. However, I do not consider the present environment a hard market. Reinsurance demand is at an all-time high and so is reinsurance supply. We have a global profitability issue which, in turn, has translated into an underwriter's market, requiring more discipline. This correction needs to happen. In the absence of more market losses, I expect it to be a long-term correction – rate increases over several years. If we don't have that, it's not viable or sustainable.

Jason Howard
It's an interesting market because it's neither really soft nor really hard. It gives the ability for people to negotiate some interesting deals. It's not a uniform movement in any sector or geography. Much will depend on the relationships that exist as to whether deals can get done.

David Flandro
It's important to look at the broader context – specifically, we had a big drop in rates from 2013 to 2017. We called it the Groundhog Day market. We would all show up and talk about all the reasons why rates could increase or stay firm, and then they would just be down 5 percent every year, relentlessly. We finally got to the beginning of 2017 and we were at some sort of record whereby property catastrophe rate on line indices were down to where they were in the late 1990s.

What's happening now has to be seen in that context. Yes, rates are bouncing up in certain lines, not least in property, but not as much, as you say, in reinsurance property, with casualty moving higher as well.

The questions are, is this cyclical and, if it is cyclical, how long will this part of the cycle last? What are the cyclical factors driving it? Reserve releases running out? Third-party capital not coming in as fast as it was? Or has something structural happened? Are we just experiencing a temporary correction because we had in 2017 and 2018 the largest insured catastrophe losses ever?

What most people round the table don't want is a situation whereby the catalysts fizzle and we just bounce along the bottom.

Kathleen Reardon
I agree with David. The reinsurers are forever optimists that rates are going to get off the bottom. Europeans are expecting flat to decreasing rates. They haven't experienced a loss so this idea that they need to support the rest of the market has been lost somewhere.

Rod Fox
This is the unspoken word. I was talking to a major European global company and asking is anybody talking about rates going up in cat? They said no.

Greg Hendrick
How many of the younger generation in the reinsurance industry have lived and worked through a hard market? Reinsurance rates not rising is just unsustainable in an insurance market where rates are going up.

As a market we are now in double digits in the quarter, globally, across all lines of business. Double-digit rate increases. And at the same time having retro going up double digits and having reinsurers sit around Monte Carlo and say, "That's okay, you go ahead insurer, make more money, go ahead retro manager, take more margin. I'll just be happy to plug along." And the 100 percent combined ratio I spoke about earlier becomes 105 percent.

Kathleen Reardon
So, given this reinsurance squeeze, we're threatened with becoming extinct?

Greg Hendrick
It is a concern of mine and that's why I mentioned this "inverted rating curve" – suppose the insurance and retro businesses collapse on top of each other?

Rod Fox
But I don't think that leads to extinction though. Maybe more irrelevance.

Mark Hvidsten
That's how the cycle would change, right? Because as company's results become worse they get shut down, they pull out of lines of business and that's what brings about the spotty change we see now. It's always a supply and demand game.

Ultimately, this business does not change when supply is greater than demand. And as long as I've been around, we talk about the cycle and the only thing that truly matters is when people are worried and determined to achieve profitability and they say "enough". Until you pass that critical point you bob along; that's what a market is.

> "For reinsurance prices we are in an 'inverted rating curve'; insurance pricing and retro costs are going up and accelerating, yet reinsurance is just [seeing] small rate increases"
>
> **Greg Hendrick**

David Flandro
There used to be 20 quoted Bermuda reinsurers and seven Lloyd's quoted vehicles. Now we're down to three Lloyd's quoted vehicles and a handful of quoted Bermudians. That's what's going to do it.

As the sector consolidates, those capital bars are going to stay the way they are and the premium line is going to keep going up, and once the premium line passes the capital bar we may experience a structural change that looks to be getting closer. The capital bars certainly haven't grown in the past year.

Kathleen Reardon
I don't think it is going to get that far because there'll be start-ups. They're out there already. Competition doesn't go away. Companies need growth, scale. Otherwise, teams defect from their existing companies and build again.

Adrian Morgan
Taking a different perspective, what we've seen in the past 12 months is a massive take-up of data-driven underwriting. Underwriting transformation is the new policy admin replacement and our pipeline is full of it, yet we were traditionally a policy admin player. So action is being taken and underwriting driven with data at the forefront.

