Rates on the flip side

Insures and reinsurers are looking at different sides of the same coin, as different challenges impact rates on both ends.

The global reinsurance market will continue to struggle with excess capital and high catastrophe losses in the new year, but that doesn’t mean there isn’t a light at the end of the tunnel.

While 2018 was not as bad as 2017 in terms of catastrophe losses, the reinsurance market is still bracing for some sizable hits, with Aon Reinsurance Solutions expecting industry catastrophe losses for 2018 to be about half of the record $140bn experienced last year.

Those with their ear to the ground in the reinsurance space are once again expecting to see rate increases primarily in loss-affected lines and geographies, with little movement otherwise despite the elevated levels of loss.

“We would expect to see some broad-based rate increases in 2019 due to recent market losses and reported poor underwriting results, but we see this happening only in selected geographic areas or certain lines of business,” Chris Zoidis, corporate executive vice president at H.W. Kaufman Group, tells Reactions.

“I do see commercial property rates rising in 2019,” he continues. “However, rate increases will be most prominent in geographic areas impacted by losses, such as the 2018 East Coast hurricanes and California wildfires.”

Mike Van Slooten, head of market analysis at Aon Reinsurance Solutions, agrees that excess capital would dampen any major rate movements but added that catastrophe losses in the past few years would have a larger impact than some might expect despite the high levels of available capital.

“On the capital side, we still see a lot in the industry,” he says. “We’ve seen roughly $200bn in insured catastrophe losses in the re/insurance markets in the last two years, so that has to have an impact.”

According to Van Slooten, one big factor that is often overlooked is the global demand for reinsurance.

“We think there is some growth in demand, people tend to forget the demand side of the equation, but it is relevant. I think the gap between supply and demand has narrowed to some extent, but it’s still a very competitive market,” he says.

“Generally speaking, we would still regard this as a good time for reinsurance buyers,” he adds.

Van Slooten believes that there are a few factors driving the demand increase.

“We predict pricing for non-cat exposed programmes to be flat to +2.5%; cat-exposed programmes are likely to face increases of 2.5% to 7.5%; and cat-exposed programmes with heavy losses could face price increases of 10% or higher.”

Joe Peiser, head of broking, North America, Willis Towers Watson

“One is at the current price point – it’s just a more attractive option for more people,” he says. “We’ve also seen some areas of growth in things like cyber, mortgage and agriculture. We’ve seen people who have had to evaluate their approach in the wake of some big losses, which tends to entail buying reinsurance. The final thing is a sort of underlying trend behind risk-based capital regimes such as Solvency II, which has changed the way people approach buying reinsurance. It tends to be a much more strategic approach these days which can have the effect of increasing demand.”

Still, Zoidis believes the liability side of the market is expected to remain largely unaffected by recent losses.

“These overall rate increases will be incrementally small and play out slowly throughout the year,” he says. “There is still just too much capacity in the property market. In other classes, such as liability, we do not expect any significant rate increases in 2019.

“We are still seeing very competitive rate environments in general liability, professional liability and environmental liability. For the majority of the market, there is still very significant competition due to overcapacity, and we don’t see this changing” in the new year, he adds.

On the primary side

In the primary space, things are a bit less uniform. As the primary market gains visibility into 2019, pricing appears to be showing signs of firming, although a true market hardening remains elusive.

“Capacity remains at an all-time high in almost all lines of business despite extremely challenging market conditions,” says Aon’s Brian Wanat, chief broking officer of US commercial risk solutions.

“Nevertheless, in the aggregate across property and casualty we’re seeing flat to a low single-digit (0 to +5%) increases, dependent of cat exposure, loss ratio and risk management credentials.”

Capacity and basic supply vs. demand is still probably the biggest impediment to meaningful price increases, says Wanat: “The M&A activity to date has done nothing meaningful in terms of taking out the supply of capital, either.”

“Pricing is firming, not necessarily hardening, in lines like cat property and public D&O,” he adds.

Joe Peiser, head of broking, North America for Willis Towers Watson, agrees that an overabundance of capacity has kept rates stagnant, even after last year’s catastrophes.

“Abundant capacity and the availability of alternative capital have fundamentally changed market dynamics,” he says.

One new development in the overall rate picture, however, is a steady increase on the casualty side, when the focus has traditionally been on the property catastrophe space.
“Interestingly, while many observers have been focused on the property market given the record natural catastrophes of 2017 and 2018, we are seeing a stealth firming in the casualty market,” Peiser says. For 2019, he expects auto liability rates to rise between 6% and 12% while the sector tries to overcome deteriorating loss costs.

Peiser also expects pricing for general liability, umbrella and excess liability coverages to increase by low-to-mid-single digits following what he refers to as “catastrophic liability events,” including the California wildfires, the opioid epidemic and litigation from the #MeToo movement.

“We are also seeing significant challenges for professional liability lines for long-term care and senior living facilities. Here, renewals are expected to increase 5% to 30%,” he says.

In the property catastrophe space, hurricanes Michael and Florence are not expected to be market-moving, according to Peiser – although smaller events are likely to take a toll.

Attritional losses that do not garner headlines are taking their toll on property insurers’ loss ratios and bottom lines, he explains: “We predict pricing for non-catastrophe exposed programmes to be flat to +2.5%; catastrophe-exposed programmes are likely to face increases of 2.5% to 7.5%; and catastrophe exposed programmes with heavy losses could face price increases of 10% or higher.”

According to Wanat, there is building pressure behind the scenes for higher rates, despite the roadblock presented by the amounts of excess capital present in the market.

“There’s a certain amount of tension in the P&C insurance marketplace right now,” he tells Reactions. “All signs absent capacity point to the propensity for higher premiums. Higher interest rates, higher payrolls, a growing economy, more IPOs, a rise in litigation funding, increasingly volatile storms & wildfires, M&A activity any combination, let alone a confluence of events, could lead to a more substantial increase in P&C pricing.”
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Emerging risks 2019

Casualty market is primed for 2019 increases

Property cat rates are usually the centre of attention in the run-up to 1 January 2019 renewals. But now long-tail business is also in the spotlight – and it’s because premium rates are ready for takeoff.

Market-watchers have latched on to the uptick in rates for commercial auto liability (CAL) in the US, positing the idea that it could trigger a much-needed lift for the wider casualty market.

CAL claim severity has grown to higher-than-anticipated levels for different reasons, including large jury awards due to trends in the plaintiffs’ bar, along with factors like medical cost inflation, distracted driving and the high cost of repairs in 21st century vehicles.

Guy Carpenter managing director Nick Durant believes the poor performance of the CAL line has been a drag on property and casualty industry profitability in the US for years.

“On both a calendar and accident year basis, industry CAL underwriting results have been deteriorating for the past decade,” he wrote in a recent note. “Accident year combined ratios have been above 105% since 2010, and carriers are feeling the pressure to reverse this trend.”

In addition to managing limits and obtaining reinsurance covers that address both frequency and severity of loss, Durant said that carriers that write commercial package policies or multiple casualty lines should avoid the temptation to use CAL to “oversubsidise” other casualty lines, such as workers’ compensation and general liability.

Durant is not the only one to notice that CAL is on the move and that the rising market could have a knock-on effect. Citing a survey by the Council of Insurance Agents & Brokers (CIAB) showing that CAL rates increased by 8.2% in the second quarter of 2018 (the 28th consecutive quarter of increased rates), JLT Re executive vice president J.J. Johnson believes that much-needed rate levels are happening partly because a number of big players have exited the market.

“Almost all insurers that write commercial auto are taking underwriting action on their business, either in the form of rate increases, re-underwriting or non-renewal of policies/portfolios,” Johnson stated in a recent note.

Clearly, the number of major players that have exited from the CAL market has probably contributed to the strengthening in that class, but many of the other factors are reflected in the wider casualty market.

Mark Shumway, global head of strategic advisory at JLT Re, added that many of the other factors seen in the CAL space are reflected in the wider casualty market – higher frequency and severity of claims (resulting in poor accident-year underwriting results) and growing loss-reserve deficiency.

