Insight and Intelligence on the 2018 *Rendez-Vous de Septembre*

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MONTE CARLO

AIG starts marketing $2bn casualty quota share

AIG has embarked on the next stage of its reinsurance overhaul by approaching the market to discuss the purchase of two new major US casualty treaties, *The Insurance Insider* can reveal.

Sources told this publication AIG had begun marketing the proportional and non-proportional covers for its US general casualty book this week in Monte Carlo.

The dual purchase fits in with the global insurer's strategy under group CEO Brian Duperreault and general insurance CEO Peter Zaffino to lay off more risk to reinsurers and to utilise the reinsurance market more strategically.

It is understood that AIG held a broker request for proposal lasting a number of months earlier this year, with Aon handed the mandate to place the quota share and Willis Re picked to handle the excess-of-loss placement.

Sources said Aon would look to place a 30 percent quota share on a general casualty book with $2bn of subject premiums. The book includes primary casualty, general liability and mid-excess business.

The deal will be the biggest new US quota share cover brought to the open market in years.

The response from reinsurers will be a litmus test of the market's belief in the portfolio remediation work undertaken by AIG's new management team given the weak historic performance of the book.

Meanwhile, Willis Re will market a non-proportional treaty to cover AIG's excess casualty book, with substantial vertical limit believed to come in excess of around $25mn.

The new covers will replace a number of quota share deals – the biggest of them with Swiss Re – that have rolled off risk during the course of the year, or which are due to expire shortly.

Sources suggested the proportional cover would be placed for a 1 December or 1 January inception, while the non-proportional cover would be placed in the fourth quarter.

It is believed the US excess casualty exposures could be rolled into the new international casualty treaty that AIG purchased in the first quarter rather than via an entirely new placement.

AIG's reinsurance buying ethos has changed since Duperreault replaced Peter Hancock as CEO in May 2017.

For many years Hancock's AIG was the posterchild for a reinsurance-buying philosophy that emphasised diversification as a risk management tool and which was comfortable taking increasingly large net bets at group level.

In contrast, Duperreault and Zaffino have steered the company towards the increased use of reinsurance, as the global insurance giant looks to reduce its volatility.

On the carrier's third-quarter earnings call last year, Duperreault said: "It's not my style to take large limits and retentions of risk." He also said AIG would look to "dampen" some of its volatility through its reinsurance purchases.

AIG's executives have also stressed the value the company can get from working in partnership with reinsurers to optimise its own book.

On AIG's second-quarter earnings call, Zaffino said the focus to date had been on "reducing volatility, [and] making sure we're addressing some of the large limits".

"And as we look to the back half of the year, we're going to look at our entire portfolio, in particular casualty, and be very strategic on how we look at reinsurance with partners in the reinsurance market, and we would expect to see a benefit from that in 2019."

Duperreault said improved reinsurance buying would be one of the levers that would put it in a position to deliver a combined ratio of less than 100 percent in 2019.

In the first quarter, AIG bought a $75mn xs $25mn international casualty treaty, reinsuring a book that had previously largely been run net. The treaty is led by Swiss Re.

This followed a raft of reinsurance changes at the turn of the year, as AIG reduced its risk tolerances.

The revamped 1 January purchases included a new $2bn aggregate catastrophe cover, a "top or agg" cat deal and a new international cat treaty.

All told, AIG is understood to have purchased around $2bn of additional cover and lowered its first-event retention to around $750mn-$1bn.

Guy Carpenter, historically AIG's biggest broker and previously its lead casualty

CONTINUED ON PAGE 04

INSIDE

Sisyphus Re

Another Monte Carlo with hurricanes attached.

Last year Irma was barrelling across the bottom of Florida, keeping us all guessing right up until the last minute. Delegates loaded their favourite storm tracker onto their phones and hit refresh after every meeting.

Would we get "Irmageddon" with a direct Cat 5 hit on Miami, depleting industry capital, or would the roof be ripped off another year's earnings?

In the end, it was the latter.

This year we have Florence threatening either of the Carolinas with a Cat 4 landfall. She may bend north and, like so many before her, just scrape Cape Hatteras and leave us alone, or she may keep going straight and hit hard.

Either way we will have our answer on Thursday as the *Rendez-Vous* draws to a close.

But we already have our most important answer.

For, unless Florence intensifies to a Cat 5 and veers miraculously south towards Miami Dade, we already know one thing that she is not.

She is not a capital event.

Florence is here to make another dent on our earnings and test our investors' patience to destruction.

In Greek mythology, Sisyphus was condemned to an impossible task.

He had to roll a huge stone ball up a hill through eternity. He could never quite get the ball safely to the top before his strength gave out and it rolled back down to the bottom with a crash.

It looks like we are going to be condemned to the Sisyphean task of paying claims that mean we earn very little in 2018, but with little or no pricing reaction because of capital levels not being depleted sufficiently.

As with this year, we may get the rating ball halfway up the hill but new capital inflows will cut us off before we get to the sunny uplands.

> "It looks like we are going to be condemned to the Sisyphean task of paying claims that mean we earn very little in 2018, but with little or no pricing reaction because of capital levels not being depleted sufficiently"

As Willis Re's president and global head of casualty Andrew Newman said at his firm's press conference on Sunday, capital creates a ceiling on pricing while modelling creates a floor.

We can neither have it too good nor can it be too bad. If the ball rolls up the hill too far, new capital weighs it down, but when it rolls to the bottom it doesn't go any further down because the models have given the market an absolute bottom-line price below which it cannot sell.

