Autumn 2019

The Insurance Insider

NEW YORK ROUNDTABLE 2019

State of the market

Dislocation and disruption characterise the rapidly changing US (re)insurance market

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In association with phinsys

State of the market

This publication has well documented the rapidly changing environment within the US (re)insurance market.

From the upper echelons of the retrocession sector, through to reinsurance and then onto the commercial and personal lines markets, there is certainly a sense of dislocation and disruption as the industry comes to terms with a whole host of competing trends.

On the one hand, industry capital levels continue to be far higher than what is actually needed. That has the effect of putting downwards pressure on pricing as supply outweighs demand.

On the other hand, rising loss costs and tighter underwriting controls being implemented at some of the major market players mean there is also upwards pricing pressure.

Added into the mix is that while industry-wide capital remains at a high level, there are reductions and withdrawals in certain specific segments.

"While industry-wide capital remains at a high level, there are reductions and withdrawals in certain specific segments"

These dynamics make for a market that is rapidly changing and one where it is difficult to predict what will happen next.

The Insurance Insider, in partnership with technology specialist Phinsys, brought together a panel of industry experts to discuss these trends and how they are impacting the (re)insurance market in the US.

Hosted in New York at the official residence of Antony Phillipson, the UK's trade commissioner for North America and consul-general, a diverse group of (re)insurance industry executives discussed a wide variety of topics including expectations for the upcoming 2020 renewals, the impact of social inflation, new opportunities on the horizon and what forms of InsurTech have caught their eyes, among others.

One of the main talking points was whether the pricing increases that have been seen in the past 12 months are actually enough to leave the market in a positive position – are the rate rises being imposed sufficient on a risk-adjusted basis?

Among the other changes going on in the marketplace is the shifting nature of the exposure, and this was a keen talking point for some participants.

It remains to be seen what positive impact, if any, the changes to assignment of benefits rules in Florida will have for carriers, while on the West Coast, the region continues to struggle to come to terms with the wildfires that have raged through parts of California.

How the industry gets to grips with these issues will be important in determining in its ability to write coverage for such perils in the future.

You can learn more about what was discussed by reading the following pages.

Christopher Munro
Associate Editor,
The Insurance Insider

Participants

Ross Allen
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Anita Kuchma
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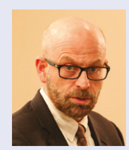
Richard Mayock
Global Insurance Broking Leader, PwC



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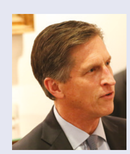
Founder & Managing Partner, Hudson Structured Capital Management

Johan Slabbert
CEO, Augustus Specialty

Richard Tyler
CEO, Phinsys Group



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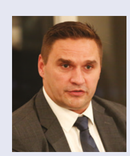

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New York Roundtable 2019

Christopher Munro
Let's start with pricing, which seems to be a hot topic. Anita, can we start with you?

Anita Kuchma
There's been firming and some price increases across the market, depending on where you are and in what lines you are in. On an industry basis, we're still concerned about commercial US casualty and social inflation – and the impact of that on loss trends. So, although we're happy that the market is firming and there are increases, we're still cautious when it comes to US casualty business.

"Although we're happy that the market is firming and there are increases, we're still cautious when it comes to US casualty business"

Anita Kuchma

Keith Wolfe
We're really concerned that the industry is not fully accounting for the depressed interest rate environment and the running yields coming down so low. We don't see an end to that. We're especially talking about casualty portfolios and longer duration.

On the property side, it's important for people to realise that insurance and reinsurance is a globally interconnected industry. The capital pools are fungible which provides a lot of benefits, but when something bad happens in another part of the world, like Japan, it does not mean the rest of the world doesn't feel the impact.

Christopher Munro
You mentioned the low interest rate environment – I suppose discussions for 1 January casualty reinsurance renewals are taking place now. Do you have a read on that situation?