“We expect general commercial casualty and specialty rate increases to continue steadily if not increase for the short term, particularly where we continue to see gaps between expected returns and gross [pre-reinsurance] costs of capital for insurance carriers. Carriers’ margins are not yet reflecting the rate strengthening, overall,” Shumway wrote.

Sentiment is hardening on badly performing casualty business in the London market as well, partly because the Lloyd’s performance directorate took a wire brush to syndicates’ business plans in 2018. But insurers themselves could see that their ability to rely on reserve releases has weakened.

In the same way that cat margin release has been a winner for cat underwriters, casualty underwriters have relied on prior year reserve releases to boost results, Simon Bird, portfolio leader for long tail treaty at Brit Insurance, recently told Reactions.

“But they’re running out of road,” he says. “According to Willis, the sector’s combined ratio was reduced by 5.2% in 2016, 3.6% in 2017 and 3% in the half year to date. This is happening when attritional loss ratios are on the up as pricing has been pared to the bone.”

Emerging macroeconomic factors could be the last push that’s needed to get the wider casualty market moving.

Swiss Re senior economists Irina Fan and Kulli Tamm believe that wage growth will accelerate in advanced markets in the near term, prompting the return of inflation-associated stresses on profitability in insurance.

“The acceleration in wage inflation will drive up bodily injury claims severity and possibly also weaken reserve adequacy in casualty lines. Non-life insurers should additionally be worried about the potential increase of claims frequency connected with an economy at full employment,” the economists warned in a recent bulletin.

According to Chris Buse, manager of casualty treaty reinsurance at AXA XL, the market started moving in the first half of 2018 for all the above reasons.

Speaking to Reactions at PCI this year, he boiled them down to one imperative: “Clients are expecting more increased rates in 2019 in the low to mid-single digits – and the reason why is simply that the market is not making money.”
Betting on blockchain

Industry consortium-turned-product pioneer B3i seeks to foster wider adoption.

The debate over blockchain’s role in the re/insurance industry has slowly evolved from “if” to “when” the technology will become commonplace, if the Blockchain Insurance Industry Initiative (B3i) has anything to say about it. B3i was originally conceived in 2016 as a consortium of 15 insurers and reinsurers in order to collaborate on how to best integrate distributed ledger technology within the industry. The group has since incorporated to form Blockchain Services AG, a company focused on bringing blockchain products to market. Its first product, Property Cat XoL, is scheduled to launch in January 2019. “The re/insurance industry, like most other industries in this age of rapidly changing technology, is in the midst of a transformation journey that includes optimising interactions within its ecosystem. Blockchain technology is instrumental in achieving this objective,” says Régis Delayat, chief information officer at SCOR, one of B3i’s original members. “For the industry to extract the maximum benefit, it needs to the largest possible number of users on the platform. I am confident that within five years most industry players will be on board.”

“A key focus for 2019 is to have real contracts, with real data on a real live platform. We keep quite a strong focus on the areas of reinsurance and commercial insurance,” says B3i CEO Paul Meeusen. B3i’s ambition is to accelerate the world’s transition to “a more relevant, accessible and affordable insurance,” Delayat says. “We are focused on helping B3i drive more automated and efficient interactions with our clients. Our involvement in B3i spans multiple levels and we are currently part of the ‘Early Movers Program’ for trading our Cat XoL contracts on the platform in parallel with the 2019 renewals.”

For B3i, its initial products are just the tip of the iceberg, adds Meeusen: “We have a roadmap that we have agreed with our shareholders that looks beyond 2019, which includes going into other lines of business like reinsurance, but also life and health.” Meeusen says B3i is working actively with the London market: “They are looking at various technologies especially with the target operating model initiative, and blockchain is one of them,” he added.

While B3i is a force behind distributed-ledger technology in the re/insurance industry, it does not encompass the entire market. As Meeusen explains, partnerships with other organisations are important: “It is clear we can only benefit together if we establish some common industry taxonomy and standards.”

Wider adoption of blockchain is not without its challenges: One issue facing the development of distributed-ledger technology in the re/insurance industry is that of regulatory constraints, which included certain prejudices against the technology due to its association with cryptocurrencies.

“Cryptocurrency has major challenges, but just like e-mail is an application of the Internet, it is just an application of distributed ledger technology”

In Europe, GDPR has likewise emerged as a potential roadblock for insurers looking to utilise blockchain technology, although some believe that the two do not necessarily have to be at odds.

“Blockchain technology can directly support GDPR,” Claire Bury, deputy director general, DG Connect said in a report published by the EU Blockchain Observatory and Forum in June. “There are different technical techniques that can be used to better secure personal data. Blockchain provides auditable and transparency, which can help in protecting data subjects and enforcing GDPR,” she added.

“Like any new technology, there will be early and late adopters, but the strong community that B3i has built is a sign of the market’s understanding and commitment to working together differently,” adds Delayat.

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“wherever my business needs to go, I know QBE will be there”

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Swiss Re predicts in a report that the economic power shift from West to East “will drive insurance sector development to 2020 and beyond.” But will that come to pass?

The Chinese economy still shows no signs of slowing as it enters a third consecutive decade of growth, its international pull ever more enticing. With global premiums forecast to grow by some 3% annually in 2019 and 2020, in Asia they will accelerate by more than three times that figure. However, in China, non-life and life premium growth in real terms was 11.9% in 2018.

It is an impressive feat, and explains the tilt that is happening in global re/insurance. Allianz, AXA, Chubb, Korea Re and Willis Towers Watson have all made new inroads into the Chinese domestic P&C market over the past 12 months. Willis Towers Watson and Korea Re received new operating licenses; Chubb announced a “strategic co-operation agreement” with a Chinese P&C insurer; AXA bought out the remaining 50% of one of the country’s largest auto insurers in November, four years after it first invested; and e-commerce operation JD bought a 30% stake in Allianz’s Chinese operations.

While this is potentially good news for insurers, insurance penetration languishes at just 1.3% on the mainland and Chinese businesses and individual consumers still have little knowledge of insurance outside its state control.

While giants like China will partly drive growth going forward, Asia has other strongly performing emerging economies that have rapidly growing middle classes and new infrastructure programmes.

There is also demand for new and more innovative products in the region, which are more specific to the needs of a young, urban, tech-savvy population. “Insurers must respond to the market demand for non-material damage coverage in Asia Pacific, especially cyber, as demand is certain to grow as businesses become more aware of the potential costs with each new major incident,” Allianz Asia Pacific CEO Mark Mitchell tells Reactions.

However, the news around Asia has not been entirely positive. In November, CNA Hardy ceased underwriting new business at Lloyd’s in Singapore and China, with the global commercial insurer retreating from underwriting locally in Asia. A month earlier, Tokio Marine Kiln closed its Hong Kong office with immediate effect among a reorganisation of its Asian operations, based primarily in Singapore, with a third supporting office in Shanghai.

Still, there is great optimism for the region. “The rating environment across Asia will remain challenging, but we are seeing signs of change driven by both investors and regulators,” says Chris Kershaw, managing director for global markets at Hong Kong reinsurer Peak Re. “[There is] the chance to take a major step forward in 2019 not just through the ‘Belt and Road’ and the ‘Greater Bay Area’ initiatives, but also through the regulatory equivalence agreed with China that reinsurers in Hong Kong are now able to enjoy. They must not waste this opportunity.

“The availability of a young, energetic and talented workforce, with an interest in both tech and finance will help to modernise both products and distribution in our world,” Kershaw added. “There are challenges ahead, but there are also opportunities to move forward.”
Brexit: all bets are off

The UK prime minister’s slogan “Brexit means Brexit” had a hollow ring to it by the end of 2018, with many UK companies less certain than ever about what the future holds for them.

For an industry whose business model is predicated on managing risk and mitigating uncertainty, the London insurance market ended 2018 with no clear idea of what the future held for them – on the European front, at least.

At the time of going to press, the House of Commons vote on the terms of the country’s departure from the EU had been suspended. In short, the UK was facing an unprecedented political crisis.

