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Outlook 2017

Analysis of the issues shaping the market in the year ahead

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Toughening up for 2017

Excess capacity, falling rates, dwindling reserves and low interest rates have turned up the temperature on the global re/reinsurance market.

In their recent end-of-year message to the market, Lloyd's chairman, John Nelson, and chief executive, Inga Beale, said Lloyd's needed to address the "worrying trend" of the market's deteriorating underwriting profitability. And they warned that the market's aggregate current year loss was "a matter of great concern".

Outside London, the reinsurance market is not immune to the various macro trends. Indeed, some analysts have been warning of an "existential crisis" facing the reinsurance sector.

Industry executive are looking at how to navigate these headwinds and position their businesses to make money.

Yet for the bold and innovative there are still ways to make money.

In this supplement we speak to senior executives in Bermuda and London to explore how the current market conditions are shaping strategy for 2017, looking at areas such as new products and geographic markets; cost-cutting; and distribution.

We also look how the composition of insurance company boards is evolving to reflect the new challenges and opportunities facing the sector.

The re/insurance market is starting to grapple with the evolution of insurtech. We examine how the sector is responding to the opportunities presented by such new, innovative technology.

Lastly, we explore some of the key issues affecting a range of specialty classes and look at the growth of facilities in the London market.

Enjoy.■

Michael Faulkner, editor, Insurance Day

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STRATEGY

Surviving in the London market bear pit

Pressures from a number of sources are set to make the next year a challenging one and insurers will need to develop strategies to cope

Sarah Veysey
UK correspondent

Next year looks set to be a challenging one for London market insurance companies.

A likely continued soft market, coupled with low investment returns, less opportunity to bolster results with reserve releases, and uncertainty over the timing and nature of Britain's exit from the EU – among other things – mean senior executives in the market are exploring the strategies that will keep their companies competitive and profitable in what looks likely to be a testing 2017.

The continued influx of capital into the market means "capacity isn't a treasured asset, it's a commodity," says Paul Merrey, a partner in the global strategy group at KPMG. As a result, London market insurers need to adapt their businesses to "thrive and survive" in the current environment, he says.

London market insurers are also being pressured by the increased sophistication of overseas markets and the twin opportunities and threats offered by technology. To meet these challenges, they are looking at ways to find growth, reduce cost and produce innovation.

Senior executives at London market insurers say a focus on profitable business and reducing shares of softer lines of business will be uppermost in their strategies for 2017.

"You have to learn to survive in the environment that exists, and go back to business and employ world-class underwriters," says Julian James, president of Allied World Europe. James says Allied World Europe has "pulled back on certain lines and increased capacity elsewhere".

For example, Allied World has dramatically reduced its underwriting in certain segments of the aviation market where rates are still falling but the insurer and reinsurer believes they should be increasing. Allied World has, however, increased its underwriting in other areas such as warranty and indemnity business and property lines in certain areas of the world, James says.

Andrew Horton, chief executive of Beazley, says most short-tail classes are "under pressure" with many catastrophe lines close to break-even return on capital. "We will try to remain relevant in those lines," he says but focus on specialty lines such as errors and omissions, directors' and officers' and cyber.

Beazley will, in 2017, develop a greater focus on international speciality lines – predominantly in Europe but also in Latin America and Asia – and is in the process of recruiting a team to lead that effort, Horton explains.

The key for London market companies to stay competitive and profitable will be to look at how they get access to business, says David Croom-Johnson, managing director of Aegis London.

"The underwriting environment we're in is probably the worst we've seen since the late 1990s, and to make an underwriting profit going into 2017 is going to be extremely difficult," says Croom-Johnson says. "Distribution is at the top of everyone's agenda."

And underwriters can no longer simply wait for brokers to bring them profitable business, he contends. To be successful, London market companies will need to "change from being reactive underwriters to being salesman and getting out there to find where those thin seams of gold might be," he continues.

The distribution dilemma

The use of broker facilities and other shared arrangements will remain a hot topic for 2017, industry leaders say.

"We are open to opportunities created by new distribution channels and platforms, where they are supported by quality data and bring new business into the Lloyd's and London markets," says David Reeves, chief executive of Barbican Insurance Group. "We need to be open-minded and evolve to meet clients' changing insurance and reinsurance buying habits."

The use of shared services and facilities is a good way of making the market more efficient and reducing costs, according to Beazley's Horton.

Beazley participates in

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'You have to learn to survive in the environment that exists, and go back to business and employ world-class underwriters'

Julian James
Allied World Europe

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'The underwriting environment we're in is probably the worst we've seen since the late 1990s, and to make an underwriting profit going into 2017 is going to be extremely difficult'

David Croom-Johnson
Aegis London

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some consortia, he notes, and says that broker facilities also can increase efficiency as they mean brokers need to go to fewer carriers to get a risk placed.

And while, as a leader in the market, Beazley is "not a fan of blind quota shares," they can make sense if they increase the efficiency with which certain risks are placed, Horton adds.

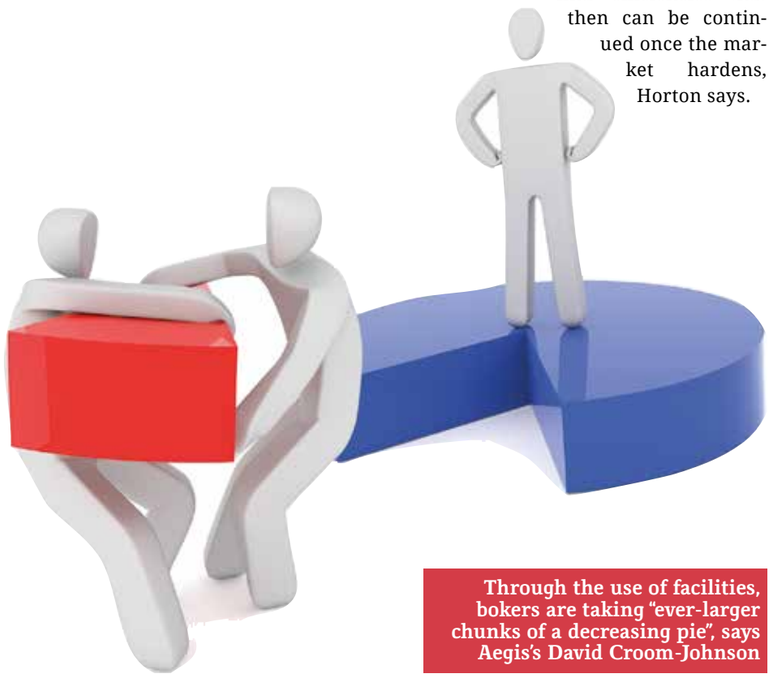
Allied World Europe's James says his company is selective in its use of facilities because in some cases it can appear as though underwriters are delegating their pen and being charged for it.

Croom-Johnson of Aegis says, through the use of facilities, brokers are taking "ever-larger chunks of a decreasing pie".

He urges the industry to find ways to "drive through change and become a 21 century industry". This is in part to prevent an outside player coming in and introducing an Uber-type model that would completely change the way that business is placed.

History would suggest facilities are a soft market phenomenon and likely will reduce in number once the market hardens.

Executives say they are focused on finding other ways to increase efficiency and streamline business processes. The "beauty of the soft market" is that it incentivises everyone to work together to find efficiencies that then can be continued once the market hardens, Horton says.



Through the use of facilities, bokers are taking "ever-larger chunks of a decreasing pie", says Aegis's David Croom-Johnson

The Lloyd's Market Association is working to find ways to help managing agents to share services in "an economical way," says the association's chief executive, David Gittings. This includes work on shared credit control, which has been in place for about two years, and the Oasis catastrophe modelling project that is currently being undertaken, he says.

Cost control

A focus on reducing expenses at the company level, and market-wide efforts to reduce the cost of doing business in London, also will come to the fore in 2017, senior executives say. Beazley's Horton says in the soft market conditions, London market companies need to find innovative ways to reduce expenses and then retain those efficiencies once the market hardens.

Barbican is currently conducting an extensive expenses review, says Reeves. "We are introducing a series of measures which will make us a much more effective operation and deliver multiple benefits for our brokers and partners," says Reeves.

Many London market companies are exploring ways to reduce costs such as automating elements of the underwriting and claims model.

Artur Niemczewski, chief executive of Pro Global Insurance Solutions, says some companies are examining the "build versus buy" question, looking at whether some functions are outside their core expertise and which might be better served by outsourcing them.

For example, he says, London market companies may seek to outsource elements of the underwriting assistant role, bordereaux management, technical accounting or data cleaning, among other tasks, to focus on their core business, reduce costs and increase efficiency.

"Efficiency and competitiveness should always be at the top of any insurance business's agenda," says Julian Tighe, chief executive of Asta Managing Agency. But "just looking at cost-cutting alone can never fully deliver results," he adds.

Companies should focus on a combination of underwriting, claims, distribution and the associated costs to "get the most out of all elements rather than simply looking to cuts to improve short-term profitability," he says.

Aegis London's Croom-Johnson says the "big piece" is to find ways to reduce the costs of doing business in the Lloyd's and wider London marketplace.

Allied World's James adds: "Collectively, in London, there is a huge opportunity for the market to reduce the cost of doing business in London."

And senior executives will focus on this going into 2017. Increasingly, London market companies are exploring the use of central systems. And market-wide initiatives are gaining traction.

Lloyd's remains a fantastic place to do business, says Peter Bilsby, chief executive of Talbot Underwriting. But, he says, there is a "huge opportunity to streamline and modernise the Lloyd's business model".

The Target Operating Model (Tom) initiative is a good example of the market working together to try to achieve this, says Bilsby.

Technological innovation

In addition, many London market companies increasingly are looking to innovative uses of technology, such as cloud-based systems, to improve their efficiency.

"There is increasing market-level discussion about the role that initiatives such as blockchain can play in facilitating a more effective and efficient underwriting environment," says Barbican's Reeves.

The ability to create a series of data sets that underpin the market as a whole, and streamline the interaction between all parties in the insurance chain, should deliver numerous opportunities, Reeves says.

"We see this technology as having significant potential if applied correctly across the industry," he adds.

KPMG's Merrey says there are now more discussions about insuretch taking place in the market, and conversations about how London market players can collaborate and partner with new entrants.

For instance, Aegis London has been "putting quite a lot of emphasis" on online quote and bind systems which gives it virtual offices around the world, says Croom-Johnson.

Digitalisation is happening in volume-driven classes in the London market. Despite the complexity involved, London market companies are looking to change their underwriting and claims platforms to be more digital.

Pro's Niemczewski notes that digital innovation brings with it digital legacy, and management of these legacy systems may be something that senior executives seek to outsource to reduce cost.

Next year may also see merger and acquisition activity as London market companies seek bolt-on acquisitions to give greater access to distribution, says Merrey. That may see companies seeking acquisitions that give access to managing general agencies or brokers, he says.

In a soft market, acquisitions can offer companies a route for consolidation, diversification or geographic reach, says Andrew Holderness, a partner at Clyde & Co.

But, he says, the challenge of finding the right target at the right price may mean that companies follow other routes to grow, for example by setting up joint ventures with local partners or establishing operations in local underwriting hubs, such as Singapore or Miami.

Other London market insurers say that it is access to business, rather than a physical presence, that will be key. Aegis London, for instance, wants to remain "London-centric" rather than "planting flags around the globe" which can prove a distraction, says Croom-Johnson. The company is putting a lot of effort into its relationships with wholesale brokers in order to ensure access to good business, he adds.

And there are other avenues for growth, executive says. For instance, Barbican will "explore the option" of expanding its capabilities through the establishment of another managed syndicate, says Reeves.

But against this backdrop is a looming question: what form will Britain's exit from the European Union take. The LMA's Gittings says that resolving the "Brexit conundrum…will be a really big issue" for 2017. The association, he says, will continue to lobby the government to retain access to the EU single market.

And companies within the market will continue to work on their plans to retain access to that single market – either through the establishment of a Lloyd's subsidiary or branches throughout the EU.

"Ongoing Brexit uncertainty has led some [insurers] to consider transactional activity to create a platform within the EU so they can continue to access business that will disappear if passporting rights are rescinded," says Clyde & Co's Holderness.

It is clear that in 2017, there will be "a lot on everyone's plates" and London market chief executives must make choices about where to focus, according to Merrey.

"But we are increasingly seeing people doing things," he says. "Executives are realising doing nothing is not an option."■

'There is increasing market-level discussion about the role that initiatives such as blockchain can play in facilitating a more effective and efficient underwriting environment'

David Reeves
Barbican

'Efficiency and competitiveness should always be at the top of any insurance business's agenda. [But] just looking at cost-cutting alone can never fully deliver results'

Julian Tighe
Asta

STRATEGY

Bringing fresh blood to the boardroom

Insurers are looking to bring new skills and experiences to their boardrooms. But the battle for the best talent is driving up compensation packages

Rodrigo Amaral
UK correspondent

Insurance company boardrooms are changing. Tighter governance requirements, a new generation of customers and the digital economy, are forcing company boards to look for leadership talent outside the confines of the insurance industry.