"There are huge streams of data in our sector that could be used to create claims and pricing information. They simply are not organised properly"

David Flandro

Mark Geoghegan
Do you think the last renewal made traditional reinsurance more relevant than before, given what's happened in the ILS market? And also the fact that reinsurance has aligned itself better with ILS?

Mark Hvidsten
You can take two perspectives on this. For our customer base, there's no question that reinsurance is more valued than ever. Demand for reinsurance is higher than ever. You can point to various obvious things such as people are no longer focused entirely on efficiency in the tail and capital structure, they're now looking at earnings volatility more. And, broadly speaking, the reinsurance market over the past few years has been responsive to that.

The cynic says – well, this is the cyclical phenomenon, people always buy less reinsurance when times are good but reinsurance is cheap. And when times are bad, the opposite. But we think present demand will be retained through the pricing cycle. It's supported by data, it's supported by technology, it's supported by competent reinsurers who are able to be more consistent in pricing than they otherwise were, and are more capable of sustaining capacity in different lines of business and different types of structure.

Steve Arora
I'm not concerned about the market losing relevance. Strong demand will continue and likely lean towards earnings volatility protection rather than pure capital management. More focus needs to be on the market having the courage to walk away from business that's not priced adequately.

Rod Fox
There's always going to be some form of capital taking risk around this business in a secondary market. So what it looks like exactly will reshape over time. But I agree, it comes back to the need to ask the question – if the results aren't there, either ask to fix it or get out. But I haven't seen any of that.

Mark Geoghegan
So it's the rationality question. A recent Willis Re report said this is a rational market, we've had these remedial actions. Are you saying the market is not going to let you be rational?

Kathleen Reardon
I like Adrian's point on technology. We're not underwriting as effectively as we could be because we're not using all the information. One issue is the inconsistency of data we get from brokers, submissions from clients and multiple broker platforms. If we could remove that clutter and get to one common place we could take our heads out of the weeds and do a better job underwriting, and maybe price the risk better. Maybe we get an acceptable rate but we just don't know that yet because we haven't had time to focus on doing a better job and use all the new information available to us.

David Flandro
That's such an important point. The ubiquity and consistency of data in the insurance market, when you compare it to other financial markets, is egregiously scant. You can Google the Washington County, Utah 30-year jumbo adjustable rate mortgage and see where it was trading yesterday. But can you see where Spanish marine cargo business was priced on average yesterday? Last week? No, you can't.

But there are huge streams of data in our sector that could be used to create claims and pricing information. They simply are not organised properly. They need to be to do what Kathleen is saying. Everybody talks about data constantly, everybody talks about machine learning, big data and AI. But you need data scientists and programmers as well as people who have grown up with the data and can really understand it across all business lines to create that competitive advantage.

Jason Howard
The problem is that brokers and carriers use the data they have to try and compete against each other. Rather than pool it to try and make the industry more aware and prepared for what's actually there, they use it to compete. I don't see that changing in the short term. That's the reason you don't get industry-wide pools of data.

David Flandro
It has to change. We've been talking about it for a long time. We have to deliver.

Kathleen Reardon
Is that where you are really going to differentiate? With the raw data? We talk about the vendor models, having one version, one exposure data model, one version out in the cloud, and you can differentiate from there. You can have an algorithm that points to something in the data that provides you with different insight from the next person. But the starting point needs to be the same.

David Flandro
I understand what you are saying and yes, having good data is only the first step. Mark, think about what you guys do with Radar. You can go into Florida, figure out where you're overweight, where you're underweight, where the business is profitable, where it is unprofitable, in which counties, and which business lines. But you're not using your own data, you're using Florida rate filings. What if you could do that for German E&S or Spanish marine? There are many applications once we create better datasets.

Mark Hvidsten
There are people doing this. Willis Re has entered into a deal with an InsurTech called Concirrus. They are data scientists who aggregate, cleanse and enrich data from third parties and use machine learning to link behavioural characteristics to insurance risk. They use this live data to derive additional new measure of risk based on behavioural factors which can be combined with the traditional rating factors to create an improved understanding of risk. They have developed platforms for marine hull and motor, and marine cargo comes out soon. Instead of the five or six rating factors most hull underwriters would adopt, they give you 1,000. Seriously, 1,000. So they bring any data you could possibly want, and now underwriters can all have that same data if they buy it, and they can choose their pricing algorithms accordingly.

David Flandro
The place where data on pricing and claims by business line and regions exist is in the brokers. We have the data between us.