Up to the point of the Commons vote the insurance industry had prepared itself for losing the passporting rights that have allowed them to conduct business across the European Economic Area (EEA) trading bloc. Without passporting rights, UK-domiciled insurers would no longer be able to issue insurance contracts in the EEA. Nor will they be able to service existing EEA contracts by settling and paying claims. Companies based in EU countries that do insurance and paying claims. Companies based in EU countries that do insurance.

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There’s no doubt that Brexit presents an extra challenge for a market which is already going uphill.”

Dominic Kirby, managing director, ArgoGlobal

fixing. This is being achieved by some insurers transferring their EEA business to an affiliated EEA insurer under a time consuming process called a Part VII of the Financial Services and Markets Act 2000.

Lloyd’s, for example, announced that it would be transferring all of its EEA business to its new Brussels-based subsidiary by the end of 2020 via a Part VII transfer. Lloyd’s and others, have to hope that they will be allowed a grace period until the transfers are complete.

“There’s no doubt that Brexit presents an extra challenge for a market which is already going uphill,” said Dominic Kirby, managing director of Lloyd’s insurer ArgoGlobalGroup, told Reactions, on the issues around it, but added that Lloyd’s had been a great leader in the area. “[They’ve] played a proactive game. The Brussels office is a solution: a city and a regulator that understand insurance. As the uncertainties are resolved and the costs stabilise, the Lloyd’s Europe operation could also shift from being a defensive play to a further vanguard for growth.”

Most re/insurers rely on EU passporting or Freedom of Services to service its UK and EU General Insurance customers European insurers passporting into the UK also face re-licensing hurdles. “We have submitted an application to the Prudential Regulation Authority (PRA) for a new licensing scheme, which means we can continue to do business with the least disruption for our customers and distributors and avoids them having to transfer their policies unless absolutely necessary,” a spokesperson for Zurich recently told Reactions and said there had been some attempts to work with the market. “The government has also provided additional certainty by agreeing a Temporary Permissions Regime (TPR) in the event of ‘No Deal.’ The PRA has confirmed that Zurich will be part of that regime.” So far, so good. But right up until the vote on the terms of the UK’s departure in December, some important business continuity questions remained unanswered, especially for reinsurers and intermediaries.

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The unique challenges of managing wildfire

Guy Carpenter helps clients improve their wildfire aggregation management and catastrophe planning and response.

Today, the frequency and severity of wildfires are garnering greater attention – not only from the media, but also from re/insurers, catastrophe modellers, mitigation experts and other invested parties. According to the California Department of Forestry and Fire Protection, five of the 10 most destructive wildfires in the state’s history have occurred in the last 13 months. The recent Camp Fire (November 2018) impacted more than triple the number of structures burned in the second-most destructive fire – the Tubbs Fire (October 2017). While the re/insurance industry is embracing innovative tools to create bespoke risk transfer solutions for the conditions now emerging for this risk, there are many challenges unique to managing wildfire.

Risk assessment tools for the wildfire peril are rapidly progressing, but remain less well-developed and understood than the counterparts for other major perils. While wildfires are not infrequent, catastrophic fires occur less often and are generally of a smaller magnitude than large hurricanes or earthquakes, leaving a smaller experience record from which to calibrate models for large events. Additionally, a number of factors contribute to an arguably more dynamic peril – including a wide range of ignition sources, a risk not present with earthquake or hurricane. There are also spatial and temporal elements that make the peril difficult to predict. Fire is a molecular process, and the manner in which it spreads from one blade of grass to another, from tree to tree, and from house to house is less well understood. Under the right conditions, a wildfire might jump from wildland to an urban area, causing structure to structure fires and extreme loss. This phenomenon is evident in the historical loss data, where a ~1,500 acre fire might burn more homes than a 200,000 acre fire. It is also possible to see much of a neighbourhood impacted but some individual structures left untouched. In a hurricane, if you know the basic parameters, its path may still be hard to forecast but the damage potential within the event is more predictable, with any deviation often attributable to a known variable such as construction. With wildfire, two homes with similar risk characteristics can be in the same event footprint, but

“Guy Carpenter is helping carriers differentiate and drive profitable growth using innovative, technology-based tools to adapt solutions for the emerging opportunity.”

Visual Intelligence assets provide critical before/after imagery to help first responders and claims adjusters identify the most at-risk locations almost immediately after a wildfire event – even if conditions prevent physical access. Imagery courtesy of Geomni.
one might escape unscathed while its neighbor suffers a total loss. Adding to this complexity, factors such as drought conditions, ground cover, topography, and even an open window or a gutter full of leaves can combine with real-time weather conditions like wind and humidity to create a more volatile peril. The largest fires of the past two years exploded in size due to extreme wind conditions combined with several other factors favourable to wildfire.

When factoring in differing event definitions and intricacies in predicting and measuring smoke damage, the ignition risk of embers, and secondary modifiers such as year-built and roof construction, the result is large discrepancies in modelled losses, which may not reconcile with a re/insurer’s own experience. This creates difficulties in portfolio and enterprise risk management, and the ability of companies to own their view of the risk. After two years of significant wildfire activity, re/insurers have an urgent need to better understand the factors exacerbating the risks and the tools to mitigate them.

The Camp Fire has already resulted in one insurance carrier insolvency, prompting the California Department of Insurance to warn of increased scrutiny of wildfire aggregation management.

As the industry searches for better understanding of this dynamic risk, Guy Carpenter is helping carriers differentiate and drive profitable growth using innovative, technology-based tools to adapt solutions for the emerging opportunity. Based on our deep understanding of the model-based approaches and the many other factors that impact the models’ ability to produce useable results, we created our Model Suitability Analysis (MSA)* platform. Application of MSA helps clients identify which model components, or combination thereof, best reflects their own view of risk while giving transparency to results that differ from their experience and expectations. By quantifying model vulnerability sensitivity to changing risk features across geographic locations, carriers can better optimise risk selection and data collection.

Guy Carpenter’s risk assessment framework also allows for comparisons between modelled frequency and severity and historical observations by using third party scientific data sets – such as the stochastic FSIM event sets generated by the US Forest Service’s Missoula Fire Science Laboratory – to validate modelled losses and identify lower-risk areas for diversified growth.

In addition, Guy Carpenter uses historical weather patterns, local suppression effort information and ambient population statistics, which account for people movements, to further inform risk quantification.

While it is not always feasible for commercial vendors to update their products with every new scientific discovery or wildfire event, Guy Carpenter leverages public data to complement these platforms and ensure sensitivity tests and event recurrence intervals are based on the most current information.

The use of insurtech solutions such as satellites and drones to create visual intelligence also improves re/insurers’ ability to respond to catastrophic wildfires. Following the Fort McMurray fire in 2016, a 12km cordon prevented both residents and loss adjusters from accessing the site for up to six weeks, but using aerial and satellite technology, Guy Carpenter was able to provide affected clients with images of the footprint within a day of event, helping them begin damage assessments and reserving processes almost immediately.

In the Kynsna wildfire in South Africa, visual technology assets helped track the progress of a single concurrent weather-event across multiple days, demonstrating that high winds influenced the spread of the fire and thereby ensuring the hours clause of clients’ loss occurrence definitions was satisfied. For many re/insurers, this meant retaining one deductible instead of several.

To bring all this information together, GC AdvantagePoint® helps clients seamlessly integrate visual intelligence and other data and analytics into a client’s existing workflow through direct data integration into underwriting platforms, portfolio aggregation management, real-time event monitoring and location evaluation using exposure visualisation. GC Securities, a division of MMC Securities LLC, is also pioneering alternative capital risk solutions for the peril, having placed the first-ever wildfire-only catastrophe bond to protect a utility against third party liability resulting from a wildfire, Cal Phoenix Re.

GC Securities followed that with SD Re Ltd, which protected a second utility against third party liability triggered by a wildfire. Both bonds feature an indemnity trigger and also cover losses relating to loss adjustment and litigation expenses as well as fire suppression costs. These solutions help the insureds leverage different capital sources to increase protection and reduce counterparty credit risk.