The need to add new skills and fresh experience to their boards is also boosting compensation packages for board members. Remuneration for subsidiary board members at global insurers and reinsurers has doubled in the past 18 months, headhunters say.

The pace of change is slow, as those people with traditional skills such as underwriting and actuarial experience remain the most sought after to fill open positions at boards. Yet recruiters say that the search for variety and diversity is here to stay and should become more acute in the future.

"The core of the boardroom membership still comes from people with many years of experience in the insurance and reinsurance market," says Andrew Eliot, the managing partner and director at Eliot Partnership, an executive search firm focusing on the insurance industry. "But the blending of skills from people who have not necessarily been brought up in the industry is a trend on the rise."

Skills in demand by insurers reflect the factors that are driving change in the industry as a whole. One of them is regulatory change, where new rules such as the Solvency II directive is forcing companies to put more emphasis on risk management and compliance, and therefore boosting demand for board candidates with a thorough understanding of risk. Another is a shift in customer behaviour caused by the emergence of a new generation of consumers whose purchasing habits differ considerably from their predecessors.

"Regulators have played an enormous part, from a corporate governance perspective. But there have been other trends as well, such as a continuous focus on the customer, the rise of innovation and the need for distribution to be much more digitised," says Jenni Hibbert, a partner at headhunter Heidrick & Struggles in London, who leads the UK financial services practice.

"All these trends mean boards are going to the market more often and are being more specific about the type of skills that they want to bring to the table."

Recruiters say insurers are increasingly handing executive search firms a mandate to find board membership candidates with particular profiles. Sometimes the requirements are very specific, but in others they need to find someone who can help the board address certain themes that are gaining importance in their particular activities. And sometimes the mandate is simply to find the best candidate, irrespective of the background.

Eliot says the key to building an effective board is to find a right mix of executive and non-executive members who can challenge the strategy and vision of the company. The challenge must come from several different aspects of the business. For example, companies are looking for non-executive members with a deep understanding of underwriting, to challenge the firm's commercial strategy.

Recruiting non-executive members with strong competence and experience around risk and governance to challenge the tolerance and risk appetite at board level is also advisable, Eliot says.

Asset management experience is also valued, as investment policies are becoming ever more of a focus given the long-running period of low interest rates and difficult technical results. Another much sought-after skill today is the ability to assess geopolitical trends, as companies increasingly strive to grow their international activities.

'The core of the boardroom membership still comes from people with many years of experience in the insurance and reinsurance market... But the blending of skills from people who have not necessarily been brought up in the industry is a trend on the rise'

Andrew Eliot
Eliot Partnership

Baffling

More specific mandates include non-traditional skills such as an ability to deal with the digital revolution that very often baffle the baby boomers that tend to populate company boards today. "We see a growing interest from boards to add professional backgrounds in technology, data analytics and consumer behaviour," says Peter Fisher, a partner at Tapestry, a networking firm. "It is difficult to find, but insurance companies understand it is increasingly important to have that kind of expertise in their boards."

Simon Hearn, the chief executive and board practice leader at executive search firm Per Ardua Associates, says getting the digital revolution right requires an understanding of the new needs and habits of customers who are changing

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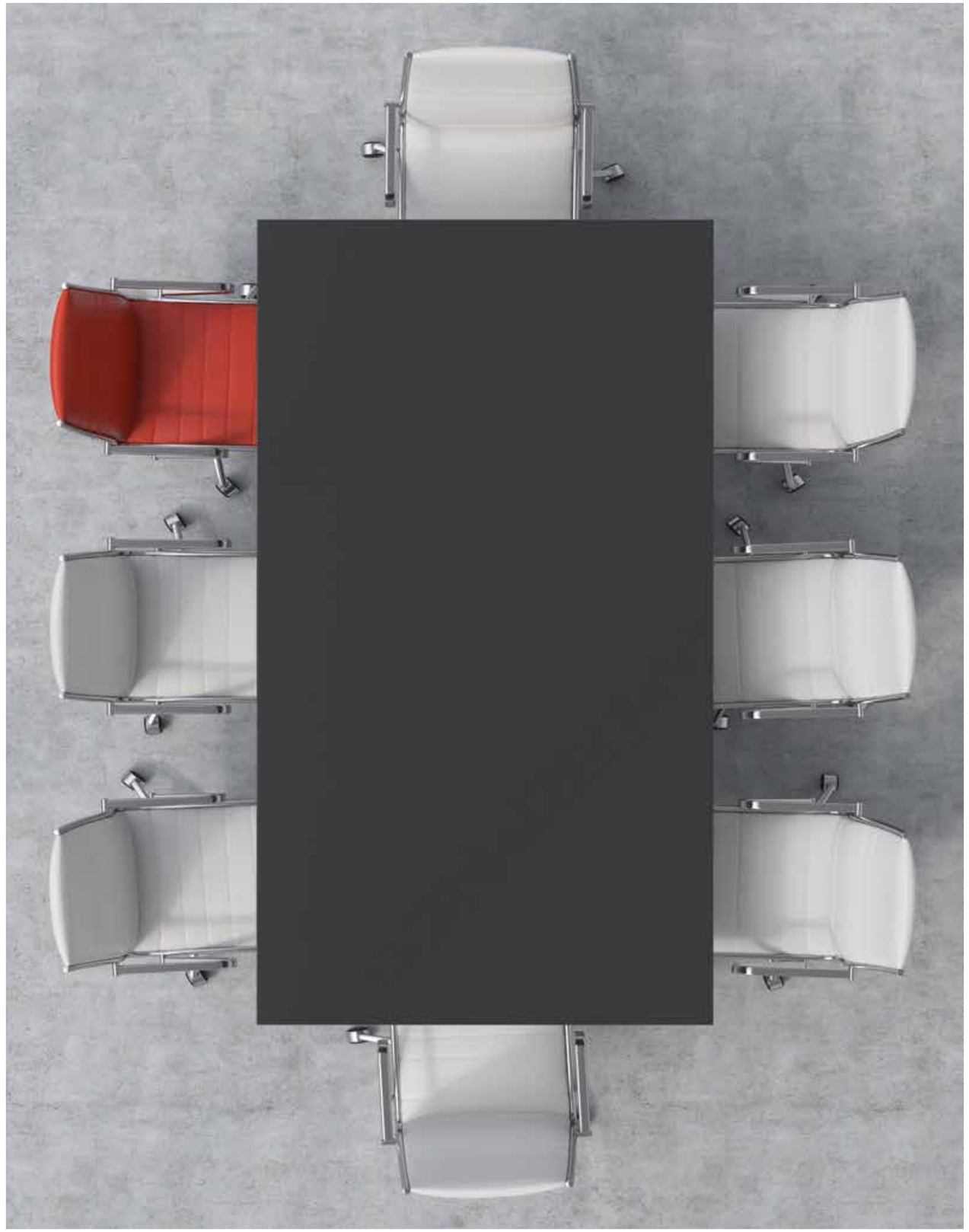

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the way they buy the products and services they need. "When boards say they need people with a background in digital, what they actually mean is someone who has experience with a customer-facing role," he says. "With that, they should get the digital experience."

Knowledge of compensation policies is also becoming more important for insurance company boards, says Hearn. "Albeit slowly, boards are sometimes looking at senior ex-HR people with experience of dealing with compensation issues," he says. "This will happen more often in the future as remunerations committees become more demanding."

New skills and talents are not the only factor changing the way board members are hired by insurers today. Public and regulatory pressure for diversification, both in terms of gender and ethnic backgrounds, is also making inroads in an industry traditionally associated with a club of white male executives.

"Diversity is a hard issue to address when you are running a company," says Rupert Atkin, the non-executive chairman of Lloyd's insurer Talbot Underwriting. "But it is not one that we should duck."

Hibbert at Heidrick & Struggles says the insurance industry has finally "woken up" to the need to achieve "real diversity" around the leadership table. "In the insurance industry today, there tends to be a commonality of backgrounds in the boardroom. Our clients acknowledge the need to change, and diversity is today a key driver in the market."

Some companies have made further progress than others in this particular field, especially in Europe, where EU legislation puts an emphasis on the integration of women and people with different backgrounds in leadership positions. French insurer Axa, for example, counts seven women among the 16 members of its board of directors.

Lloyd's of London and a few other important players are led by women today, and Abu Dhabi-based RAK Insurance has recently appointed the first female member of its board. Some companies have also announced public support for gender diversification efforts. For instance, Aon and Aspen Re have become members of Women in Boardrooms, a US-based non-governmental organisation.

But they are the exception rather than the rule, as a cursory view of the membership of the boards of insurers and reinsurers very quickly makes clear. "There is a real diversity need today," Hearn at Per Ardua says.

'If a company hires a senior banker to be its new CFO, this person is likely to be more expensive than someone from the insurance sector, but this is where a lot of good people will be found'

Simon Hearn
Per Ardua Associates

"There will have to be many more women on insurance company boards than there are now and that should extend to a requirement to have people with a wider diverse background as well."

Acknowledging the need is a first step, but some kinds of change tend to take place at a snail's pace in the industry. A survey by consultancy EY on diversification in financial services found that only 6% of respondents who worked in the insurance industry said they expected a significant increase in the number of women in leadership positions in the near future. Among bankers, the ratio was 27%. Furthermore, only 39% of the insurance companies surveyed said they are formally measuring the progress of gender diversity among their ranks, and a mere 8% have programmes in place to develop their female staff members.

"There is a desire to diversify the composition of boards, certainly in terms of gender and other dimensions as well," Tapestry's Fisher says. "But the pace of change can sometimes be slow because the relevant pool of candidates is not as big as people would like."

Hiring the invisibles

To expand the universe from which board members can be recruited, insurers and reinsurers are already looking further afield, taking professionals from other industries with skills and expertise that are difficult to find among their own ranks.

"We help our clients to find the people that we call 'invisibles'," Eliot at the Eliot Partnership says. "They are professionals who have not necessarily come from insurance market, but who bring to the table a much wider perspective in areas such as corporate social responsibility, geopolitics or asset management."

The search becomes more complex because board members must show an eagerness to raise issues and to try and change the direction of a company's strategy when necessary. "Today, there is more interest in the independence of non-executive members of the board," notes Atkin at Talbot.

As boardrooms are beasts that often move slowly, change has sometimes been accelerated by the appointment of advisory boards, Fisher at Tapestry points out. And having to compete with other business sectors, means many firms have also been forced to offer higher compensation packages to potential board members than was the case not so long ago. According to Per Ardua's Hearn, the most suitable candidates will be often in the banking industry, where remuneration is historically significantly higher than in insurance.

"If a company hires a senior banker to be its new chief financial officer, this person is likely to be more expensive than someone from the insurance sector, but this is where a lot of good people will be found," Hearn says.

The rise in compensation packages has also been boosted by higher demands from subsidiary board members of foreign groups. "Multinational financial services organisations, when they have a UK entity, are working to ensure a greater degree of independence and oversight around their subsidiary boards. As a result, the non-executive market is more alive and competitive," Hibbert at Heidrick & Struggles says. "There has been a meaningful shift in compensation levels at the subsidiary board level. Compensation there has typically doubled in the past 18 months."

6%
Insurance industry respondents to EY survey that said they expect a significant rise in the number of women in leadership positions in the near future

But meeting higher compensation demands is not the only challenge that insurers and reinsurers face when they try to secure board members from other sectors of the economy. Being part of a highly regulated industry, they also have to make sure the potential candidates meet the expectations of regulators in terms of experience and knowledge of the activities that they will help to oversee - again, limiting the universe of candidates that they can chose from.

"To be approved by regulators, candidates to become board members need to have a very good understanding of the insurance business, so they are always likely to come mostly from within financial services," Hearn says. ■

The "invisibles": professionals from other industries with diverse skills and abilities not often found in the insurance industry are becoming more sought after

STRATEGY

Soft market moulds Bermuda carriers' strategy

Cycle management, innovation and new product development will be key issues for insurers in Bermuda next year

Kat Blackler
UK correspondent

Hurricane Matthew provided an unwelcome early fourth-quarter loss for many Bermudian reinsurers. Initial estimates for losses are within a wide band of up to $9bn, with XL and Everest Re estimating maximum losses of $200m at the top end of the range.

Despite soft rate conditions, Bermuda re/insurers continue to assume larger exposures of catastrophe risk, according to a study by the Bermuda Monetary Authority (BMA).

But the report also showed the Bermudian market remains resilient to various potential catastrophe loss scenarios, with capital remaining to settle policyholder obligations even in the event of a potentially large loss.

Financial reports for the third quarter of 2016 saw many Bermudian re/insurers report healthy profits, but many also saw a significant decrease in underwriting incomes.

Insurance Day's quarterly analysis of the Bermudian market found overall net profit of $4.67bn for the 17 companies analysed, up from $4.03bn a year earlier. Of those 17, some 11 companies delivered an increase in profitability compared with the 2015 period.

However, the improved figures are propped up by good investment returns as current soft rate/low yield market conditions in the island's traditional property casualty business have left underwriting performance with much to be desired.

Michael Price, chief operating officer and president of Arch Capital, says Bermuda re/insurers are used to facing significant cyclical conditions, and the current soft market conditions are simply a phase of this.