Keith Wolfe
If you look at some of the fundamentals providing challenges, I mentioned loss cost for property so that's probably the most important one now. And social inflation is important. We've seen the top 50 litigation settlements over the last five years double in size. That's really surprising and we don't see anything stopping that any time soon. There are a few bright spots – I never thought I'd say this but workers' comp is one. It is seeing great reductions but it is also seeing loss costs go down so the margin pressure is not quite as much as before the reductions came in.

Christopher Munro
I saw a graph from AIG a couple of weeks ago detailing those top 50 jury awards escalating. It's startling to see just how in the US they have rocketed in the past few years.

Greg Wolyniec
Reflecting on the state of the market today relative to the past 24 months, there's no question that ceding commissions have come down and there's continued downward pressure. Given pricing lag and the development of loss lag on all casualty in the US, you're seeing a no-man's land in casualty reinsurance where the benefit of the present primary insurance rate increases won't be factored into the reinsurance structures for another year or two.

Michael Millette
Pricing in casualty is stable, even firming, but risk is moving and compressing the spread. We attribute that to three causes. There's an expanding social notion of blame and that's what casualty is – blame. That's manifested in an increasing number of categories from opioids to vaping

to herbicides to other new types of liabilities. A cohort of judges are receptive to expanding notions of liability, and juries even more so. A third factor is hedge fund investment in alternative litigation finance. Such funding is, in effect, turbocharging the activities of plaintiffs. Casualty pricing is firm and perhaps improving but it is highly likely that risk is increasing faster. We look for an excess spread and in some areas of casualty we see it. We're very active in auto and cyber and run-off, but across broad new issue casualty, we're concerned.

Anita Kuchma
Even in the auto space where there were rate increases for the past several years, they just haven't been able to keep up with losses. Loss cost is outpacing rate increases.

Hank Watkins
Some risks just aren't right at any price and that's something a lot of us have taken a look at over the past couple of years. Lloyd's is coming off some pretty awful years. We're not closing any business but a lot of lines of business have been pared down or completely re-underwritten, which is the right thing to do.

Michael Millette
Personal auto is interesting; there are so many things going on. Both cars and insurance are changing, and unfortunately everyone is texting while they're driving. Commercial auto is a great example of a line of business where pricing is firming materially every year but the experience is getting worse. It never quite catches up, and there are other lines of business like that.

Johan Slabbert
What we're seeing on the auto liability and the transportation side in general is yes, the rates have been coming up, but the losses have been following. It's a persisting rate of increase to try and get to what an acceptable rate. We're still getting rate increases to a large extent on motor truck cargo, auto liability and the physical damage side. Is it enough? I guess time will tell.

And to the casualty side, the question around workers' comp for me is – what is the true correlation to the economic environment we're in? There's data around workers' comp that says when the economy starts slowing people retrench, the claim frequency goes up and the severity goes up. And then if you look at the medical cost side, it has to go up because we're constantly paying more for medical and social inflation.

Richard Tyler
I was chatting to someone who is placing a large casualty book at a pretty large P&C insurer and they were exactly the same as Michael's point. Two years ago they looked at the price and, in effect, they got the rate increase they'd been expecting. However, they think it's now 25 percent under because of the risk. They're honest about it because they realised they weren't going to be able to place this risk with the people they were talking to.

Michael Millette
That's slipped into property, because property probabilities

"On the auto liability and the transportation side in general the rates have been coming up, but the losses have been following"

Johan Slabbert

shouldn't move around as much but they do. As far as I can tell in Florida, the occurrence of the loss is a starting point for action. And we don't count on that. We have to think about the impacts of climate change on hurricane frequency and severity. But the real devil is what happens after the loss in terms of assignment of benefits, the inflation of loss adjustment expense, competition for loss adjusters and the social inflation category in property which has caused a great deal of the loss peak we've seen.