By combining these innovative tools, Guy Carpenter helps clients improve their wildfire aggregation management and catastrophe planning and response.

Through better quantification of exposures, re/insurers can more confidently articulate their own view of wildfire risk and improve underwriting practices, reinsurance allocations, and rating and regulatory reviews. Guy Carpenter’s experience with re/insurers of all sizes across geographies and lines of business, and with multiple modelling and technology providers, gives us a unique ability to offer clients insights and best practices regarding wildfire risk tolerances to improve overall risk management and transfer.

Lara Mowery,
Head of Global Property Specialty at Guy Carpenter

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The evolving role of forensic accountants: more than just numbers

In a traditional industry like insurance, engaging forensic accountants to review the significance of an insurance claim can be seen as “almost modern.” It’s hard to imagine that only 30 ago, most complex stock and business interruption claims were settled by a loss adjuster, with no dedicated accounting assistance.

Today, it’s common practice for loss adjusters and claims managers to utilise a range of experts, however, whilst forensic accountants originally “just provided the numbers” on business interruption claims, their involvement is now far broader.

The rise of forensic accountants
A forensic accountant assesses the financial credentials of an insurance claim to form an opinion on the significance of the loss. Typically, this involves analysing the insured’s financial information and the assumptions behind the claim.

The rise of forensic accountants corresponds with changes in the business world where entities grew larger, developed complex inter-dependencies and began generating extensive financial reports via computerised accounting systems.

Consequently, business interruption claims became larger and more complex, often using intricate and time-consuming claim models. These models required accounting expertise to review in order for the settlements to be robust and defensible.

The scope of the forensic accountant to add value no longer ends here, as was highlighted again to me just recently when reviewing a recovery claim for an attorney that involved a fire and the subsequent closure of a medical centre.

Whilst the first-party business interruption claim had been reviewed and settled by the insurer without engaging a forensic accountant, our review identified a critical oversight. We found that the doctors were contractors at the medical centre, not employees. As a result, their cost was variable with their billings.

Armed with this knowledge, we demonstrated that the claim was significantly overstated as the large savings in doctors’ costs during the closure had not been accounted for.

As a result, that insurer will now only recover a fraction of what they initially paid. This is a simple example of how the business insight of a forensic accountant continues to add value to the claims process.

Beyond business interruption
Historically, forensic accountants were utilised mainly on business interruption losses, however their expertise is now regularly applied across a variety of claims types, including cyber, product recall, crime and marine.

More recently, insurers have begun to engage us in environmental liability claims and the tax audit cover of management liability policies. It can be argued there is hardly an insurance line where the application of forensic accounting expertise cannot add value.

Providing more than just numbers
As forensic accountants become involved with a broader range of claims, the scope of their role and the manner in which they undertake them will continue to evolve. Here in Australia, emerging trends within the insurance industry are changing the way forensic accountants work on claims, in a variety of ways.

Today’s insurers are wanting to engage with forensic accountants who can provide policy knowledge and the skills and experience to bring claims to settlement. This is far removed from the days when forensic accountants would refuse to engage with the policy wording and would simply provide the numbers.

Insurers are now seeking deeper relationships with their advisers and therefore value the insight of a forensic accountant. The emerging area of cyber insurance is a great example of this and underwriters regularly draw on our claims experience when developing policy wordings for business losses that provide true value to their clients.

More than ever before, insurers are making “customer experience” the priority in the claims process. Whilst some forensic accountants, and perhaps adjusters, have traditionally demonstrated an adversarial approach to claims, this is now being rejected by insurers and brokers in favour of an approach which sees claims settled accurately, whilst valuing customer relationships. Success for forensic accountants is dependent on a mindset of collaboration rather than confrontation.

Many insurers and brokers are reporting they prefer, what I call the “combined model” of loss adjusting and forensic accounting, where the forensic accounting capability sits within the loss adjusting company.

As a result of improved communication and collaboration within the loss adjusting team, insurers and brokers are recognising significant reductions in claim life and spend, not to mention increased customer satisfaction.

Subsequently, loss adjusting companies globally are now investing heavily in this “combined model,” with Sedgwick being one of, if not, the first. No longer simply a consultant, the forensic accountant is now an integral and valuable part of the team.

“More than ever before, insurers are making “customer experience” the priority in the claims process”

Reactions

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Kimberley Daley, Head of Forensic Advisory Services (Australia) Sedgwick Forensic advisory services division
2019 market outlook

Soft market conditions foster a need for differentiation.

As another tumultuous year of property catastrophe losses winds down, the spotlight remains focused on the impact of hurricanes and wildfires on the pricing of insurance and reinsurance in 2019.

The industry will likely experience a continuation of the severe weather conditions that produced major hurricanes in 2017 and 2018 in addition to the worst wildfires in our history. At this time, no one is predicting an abatement in wildfires in 2019.

As US catastrophe losses are added to the tallies of other natural disasters worldwide, the slight firming in property reinsurance pricing that surfaced in 2018 should persist into 2019. The question is whether or not other lines of insurance will follow suit.

I’m not optimistic. Here’s one reason why: Although lines like directors and officers (D&O) liability experienced significant public and private company loss activity in 2018, its pricing remains frustratingly soft. A correction is inevitable, although it is unlikely this will happen in 2019.

Insurers and reinsurers have long modelled their experience from earthquakes and hurricanes to provide insight into adequate pricing, but this has not been the case with non-modelled exposures which continue to increase in severity.

A continuation of severe non-modelled property Catastrophe losses, such as those produced by wildfires and straight-line winds may ultimately drive a market correction.

Tech to the rescue

Against this backdrop, in 2019 insurers are likely to seek other ways to competitively set apart their value proposition. In this regard, insurers will continue to leverage digital technologies like artificial intelligence, machine learning and predictive analytics to enhance their operations, improve the customer experience and generate margin-widening cost savings.

QBE has engaged in several such partnerships in the past year. One is with Jupiter, a firm that uses leading edge data analytics to assess a variety of environmental factors that contribute to severe weather and climate change. These exposures are then given a score to improve underwriting and pricing.

Another partnership is with Cytora, which uses artificial intelligence and open source data to reduce loss ratios, grow premiums and improve expense ratios. In 2019, we’ll deploy Cytora’s Risk Engine across our property and casualty lines to obtain sharper insights into expected claims activity — at both an individual risk and portfolio-level basis.

We also partnered with Zeguro, an online platform enabling customers to detect, mitigate and monitor the risk of a cyber attack.

Specialisation

Technology is just one way to counter distressing market conditions. Another is differentiation.

Our vision is to deliver a customer experience on an integrated specialist basis. We have assembled a team of experts in underwriting, claims and risk solutions to tailor an evolving portfolio of comprehensive, purpose-built products on an industry-by-industry basis.

We are not stapling together a group of existing insurance policies and calling it an “integrated solution.” Rather, we are creating new multiline offerings designed around each sector’s unique risk exposures; they are designed with our customers’ needs in mind. We have also made it easier for customers to access our solutions.

Organising our business around vertical markets, or industries, lets us align our products around our customers’ needs; in this way we can be more responsive to our customers and be more efficient in our solutions. Healthcare, our first industry vertical, launched in the Fall, and a Financial Institutions vertical will follow in early 2019, with more to follow.

No other carrier has organised itself in this way.

In summary, our view is that there will be a continuation of the soft market in 2019, with some modest firming in the property market caused by both modelled and non-modelled catastrophes. In response, insurers and reinsurers will want to continue to invest in digital and data technologies to transform their operations, improve outcomes and enhance the customer experience.

Jeffrey S. Grange, President of Specialty and Commercial Insurance at QBE North America.
The major contribution that corporations, and indeed the world at large, need to make towards mitigating climate risk was brought sharply into focus recently. In December, delegates at the UN COP 24 climate conference in Poland were told that with greenhouse gas emissions rising for the first time in four years, the planet has reached a crossroads.

The United Nation's 2018 Emissions Gap Report revealed that global CO2 emissions from industry and energy production went up by 1.2% in 2017. Economic growth was responsible for the rise but it seems national efforts to cut carbon have stalled.