He says it is important for Bermuda company executives to remember this when formulating their plans for 2017 and beyond. "Arch was built from day one with a fundamental belief in cycle management as its bedrock principle," says Price.

Arch uses those business lines with low-volatility, predictable, sustainable revenue and returns as "ballast for us to remain opportunistic in the higher volatility cycle managed lines" such as peak zone property catastrophe.

Price describes cycle management as an "easy concept" although one that "the industry never seems to get right".

"Hubris, bad judgment and rationalisation, and simply self-preservation, cloud underwriters' judgment and lead to firms expanding at the wrong time in the cycle," he adds.

Cutting costs

When facing tough times, there can be a natural inclination to cut down on head count to keep costs as low as possible and this has been seen with some job losses across the island in 2016.

Price says while there may be a temptation to cut staffing expenses to cut costs, that would be the wrong decision for the industry.

"Balancing cycle management principles with market relevance is an extraordinarily difficult task and requires keen focus on underwriting and underwriting discipline in order to effectively execute," he says.

Price describes Arch as "talent intensive" and that the company continues to invest in training and development – something that others in the market are not doing, he argues.

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Hurricane Matthew: hit Bermuda carriers with a loss in the fourth quarter

Bermudian market is proving to be resilient to potential cat losses

Still strong

15.9%
Rise in net profit for Bermuda reinsurers for the 9M period of 2016

Despite the challenges with soft market conditions continuing, it is important to note the majority of the Bermudian re/insurance industry continues to thrive.

A 15.9% increase in net profit for the first nine months of the year, compared with the same period of 2015, suggests Bermuda's leading groups are having some success managing adverse conditions in the reinsurance market, as well as moves to widen their accounts.

Bermuda's reinsurance sector has also been stress-tested on its ability to withstand losses from a number of disaster scenarios – and it came through with flying colours.

The Bermuda Monetary Authority, the island's financial-services regulator, said the Bermuda insurance market is "resilient to potential adverse impacts from various catastrophe underwriting loss scenarios".

The BMA's report notes: "The results also establish Bermuda insurers' ability to absorb these unlikely potential large losses and still have capital remaining to settle policyholder obligations."

The report says Bermuda reinsurers are well capitalised, innovative and technically proficient.

'[The Bermuda market] is resilient to potential adverse impacts from various catastrophe underwriting loss scenarios'

Bermuda Monetary Authority

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"What we have witnessed from our peers in the market is that during periods of prolonged softening, the industry cuts expenses in the wrong areas. Cutting back on training and development is penny wise, pound foolish."

In addition to cycle management, innovation and new product development will also be crucial next year for Bermuda carriers.

Mike Krefta, the new chief executive of Hiscox Re, said in a recent interview with *Insurance Day* innovation "will make the difference between long-term success or eventual irrelevance".

Bermuda-based Hiscox Re has launched products in areas such as cyber insurance and risk aggregation covers. These have added more than $75m in new premium since 2015.

Hiscox Re has also been developing its insurance-linked securities business, Kiskadee Investment Managers, which now has more than $1bn in assets under management.

One aspect of innovation on the books for Bermudian re/insurers for 2017 is the launch of new products.

Fellow Bermuda carrier Validus has been expanding its profile in the US insurance sector and the management of third party capital to reduce its exposure to areas facing the most competitive pricing pressure.

"Given current market conditions we continue to reduce exposure in areas under the most competitive pressure – notably marine and energy and certain property classes," says Ed Noonan, the group's chairman and chief executive.

In the third quarter, Validus Re and Lloyd's subsidiary Talbot both reported falling gross written premium, partially offset by growth in its Western World unit.

"Balancing cycle management principles with market relevance is an extraordinarily difficult task and requires keen focus on underwriting and underwriting discipline in order to effectively execute"

Michael Price
Arch Capital

'Given current market conditions we continue to reduce exposure in areas under the most competitive pressure – notably marine and energy and certain property classes'

Ed Noonan
Validus

Endurance Specialty has also been diversifying with the launch of new products already underway. For instance, it launched a new excess casualty product for commercial transportation clients in December.

Similarly, Bermuda-based XL Group has also launched new products such as an emergency security and disaster evacuation product for businesses with employees working internationally, and a consumer products recall solution for the UK market.

Arch Capital has also been looking beyond Bermuda's traditional markets. In November, the Bermuda-based re/insurer partnered with American Specialty Insurance and Risk Services to provide customised insurance programmes for the sports, recreation and entertainment markets.

The group has already been reaping the rewards of previous diversification efforts, such as the development of its mortgage re/insurance business.

Earlier in the year, Arch clinched a deal to buy AIG's mortgage insurance business United Guaranty for $3.4bn.

The acquisition – its biggest deal on record – makes Arch Capital the leading mortgage insurer in the US and is expected to boost its run-rate earnings per share by more than 35%.

Arch is not the only Bermudian re/insurer making acquisitions. Axis Capital announced in December that it is to acquire aviation insurance and reinsurance specialist Aviabel, based in Belgium.

Mark Gregory, chief executive of Axis Insurance's international division, says the transaction will increase the re/insurers' "scale and market relevance" in the aviation sector.

In November, Argo Group struck a deal to purchase global insurance and reinsurance underwriter Ariel Re for approximately $235m.

Acquiring Ariel Re will give Argo's Lloyd's business the scale it needs to justify the compliance costs of operating in the Lime Street market, Argo Group chief executive, Mark Watson, said at the time.

The deal will give a combined Argo/Ariel business a gross written premium base of around £700m ($873.04m) at Lloyd's, which would make it the 12th-largest player at Lloyd's.

Diversification

Diversification is seen as key to the success of the re/insurers on the island. As the BMA noted in its recent report, most of the formerly monoline catastrophe reinsurers have either been acquired or have expanded into other lines of reinsurance and insurance, which has diversified their risk.

But the Bermuda Business Development Agency (BDA) is keen to point out that the launch of new products is not the only way for re/insurers to diversify.

The BDA is involved in a wide range of industry initiatives, including Bermuda 4.0, a cross-sector industry think-tank that is defining and promoting Bermuda's value proposition related to fintech.

"Our market has always been innovative and highly collaborative – qualities that are critical in this emerging industry and that set Bermuda apart from many other financial centres," says Ross Webber, chief executive of the BDA.

"The development of insurtech in Bermuda is one way our jurisdiction is responding to the continued soft market. M&A consolidation is another," continues Webber.

"Maximising shareholder return remains paramount, so it is incumbent on boards and management teams of insurance companies and their service providers to deliver.

"With this in mind, all aspects of operating efficiency need to be seriously explored. Bermuda's emergence as a fintech centre of excellence is a natural evolution."■

Insurers seek partnerships to counter insurtech threat

The traditional market may lack innovative capability but there are ways around that

Graham Village
Global markets editor

Could the existing insurance industry be the big winner in the wave of technical innovation that threatens to disrupt the whole process of insurance and risk transfer?

On the face of it, that seems fanciful. A host of nimble, tech-enabled start-ups promise to reinvent insurance from distribution to underwriting to claims handling, transforming what is touted as an unpopular, fuddy-duddy industry into a hip, fun experience that meets customer needs more accurately.

Insurers routinely rank on a par with estate agents when it comes to public perception and they are used to their low profile and standing within the overall financial services industry. Few major industry conferences in the 1990s and early 2000s were complete without a session from a banker telling insurers in the audience how much they could learn from the banking sector about risk management. Incorrectly, as it turned out.

A dystopian narrative for the incumbent insurance industry sees them as incapable of adapting to changing expectations in the 21st century and swept away by the digitised start-ups.

But after a fairly slow start, many insurers are now targeting digitalisation in a big way – and the larger companies enjoy several advantages. Most obviously, they have huge underwriting experience and associated data as well as existing relationships with customers.

Insurers have plenty to lose but a chance to benefit from digitalisation revenue, as Murray Raisbeck, insurtech expert at KPMG, wrote in the firm's most recent "Pulse of Fintech" publication: "Low levels of consumer trust, high competition, declining profitability and challenges around legacy IT systems make the insurance industry ripe for disruption," he said, but more optimistically "Insurtech is increasingly enabling insurers to solve these issues through new and emerging applications in P2P, blockchain, IoT and SaaS".

That is peer-to-peer, Internet of Things and Software as a Service for those not up to speed with the jargon. One thing insurtech won't be doing away with any time soon is the acronym.

According to CBInsights, insurance technology (insurtech) start-ups have raised $5.67bn through 464 deals since 2011, with the current year's financial total of $1.39bn putting it on course to exceed 2015's record.

Both broad and specialist venture capital investment firms have targeted insurtech but plenty of well-known insurance names are active, as investors, sponsors and partners.

$5.67bn
Amount raised through insurtech start-ups since 2011, through...

464
Deals

Deep pockets

Insurers see funding external insurtech projects as both an investment and a research and development (R&D) cost. They, more than any other potential investor, have an interest in insurtech, in identifying what works and what doesn't, and the large insurers have deep pockets and can afford to see some projects fail in their search for successful models and solutions. Insurers also have a long track record of working with third parties, such as banks and affinity groups, where necessary.

The insurtech capital raised so far seems impressive but investment is low compared with the banking sector.

A white paper issued earlier this year by Commerzbank's CommerzVentures estimated insurtech start-ups should have absorbed 12 times more funding than they have so far, given the insurance sector's size in relation to the banking industry.

CommerzVentures identified four areas of opportunity for insurtech, taking in development of tech-enabled products and business, offering huge potential; use of technology for risk mitigation; innovation in distribution channels; and lower claims-processing costs.

Insurers realise the potential of technology and are willing to change, CommerzVentures says, but they lack innovation, explaining the insurtech investments they have made and the partnerships they have entered into. They seem to lack the data-generating capability and the entrepreneurial spirit of companies like Google, Amazon, Apple and Facebook.

But CommerzVentures argues those tech giants are unlikely to dive headlong into direct competition with insurers. Such a move "would cannibalise advertisement revenues and may not be a good fit for brand images", it says. Absence of consistent global regulation, the time required to develop historical data sets and the lack of interest shown by internal engineering teams all suggest the tech giants will form partnerships rather than compete directly with insurers.

Google's example so far provides some evidence to back this theory. The company launched its Google Compare com-

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'Low levels of consumer trust, high competition, declining profitability and challenges around legacy IT systems make the insurance industry ripe for disruption [but] insurtech is increasingly enabling insurers to solve these issues through new and emerging applications in P2P, blockchain, IoT and SaaS'

Murray Raisbeck
KPMG

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parison site in the US and UK in 2015 but shut it early this year, preferring to concentrate on its AdWords business and admitting the initiative "hasn't driven the success we hoped for".

Speaking at this year's Monte-Carlo Rendez-Vous, Nick Leeder, head of Google's operations in France, confirmed the company was keen to work with the existing industry and had already entered into partnerships with Axa and Allianz.

The existing insurance industry would be wise not to rule out Google completely as a potential rival, though. India's large population and low take-up of financial services make it highly attractive to the company and recently Google announced it planned to launch a website called Bharat Saves as an insurance comparison site and source of general guidance to raise financial awareness in the country.

The insurance industry's bumpy regulatory environment and lack of historic data may also act as a deterrent to other business sectors considering a foray into the insurance sector, such as telecommunication companies and major industries like motor and healthcare, according to CommerzVentures.

And the firm argues many of the same drawbacks apply to insurtech start-ups, making them more likely to enter into partnerships with existing players or target specific areas of the value chain.

Fingers in pies

In the meantime, the large insurers have not been idle and they are clearly pursuing a policy of having as many fingers in as many pies as possible.

Axa has been one of the most active insurers in the insurtech and wider fintech area, making full use of its financial muscle and global position. The group provided seed funding for five European start-ups under a fund set up in France in 2013 before launching Axa Strategic Ventures early last year. This new €200m ($223.47m) venture capital fund has a brief to invest in innovations in insurance, asset management, financial technology and healthcare services, establishing presences in San Francisco, New York, London, Paris, Zurich and Berlin. It subsequently opened an office in Hong Kong and set up innovation labs in Shanghai and Singapore.

In September last year, it created Kamet, a €100m insurtech incubator working with both internal and external entrepreneurs.

One of Axa's more significant moves is its investment in e-commerce company Africa Internet Group. The French company has invested €75m to take an 8% stake in the African company and Axa has become the exclusive provider of insurance through Jumia and other platforms. The lack of traditional infrastructure and financial services industry in much of Africa means financial technology is in many ways creating a new market rather than disrupting an existing one.

Also this year, Axa has joined forces with two Chinese digital companies, Alibaba and its former unit Ant Financial Services, an online payment company. The three intend to work towards distributing Axa's insurance products through Alibaba's network. Under the first phase, the partners would work in three specific areas: Axa would develop and provide insurance for customers of AliExpress, a retail marketplace; the French group would provide insurance to small and medium-sized businesses trading on Alibaba's wholesale marketplaces; and Axa would offer travel insurance through Ant for Chinese travellers going abroad.

Allianz Ventures is the German group's centre for investments in and partnerships with start-ups with a brief to target five key areas: insurtech and wealth management; mobility and connected cars; connected homes and properties; digital health; and cyber security and data intelligence. Among recent investments, it has taken a minority stake in digital wealth manager MoneyFarm.