Mark Hvidsten
I'm not sure that's right. We could never do what Concirrus have done.

David Flandro
Maybe not in terms of rating factors, but we've got information on lines and classes of business that don't exist anywhere else. The larger brokers will consolidate and use the data in a productive way only when they have to but until then, there will be competitive factors that compel them not to. But the data exists and the time is now.

Steve Arora
Jason, you said something before about a competitive advantage for reinsurers to use around data. I believe our industry doesn't utilise data to its fullest potential to gain the insights that are possible. Systems are not perfect for data capture. The analytical capabilities are not as high as they should be. There's an opportunity within companies to extract more insights, even before we go to a global data-sharing model.

Adrian Morgan
The data is there but it's the volume of it and having the technology that can analyse it and bring it to the point of underwriting.

Jason Howard
We have an amazing data system at our group level but is it picking up exposure data, is it picking up claims data?

Not yet, but we are starting the process. It's about capturing all appropriate data as the risks are entered and being able to interrogate that data. At present, we are scratching the surface of what should be available.

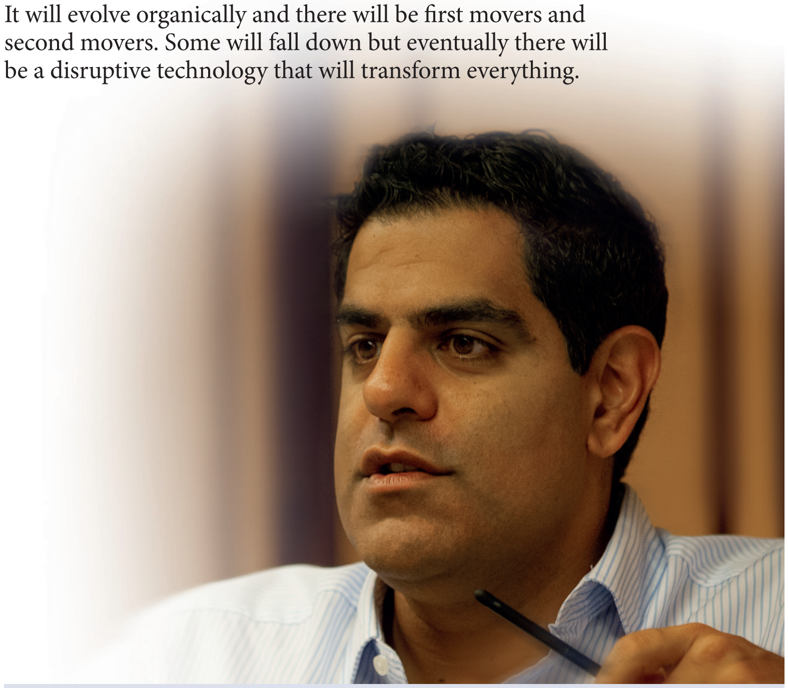
Rod Fox
If you look at insurance, reinsurance, versus other sophisticated financial sectors, there are complex derivative transactions that are done electronically in other markets. We hold ourselves out saying that we've got this super-complex industry and nobody could ever do this electronically. But that's not true.

Mark Hvidsten
It is inevitable that almost all reinsurance will be transacted digitally in due course. I don't know whether it's one year, five years or 10 years, but I do know that third-party systems are not the answer. It will come from the industry. Hopefully, some visionaries will do it.

Kathleen Reardon
If we take XL Innovate's investments – and I'm sure Axis has an InsurTech investment – if we pulled them and put those funds towards a standard platform, give it two years.

Steve Arora
Easier said than done. The concept makes sense but the practical challenges of implementation are significant.

David Flandro
It will evolve organically and there will be first movers and second movers. Some will fall down but eventually there will be a disruptive technology that will transform everything.



"I believe our industry doesn't utilise data to its fullest potential to gain the insights that are possible"

Steve Arora

"It is inevitable that almost all reinsurance will be transacted digitally in due course, whether it's one year, five years or 10 years"

Mark Hvidsten

A good analogy for this is the options market, believe it or not, in the 1970s. People used to sit around tables like this and say derivatives are far too complex to ever be traded on the stock exchange. But here we are. We can do that all the time.

Jason Howard
But crucially, it's traded by the people that were still there in the 1970s. There were not a lot of new entrants, it was the same participants who took the technology forward.

Mark Geoghegan
It will only happen surely when you get the three big brokers working on it. Do you think so?