The scientific consensus in Intergovernmental Panel on Climate Change (IPCC) report has asserted that to avoid catastrophic and irreversible climate change, global temperatures must not go up by more than 1.5°C. According to the UN, to keep the world below that target, global greenhouse gas emissions in 2030 would have to be 55% lower than they are today.

Matt Christensen, Global Head of Responsible Investment at AXA IM, believes that all businesses should be galvanised by the news and redouble their efforts to create a more sustainable global economy.

He explains: “The insurance industry is uniquely well placed to influence and give momentum to sustainability efforts. And that applies to participants across all lines of business.

“It should include all key functions in an insurance company, from risk management and underwriting, through sales and marketing to investing."

Christensen, who directs the development of AXA IM’s responsible and impact investment programme, is also tasked with integrating Environmental, Social and Governance (ESG) criteria across the firm’s €740 bn of assets under management*.

Christensen’s role includes developing innovative solutions that help AXA IM’s insurance clients invest sustainably while meeting their financial, accounting and regulatory needs.

Before joining AXA IM he was a member of the European Commission's coordination committee, to explore the future of sustainability policy and legislation across the European Union (EU)

“It’s important to remember that sustainability is not only about the environment. Of course insurers have a vested interest in future proofing their business models against catastrophic climate change but they can also drive positive changes for society in other ways, to do with accountability and transparency, for example,” he says.

Cornerstone framework
Christensen believes that insurers, reinsurers, brokers and asset managers, together can make a big difference - pointing to guidance put in place by the UN.

The cornerstone framework for the insurance sector consists of the UN Environment’s Finance Initiative (UNEP FI) Principles for Sustainable Insurance Initiative (the PSI Initiative), which is intended to prevent and reduce ESG risks, and better manage opportunities to provide quality and reliable risk protection.

The PSI provides a global roadmap to develop and expand the sort of risk management and insurance solutions...
that are needed to promote renewable energy, clean water, food security, sustainable cities and disaster-resilient communities.

Co-founded by 27 organisations in 2012, the initiative now has around 100 members worldwide, including insurers representing around 20% of global premium volume and US$14 trillion in assets under management. The PSI’s evolving principles are part of the insurance industry criteria of the Dow Jones Sustainability Indices and the FTSE4Good ethical index.

In November, having announced the decision to extend the Group’s climate policies to its new AXA XL division, AXA also announced its support for the PSI’s launch of its Climate Ambition Coalition, which starts in 2019. Members of the coalition will commit to actions on decarbonisation and climate resilience in their insurance and investment activities, and also raise their ambition in line with the Paris Agreement on tackling climate change.

Separately, UNEP FI has announced a partnership with 16 of the world’s largest insurers, including AXA. The group’s aim is to develop a new generation of risk assessment tools to give the insurance industry a better understanding of the impact of climate change on their business.

This latest high-level initiative focuses on assessing climate risks in insurers’ core insurance portfolios and products. But Christensen believes there’s plenty of scope for insurers of all sizes to start making a bigger difference through smarter investment decisions.

**ESG integration**

“AXA IM was a pioneer in the ethical and sustainable investment domain, launching a fund in France in 1998 that integrated specific screening criteria. Today, ESG criteria is progressively being integrated into our investments irrespective of the asset class - across equities, bonds, high-yield, property, alternatives and so on,” Christensen says.

“As a responsible investment leader and as an investment manager with insurance heritage we’re uniquely positioned to advise clients.”

Christensen, who is in dialogue with AXA IM clients around the world, finds the pace at which responsible investing is developing varies across the global insurance markets.

He says: “While some insurers are just starting out, others are beginning to align their investments with core values and business lines, for example in divesting fossil fuels. Others are quickly moving beyond ESG integration risk management onto impact investing opportunities, such as microfinance or green bonds.

“Being an early starter in sustainable insurance investing, we have developed the resources to help clients drive change through their investments. Not only that, we’re firm believers that ESG analysis can offer improved risk-adjusted investment returns, that are greater over the long term.”

Christensen’s conversations with insurance carriers around the world are taking on a new urgency, he says, in response to the human and economic toll of natural catastrophes – from historic wildfires in California to flooding across Asia as a result of unprecedented typhoons in the region. He asserts: “Taking a lead role in mitigating climate change is no longer a ‘feel good’ issue: it’s a social issue and it’s a business issue.

“The insurance industry has the resources and expertise to make a real difference - and I’m proud to be a part of it at such a time as this.”

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**Regulators gearing up to adapt to sustainable strategy choices**

Regulators are responding to the evolution of sustainable investment strategies by working with insurers and policymakers to accommodate change.

In November, the European Insurance and Occupational Pensions Authority (EIOPA) published its draft technical advice on possible amendments to the delegated acts under Solvency II and the Insurance Distribution Directive (IDD) to do with the integration of sustainability risks and factors. The proposed draft amendments to the Solvency II Delegated Regulation are aimed at ensuring identification and assessment of sustainability risks in both underwriting and investments.

Meanwhile, industry lobby group Insurance Europe published its response to a consultation on the European Commission’s proposal for a regulation on disclosures for sustainable investments and sustainability risks. Insurance Europe said it welcomes the Commission’s proposal to improve the availability of information on sustainability and also supports the recognition of all ESG factors in the sustainability definition.

In the UK, the Financial Conduct Authority and the Prudential Regulation Authority are working together to develop a joined-up approach to enhance the resilience of the UK financial system to climate change. To coordinate this, the two regulators are setting up a Climate Financial Risk Forum, that will support innovation for financial products and services in green finance, as well as help the sector manage climate change related financial risks.

Earlier in 2018, the European Commission (EC) announced that sustainability was to be introduced into the suitability obligations outlined in MiFID II, the Markets in Financial Instruments Directive. To enable investment firms to recommend the most suitable products to clients, the EC is looking into including ESG preferences in suitability assessments. Although regulators in Europe are at the forefront of developing responses to insurers’ sustainability issues, more are starting to take notice. For example, the Sustainable Insurance Forum (SIF), a network of insurance supervisors and regulators from around the world, launched in 2016. Member countries include Brazil, France, Netherlands, Philippines, South Africa, and the UK as well as the US states of California and Washington.

More recently, 18 SIF members met at the Annual Conference of the International Association of Insurance Supervisors (IAIS) in Luxembourg, to develop an action plan for the group’s work in 2019.
As the planet gets warmer, extreme weather events are becoming more frequent, and their impact on society more evident. The death toll from the recent California wildfires is the highest in the US since 9/11, with insured losses estimated up to $15bn.

The potential impacts of a changing climate in the medium to long term emphasise the need for strong mitigating action to reduce carbon emissions. Without this, we could reach a tipping point beyond which little can be done. Self-perpetuating natural processes may have commenced, leading to further increases in temperature and more extreme weather.

In some risk areas – e.g., thawing of permafrost and Arctic sea ice – we may have passed this tipping point. For others – e.g., the impact of deforestation and changes to ocean currents – the clock continues ticking. Unfortunately, the potential magnitude of these processes is difficult to comprehend so instead they are disregarded, particularly if well into the future.

The need for mitigating action – by governments, industry bodies, environmental groups, companies and the general public – is clearly urgent. However, we also need to be mindful of potential “transition” risks. Measures to reduce emissions may have unintended consequences, e.g., resistance from the parts of society most affected, particularly if well into the future.

The role of the re/insurance industry

The re/insurance industry can play an important role in building resilience and assisting society in the transition to a low-carbon economy. Some aspects to consider here include:

- **Leadership:** Re/insurers can encourage industries to change through the provision of insurance capacity, they can cover transitional run-off risks, and propose products to cover new insurance risks.

- **Insurance gap:** Can the insurance industry find ways to bridge the gap between economic and insured losses? Can it extend insurance coverage to a greater cross-section of society in the future?

- **Asset portfolio:** The industry will need to consider the impact of stranded assets. Can it also set an example to others in terms of responsible investment allocation going forward?