Allianz X is the group's "company builder" with a brief to identify, build and scale new business models in insurtech and related areas like blockchain and artificial intelligence. The group has recruited Peter Borchers, previously with Deutsche Telekom incubator hub:raum, as chief executive of Allianz X, effective from the beginning of October.

In China last year, Allianz joined forces with local internet company Baidu and Asian investor Hillhouse Capital to set up a digital internet company, fo-

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Aviva: getting involved in a number of insurtech partnerships through its Aviva Ventures capital arm

£20m a year

Amount Aviva Ventures plans to invest in digital businesses over the next five years

IT trends to watch and their potential benefits

Smart home
Damage reduction and prevention for properties

Algorithmic business
Better, fast and independent decisions by automated analytical processes

Internet of Things
New services can emerge like remote health monitoring and pay-as-you use services

Information of Everything
Better understanding of customers and risk

Autonomous agents
Reduces failure rate and saves time

New payment models
Reduction of physical payment generates more and better data of consumer payment habits

Blockchain technology
Allows verification of portfolio data between primary insurance and reinsurance markets

Digital health services
Better support and more customer focus, prevention of diseases

3D printing materials
Quick production of complex products with minimal lead time

*extracted and adapted from Munich Re/ Ergo's "IT Trend Report 2016"

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cusing on travel, e-commerce, internet finance, short-term health, lifestyle and potentially motor insurance.

In Europe, Allianz has entered into a co-operation and investment partnership with simplesurance, a German e-commerce start-up which now distributes the insurer's products in 28 countries through customer portals and online shops.

Hipster central

In the UK, Aviva launched a venture capital arm to invest in new digital businesses last December, based in Hoxton Square, the epicentre of London's digital hipsterdom, with a mandate to invest about £20m ($24.8m) a year over the next five years. Over time, Aviva Ventures expects to manage "a portfolio of small investments in a number of companies which have significant potential". Its inaugural investment was in Cocoon, inventor of a smart home security device that alerts householders to movement and sound within their property.

In May, the group announced an acceleration of its plans through a partnership with Founders Factory, a digital accelerator and incubator co-founded by Brent Hoberman who was one of the launchers of lastminute.com. Aviva has agreed to become the exclusive financial services partner of Founders Factory over the next five years as it provides capital and resources to support the growth of more than 200 technology businesses. Aviva will work with seven start-ups each year. As part of the deal, Aviva Ventures has taken a multimillion-pound investment in Founders Factory.

And in California's Silicon Valley, Aviva has entered into a joint insurtech partnership with Plug & Play, a global digital start-up. The two hope to attract up to 1,000 applications from insurtech start-ups looking to disrupt the insurance industry, whittling the number down to 40 to 50, which will work from Plug & Play's headquarters.

Generali last year worked with Microsoft through the insurer's innovation challenge programme to promote talent and start-ups in the insurance area. The partners contacted more than 3,000 start-ups, with 700 taking up the offer of help on the challenge platform. The winner was LYT Sonic, a home safety control idea that uses an LED bulb and infrasound detection to recognise movement over an area of 150 square metres.

Fabio Santini, director of the developer experience division of Microsoft Italia, said start-ups have a strategic role to play everywhere, "particularly in Italy where the youth unemployment rate is more than 40% and there is a paradox between the demand of the end-customer for innovation and the lack of innovation shown by some Italian companies".

The Italian insurer has been particularly keen to make full use of developments with a motor application. Last year it acquired MyDrive Solutions, a UK firm launched in 2010, which uses data analytic tools to profile driving styles. The acquired company now forms part of Generali's motor telematics hub based in London.

In the US, Generali has this year entered into an R&D collaboration with US insurer Progressive to improve their individual data analytic capabilities and foster product development. In addition to its capability through MyDrive, Generali has experience of five years as a pay-as-you-drive insurer in its home market. In the US, Progressive introduced the first wireless telematics device in 2008 and since then has collected 15 billion miles of driving data.

Not surprisingly leading reinsurers have been active in insurtech. Munich Re has made an additional investment through its HSB Ventures division in Slice Labs, a US provider of on demand insurance, which in October launched a homeshare product to hosts using platforms like Airbnb, HomeAway, OneFineStay and FlipKey. The insurance lasts specifically for the time the owner is acting as a business so insureds need to buy cover only when they need it.

In September, Munich Re secured the right to provide underwriting capital and insurance licensing for on-demand insurer Trov in the US market. Trov's app allows customers to insure individual items like electronics or sports equipment from their smartphone and gives them the facility to switch cover on and off when required. The company says the app is built on its "revolutionary cloud-based insurance platform that features micro-duration policies, algorithmic pricing, integrated billing and intelligent bot-assisted claims".

Trov has already launched in Australia and intends to open in the UK before the end of 2016, in partnership with Axa, before the US launch in 2017.

Among many other developments, the German reinsurer has sponsored Plug & Play.

Swiss Re has also been busy, setting up an insurtech accelerator in Bangalore and backing the Startupbootcamp accelerator, to name just two moves.

German group Talanx, owner of HDI and Hannover Re, in October announced co-operation with Plug & Play and Startupbootcamp.

In the US market, Liberty Mutual's global consumer group has set up a $150m venture capital initiative, Liberty Mutual Strategic Ventures, to back ideas at the intersection of innovative technology and the insurance industry.

MetLife has launched LumenLab in Singapore as a developer of disrupters in the areas of wellness, wealth and retirement. ManuLife has a similar project in Singapore as well as labs in Boston and Toronto.

With so much investment and interest in insurtech, major insurers are unlikely to be caught unawares if any of the new ideas under development proves a winner, and there is a chance an insurance company will already be linked in some way with the developer.

Young pretenders

Although many of the new ideas will fail to make much headway or be of limited use, the traditional industry would be unwise to think they cannot learn from the start-ups. Their lack of experience may prove a problem but may also stimulate innovative thinking that leads to ground-breaking progress – better ways to do things or ways to do completely new things.

In the US, one start-up attracting a lot of interest is Lemonade, a peer-to-peer insurer that officially launched operations in September in New York, providing cover for homeowners and renters. The company, set up by tech entrepreneurs Daniel Schreiber and Shai Wininger, raised $13m in a funding round led by Sequoia Capital and Aleph but has only recently divulged much about its plans.

The company sells policies through an app that boasts application approval in a couple of minutes and promises claims payment in not much longer. Lemonade says it will keep a flat 20% of the premium and therefore has no incentive in stalling or denying claims. Any surplus cash in the process goes to charity.

Lemonade's website is a fascinating read, after stripping out the promotional pitch, and gets to the heart of why the insurtech start-ups think they can "reinvent" insurance. From its origins as a provider of security for various affinity groups, the insurance industry has mushroomed to insure ever wider groups and types of customer, and with each extension has come a weakening of affinity and a worsening of loss ratio, the company says.

"Fortunately, the trade-off between affinity and growth exists only in the old economy," according to Lemonade. "Facebook has 1.6 billion users, but it didn't dilute affinity even as it grew exponentially...in software, the cost of spawning a new social group is zero, so Facebook was able to grow its memberships without sacrificing cohesion. In the digital economy, affinity doesn't stall growth, it propels growth."

The website knocks the conventional insurance model and conventional insurers, but Lemonade is not averse to tapping the industry where needed – on both the investment and underwriting side. XL via its XL Innovate venture capital operation is one of the financial backers of the company and Tom Hutton, head of XL Innovate, has joined Lemonade's board. And the start-up is buying reinsurance from the likes of Everest Re, Hiscox, National Indemnity, XL Catlin, Munich Re and TransRe.

Another US start-up, Metromile, offers pay-per-mile motor insurance cover and claims to be able to save low-mileage drivers an average of $500 a year. The company's driving app and telematics include vehicle diagnostic tools, tracking technology, vehicle locator and trip analysis information. The company is licensed across the US but currently underwriting in New Jersey, Oregon and Pennsylvania, soon to be joined by California, Illinois, Virginia and Washington. The insurer has an alliance with rideshare company Uber.

Metromile has given insurers pause for thought with September's funding round of $191.5m, bringing total capital raised to $205.5m. Part of the new capital will go towards acquiring an insurance carrier, Mosaic Insurance, to allow Metromile to "underwrite its own policies and manage the entire claims process from start to finish". Participating in the first and second round of funding was Canadian insurance group Intact Financial. The list of investors includes China Pacific Insurance.

But it is not all plain sailing for the start-ups as they progress from the drawing board to the marketplace. Zenefits, a human resource and health insurance start-up launched in 2013, attracted plenty of funding and attention, leading to a valuation of $4.5bn at one point. Internal problems and regulatory investigations followed; chief executive Parker Conrad has departed and the company has laid off hundreds of staff. At the time of a restructuring of the company a few months ago Zenefits was valued at $2bn.

US tech-enabled health start-up Oscar raised close to $400m earlier this year and was valued at about $2.7bn. But the company lost money last year and has been forced to revise its plans for the individual health market in the face of further losses under its Obamacare offering. It is pulling out of Dallas and New Jersey as a result. ■

The article was first published in Insurance Day on October 11. 2016

Start-ups: innovative ideas in the insurtech arena could teach traditional insurers a thing or two

TECHNOLOGY

Bermuda looks to insurtech as it plots market's evolution

The Bermudian market has become increasingly open to using digital technology and is looking to promote itself as an e-commerce hub

Kat Blackler
UK correspondent

Fintech has attracted investors for some time, however until recent years much of the funding was focused on technologies that could change banking and investing. With insurtech start-ups increasingly delivering products that work, and many of the big insurers starting to get behind many projects, more funding is being ploughed into this fast-growing market.

Funding for insurance-focused start-ups hit a record $2.7bn last year. The number of investments involving such companies is expected to exceed 75 this year, up from 61 in 2015 and just one in 2012, according to venture-capital researcher CB Insights.

Two-thirds of re/insurers say they have taken concrete steps to address the rise of fintech in insurance, according to the PwC Insurance FinTech Global Report 2016. And Bermuda-based insurers have been getting in on the action.

In August Buzzmove, a price comparison and booking platform for the moving industry, claimed the "largest early stage super seed raise for an insurtech startup" after pulling in a £6m investment led by Bermuda-based White Mountains to develop a new platform to enable consumers to inventory their belongings digitally and to purchase home and household contents insurance. White Mountains' investment followed Buzzmove's participation in Startupbootcamp InsurTech, a three-month insurtech accelerator programme.

XL Catlin has even set up its own venture capital fund in April 2015, XL Innovate, with a focus on insurtech among other companies trying to find ways to operate outside of the traditional insurance space.

75+
Number of investments involving insurance-focused start-ups in 2016, up from...

61
In 2015, and just...

1
In 2012

In the past, technology has been greeted by much of the insurance world with suspicion and as a disruptive force. One only has to look at the somewhat mixed reception that greeted insurance aggregators when they began to upset traditional insurance sales models with high volume, low value, online sales.

"Insurtech is often thought of as a disruptive force driving upstart companies fuelled by technologies into established consumer insurance markets," says Scott Quiana, president of insurance data integration and analytics provider QuanTemplate, whose investors include Allianz. Quiana sees Bermuda as a key market for the company.

However, in contrast to some markets, Bermuda has been increasingly open to using digital technology, and in particular when it comes to the storage and usage of data and administration.

This is perhaps unsurprising given that Bermuda has welcomed a multitude of new start-ups since entering the insurance scene, including supporting the application of data analytics and computer-based modelling. In fact, the island is looking to positively promote itself as a hub for e-commerce.

Bermuda 4.0

The term "Bermuda 4.0" has been coined in 2016 and Ross Webber, chief executive of the Bermuda Business Development Agency (BDA) sees insurtech as having an important role in the development of the island's re/insurance market. The BDA is working on a project to determine how best to harness it.

"We have brought together a cohesive group that is leading Bermuda's market development in this rapidly-evolving digital economy. Bermuda 4.0 is a cross-sector industry think-tank that is defining and promoting Bermuda's value proposition related to fintech," says Webber.

Webber believes Bermuda will be able to stay ahead of the game. "Our market has always been innovative and highly collaborative - qualities that are critical in this emerging industry and that set Bermuda apart from many other financial centres."

Bermuda reinsurers and wholesale insurers alike are beginning to look for non-disruptive next generation technologies which enable them to unleash the power of the data which may be trapped within their disparate databases and in some cases also integrate with new, disruptive insurtechs.

Many insurers and reinsurers see insurtech's huge potential for transforming the back office. Two-thirds of insurers surveyed for the PwC Insurance FinTech Global Report pointed to the potential impact of insurtech's innovations in data and analytics. And half of insurers saw insurtech as pointing to new approaches to underwriting risk and predicting loss.

In Bermuda, so far the main focus has been on insurers and reinsurers applying insurtech to harness the data and information they have today to maximize the use of their platforms, feed business that is thriving, respond to the external pressures and the ever-changing demands of the customer and distribution channels.

They are using technology to innovate, and advance core technologies to the next generation. For example, blockchain is seen to have the potential to transform insurers' infrastructure and processes. A claims department could use blockchain to speed up processes, reduce fraud and enable instant communication with customers and other suppliers.