Richard Mayock
Prices are directionally improving. The question is – on a risk-adjusted basis, is it enough? We are all saying probably not. One thing that should facilitate price increases is that reserving adequacy is starting to deteriorate on a relative basis. Consequently, there should be less margin of safety to assume mispricing risk.

Christopher Munro
Property prices are going up month after month. At WSIA the expectation was that this trend would continue for at least the next 12-18 months. What's your take on that?

"Property rates on a primary basis need to increase for companies to be able to pay for their reinsurance"

Michael Millette

Michael Millette

There's a squeeze on both coasts on the primary side. In the east we have social inflation after storms. In the west we have extraordinary and historically unusual wildfire experience. So property rates on a primary basis need to increase for companies to be able to pay for their reinsurance.

Reinsurance rates need to increase to compensate for the changes in risk. And as far as I can tell, both are increasing. We've had a crisis in the retro market, which has had a few causes. One is the underlying trends. Second is an extraordinary accumulation of aggregate losses that have been improperly modelled and improperly priced for. And third, we've had some implosions of major players in the retro market that has caused a squeeze. And we've had a bigger problem with trapped capital. The majority of the retro market is capitalised in the capital markets, not the traditional markets, and there's simply not enough capital to clear the retro market year by year.

Keith Wolfe

On the wildfire front, prices are going up dramatically but there's not enough coverage. And that's largely because it's not well enough understood by the industry. It's not modelled like hurricane or earthquake. There are models out there and ways to assess it but they're not nearly as robust, which makes people not understand the risk, which makes it difficult to price.

Anita Kuchma

We've been investing a lot of time in developing additional capabilities and a wildfire strategy. We're looking at tools and models we can use to assess and provide our partners with a better understanding of exposure and accumulation. The market, post-event, has tightened. That's why we're focused on the need to develop a better capability and understanding of the exposures.

Greg Wolyniec

Picking up on the starting question, we're seeing significant dislocation in capacity in a number of casualty classes and it's difficult to see how that stabilises in the next 12 months or so. Some of the Lloyd's retrenchment is driving AIG's clarity around wholesale versus retail, admitted versus not admitted, and that's starting to create some real capacity shortages.

And then there's the pricing conversation – where on the curve and where in the cycle are we with rate increases relative to risk scope trajectory? That's the dynamic, but it's difficult to see how, on primary casualty, the rate increases will stop over the next 18 months.

Richard Mayock

Greg hit the mark. There will be a continuous need to raise rates. I guess it's just a matter of degree and the question will be whether the industry will move in unison. If there are undisciplined players, it remains to be seen whether companies are prepared to walk away from business.

Johan Slabbert

Recently, I saw a graph of the past 20 years' overall market performance for insurance companies and I think there were three out of 12 years that were profitable, and those were somewhere in 2011, 2012 and 2013 – the years when reserves were released rather than added to the balance sheet. So the market needs to move in tandem to ensure the industry as a whole obtains sufficient rate. However, there's still capital flowing into the insurance industry that puts further pressure on pricing. There needs to be a broader realisation that the sector makes a heap of money, if you look at the overall performance over the past 12 years, so we all have to work together to get the right balance.

Michael Millette

We had a series of events, starting with 9/11 and ending with Hurricane Wilma, from 2001 until 2005 that succeeded in hardening broadly the property, the casualty and the E&S markets. And then we had a gorgeous decade from the landfall of Wilma to the landfall of Harvey. Then we had another series of events including hurricanes, wildfires and the sharp uptick in litigation settlements that have brought about a mood that is more redolent of that in 2005 than that at the beginning of 2017. This mood is good for the industry because profitability lines were not improving, but it's too bad that it requires a series of events to shock the industry into discipline.

Christopher Munro
Focusing more on the primary side, I've heard that because there have been withdrawals of capacity or re-underwriting of some classes of business, instead of companies putting down $15mn, $25mn, $50mn, $100mn lines they're now putting down $5mn and $10mn. How much of an impact is that having?