- **Governmental support:** The industry can continue to work with organisations, such as the World Bank, assisting countries after natural disasters. There are good examples of parametric products in South America, but can more be done?

- **Education:** The industry can continue to play a role in educating society on the value of insurance, particularly in emerging economies. Encouraging building replacement quickly after events, and using applicable building standards, will increase resilience in the future. The continued promotion of microinsurance and other products can assist individuals as they develop and mature, enabling families to protect their valuable assets.
Renewables growth: all that insurers hope for?

What is now a small market could become a very large one – if and when it becomes mainstream.

In today’s complex and ever-changing world, new risks continually emerge. Our industry has been attracted to the potential growth area of renewables, and a market for it has arisen and evolved. However, it remains nascent, and may not be the next new opportunity for profitable expansion that some have hoped.

On the face of it, renewables appear a great opportunity. A recent BP report anticipates that by 2040 the renewable energy sector will grow by 400%, after recent rapid growth driven by technological progress and policy incentives. Renewables are expected to attract a large portion of future infrastructure investments, according to the Swiss Re Institute. The sector is highly capital-intensive and funded primarily by private or institutional investors. However, it has significant risk exposures, including operational vulnerabilities from weather risks – which has attracted many insurers.

Meanwhile, the quantum of change in the insurance and reinsurance sector has been significant, and often very divergent from our previous experience. The continuing spate of natural and man-made catastrophes, tough competition, difficult market conditions, non-traditional capital sources and new regulations have combined to present a major challenge for risk carriers. Even as that happens, we are being asked to cover new renewable energy risks which are not yet broadly understood. Neither the total scope of risk nor the potential losses from a cataclysmic event can be adequately estimated. That lack of knowledge has led to an unstructured market approach, fueled by speculation about growth opportunities.

The growth has been real. Coverage take-up and product innovation – particularly in reinsurance – have positive forces behind them. Public policy and regulation typically encourage or even force municipalities to adopt renewable energy sources. Corporations are beginning to address climate-related issues in their business planning and insurance needs, for example through carbon emissions reduction and increased renewable energy use. Consumers have taken advantage of tax concessions to go green. Yet despite the apparent growth opportunities, insuring renewables brings a host of challenges:

- Costs of underwriting these new risks highly engineered risks are prohibitive for many
- A foothold in the market is not easily expanded
- Insurance regulations sometimes inhibit innovation
- Custom policies are required

Even when these challenges can be met and overcome, the renewables market must mature before product innovation can truly take off and become sustainable. It has not yet achieved that maturity. We must adopt a more structured approach. Market players recognise that rampant development and speculation in renewable energy may fuel insurance growth, but it may not be sustainable growth.

If renewables do not gain traction as a major insurable business risk, if a sustainable reinsurance market does not evolve behind it, demand may begin to lag more seriously behind supply (which is already more than sufficient, and forcing prices to walk-away levels in some areas). Put another way, the industry may be ahead of its skis when it comes to renewables, caught up in our own hype, and unaware that brokers and insureds are not there yet in terms of their own understanding of the scope and magnitude of these climate-related risks.

We have had plenty of time to get ready. Humans have used solar energy, windmills, sail power, and other renewables since before recorded time. Despite a history of innovation, take-up of coverage has been relatively low compared to other emerging classes of business, such as cyber insurance. Many insureds still struggle to understand the innovations, let alone the risks, and may not be thinking about how to protect against its risks with insurance. Meanwhile, re/insurers too have more to consider, such as the potential aggregation of renewables catastrophe perils with more conventional cat risk.

Other factors may curb our enthusiasm. Recent US tariffs are already having an impact on solar energy. Meanwhile the federal solar tax credit, which fueled the initial growth of the solar power industry, will decrease to 10% in 2022. It has caused a boom in solar projects before the current 30% credit expires, but could equally cause a commensurate crash. AXIS has adopted several answers to the challenges of the renewables market. We prefer to be involved from the design stage of any project, to provide guidance on risk and insurance implications form the outset. We are aware that renewable energy is a very claims intensive business, and have structured our approach to acknowledge this. We have invested in the expertise to keep up with fast-changing technology, and focused some attention on very niche areas of the market, such as utility-scale battery storage.

We are also realistic. Developments such as plans in California and Hawaii to move to 100% clean energy will certainly increase the size of the pie, and must drive some measure of risk standardisation. Elsewhere, however, incentives are decreasing. What is now a small market will become a very large one if and when it becomes mainstream, but we believe the reality is that a cataclysmic climate risk event will be necessary to spur market take-up and product innovation.
Insurers likely have exposure to London Interbank Offered Rates on both sides of their balance sheets.

Interbank Offer Rates (IBORs), which range in maturities from overnight to 12 months, are an indication of the average rate at which banks can obtain unsecured funding. The impact of these rates are felt far beyond the funding of bank’s balance sheets. IBORs are widely used as benchmarks for a large volume and broad range of financial products.

According to the Financial Stability Board, $390trn of financial instruments are linked to various IBORs, the best known being London Interbank Offered Rates (LIBORs). The scandal resulting from the widespread misreporting of LIBOR rate settings by money center banks has resulted in total fines topping $10bn. The market manipulation of these rates has led global regulators to call for the reform and possible replacement of LIBORs.

Insurance companies likely have exposure to LIBOR on both sides of their balance sheets. Their asset portfolios might hold Floating Rate Notes (FRNs) and structured securities or derivatives for hedging linked to various LIBORs. Firms may offer products with LIBOR linked features or issue LIBOR related debt. Additionally, they may have indirect exposure through the modeling of liability analytics. The scale and complexity of the LIBOR usage makes reform a significant challenge for the insurance industry.

Firms need to be prepared for the potential (eventual) replacement of LIBORs with alternative risk free rates (RFRs). Many of these alternative RFRs are new and the markets for trading these rates are in their infancy, and volumes are still low. For example, the US Secured Overnight Financing Rate (SOFR), a more robust alternative reference rate, was launched on April 3, 2018. Several firms have recently issued floating rate debt linked to SOFR. While SOFR based derivative contracts have launched with limited market uptake.

The disruption of the publishing of a LIBOR could result in contract frustration and potential risk of financial contacts ceasing to perform. Subsequently, the transition to alternative RFRs could have accounting, tax and capital implications for insurance companies. Existing contracts will need to be amended to help address these potential risks.

Given these complexities, a firm’s plan to address LIBOR reform will require sponsorship from the top of the house. The project governance structure will need representation from each of the impacted functional areas. A firm-wide impact analysis with all related stakeholders is a needed first step. Preparing an organisation to transition to these new rates may require significant reworking of systems, legal agreements and processes. Fallback language in existing agreements need to be analysed and potential risks identified. Over time, large legacy LIBOR exposures need to be managed. The potential conversion of LIBOR based positions to alternative RFRs could introduce price risk. The uncertainty surrounding how markets will evolve post-LIBOR will require flexibility in transition planning.

A disorderly transition could disrupt a firm’s ability to hedge market risk, invest in or issue floating rate debt and properly model liabilities. Regulators have put a stake in the ground for the markets to transition away from LIBORs. Starting January 2022, banks will no longer be required to submit rates to the calculation of LIBORs. Firms that rely on LIBOR need to prepare for the uncertainty surrounding LIBOR beyond this date. The industry needs to be preparing for this change in earnest today.

Brett Pacific is Senior Managing Director and Head of Derivatives for Sun Life Investment Management
The unseen value

How the future of risk management – and risk transfer – will be determined by intangibles.

The economy and its levers have been constantly changing. In the past, 80% of a company’s assets were tangible – properties, plants, equipment. Today, however, we experience this ratio reverted: The share of tangible assets has fallen to 16%.

According to an analysis of the market value of Ocean Tomo’s S&P 500 companies, corporate worth is being primarily being determined by intangible assets: patents, intellectual property, customer data, IT and software, networks and supply chain, brand image and reputation. Former Lloyd’s CEO Inga Beale puts it in a nutshell: “Today, companies’ valuable assets are more in the cloud than in the warehouse.”