The Bermuda 4.0 think tank has been looking at a wide range of potential uses for fintech in the insurance industry, including blockchain and other distributed ledger initiatives.

"Insurtech and regtech are areas where Bermuda has a huge nexus and great potential. We have gathered technology, underwriting and regulatory experts to explore insurtech, understanding how it could fundamentally change their business," Webber says.

"The fact Bermuda is already a top centre for finance and reinsurance means our ecosystem is well-suited to leading the evolution of both sectors."

Beyond the consumer

The majority of insurtech start-ups are focused on consumer products at present, which could potentially be less relevant to the Bermuda market.

According to the PwC report, new entrants providing "customer-facing tools and technologies which improve customer experience and engagement" represent the largest share of start-up activity. There are currently fewer start-ups "focused on delivering back-office efficiency and core insurance processes", the report notes.

QuanTemplate's Quiana does not see this as a problem and believes innovation in customer-facing areas will push insurers and reinsurers to innovate as well.

"On the consumer insurance side, an insurtech ecosystem of new, disruptive distribution platforms has evolved. But incumbent insurers' and reinsurers' existing legacy systems don't interface with this new ecosystem," says Quiana.

"Genuinely new tech is creating new markets, products and new forms of distribution. For incumbents to take advantage of this new data and information, and to avoid being disrupted, they have to become flexible enough to harness their existing data and information in order to augment it with the data, information and technologies of these new players," he explains.

Bermuda re/insurers have realised that they can adopt more sophisticated, higher-performance technologies to manage and analyse data at a granular level. This in turn can allow them to model and underwrite more accurately, improve underwriting performance, conduct in-depth analysis of distribution channels and support the changes applied by external forces.

For many of those on the island it is not a question of if, but a question of how insurers decide how to embrace the opportunities new technology brings. ■

'Our market has always been innovative and highly collaborative – qualities that are critical in this emerging industry and that set Bermuda apart from many other financial centres'

Ross Webber
Bermuda Business Development Agency

SPECIALTY

Energy market defies logic as unprecedented dip continues

Despite mitigating factors, offshore energy insurers are still likely to face continued rate reductions

Scott Vincent
Editor, news services

Amid continued pricing pressure across most lines of business, one class stands out in terms of the frequency in which it is cited by management as a cause for concern.

Energy rates have been tumbling in recent years as the market deals with a host of challenges, putting increasing pressure on insurer's margins.

The collapse of the price of oil has led to operators and contractors to reduce activity, with a knock-on impact on insurance needs and premium spend.

Market commentators have warned the current dip is unlike any they have seen in their careers. Simon Williams, chairman of offshore energy committee for the International Union of Marine Insurance (Iumi), recently described the sector's conditions as the worst dip for 30 years.

Offshore energy underwriting losses are very likely this year if claims levels match those seen in 2015, Iumi has been warned.

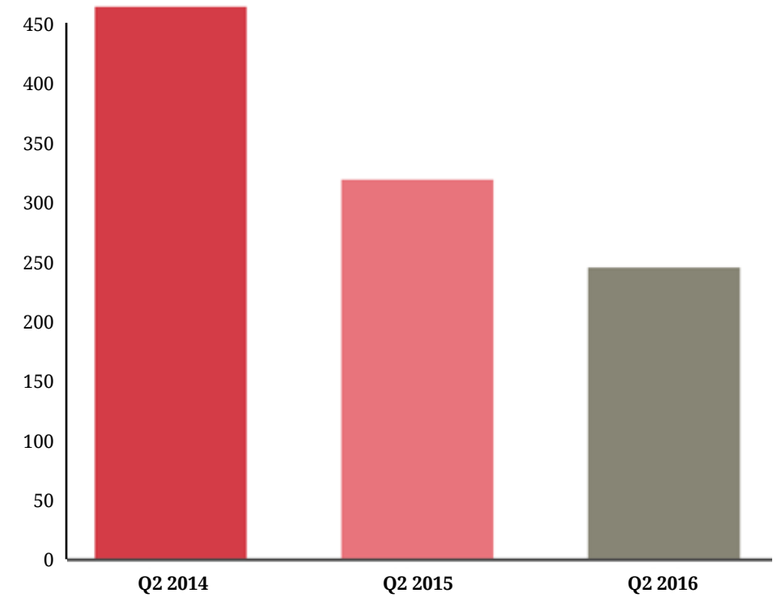
Williams warned provisional 2015 figures show a 20% downturn in offshore energy premium income, with a similar trend expected for 2016.

Writing for *Insurance Day* earlier this year, Steve Warren, group head of energy and engineering at Sompo Canopius, said market conditions were unlike any he had seen during four decades in the business.

"Never before have underwriters had to contend with such a vast pool of aggressive capacity at the same time as the exploration and production [E&P] industry is plagued by the dramatic collapse of the commodity price, which has led to a stagnation in the business," he said.

Lloyd's upstream energy premiums have fallen rapidly in the past three years. From $465.7m in the second quarter of 2014, the market's premiums were down to $320.4m in the second quarter of 2015, falling to $245.2m in this year's second quarter.

Graph: Lloyd's second-quarter upstream energy premiums, 2014 to 2016 ($m)



Richard Palengat, head of marine and energy at Aegis London, says the cocktail of reduced revenue, the fall in pricing and increased market capacity has reduced most E&P underwriters' top lines by more than 40% during the past couple of years. "In an insurance market where behaviour is driven by a desire for growth, the substantial setback in revenue is significant," he says.

"Commodity prices remain relatively weak and consequently most exploration is either unaffordable from a cash-flow standpoint or unattractive from a return on capital standpoint. Brokers are also affected by a combination of reduced commissions due to the reduced premiums and by stiff competition on their fees from other brokers."

This year's loss activity has further compounded the challenges that face the sector.

Premium wiped out

The offshore energy insurance market is likely to produce an underwriting loss for 2016 following a series of large losses, which have eaten away at the market's premium throughout the year.

In its latest report on the sector, Lloyd & Partners estimates worldwide aggregate upstream premium to be approx-

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"Never before have underwriters had to contend with such a vast pool of aggressive capacity at the same time as the exploration and production [E&P] industry is plagued by the dramatic collapse of the commodity price, which has led to a stagnation in the business"

Steve Warren
Sompo Canopius

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imately $1.5bn – a figure likely to be equalled or exceeded by the cost of the three largest market losses of the year.

The most significant of these losses occurred in the Jubilee oil field off the coast of Ghana in March. Damage to a floating production storage and offloading (FPSO) vessel operated by Tullow Oil is expected to result in an insured damage bill of more than $1bn.

In September, Tullow Oil revealed it has received confirmation from its insurers that the event is covered for business interruption and hull and machinery damage. Tullow said it is expecting to receive payments for lost revenues equivalent to average production of 4,000 barrels of oil per day.

Further disruption will occur in 2017 when the FPSO is returned to its permanent position, which is expected to lead to 12 weeks of production shutdown, triggering further business interruption payouts.

In its November trading update, Tullow said it is "working with its loss adjusters to establish efficient payment schedules for reimbursement of operating and capital costs associated with the remediation project and lost revenue from reduced production".

The full cost to insurers has yet to emerge. According to Lloyd and Partners, the FPSO has at least $1.7bn of loss of production income insurance purchased by various joint venture partners. The broker said some underwriters are fearing a worst-case loss of $1.7bn.

Events such as the Jubilee oil field loss highlight some of the challenges facing the energy insurance market at the present time.

The reduction in the premium base has not been matched by a reduction in peak exposures, leaving energy underwriters facing a much more volatile book of business than once was the case.

But even with these challenges, downward pricing pressure is continuing and showing no signs of reaching a floor.

In a recent earnings call, Lancashire chief executive, Alex Maloney, revealed the extent to which this pressure is being exerted. "In the last quarter, we saw an energy account with a 50% reduction, which is insane, particularly given the current state of the market," he said.

Maloney said Lancashire walked away from that particular piece of business, and a number of other companies have indicated a willingness to walk away from business during the recent results reporting season.

Energy is one of the markets cited by Hiscox in which it is actively reducing its business as a result of rates being under "severe pressure". Hiscox has said its London market business will "shrink materially" in 2017.

At Talbot, premiums in energy classes have also been reduced. Talbot's third-quarter results showed a $3.2m decrease in downstream energy premiums and a $10.5m reduction in upstream energy classes due to continued pressure caused by the lack of activity and lower prices in the oil and gas sector.

$1.5bn

Worldwide aggregate upstream premium for 2016, as estimated by Lloyd & Partners, and set to be exceeded by the three largest market losses of the year

Excessive competition in the energy market was cited by parent company Validus as the driver of a 6.1% year-on-year reduction in rates across Talbot's portfolio during the third quarter.

Validus chief executive, Ed Noonan, said Talbot had responded by shrinking its top line, which had meant the insurer had "essentially missed the two biggest energy losses in the market this year".

Signs of change?

Current sentiment among London market insurers suggests there is little hope of a significant upturn in the energy market's fortunes in 2017, even with this year's loss activity.

Aegis London's Palengat says the recent significant claims, likely to be historically unprecedented in scale, have come when insurers can least afford them. "Some of these claims have not appeared in insurers' financials yet but they will have a heavy impact when they do," he says.

"Most clients understand that to expect renewal terms to continue to be as soft as in recent years would be unwise. While most underwriters are unlikely to predict significant rate increases until they see the departure of some of the capital, there is a sense something has to change."

In its most recent market report, Lloyd and Partners said when the losses hit earnings, probably in the fourth quarter, it "may ultimately force some capital to withdraw". The broker believes insurers will target sub-10% price cuts at January 1, but their struggle to achieve healthy signings on business they are now binding due to the persistent competition means this may prove to be only an aspiration.

Paul Gregory, group chief underwriting officer at Lancashire, revealed during the company's third-quarter earnings call he believes 2017 is too early for meaningful changes to market conditions.

"Our market isn't particularly logical. We've seen a run of losses in 2015 and 2016, and premium in the upstream energy market has pretty much halved in that time. Margins remain tight, and one thing we have not seen is capacity leaving the sector.

"I think rate reductions will reduce slightly in 2017 as people realise there is very little margin in the business, but there will still be reductions."

Gregory says a reluctance among reinsurers to grant further rate reductions will further squeeze margins among primary insurers, and may start to drive some change in behaviour.

"But my view is 2017 is too early. I think we're looking at 2018," he said. "If nobody leaves the sector and capacity doesn't come out, and there is a far less premium, people will chase that premium which will mean there is still competition there."

The Trump factor

Amid all these pressures, the election of Donald Trump as US president brings a further uncertainty for the energy market.

One of the pockets of geographical opportunity to emerge in recent years has been Iran, where the lifting of US sanctions by President Barack Obama has led to soaring Iranian oil exports.

While the impact on the oil price has not been a positive for the energy insurance market, it has benefited from opportunities as Iran returns its energy industry to work.

Among Trump's many proclamations during the election campaign was a pledge to undo the deal put in place by Obama and restore sanctions on Iran.

Post-election, it is not yet clear whether he intends to follow through with the pledge. Although complex, in theory it could be possible for Trump to veto the previous resolution and restore sanctions on Iran, which would reduce insurance opportunities in the country's energy sector but also have a knock-on impact on global oil supplies and alleviate some of the downward pressure on oil prices.

A resurgence in oil prices would also likely create opportunities for the offshore energy insurance market as it would encourage production to restart in areas where it is currently not economically viable.

Oil producers in the Organisation of Petroleum Exporting Countries (Opec) are due to meet at the end of this month in a bid to reach agreement on a deal to limit output.

Most industry commentators are relatively pessimistic about the chances of a deal being reached.