Mark Hvidsten
You have to remember that in the past, when people made these efforts, data wasn't at the forefront of their thinking. It was process. And consequently, with greatest of respect to past efforts to do this, they were doomed as they weren't trying to do what we're talking about now. So even if they succeeded in a clunky way in enabling placement online, it's just like a glorified email system.

Now there is an understanding of the power of data. There is an understanding of liberating technologies that enable things to happen in a way that just wasn't possible before. So if anybody wants to think about doing this now, the range of options is much wider than it was and the likelihood of achieving it is probably greater than it was. Technology has moved in the past two years at an unbelievable pace.

Adrian Morgan
People are doing it – we see investment and it is around data. And it feels to me, certainly as a vendor, that momentum is starting to build. This time last year, when we were sitting here, there wasn't that focus. But 12 months on, underwriting transformation is everywhere and, with data and AI frameworks, you're starting to get to the point where the industry will transform from within rather than someone from outside disrupting it.

Rod Fox
If you look at other markets, there will be several systems developed, it's not one. And ultimately they will merge, they'll coalesce, right?

David Flandro
The other thing that's going to drive this is rising broker commissions. Lloyd's acquisition cost ratio, net of reinsurance sharing arrangements. went from 22.7 in 2004 to 30.4 in 2018. I know that to say this as a broker is slightly surprising, but I'm going to say it anyway – that has to change and the only way to get it to change is with technology. And not just electronic trading, we need a sea-change if we're going to get that back to where it needs to be. It's unfair to bang on about Lloyd's expenses, because they've lowered their administrative expense ratio, without talking about acquisition costs. We've got to talk about both.

Mark Geoghegan
What are the prospects for more M&A given where we are now? We've just seen a $1.8bn start-up enter our market. Does that mean the consolidation play is over and it's the start-up phase now?

Steve Arora
We talked about supply and demand being the fundamentals of our industry so you're going to see people come and go. You'll see companies consolidate, and I don't expect any of those trends to stop. You need to have a paranoid view that there's only going to be space for about 20 reinsurers going forward, maybe even 10 in the traditional sense. This means you have to be sharp with your competitive edge. But I don't think there's anything new about start-ups; I don't think there's anything particularly new about M&A, or contractions in supply and demand. I welcome start-ups because it demonstrates the heartbeat in the industry.

Jason Howard
Individual businesses and investors will have different views on when they want to go in, when they want to come out, what they want to invest in. The strategy we employ for how we build our business is driven primarily by the opportunities we see rather than market trends, and I'm sure everyone round the table has developed their strategy in the same way.

Now opportunities might have come up because of something happening in the market and you take advantage of that, but ultimately everyone is building their own strategy to take their business forward. So it's difficult to say it's the whole market moving one way or another. There's always going to be M&A.

Kathleen Reardon
M&A will continue. There's always need for growth and scale – expanded geographic footprint. Hamilton's acquisition was about complementary lines of business, adding some other geographies. If we take the start-ups now, including Hamilton, versus the start-ups of 2005 or 2001, there was a need for capacity then but we don't need extra capacity now. We're mainly supporting the same risks that are perfectly covered by existing reinsurers. So obviously, today's start-ups need to demonstrate a pretty compelling model.

Mark Hvidsten
But that could be seen as a sign of improved efficiency in the industry. The occasions when there's a capital shock are exciting but right now capital is pretty much a commodity driven by the low interest rate environment and liquidity glut. It may not stay like that forever but it will for the foreseeable future. So the competition is unlikely to be for the lowest cost of capital every time. It opens up the ability for companies or individuals or entities to compete on something else.

Mark Geoghegan
Has the MMC-JLT deal changed the game? And are any more mega-deals likely?

Rod Fox
What about the insurance side?

Greg Hendrick
It's increased the argument for carriers to consolidate and achieve scale. Being bigger doesn't make you better. There will always be start-ups and there will always be people filling niches and doing a good job. But you need scale to have the best crack at accessing more client data and creating top-notch analytics. You need scale to be able to stand up and be, not equal with the big brokers, but certainly credible with the big brokers.

Mark Geoghegan
So you may feel you need to be bigger because now you've got bigger brokers?

Kathleen Reardon
Not necessarily. The reinsurers have to reconfigure relationships, but as long as the contract, the terms and conditions, aren't fundamentally changing and as long as the client is being served, we just have to shift our relationships a bit.