This trend began with tech and sharing economy companies such as Facebook, Apple and Uber, as their stock market value is mostly based on the power of their brands and platform economy – meaning fewer tangible assets. But traditional companies are also entering this trend, with services and solution packages for their actual products.

If a company’s main value comes from intangible assets, naturally, those are the values most at risk: either it is a reputational damage after a social media crisis or the financial loss resulting from such risks.

In the Allianz Risk Barometer, 2000 risk experts – worldwide – see fire less as the most urgent danger for companies than interruptions in operations and the supply chain, cyber incidents or changes in the legal environment. Potential losses can be extremely impactful on global companies as recent events have proven: The cyberattacks WannaCry and NotPetya cost companies losses running into billions; or, the extreme drop of United Airlines’ stock value following a viral video release portraying a passenger being ejected from an airplane.

We must keep in mind that not every business risk is insurable, but as insurers we must find new ways to provide protection for intangible risks to our clients. There is still a big “protection gap,” as insurance broker Aon points out: only 15% of information assets such as data and IP are insured, a low rate compared to the 59% of physical assets. And this is about assets that, in a connected and dynamic world, can potentially cause large-scale damage and trigger global chain reactions.

So, why do companies continue to handle their immaterial assets differently from their physical assets? Intangible assets are not adequately reported in balance sheets and are therefore often underestimated and misunderstood. Although risk managers have started pointing out this red flag, these issues have not yet reached top management’s agenda with the necessary urgency.

From the insurers’ point of view more and more carriers have started offering new products to protect intangible assets: almost all carriers now have cyber insurance in their product range.

For reputation risks, there are now products that combine loss of earnings after a scandal with crisis management support. In addition, new solutions are needed for companies with few material assets and underwriters need to further evolve accordingly, away from a focus on asset covers and balance sheet protection toward protection for earnings and cash flow risks.

The successful development of attractive insurance solutions for intangible assets depends on how insurers can make these often elusive and constantly changing intangible risks tangible and predictable. Historical loss data is a scarce and modern analytical tool that relies on big data and machine learning to help fill this gap.

In addition, customers expect more than financial compensation insurance of ships and their cargo; since then, cover for property loss damage has been the dominating type of corporate insurance sold, even though the coverage of financial losses has established itself as a standalone area.

The future of risk management and transfer will be determined by intangibles. The rethinking of companies and insurers has begun. Now both sides must work to close the gap.

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Hartmut Mai is Chief Underwriting Officer for Corporate Allianz Global Corporate & Specialty (AGCS) SE. With a Bachelors Degree in Law from the University of Cologne and an Emory Law School in Atlanta, Hartmut has been in AGCS for more than 11 years. He worked for four years in the Financial Lines at AGCS, and is a member of AGCS SE’s Board of Management.
The scope of terrorism risk has changed significantly in recent years by becoming more diverse and dispersed, bringing significant changes to businesses’ risk-transfer needs. Gaps in traditional terrorism re/insurance cover are being exposed as a result, with terror-related risks surfacing around impacts on people, loss of attraction and cyber, as well as property. The definition of the peril is also being challenged by recent malicious acts that appear to lack political, religious or ideological motivation and where there is alleged, but deniable, hostile state involvement. Whatever the motivation, victims need support from the insurance industry.

These trends have brought serious ramifications in the West. Attackers inspired by the so-called Islamic State have used explosives, knives and vehicles as weapons of choice. The rise of populism is also increasing the prospect of right-wing extremism as the motivation for terrorism. This has seen businesses that would not traditionally have considered themselves likely victims of terrorism being caught up in the fallout, emphasising that attacks are no longer just the concern of large corporations in urban centres.

And the terrorism risk landscape is set to become even more complex as cyber and drones add to the array of possible terrorist attack vectors. Chemical, biological, radiological and nuclear (CBRN) has also become a reality at the lower impact end of the spectrum, as demonstrated by events in Salisbury last year. CBRN is arguably too broad a term for the insurance industry. At the macro, nation changing end of the spectrum, international pools and state backstops are needed but the open market should have the capacity to cover lower level events.

The changing face of terrorism

The evolution of global threats could spur further competition in the market and increase the supply of new forms of coverage.
Clearly, traditional approaches to terrorism risk no longer suffice in today’s multifaceted environment. Put simply, new risks require new solutions. With property damage no longer necessarily the primary loss driver; the limitations of traditional terrorism products have been exposed as they require a physical damage trigger to pay out claims.

In response, leading specialty insurers are developing new, broader coverages that include loss of attraction, active shooter (or deadly weapon protection) and cyber. Figure 2 shows how the market has continued to innovate by expanding the scope of cover to protect against new risks and lower-level losses. Extensions such as prevention of access, for example, protect against outcomes similar to those that followed the London Bridge attack, when businesses in nearby Borough Market were prevented from accessing their premises for nearly two weeks. Other new offerings such as loss of attraction and active shooter go further by protecting against loss of income and third-party liabilities.

Even risks associated with more complex, systemic and potentially catastrophic incidents such as CBRN and cyber can be covered by standalone terrorism policies. Traditionally the domain of several state terrorism pools, private capacity for CBRN has become more widely available in recent years, a welcome development given the wide spectrum of possible CBRN attack types. Products for cyber are also being developed, albeit with some difficulty given the way risks cut across traditional lines of business.

The progress made by the marketplace so far represents a major step forward in narrowing terrorism protection gaps. But more still needs to be done. Specifically, capacity for new forms of cover in the private market continues to be relatively modest when compared to more conventional terrorism risks. Perhaps even more importantly, awareness of these new products needs to be extended beyond large corporations familiar with the intricacies of the insurance market. Brokers have an important role to play here: robust economic resilience to terrorism will only be possible if accessibility is extended to the small and medium-sized enterprises that are increasingly being caught up in attacks.

State terrorism pools are also likely to be crucial in facilitating this. Pools have a unique opportunity to increase penetration and better position economies to recover from future attacks given their scale and influence in the market, along with the direct distribution channels they have built. Over time, this could stimulate further competition in the market and increase the supply of new forms of cover as more carriers offer additional capacity to meet building demand.

**Figure 2: Selection of additional terrorism coverages available today**

<table>
<thead>
<tr>
<th>Coverage Type</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ACTIVE SHOOTER/ MALICIOUS ATTACK</strong></td>
<td>Coverage responds to attacks that cause bodily injury and involve deadly weapons (no physical damage trigger is required)</td>
</tr>
<tr>
<td><strong>CYBER</strong></td>
<td>Coverage triggered by defined terrorism perils and related to cyber attacks</td>
</tr>
<tr>
<td><strong>CHEMICAL, BIOLOGICAL, RADIOLICAL &amp; NUCLEAR (CBRN)</strong></td>
<td>Coverage responds to attacks involving chemical, biological, radiological and nuclear materials (for damage and non-damage risks)</td>
</tr>
<tr>
<td><strong>LOSS OF ATTRACTION</strong></td>
<td>Covers loss of profit to the assured at a named location</td>
</tr>
<tr>
<td><strong>LIABILITY</strong></td>
<td>Legal expenses and settlement costs resulting from action against the insured after a terrorism-related event</td>
</tr>
<tr>
<td><strong>THREAT</strong></td>
<td>Covers non-physical damage business interruption as a result of a direct or indirect threat</td>
</tr>
<tr>
<td><strong>ORGANISED CRIME</strong></td>
<td>Cover for actions perpetrated by organised crime groups such as cartels in Latin America</td>
</tr>
<tr>
<td><strong>EVENT CANCELLATION</strong></td>
<td>Loss of revenue and additional costs to an assured as a result of an act or threat of terrorism that leads to the abandonment or relocation of an event</td>
</tr>
</tbody>
</table>
Emerging risks 2019

The biggest risk for most insurers in 2019

Hint: It’s not catastrophic weather, cyber breaches or geopolitical instability.

The insurance industry is at a critical and uncertain inflection point. The global macroeconomic climate, hyper-maturity of key segments, and increasingly sophisticated consumer demands create an environment where technology can drive both positive and negative effects to an unprecedented degree.