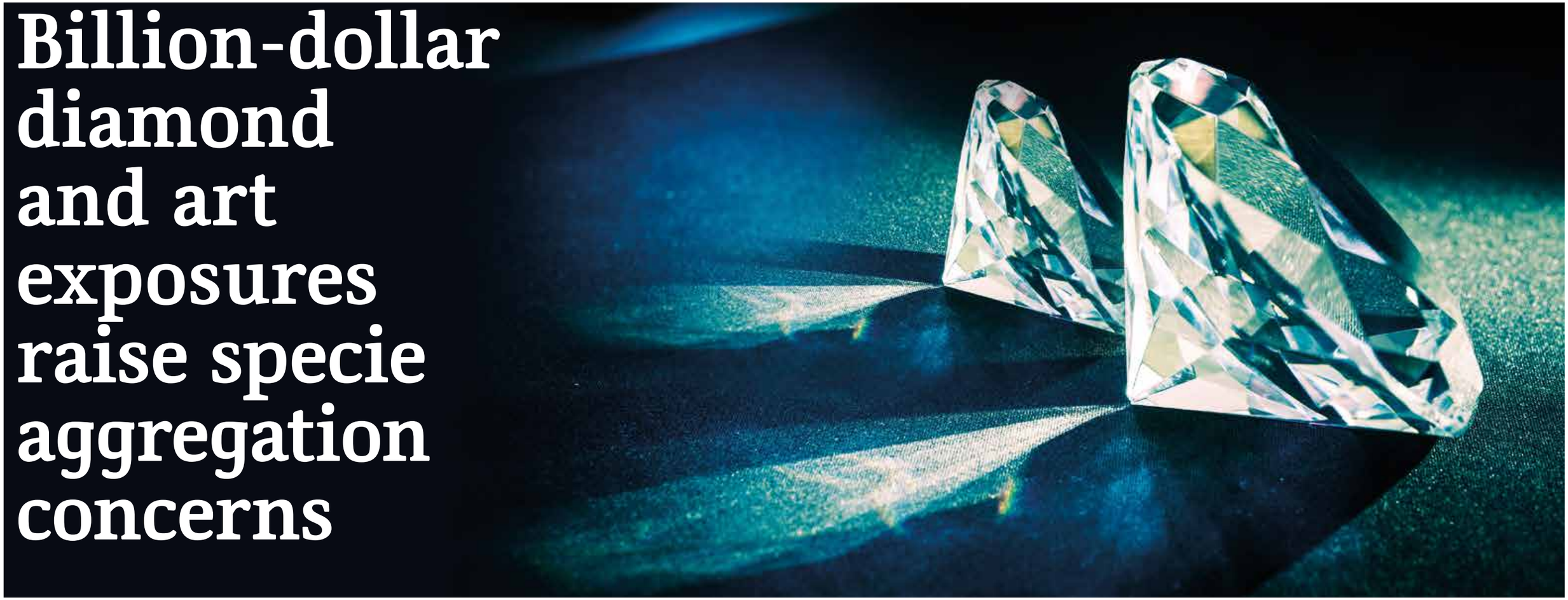
A failure to limit output is expected to mean a continuation of the current low oil price situation, which will do little to boost prospects for offshore energy underwriters at the market's most challenging point in living memory. ■

The article was first published in Insurance Day on November 17. 2016

Oil refinery in Iran: if Donald Trump were to reintroduce the sanctions lifted by Barack Obama, the implications for insurers would be mixed

SPECIALTY

Billion-dollar diamond and art exposures raise specie aggregation concerns



Diamond and jewellery shows, art fairs and art storage facilities represent major risk aggregations for specie/fine art markets

Scott Vincent
Editor, news services

The escalating value of fine art and jewellery is increasing concerns among specie underwriters about unquantified large aggregations of exposure being held in single locations.

Large art storage facilities, art fairs and diamond and jewellery shows can each see large accumulations build up, with underwriters often unaware of the extent to which they have exposure concentrated in one location.

In some cases, the value of the total exposures held in one location can total billions of dollars.

In a series of interviews with *Insurance Day*, underwriters have consistently said aggregation of risk in these locations is a concern.

And while risk management measures at storage facilities and art fairs are sophisticated and improving, the unknown large aggregations of exposure contained within are troubling the underwriting fraternity.

Large jewellery and diamond shows are among the biggest concerns for specie underwriters, with large exposures on display at the shows, and an associated risk for the jewellery and diamonds while in transit to the events.

Around 50 jewellery and diamond shows take place each year with three major events held in Basel in the first quarter, Las Vegas during the summer months and Hong Kong in October.

Hong Kong is the largest of the three. According to Philip Turner, head of specie at Sompo Canopius, total values at the event exceed $3bn. "There are floors and floors of diamond booths with counters where diamonds are shown to prospective buyers. This represents a massive aggregation of exposure," he says.

While underwriters can take steps to limit its total exposure, the underwriting community cannot pre-determine how many sellers will attend and what values they will bring with them.

These seven- to 10-day events also bring transit exposure, with the diamonds and jewellery needing to be transported to and from the shows.

"There can be a massive amount of diamonds flying from Kennedy Airport into Las Vegas for the one show. The val-

Continued on p30 >>

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'[At the Hong Kong International Jewelry Show] there are floors and floors of diamond booths with counters where diamonds are shown to prospective buyers. This represents a massive aggregation of exposure'

Phillip Turner
Sompo Canopius

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ue on a flight could easily be hundreds of millions of dollars," he says.

While all specie is shipped as valuable cargo, no values are declared and it is not possible for underwriters to be aware of what accumulations are on a flight; in the same way, an accumulation of exposure in transit on a marine vessel is also unknown.

Art storage aggregations

Art fairs also present a risk of aggregation which is causing some concern among the underwriting community. As is the case with jewellery and diamond shows, major art fairs such as The European Fine Art Fair (Tefaf) in Maastricht, Art Basel and Frieze London can bring together billions of dollars-worth of art under a single roof.

Louis Robertson, fine art and specie underwriter at Tokio Marine Kiln, says these values mean there will always be aggregation risk, even if an underwriter has a fairly clear picture of what they are insuring under that roof.

"Art dealer insurance policies require them to keep us informed which art fairs they are at, so we normally have a reasonably accurate idea of the exposure we face at each art fair," he says.

In terms of measures being taken to better manage this risk, Robertson says the underwriter is reliant on the fair organisers. "At some events insurers have sent surveyors and we can try to work with organisers to lower the risks, but the impetus is really on how much an organiser wants to work with the industry," he says.

"There haven't been any major losses at art fairs recently, so things seem to be working."

Large fine art storage facilities are another major aggregation concern of underwriters, with a number of global hubs for storage facilities. "The largest storage facilities are in Switzerland with Geneva Freeport being the most noted. However, Luxembourg and Singapore are also important hubs for storage facilities," Robertson says.

Major facilities also exist elsewhere in the US, the UK, the Far East and Europe. "One of the greatest problems with aggregation of risk is that insurers don't always know where the art they insure is located," he adds.

An underwriter may be unaware that more than one client is storing valuables in the same facility, creating unknown accumulations an insurer will not necessarily be able to track.

'Technology is now helping better protect art in transit. Shipping and packing technology is improving, with 3D printers now allowing for very bespoke package crates and material to be created for specific works of art'

Andrew Mitchell
Hiscox

Policies will generally contain a limit for unknown locations to allow their insureds the flexibility of moving their art around.

Robertson says there have been improvements in security as building design becomes more sophisticated. "The Luxembourg and Singapore Freeports were both built in the past five years, so have all the perks of modern buildings," he says.

According to Mark Bosshard, underwriter at XL Catlin, many of facilities used to store fine art are dedicated warehouses which were purpose-built and designed with risk managers to mitigate the threat of flood or fire. "These modern purpose-built facilities are obviously more attractive to insurers," he says.

Bosshard says risk management and security at storage facilities has improved hugely during the past 20 years.

"The insurance market has been partially alert to this over that timeframe – the market moved to survey major facilities and grade them for security and fire," he says. "This has also been mirrored in the storage industry's approach when building new warehouses and they are as keen as we are to develop world-leading risk management facilities and practices."

Co-operation improving

Bosshard says the level of co-operation between insurers and storage facility owners is increasing, with storage owners aware engagement with insurers can make them more attractive to clients.

"Many engage with insurers right from the design stage if it's a new building. Two new European facilities were particularly keen to engage recently – bringing in security consultants and insurers at the design stage and have been open to showing the market their facilities," he says.

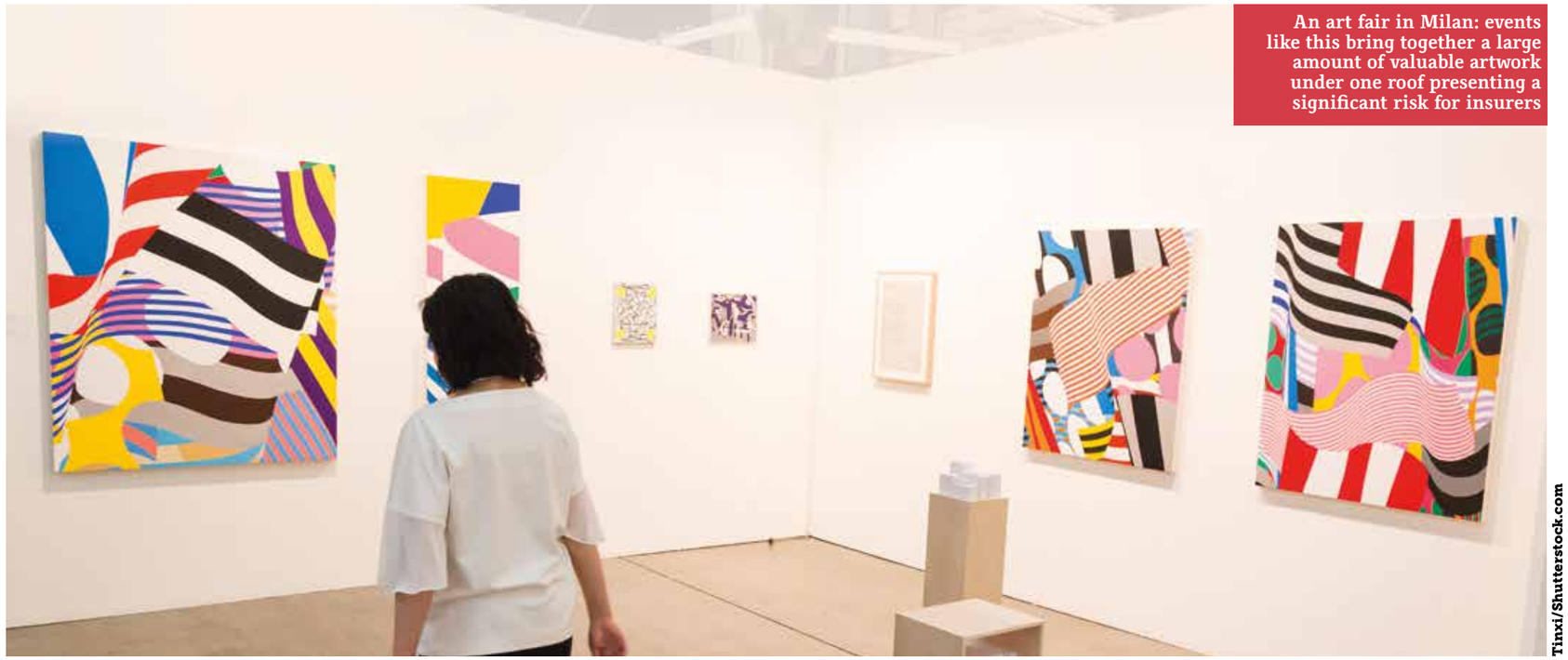
Large loss aggregations have not translated into large losses in recent years, reflecting the security measures being taken.

But the scale of exposure at risk highlights the need for a better understanding of the risk profile by all stakeholders.

In time, this may be derived from more granular modelling of art and specie exposures, which are not best served by existing market models.

Some commentators have also suggested there is a need for a greater depth of market data to be made available to following markets, many of which "follow blindly" on lineslips and binding authorities at present.

With specie highly attractive in the Lloyd's market and regularly attracting new entrants, the need for better monitoring and understanding of aggregations is becoming increasingly pressing.



An art fair in Milan: events like this bring together a large amount of valuable artwork under one roof presenting a significant risk for insurers

Tinxi/Shutterstock.com

Lessons from large losses

The Securitas depot robbery, which took place 10 years ago this week, is believed to be the largest in UK history, with an estimated £52m ($72.5m) stolen after a gang held the facility's wife and child hostage and coerced him into opening the facility for them.

One of the lessons learned from the event was the value of having a central control station monitoring activities at all facilities.

"Today, most high-value storage locations have a central control station and are monitored by CCTV," Philip Turner, head of specie at Sompo Canopius, says. "This allows them to see live CCTV of their locations globally. If they choose, they can also put in place remote opening and closing of the facilities. This would mean they could not open the facility in one location if the central location has not given approval."

The most recent high-profile robbery was of an underground safe deposit facility in Hatton Garden in April last year. The robbery has attracted widespread media attention and it remains unclear the true cost of the event. The Hatton Garden Safe Deposit Company, which operated the facility, has since gone into liquidation.

"Had someone else been looking in from another location they would have seen what was going on," Turner says. "No-one knows the true cost of the loss, but it is not a loss that will cause the market to harden."

The 2004 fire at the Momart storage facility in Leyton, east London provided a lesson to underwriters to be aware of what is situated next door to facilities storing high-value items. The fire destroyed almost all the artwork at the facility, which was valued at tens of millions of pounds.

£52m
Largest robbery in UK history, when a Securitas cash-management depot was targeted back in 2006

Joyce Webb, group head of marine at Sompo Canopius, says: "With historical claims it is very often a fire or incident that is started next door, and it is very hard for an underwriter to have a handle on that."

The main driver of fine art claims remains accidental damage while in transit. According to Andrew Mitchell, fine art underwriter at Hiscox, accidental damage drives around 50% of the claims traditionally impacting the sector, most of which results from when in transit.

"Technology is now helping better protect art in transit. Shipping and packing technology is improving, with 3D printers now allowing for very bespoke package crates and material to be created for specific works of art."

David Saillen, who leads Liberty Specialty Markets' business in continental Europe, says: "With regard to fine art, in terms of numbers transit and accidental damage is the main driver of loss. In terms of claims value, loss drivers are fire and natural catastrophes. With regard to the other specie sub-classes, socio-economic factors can be detrimental to risk performance."

He says insurers offer risk mitigation services against these perils to help prevent losses occurring.

Theft is less of a driver of losses for fine art insurers. Ian Seakens, class underwriter for specie at Aegis London, says loss drivers tend to be fortuitous damage rather than theft. "Art is unique and stories of art being stolen to order are usually far-fetched," he says.