Greg Wolyniec
There are classes and deals that are difficult to get placed. Part of it is this convergence of a number of these corrective actions, whether it's markets or whether it's views on profitability and risk.

Part of that is driven by larger primary insurance companies being relatively rigid in the way they think about underwriting in layers of towers.

So an example would be where you have a large US-based insurance company that has a primary division and an excess division. The primary underwriter has been writing a primary $10mn line for the past 15 years and all of a sudden there's a directive: hey, take your lines down by a half and keep the same rates. That primary underwriter all of a sudden goes from writing a $10mn primary to writing a $5mn primary for the same rate.

That's great, but on a risk-adjusted basis it would be better to sit on the $5mn excess of $5mn. You'd rather be sitting at a higher level in the tower than the lower layer for a relative price.

Richard Mayock
Companies are refocusing their efforts on how to make more informed risk selection decisions using big data and technology. Companies are spending more time understanding the voice of the customer to drive product innovation and solutions.

Johan Slabbert
We've seen some rather bizarre requests to write risks at the top of the tower within our captive, which is not typical business for us. And Lloyd's may have something to do with it, on the basis that there's a lot of uncertainty.

I think there's some shift in the US markets, asking why they need to go to Lloyd's. But when they go to place that risk, it's not as easy as they thought it would be. So they go through the market trying to find places to put risks, and we're seeing some of that as well. It's unusual for us to write third-party risks in our captive, but it's certainly coming to us.

Hank Watkins
We are seeing a lot of opportunity in areas that previously may not have been there. Are we going to talk about the gap in what people should have and what they don't have? For all the expertise our industry has, we don't get close to providing what's needed around the world. And that's a question we've all asked ourselves.

I know this is a US-focused conversation and I don't know how we do that as a global industry but there's so much opportunity out there for this capital, if we can somehow convince governments to stop paying for major damage and get their citizens to step up and take more personal responsibility for their financial futures.

Johan Slabbert
It's easier in markets where there's a high penetration of insurance. In areas or countries where it's more needed, there's no or little penetration, there's no money to pay for that loss – no insurance nor state funding. So it becomes a government responsibility. In this scenario you've got to figure out that the route is different to get to consumers.

Keith Wolfe
But that's generally not the case in the US. The penetration rate is dismally low, no matter how many products we come up with. We have a lot of hope there but it's still just that. Flood is a big one – that's an enormous opportunity in the US. And we all probably have some version of a flood offering out there for the private space that can work well in conjunction with the national programme.

Michael Millette
Mini policies are a disaster. If you're on the coast in Mississippi you're supposed to get a wind policy, a flood policy and a homeowner's policy. Guess how many people get that right? What on earth are we doing from a public policy perspective? Florida does a wonderful job. People have all sorts of criticisms but everybody has insurance.

"There's so much opportunity... if we can convince governments to stop paying for major damage and get their citizens to take more personal responsibility"

Hank Watkins

"There's a tremendous opportunity to drive more automation into the front end of processing submissions"

Greg Wolyniec

What they do is create constructs in back of the insurance that facilitate the offering of primary insurance. Asking confused consumers to buy two, three, four policies on their house against different perils is not a road to success.

Christopher Munro
One of things I want to expand on is areas of opportunity. Hank, where do you see opportunities for Lloyd's, and also for the industry here in the US?

Hank Watkins
We haven't talked about AI too much. There is insurance for disgrace out there, it's been there for a long time but there's now a company using AI to monitor it. Think of any publicly traded board of directors, any Hollywood studio, anyone who relies on an individual CEO, a producer or an actor to present their brand well. There's now a company using AI to monitor thousands of media points – social media, print media, TV and radio – every day, and they help clients to find trends that their CEO might be falling into a problem. There's insurance attached to that, almost like a cyber policy. They give you the front-end loss prevention, loss mitigation support through AI, but if you have a bad event this policy kicks in. If you can expand it across any number of things that are emerging, there's a great opportunity for the industry.