Resource constraints are forcing insurers to face the challenge of balancing near-term results, long-term growth and value creation through leveraging technology. The biggest risk for most insurers in 2019 will not be catastrophic weather, cyber breaches, or geopolitical instability, but a more insidious risk that could render them unable to deal with these issues – the risk of sliding into technological obsolescence, one quarter at a time.

Most insurance leaders show cautious optimism in their approach to technology spending, accompanied by varying degrees of skepticism. Depending on geography and line of business, insurers on average spend 3% of their premium on technology. Comparatively, banking and securities spend 7.2% of revenue, and professional services spend 5.8%. As an industry, we collectively underinvest in technology. While insurance has long embraced technology for optimisation, most insurers still view that spend as something to be minimised. Few carriers invest in technology as a source of differentiation and driver of long-term value.

To be fair, there is ample data to justify this scepticism. ACORD analysis has shown that while insurers must underinvest in digital technologies and value-chain segments, eschewing enterprise programs. This myopic approach results in incremental change versus differentiated innovation. Incrementalism is tempting and easy, achieves quick results and engenders feelings of relief and accomplishment – but ultimately leads to a weakened state. Limited, incremental change is akin to rearranging the proverbial deck chairs on a foundering ship.

Successfully navigating the digital journey requires that insurers embrace three key imperatives.

1. **Talent and culture** – Not only is attracting and retaining high-skill / will talent critical, but a supporting culture must be in place. The “right team” sharing aligned values and structure are necessary to support meaningful change.

2. **Change management** – Technology differentiation requires an enterprise scope and approach. Colleagues must understand the rationale, be measured and incented along the way, and be governed by an explicit plan.

3. **Tech-value mindset** – Organisations must have the capabilities to identify, screen, select, and deploy winning technologies. Digital competitors create consistent value through deploying fundamentally new capabilities and operating models. Legacy technology, and the resulting obsolescence risk, accumulate gradually, over years and even decades – slowly enough to be ignored and deferred. By the time a technology laggard realises they have been systematically underinvesting in digital capabilities, it is often too late, and the required scope, time, and resources are beyond what the organisation can invest. In 2019 and beyond, insurers must avoid this growing and pernicious risk.

“As an industry, we collectively underinvest in technology”

3. Meaningful transformation efforts necessitate material investment and extended timeframes, while creating considerable execution risk. However, while undertaking substantial technological change may present significant difficulties, doing little-to-nothing carries significant risk. Why? There has been a fundamental change in the insurance landscape – in a word, digitisation. ACORD analysis has shown that while technology spending alone does not necessarily lead to high performance, proper alignment of strategic intent and capabilities with digital maturity unambiguously does. Enterprise digitisation across the value chain creates the flexibility and adaptability necessary to address emerging challenges and opportunities at the moment of value. Digitally mature competitors in the insurance industry have total shareholder returns 2.3 times greater than laggards.

Insurance leaders recognise the inevitable role of technology in driving stakeholder value across carriers, brokers, agents, customers, and shareholders alike. The essence of strategic intent is resource allocation – and we are not investing or executing proportionate to the risk and opportunity. There is a profound knowing-doing gap in our industry. Factors such as limited budget and talent, risk aversion, complacency, and outmoded metrics and incentives present significant change barriers. Additionally, leaders must manage the tension between achieving short-term quarterly results while positioning the organisation for the long term, a paradox making it difficult to invest sufficient resources.

Most carriers confine themselves to selective investment in discrete technologies and value-chain segments, eschewing enterprise programs. This myopic approach results in incremental change versus differentiated innovation. Incrementalism is tempting and easy, achieves quick results and engenders feelings of relief and accomplishment – but ultimately leads to a weakened state. Limited, incremental change is akin to rearranging the proverbial deck chairs on a foundering ship.

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1. **Talent and culture** – Not only is attracting and retaining high-skill / will talent critical, but a supporting culture must be in place. The “right team” sharing aligned values and structure are necessary to support meaningful change.

2. **Change management** – Technology differentiation requires an enterprise scope and approach. Colleagues must understand the rationale, be measured and incented along the way, and be governed by an explicit plan.

3. **Tech-value mindset** – Organisations must have the capabilities to identify, screen, select, and deploy winning technologies. Digital competitors create consistent value through deploying fundamentally new capabilities and operating models. Legacy technology, and the resulting obsolescence risk, accumulate gradually, over years and even decades – slowly enough to be ignored and deferred. By the time a technology laggard realises they have been systematically underinvesting in digital capabilities, it is often too late, and the required scope, time, and resources are beyond what the organisation can invest. In 2019 and beyond, insurers must avoid this growing and pernicious risk.

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nurers are ready to use their portfolios to boost their profitability indicates BlackRock’s seventh Global Insurance Survey, published in September 2018. Almost half (47%) of them plan to increase portfolio risk over the next 1-2 years, and this across a wide range of assets – both public and private. There is also a desire to diversify into new asset classes and structural growth opportunities, such as the Chinese domestic market. Portfolio productivity and efficiency are the key focus points, whether it is through outsourcing, technology, or all of their private market holdings – 98%, according to our September 2018 Survey or optimising portfolios. Perhaps the most surprising finding of our Survey is the extent to which insurers are taking on board environmental, social and governance (ESG) considerations: 80% have or are planning to adopt an ESG investment policy within the next year.

We believe the above findings entail meaningful repositioning of the portfolio in 2019 and beyond. Key trends include:

1. Increasing portfolio resilience

The BlackRock Investment Institute still expects the global expansion to roll on, underpinned by US growth, which, despite some deceleration, remains above trend. The range of potential outcomes, however, is widening and markets are consequently harder to navigate. This calls, we believe, for greater portfolio resilience through a stronger focus on quality exposures across public and private markets.

2. Navigating the post-QE world

The Fed seems well advanced on the path towards ending its policy stimulus, while the central banks of most other large developed economies are only in the very early stages of monetary policy normalisation. This policy divergence provides, in our view, scope for insurers to potentially capture additional yield through diversification. From a US fixed income perspective, we see opportunities at the shorter end of the curve, where there is potential to achieve yields that in the recent past required some combination of higher interest rate, credit and liquidity risks.

3. Taking a holistic approach

Beyond repositioning for changing market conditions, we believe greater portfolio efficiency requires a more holistic approach to portfolio construction. This is probably most evident in the context of alternatives where an outcome orientated approach allows investors to move beyond asset labels and focus instead on underlying risk and cashflow characteristics. Having a common risk language across private and public assets is equally crucial to such a unified view. More broadly, we believe insurers need to think carefully about how they blend index- and alpha strategies in order to optimise the return potential of their portfolios.

4. Exploiting technology

Insurers are evolving their business models to respond to the challenges and opportunities the rapid advance of technology brings. We now see growing opportunity for investment portfolios to capitalise on new technological developments. Risk management is the most obvious area to explore, but we also see increased potential for ‘big data’ analysis to help uncover new investment insights and facilitate ESG integration.

5. Integrating ESG

While a strong majority of insurers in our 2018 Survey (83%) believes that having an ESG investment policy is important there is less consensus on whether ESG involves accepting compromises. Insurers are more focused on identifying and overcoming implementation hurdles, whether it is lack of internal ESG modelling expertise (70%) or insufficient data. While many of these challenges will take time to resolve, we believe technology and analysis can help mitigate the most obvious drawbacks, meaning insurers can exploit the growing universe of scalable ESG solutions in both public and private markets to implement their ESG goals efficiently.

In conclusion, the insurance sector is rethinking and repositioning its investments as markets change around them and new opportunities arise. As always in such circumstances, the ones who are more forceful and effective in exploiting these opportunities could potentially be at a significant advantage.
Facing volatility from increasingly complex risks, rapid transformation of insurance technology and new regulatory capital pressures, clients need to quickly adapt to the challenges and seize new opportunities. Guy Carpenter’s innovative, flexible and tailored solutions help clients achieve profitable growth with informed adaptation initiatives.