"There is little point in stealing a painting to hide it away. Any art that is stolen is either shortly after offered for ransom or turns up without the perpetrator making real benefit from the theft." ■

The article was first published in Insurance Day on February 25. 2016

Evolving piracy threat challenges insurers

While global piracy is falling the underlying trends still present challenges for the insurance market

Rebecca Hancock
Reporter

According to a recent study published by the International Maritime Bureau (IMB), global piracy has reached a 20-year low.

While this sounds like a positive development for vessels and shipowners desiring safe passage through waters that have historically been targeted by pirates, the picture is less clear than the statistics at first glance suggest.

Even though activity is down, the threat posed remains very real, with piracy evolving to become more sophisticated, as well as shifting geographically.

In recent months, a number of international organisations and government bodies have raised concerns about developing activity in both the Gulf of Guinea and the Gulf of Aden.

For centuries piracy has been considered a "peak risk", with the potentially costly losses offset by the relatively low probability of occurrence. Lloyd's and the wider insurance market have for years played a role in protecting maritime businesses against the financial impact of a piracy attack.

As the tactics employed by pirates evolve, so does the demand for insurance products to provide adequate cover, in classes such as hull and machinery, protection and indemnity (P&I) and kidnap and ransom (K&R) policies.

Gulf of Aden

Located in the Arabian Sea between Yemen on the south coast of the Arabian peninsula and Somalia in the Horn of Africa, this stretch of water has become infamous over the past 10 years as a result of repeated attacks by Somalian pirates.

Data obtained from *Lloyd's List Intelligence* shows piracy has decreased significantly in this region in recent years.

However, exactly why activity in the Gulf of Aden has decreased is open to debate and can be attributed to a number of factors.

"The work being undertaken by the national and international authorities, such as providing patrols and other anti-piracy measures, are working and the levels of piracy in the West Indian Ocean are currently decreasing," P&I club Gard's managing director, Thomas Nordberg, says. "In addition, the implementation of agreed best management practices by the shipping industry and individual shipowners employing armed guards on their ships in the region are also deterring piracy in this region."

However, while activity may be down, there is a consensus among organisations this should not breed complacency, with piracy in this region not defeated, only countered.

A report released in October by the UN secretary-general warned of the fragile and reversible nature of the successes in tackling piracy and armed robbery at sea off the coast of Somalia.

The report said the root causes of piracy, including the presence of illegal, unreported and unregulated fishing, as well as the lack of economic opportunities in Somalia, remain in place.

With a prevailing unstable political and economic situation leading to high youth unemployment and limited military capabilities, the potential for a resurgence of piracy in the area remains high.

There are also new threats emerging in the region. According to SCR, a specialist insurance broker that is part of Miller Insurance, the ongoing conflict in Yemen is having an impact on piracy. The broker says in October there were a "number of incidents affecting the Gulf of Aden, indicating a renewed wave of piracy in the region, largely as a result of spillover from the ongoing conflict in Yemen", adding: "The majority of these attacks were launched from Yemen, where the civil war continues. The incidents represent a worrying escalation in the civil war with US Navy vessels being targeted by supposed Houthi rebels."

SCR says insurers should closely monitor developments in the region – one of the most strategically important shipping lanes on the planet – to ensure they are modelling the evolving risk appropriately.

Gulf of Guinea

In recent years the most north-eastern part of the tropical Atlantic Ocean off the coast of Nigeria has seen a significant rise in piracy.

In contrast to the activity witnessed previously in the Gulf of Aden by Somalian pirates, which was suppressed by international forces, the Gulf of Guinea is not attracting the same response from the global community. This, in turn, is leading to increased attacks, significantly increasing the risk exposure of vessels navigating these waters.

There is no single factor that can be attributed to this, however, as arguably the Gulf of Guinea is not as vital a trade and shipping route as the waters off the coast of Somalia.

Nordberg says as well as going unchecked by international forces, pirates in the region are increasingly receiving more funding from criminal gangs and developing more sophisticated strategies. "These gangs have hijacked vessels involved in specialist operations, offshore work or ship-to-ship operations and stolen cargo and kidnapped crew," he says.

"Their tactics are becoming more aggressive and violent as they employ new tactics and, at the same time, they are expanding the territorial range of their attacks."

With the region continuing to witness a rise in piracy, SCR says it does not anticipate the threat dissipating any time soon. "Piracy in the Gulf of Guinea is likely to remain a serious risk throughout 2016 and for the foreseeable future and it is likely incidents of maritime kidnap will remain high in the near term," it says.

Insurance impact

Taken in the context of the prolonged soft market, which has had an impact on carriers across the industry, for many insurers the changing dynamics of piracy have made the field an attractive area of growth or a possible way to diversify.

Jon Gregory, product head for K&R at AIG, says not only has the nature of piracy changed, but so too has the way in which insurers provide cover.

Gregory says with the rise in piracy over the past eight years, especially with earlier attacks in the Gulf of Aden, many more carriers have entered the market. "There's huge competition compared to the early years of piracy coverage, going back to 2008, which is good news for the buyer," he tells *Insurance Day*. "More recently we've seen a lot more competition in the field."

As a result, Gregory says products have developed, with some carriers altering their offering to reflect the narrow margins of profit. "The impact of that is a few markets have been taken out of what I'd call standalone piracy insurance– it's become almost too competitive to cover these transits," he says.

While rates for piracy covers have "tumbled" in recent years, Gregory says he foresees rates hardening in some areas, especially when insuring voyages around Nigeria and the Gulf of Guinea. "I would argue the rates are hardening now. That's appropriate. There's still an abundance of capital there but the rates for the coastal areas of Nigeria are going in an upwards direction now."

With the past few years being a buyers' market with continued soft market conditions prevailing, buying habits across the market have evolved. This has had an even deeper impact on the sector because of the way in which it is procured.

Piracy cover is transacted in a similar way to how war cover is purchased (on an additional premium basis as a vessel moves into high-risk areas). At all other times a vessel has the annual cover provided by hull and machinery, as standard marine insurance.

Gregory says: "It's become less of an incentive for shipowners to buy longer-term contracts – because rates continue to move almost monthly, nine times out of 10 buying single voyage or shorter term has become the purchasing dynamic for shipowners. You see relative rate fluctuations that match that."

This can have a detrimental impact on business in the long run because of the short-term nature of the relationships established with the buyer, Gregory says. "It's great for the customer as they get to revisit the market frequently when it comes to cost. I'd much rather see longer-term contracts as that allows us to build better customer connections."

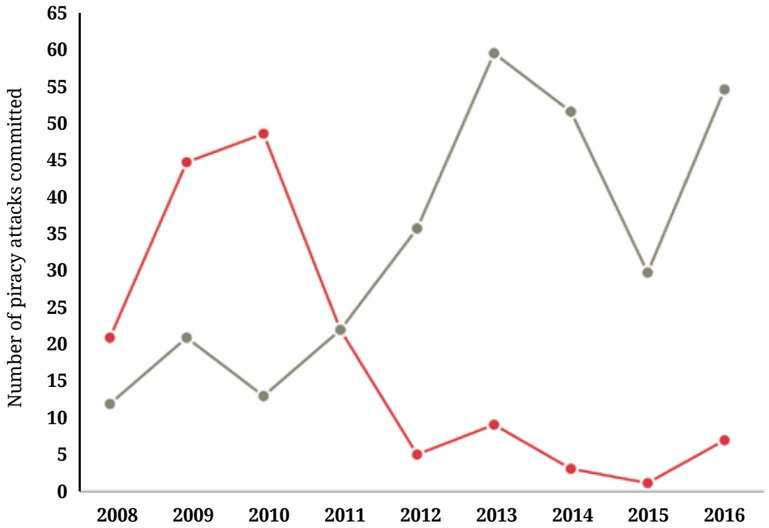
While rates may be hardening slightly the sheer number of carriers still operating in this field means even if the levels of piracy activity increases substantially, Gregory says he does not foresee the market dynamics changing. "[Overcapacity in the market] has resulted in a tremendous amount of competition – both east and west coasts. I don't see any sign of that altering if there is an increase in risk profile off either side of Africa. It's symptomatic of where we've got to in this insurance cycle."

With the situation for piracy anywhere from stable on both the east and west coast of Africa, Neil Roberts, manager for marine and aviation at the Lloyd's Market Association, says underwriters need to be able to model the evolving risk properly.

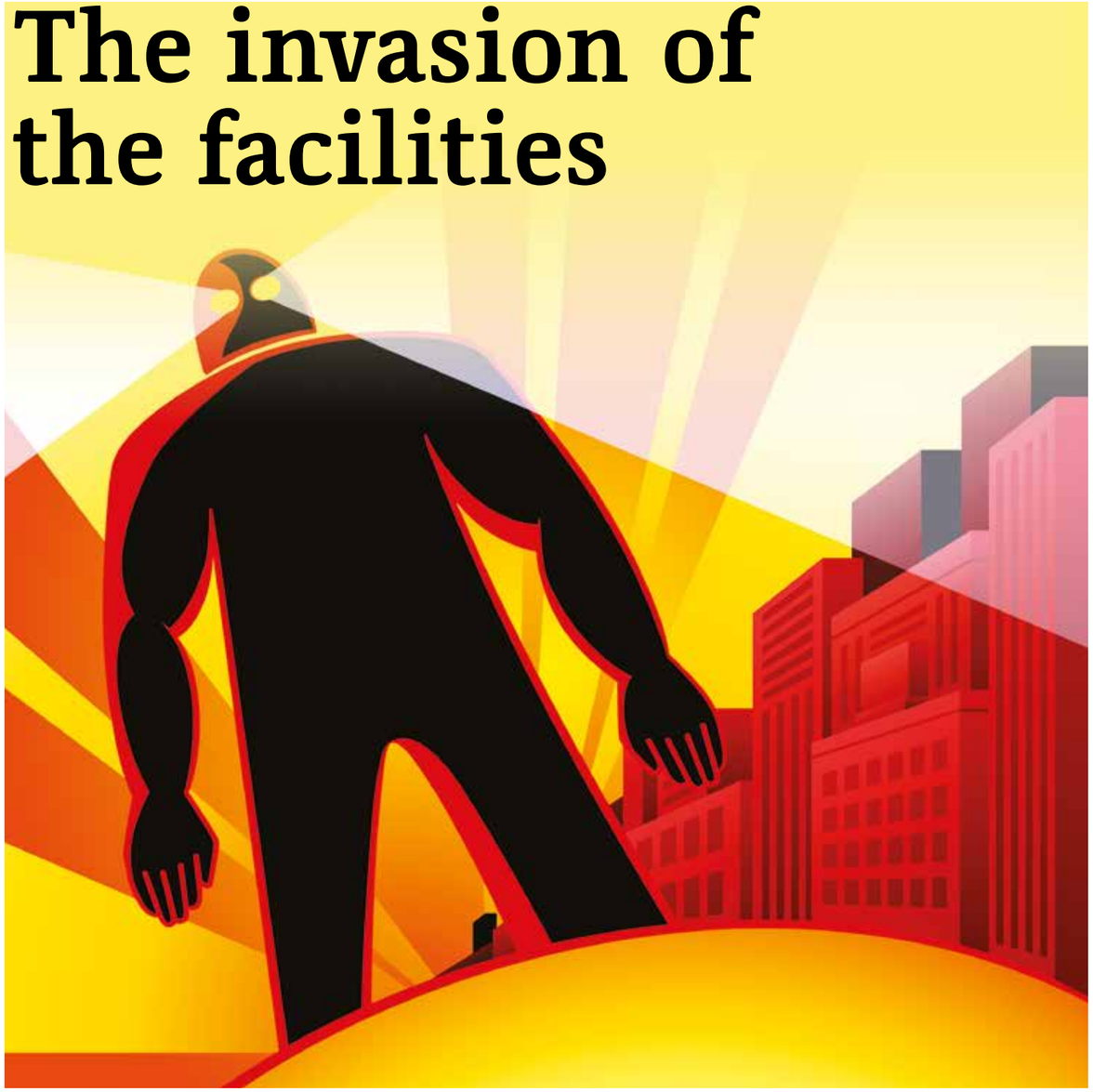
When insuring transit in these waters, Roberts says those writing these risks must use the tools they have properly and treat each vessel's voyage on its own merits. "Education is key for insurers to properly understand the risk they are writing," he says.■

The article was first published in Insurance Day on November 19. 2016

Chart: Number of piracy attacks on east and west coasts of Africa, 2008 to 2016



The invasion of the facilities



Broker facilities are evolving at such a fast pace that unless London market insurers adapt, many may end up like the dinosaurs

Rasaad Jamie
Global markets editor

Although the response to the emergence in recent years of London market broker facilities such as Willis Towers Watson's Global 360 and Aon's Lloyd's-based Client Treaty facility has been mixed on the part of both insurers and rival brokers, it has been consistent on three key points: that the emergence of these facilities is a response to the soft market; that they represent a moment of profound change for the market; and that they are here to stay.