Christopher Munro
What are the opportunities there for Lloyd's?

Hank Watkins
Cyber is a big area for us, and probably for everybody. As you all know, we tend to be the focal point of everything. In the old days, it was – take it to Lloyd's, they'll do it. Sort of like a surge tank – in and out, depending on how much the domestic market wanted to do it. But we see opportunities in a lot of things. Maybe not this year, but that's no news to anybody.

We can find ways to be more efficient, certainly. Forty percent is not an enviable number and after two years of working at it, 39 percent isn't either. There's a lot of room to improve.

Greg Wolyniec
In the near term, insurance companies are terrible operators in terms of efficiency: clunky, antiquated systems, no real use of data enrichment tools, very little API capability and stuff talking to other stuff – never mind outside your organisation, within your organisation itself. There's a tremendous opportunity to drive more automation into the front end of processing submissions, giving brokers a portal they could use as opposed to continuing to exchange Acord forms and email blasts. What century are we in!

Richard Tyler
We're part of the Lloyd's Lab programme. So we're looking at how that whole part of the business can become more efficient, and the regulatory cost for the reporting side is a significant burden. We're looking at trying to automate a lot of that, where actually Lloyd's, the PRA, the NAIC and so on can go and pool that data. Lloyd's does a lot of it through Xchanging already, but it is really going and automating that bit.

Johan Slabbert
You can differentiate yourself with true UBI [usage-based insurance] that is technology- and data-driven. When you have an Uber it has four embedded risks. It's when the vehicle is not being used in the business (private use); when the vehicle is used by somebody who is not the owner; when there is the "switch on the Uber Service" or it is left switched on, it's actually performing an Uber function even though there's no passenger; and then there is the liability added when there is a passenger in the vehicle.

We have the technology to do the analysis on the rate for each of those four aspects. And there are many other examples on the commercial side. With trucks – the transportation side – UBI should be a continuum. There shouldn't be a renewal period of your motor truck cargo policy.

Christopher Munro
Cammila and Ross, have you seen any insurance-related opportunities you think may grow in the US?

Ross Allen
It's an exciting time as we've seen large increases in investment with innovation among the major insurers in both the US and UK – many are opening their own accelerators or innovation labs. A record $2.5bn went to US insurance start-up deals in 2018, and 2019 is on pace to beat that. On both sides of the Atlantic, younger consumers and pressure from the gig economy are pushing for a better, more convenient customer experience. This has blurred the lines of standard coverage but also opened up demand for hybrid coverage and new product lines. As we look to the future, traditional insurers and InsurTechs will further integrate as technology becomes more integrated into the foundation of the industry.

Christopher Munro
What are the technological platforms that the industry needs to support its operations in the future?

Anita Kuchma
We still have to fully leverage digitisation through the whole value chain, for example using technology to make claims payments easier. We have technology, aerial imagery, that can scan the environment before an event. So post-event, even before the claimant has recognised the extent of their loss, we can evaluate what the damage is and this can help expedite the claims process.

When a tragedy happens we want to be able to serve that customer. While technology can help reduce expenses for the industry, more importantly it can help improve the customer experience.

What we, and lots of other companies, are doing is using data and AI to improve the underwriting process so we can come up with new products or address gaps in coverages. In the underwriting space, we're also doing a lot with automation or augmentation, AI and machine learning. Imagine how the customer's experience improves when underwriters no longer need to ask them to respond to 30 questions; they only need to ask five.

Keith Wolfe
One of the areas we haven't done a good job of embracing is on the loss mitigation side. As an industry we set up to pay claims when bad stuff happens and we do a bit in the prevention and mitigation space but it's not nearly what's possible.

On the technology or InsurTech area, a lot of these companies won't make it but there are some interesting ideas out there that, if they can truly be scalable, are probably better than what we would come up with as an industry, which is kind of old and staid in the way we do things.