Steve Arora
Generally speaking, less choice for your customer is never a good thing. Nevertheless, for the reinsurance industry, my view is that it's neutral. You reconfigure relationships – that's the biggest change.

Jason Howard
The same clients are out there, looking to buy their covers. They might be buying them from a different place because somebody moved somewhere that had a relationship but it's not disrupted the industry in any way. Some people have moved around but the business is still being transacted.

David Flandro
I can't comment too much but I will say, having worked in analytics in a big broker for a long time, you don't need to be a behemoth to deliver world-beating analytics. Sometimes it's better to be nimble and it's easier to get things done when you're small.

Greg Hendrick
I don't want to convey that big just makes you better. There's room for everybody. But there are only five insurance companies in the world that can insure a global corporation in the property and casualty market.

Just a handful of us with a full suite of products globally that can go to XYZ Corporation and say, "I can take care of you around the world." Marsh, Aon, Willis Towers Watson – those three are truly global. So that's why you see insurance company consolidation. Reinsurance hasn't done that – yet.

Mark Geoghegan
I want to mention the blueprint for Lloyd's. What's the most important thing you'd like to see?

Greg Hendrick
Well, as the second largest syndicate, I think John Neal and the team are a breath of fresh air and we're fully aligned with what they're trying to do. It needs to be done. Fundamentally, if the number one issue is not attacking the inefficiency and cost base of the marketplace, we're going to be really disappointed.

"It's important to regain the nimble, agile nature of being able to think about risk in different ways"

Rod Fox

Lloyd's is an important part of the global (re)insurance market, but it's one of a number of marketplaces; it's a place where capital comes together to trade risk – perhaps in one of the most inefficient ways possible. And that to us is the number one thing – getting that cost of trading risk down and being efficient about it.

Rod Fox
I would say nimble entrepreneurship. It's important to regain the nimble, agile nature of being able to think about risk in different ways. There are today huge global organisations that deal with the risk but Lloyd's has been different over time and it's important not to lose that ability to respond quickly to market conditions, opportunities and different types of risk.

Jason Howard
At *The Insurance Insider* Honours awards ceremony last week, who got the outstanding achievement award? It was Jon Hancock – and this is only a year or 18 months into the project.

You'd think he might have become the most vilified guy in the market for all the changes he has brought in, but generally both carriers and brokers have said Lloyd's are on the right track.

"You've got to have easier access for brokers from outside the London market to bring business in, in a more efficient way"

Jason Howard

There's execution risk still to come but all the elements they've picked up have generally been received with a pat on the back from practitioners in the market.

Just picking on one point from our perspective, you've got to have easier access for brokers from outside the London market to bring business in, in a more efficient way, and cut down on the expense of that business flowing in. You'd see Lloyd's being able to access a base of business it's not been able to write for some time.

Steve Arora
Just one more vote for the reduced cost of doing business and streamlining the inefficiency. We're supportive of the plan but that's where most value is being created.

David Flandro
I'd like to see that but I'd like to see something in the plan that shows the driver as better data and a way to get better and more ubiquitous, homogenised data, and do it on a digital trading platform. These aren't just words, we have to have a framework in place with the right data to do it. That's a big way we're going to lower costs.

Kathleen Reardon
We're among the top 15 syndicates but I'm supportive of the expense improvements. More importantly, we would love to see Lloyd's being a leader in extracting value from data, getting consistent submissions, trading on a standardised platform. That would be fantastic and Lloyd's would really be a leader in the industry. Maybe that's what will get everybody on the same platform thinking alike if Lloyd's leads the way.

Mark Hvidsten
It's unlikely but possible. It's difficult for them to do that. The vision is fantastic, I love it, but Lloyd's is still lots of different businesses and it will take some doing to achieve alignment

Adrian Morgan
When I think about Lloyd's I take the technology viewpoint. The legacy that underpins the market today – they've got to let it go. There's got to be a version 2 market and it's got to be hyper-efficient.

Then business will transition from being placed through the present market to the new one. If you try to transform the current market it just brings more complexity – we've seen this for years. Ultimately, you have to switch the old one off. With a more efficient market in place, the old one will decline and the new one will take over.

Greg Hendrick
Somehow the market survived getting rid of paper cards and switching to computers. So I believe this next technology change will happen.

Adrian Morgan
Yes, it's got to, but it's got to be brave and not just do what it did with TOM, which was just tweaking around the edges again.

Mark Geoghegan
I'd like to thank all of you for coming.