For some insurers, the concern is that the pre-arranged nature and sheer scale of these schemes impose an enormous pressure on risk carriers to either sign up to a facility, or forfeit a significant volume of business to their competitors. The Willis facility, for instance, allocates up to 25% of some of the business placed in the London market to preselected underwriters while Aon's facility provides a 20% all-class line to the broker's wholesale client base. An associated concern is the extent to which insurers are required to relinquish underwriting control over the business channelled through these facilities.

For Mark Skinner, broker distribution executive at Tokio Marine Kiln, the broker/underwriter relationship was fundamentally remodelled three years ago when Berkshire Hathaway agreed to write a fixed percentage of business that came in to Lloyd's via a quota share facility (where underwriters pre-agree to write a percentage share of each risk following an approved leader's terms).

"The quota share is essentially a market tracker for a particular class of business. This move by Berkshire threw down a gauntlet to the traditional underwriting model in the market, and companies have had to fight this duel. The market is evolving. But the rate of change in broker practice in the insurance market is currently happening at such a fast pace that unless underwriting firms adapt, irrespective of size, many may end up like the dodo," Skinner says.

The brokers behind these schemes are only too aware of the departure such facilities represent with the past, particularly in terms of how brokers' facilities were employed during previous soft market cycles.

Data

Jonathan Prinn, deputy head of broking GB at Willis Towers Watson, says in the past, facilities and panels were often efficiency tools that were built in the wholesale market with little engagement of the retail producer or client. "Facilities and panels are now much more focused on a market-leading product that has defined benefits and can underwrite tranches of business due to its benefits, for example coverage/terms and conditions and service levels, as well as the portfolio pricing nature," he says.

For Prinn, the key driver to today's facilities is the greater use of data not only to highlight the correct coverage and pricing, but also to demonstrate to the insurer that a book of business written holistically can be both profitable and answer clients' needs. Indeed, both Willis Towers Watson and Aon regard the use of data and analytics as one of the key benefits of their facilities to the insurers who participate in them. "The data also drives the efficiency of the model, with brokers challenging carriers as to what part of the proposition they should keep or outsource," Prinn adds.

Karl Hennessy, president of Aon Broking and chief executive of the group's global broking centre in London, similarly emphasises the critical role of data in the structuring of business channelled through the Aon Client Treaty facility which, he says, draws on an unparalleled source of data and analytics based on $5trn of total insured values and 30 million properties, as well as the advantages it brings to carriers.

"The idea is to create a portfolio of risks that enables participating insurers to benefit from the scale and diversity of Aon's London book," he says.

Efficiency savings

Some in the London market see the emergence of these facilities as a direct result of the pressure on brokers' revenues in recent years. According to Skinner, every insurer in the market is under pressure to write business for less with top line the worrying focus for many. This impact, he says, extends to brokers where the slice of cake available in commission is shrinking.

"As a result they are being forced to find ways to keep their revenues and profits up. The way brokers are doing this is efficiency savings; spending less time on non-profitable relationships, less time wearing out shoe leather in Lloyd's and less time offering small lines to underwriters."

According to Demian Smith, chief executive of London market insurer, StarStone International, in the past, the existence of facilities was not primarily an additional source of revenue for broking firms which did not have the same financial challenges as they appear to have today.

"As a market, we seem to have reached a point where the broking firms struggle to generate sufficient revenue to cover expenses and maintain the Ebitda margin. They have become used to this margin, while underwriters are struggling to make adequate returns on capital for their shareholders. All the while, there is an outcry at the level of frictional costs in a transaction between insured and insurer.

"The ability to maintain margin in a market with substantial price softening is extraordinarily difficult. Even more so now, as brokers continue to rely on brokerage which declines with price instead of negotiating a fee with their principal commensurate with the level of service they provide, as other professional advisors would do," Smith says.

Hennessy of Aon reads the situation slightly differently. He sees it more in terms of the pressure faced by insurers within the current market environment and how brokers' facilities assist in reducing those pressures. He says the continued influx of capital is driving a prolonged period of over-capacity that is sustaining downward pressure on rates and forcing many insurers to rethink their business model.

"Recent M&A activity – which reached a record $80bn in 2015 – is indicative of reactions to this difficult trading environment, where traditional underwriting responses to market conditions such as being more selective, or increasing rates, have proved challenging," Hennessy says.

"Without obvious avenues to improve operating results, insurers have turned to broker facilities like Aon Client Treaty to strengthen their combined ratios and reduce operational costs. Such facilities are helping to create a sustainable underwriting model in the face of a challenging market environment. Insurers continue to pursue diversification and scale to reduce volatility – Aon Client Treaty delivers both," he adds.

Changing dynamics

It is important to note that the market dynamics are fundamentally changing, particularly with the blurring of the lines between what is a carrier's versus what is a broker's, turf, says Prinn of Willis Towers Watson.

"New capital entrants are moving up the value chain and also blurring what were traditional 'turf' areas. Managing general agents (MGAs) are good examples of an area that is now very much of

Continued on p36 >>

'Without obvious avenues to improve operating results, insurers have turned to broker facilities like Aon Client Treaty to strengthen their combined ratios and reduce operational costs. Such facilities are helping to create a sustainable underwriting model in the face of a challenging market environment'

Karl Hennessy
Aon Broking

Continued from p35

interest to all parties. Traditional capital will evolve to not only be paid to put capital at risk, but also to manage risk on behalf of third party capital," says Prinn.

"The idea that through brokers' facilities, brokers are using insurers as merely 'capital pools', suggests limited understanding. To the contrary, we would suggest that capital is being deployed based on a much deeper understanding of the data and that this drives a better proposition," he argues.

Yet for Skinner, there is absolutely no doubt the use of facilities suits brokers. "If they have a guaranteed line without even having to lift a finger then those insurers that join this party become their new best friends. Brokers now want fewer but better friends with whom they write more business," he says.

"While this isn't new, the amount of business being put in to facilities, including quota shares, is increasing. On average 20% of business is now put in to facilities by the big brokers with this rising to more than 40% in one household name broker."

These facilities, Skinner says, enable brokers to use market management services as an entry point for business relationships. These offer insurers a range of facilities from access to in-house data to quota shares. "Increasingly popular is the 'preferred panel' which, upon winning a tender, place an insurer on a favoured shortlist of carriers who are shown each risk and given the option to write it before the rest of the market. Brokers are also investing heavily in MGAs geared to underwrite their business under delegated authorities," says Skinner.

There are slight differences between the use of MGAs and facilities by brokers. They both primarily exist to ensure an additional revenue stream for brokers, although this is heavily based on GWP and not underwriting result.

Traditionally, MGAs have existed to provide insurers access to business that has unique distribution characteristics, or that is very niche and outside the core business of insurers. "In this case, the specialist underwriting capability lay within the MGA. The focus was on writing for profit in the specialist area, so the ownership of the MGA mattered not. Generally, there were few alternative markets for these products," Smith of Starstone International says.

More recently, according to Smith, broking firms appear to be setting up MGA arms that do not necessarily possess these unique underwriting capabilities. They compete in markets where there is already expertise and on a subscription market basis.

"It seems that the only rationale for the existence of these MGAs is to generate additional income through commissions calculated on the premium being written. Often the capital supporting these types of MGAs already has its own underwriting capability, so there is now an additional mouth to feed in the chain. This either increases the cost to the insured or, as is more likely in this market, reduces the net premium to the ultimate risk taker," says Smith.

"In addition, as the MGA is remunerated on income, there will always be the temptation to chase the market pricing down to maintain GWP even if this is unlikely to lead to profitable outcomes for the ultimate risk taker. The question for insurers who support these entities is: "why give away underwriting control to an entity that will compete in your existing markets and where you already have your own underwriting capabilities?"

Facilitisation is different from MGAs in that the capital supporting these facilities does so in the knowledge that the majority of every risk ceded to the facility has been underwritten by carriers who are themselves exposed to a substantial part of the risk.

According to Smith, the broker plays no role in setting rates and terms and conditions, allowing the specialist market to do this. "The facility carriers then take the final agreed market price, less the additional commission paid, to the broker for managing the facility. The economics from an insurer's perspective are based on getting a broad spread of risk at market pricing and can take into account where the market is heading in the aggregate.

"The challenge with both MGAs and facilities for all carriers is how to reconcile being underwriters focused on profit with the acceptance of risks, without prior knowledge of the risk selection or pricing criteria," says Smith.

'The challenge with both MGAs and facilities for all carriers is how to reconcile being underwriters focused on profit with the acceptance of risks, without prior knowledge of the risk selection or pricing criteria'

Demian Smith
StarStone

Within the context of current market conditions, what are the key considerations for brokers in terms of whether they opt to go down the MGA route or the broker facility route? This, Smith says, is a difficult question for an underwriter to answer with any certainty. He notes the MGA route would require investment in underwriters, policy admin systems and additional regulatory approvals (to name a few), that facilitisation of the business would not require, as it should be able to be handled within the existing capabilities of the broking firm.

Long-term revenue

However, Smith believes the use of facilities today is driven more by the need for brokers to develop sustainable, long-term additional revenue streams rather than short-term pricing advantage. "As such, there is currently more transparency around the structure of the facilities and these are being developed in discussion with underwriters. This indicates there is a desire by brokers to create something that is sustainable and therefore adds value to insurers as well as to the broker and its clients," he says.

Hennessy of Aon agrees and says the Aon Client Treaty facility was subjected to an extensive pre-launch due diligence by insurers, precisely because Aon wanted to create confidence in a portfolio which, he says, is structured to drive much-needed efficiencies and innovation in the London market.

There is however, some fear over the potential for a fundamental mismatch between insurer and broker, in terms of the expected outcomes for MGAs or facilitised business.

"This is because the broker primarily focuses on revenue while an insurer primarily focuses on underwriting profit. An insurer's risk is the balance sheet with every risk accepted, while the broker's main risk is that there is not enough income to cover expenses," says Smith. "These are very different business models. However, there is nothing inherently wrong with facilities as long as the carriers can manage the potential mismatch in outcome.

"A good facility is one that has strict criteria around the types of risks ceded: including in-scope and out-of-scope business; an agreement over acceptable leaders for the front-end business; a diversified portfolio of risks giving access to business that the carrier may not otherwise see; very strong supporting data; a reasonable commission level for the services charged; and above all, a commitment by both broker and underwriter to make the facility work in the long term to the mutual benefit of insureds, the broker and the carrier."

The critical question is what does all this evolution mean for insurers? For Skinner, those insurers with the best chance of surviving will be the ones that effectively address three issues – scale, distribution and strategy.

Insurers, he says, need to have the size to service multiple lines of business across a wide range of products. "This includes having dual platform capabilities with both Lloyd's and company platforms, something that accounts for a spate of recent acquisitions of Lloyd's underwriting firms. In essence when brokers are choosing their fewer friends, you need to be more than just a pretty face, you need to have the depth to write serious business."

On top of this, insurers need to take a long hard look at their distribution network and think about where facilities can act as a useful conduit for business. "They need to decide what type of facilities will help them grow profits, with the emphasis on trying to use them rather than seeing them as an inconvenience," says Skinner.

Insurers need to have a strategy for getting closer to not just individual brokers in each firm, but to the entire broking company. "This is partly being done by the advent of relationship managers within underwriting firms and the advent of CRM systems that can maximise engagement with the big brokers of this world. Brokers are evolving and underwriters will need to adapt.

"The dinosaurs have long left the market, but no species is too young to avoid extinction," Skinner adds.■

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London: rapid emergence of broker facilities means the market must adapt quickly

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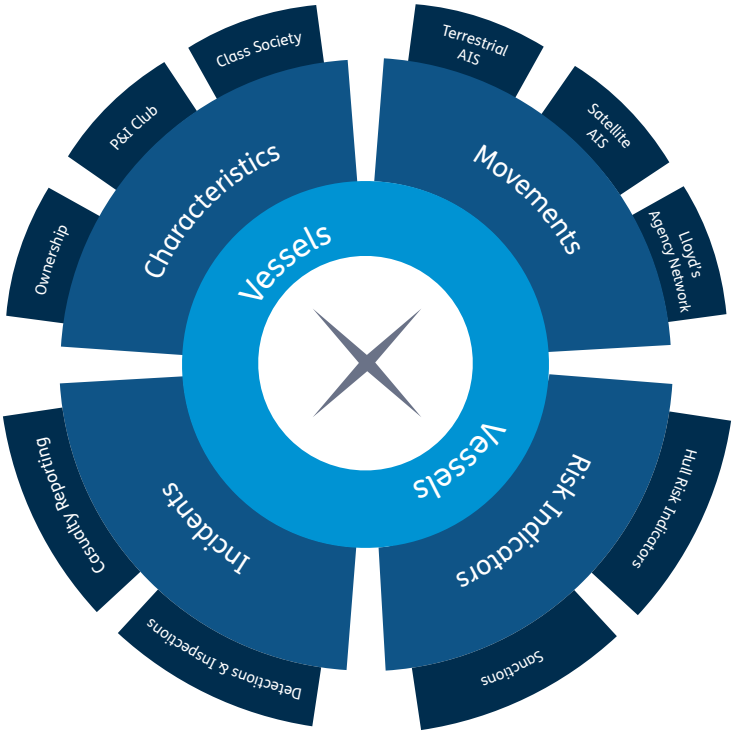

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