Richard Mayock
Is it going to be evolution or revolution? We are seeing instances where it can enhance distribution, operational efficiencies and risk selection outcomes. The other question the industry is asking is whether this a threat or an opportunity. For some of these players, technology is a core competency and some also have tremendous market cap allowing them to out-invest the competition. Consequently, I suspect some in the insurance industry feel somewhat threatened.

Greg Wolyniec
To me it feels more like evolution at this early stage. In the last 10 years there's been this big push for InsurTech to get into disintermediation on the small commercial end of the business; personal lines is quite a different story. But when we think commercial insurance, small accounts in the middle market and the notion of manoeuvring the value chain or the transaction chain around the agent or broker, it's been over-hyped by InsurTechs trying to go direct to consumers. Brokers and agents are here to stay, likely for the next decade or two. A number of platforms have found that out the tough way. They tried to go direct and weren't able to scale the way they thought, and now they're catering to brokers and agents.

Hank Watkins
I don't see InsurTech ever replacing the broker other than, as you're saying, on some personal lines. But even if you're a homeowner, with everything else going on in your life you can't possibly fully understand your life insurance needs, your medical needs, your homeowner's needs, your auto

"[With InsurTech] there are some interesting ideas that if they are scalable... are probably better than what we would come up with as an industry"

Keith Wolfe

> **"**There's still a ton of wastage on the admin side where it could become much more efficient, straight-through processing**"**
>
> **Richard Tyler**

needs. If you do, great for you, but then you have a boy who crashes the car into a tree and you're going to type in "I need to have my cancelled insurance replaced by another AI". Human distribution is here to stay and as the world gets more complex. More than ever, brokers have a place.

Cammila Garcia

May I ask how you would respond to someone who says that AI could be used to accomplish those – whether it be through a robo service or something to replace or supplement the brokers?

Hank Watkins

I think it will supplement, not replace, the broker. Initially it's great because you can go to "Give us 15 minutes and we'll save you 15 percent". That's worked for a lot of people but, again, as you no longer have a renter's policy on one car, as your life changes, you buy a small business, you have more complicated risks – it's not going to work for you anymore. It may supplement the broker but it's not going to help you as a risk manager to manage the challenges we have.

Anita Kuchma

I would agree that InsurTechs are making everyone up their game by making everybody look at AI, augmentation of underwriting, and how to take cost out of the system.

Richard Tyler

I find it interesting that a lot of InsurTechs are – and this whole conversation is – pretty much focused on acquisition cost as opposed to the admin cost ratio. There's still a ton of wastage on the admin side where it could become much more efficient, straight-through processing.

Christopher Munro

Are any specific InsurTech platforms really catching people's eye?

Michael Millette

We've invested in 11. Several are what I'd say are new types of underwriting. There are two car companies which are pay per mile and pay based on driving experience, another that changes the way health records are deployed against data, and another for ride-share. So tech can allow coverages to be customised a lot more tightly.

One company we've invested in allows companies to track and manage policy wording discrepancies. When companies deploy it, they discover surprising variations versus what they thought they were writing in the policies. We're not invested in any direct disintermediator. There is one line of business on earth that I know where the majority of transactions are consumer-to-computer and that is UK auto. But that's because it's compulsory. On the other hand, we have invested in several indirect disintermediators that empower agents.

Christopher Munro

Keith, any thoughts on which types of InsurTechs will come to the fore?

Keith Wolfe

Satellite imagery is one that I've seen be most effective. It's finally come down in cost and there's a bunch of providers out there either getting the data or processing it to make it more useful.

Richard Mayock

A lot of companies are focusing on taking out cost. The low-hanging fruit is around automating operations to better ensure companies are fit for growth and efficient.

Greg Wolyniec

It's as basic as effective OCR technology, just data scraping off of a pdf file, which might provide an advantage. Those are the building blocks we're starting from, just from the basic operating efficiency conversation.

Christopher Munro

OK, that's brought us to the end. Thank you very much to everyone for coming.