Back in less enlightened times the ball used to overshoot on both ends – either flying up into the air on the upside or boring deep below ground level.

The great mystery of Sisyphus was why he didn't give up. Surely after the big round ball had fallen down the hill for the 100th time, he would have cut his losses and taken a holiday?

No, he picked himself up and had another go. Old Sis was the original eternal optimist.

Reinsurers are Sisyphean in their belief that the sunny uplands are attainable.

Or if not sunny uplands, at least a place with a semblance of the stability that will allow them to consistently produce returns that are commensurate with their cost of capital and the volatility of their earnings.

They say that with all the new ladders, chocks and levers that ILS and clever tech are giving them, they have a better chance than ever of making it to the promised land.

Sorry, everyone – you may not make your cost of capital again this year.

I hope your investors are OK with that.

Maybe their optimism is not as eternal as yours? Maybe it is all too finite?

There is only one way of finding out – and she's called Florence.

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Tangency doubles asset base to $100mn

Start-up ILS manager Tangency Capital has raised a further $50mn of assets under management which it expects to put to work in the January retro renewals.

The latest fundraise puts the firm on $100mn of assets. A spokesperson told sister publication *Trading Risk* that Tangency expected to have a further meaningful increase in its funds ahead of the 1 January 2019 renewals.

The manager's plan is to invest in quota-share instruments backing reinsurance firms, in what it is pitching to investors as a "smart beta" take on the sector.

It is looking to build a short-tail reinsurance portfolio that will be heavily exposed to catastrophe risks, but may also assume cyber or other specialty exposures.

The start-up was founded last year by former Hiscox Re executive Michael Jedraszak, ex-RenaissanceRe portfolio manager Kai Morgenstern and Dominik Hagedorn, formerly at Deutsche Bank.

The London-based firm has recently brought former Hiscox Re ILS analyst François Delattre on board as head of analytics.

Tangency is one of several recent ILS start-ups, with another Bermuda-based firm Lutece Re – backed by BTG Pactual – also targeting the retrocession market among other segments, albeit on the excess-of-loss market.

Tangency's quota-share model positions it as more of a rival to major sidecar supporter Stone Ridge, which has built a $7bn asset base from tapping US high-net-worth advisory fundraising channels.

However, the London start-up is pitching to institutional investors, many of which may not be prepared to directly invest in reinsurance sidecars. Its low-fee model is designed to appeal to those looking for a tracker-type investment strategy, although it is not a pure beta play as it selects reinsurers to partner with.

This comes as Beazley continues to market its beta syndicate, taking a slice of broker facility risk to investors to grow after its 2018 launch.

Scor could command valuation of EUR50 per share: Autonomous

Scor's management has given the impression that it would not accept a takeover deal from Covea "at any price", however it may be challenging for shareholders to ignore an enhanced offer from the French mutual, Autonomous Research analyst Andrew Ritchie has said.

On 4 September, Covea said its EUR43-per-share bid for the reinsurer had been rejected, but that it remained interested in pursuing a "friendly transaction" with Scor in future.

The bid led to vehement comments from Scor chairman and CEO Denis Kessler, who told this publication that the offer price grossly underestimated the fair value of the reinsurer, and a tie-up between the two French companies would be negative for his firm.

In a note following Scor's investor day, Ritchie said Covea's offer of EUR43 per share was equivalent to around 1.5x tangible book value, which was lower than recent deal averages of around 1.7x.

This would point to a "more realistic" starting point for negotiations of around EUR50 per share, he noted.

"We agree with Scor that the industrial rationale is weak [or] actually negative, but there could also be a point where any offer is greater than the economic value that could be created organically," he wrote.

The analyst's calculations suggest that if Scor can continue to deliver a circa 10 percent return on equity at relatively low volatility then the reinsurer could probably achieve an approximate EUR50-per-share valuation by 2020.

Based on forward earnings estimates to 2020, Covea's EUR43 bid does not account for any take-out premium in excess of the expected organic value creation, Ritchie said.

Covea now needs to confirm whether it is walking away from the takeover or if it will make another offer, the analyst said.

There has been no indication whether Covea has a mandate to pursue a hostile bid, given that it holds a Solvency II capital ratio of 372 percent and has an obligation to return that excess capital to mutual shareholders if it is not used to fund expansion, Ritchie noted.

If the French mutual chooses to walk away, the next question will be what it decides to do with its existing 8 percent stake in Scor.

Should Covea decide to keep its stake, the market is likely to see a new round of speculation in April 2019 when the legal agreement limiting the mutual's shareholding to under 10 percent expires, Ritchie noted.

"Should they decide to dispose, we assume Scor shares would come under some pressure," he added.

Ritchie also noted that while Scor management has suggested it would not to sell to Covea at any price, this could sit uncomfortably with principles of shareholder fiduciary duty.

The analyst said he viewed Scor more as a buyer than a takeover target, and suggested there may be a long-term case for it to acquire or merge with a company that would provide additional P&C reinsurance scale, perhaps to address its lower penetration in the US market.

"We suspect management could soften their hostility to a deal (as a target) should it bring more obvious industrial synergies (with a more global player), but the list of eligible buyers at this juncture is a short one after the flurry of recent deals," Ritchie wrote.

Scor also does not "need" a deal in order to be relevant in the near term, he added.

Ritchie noted that even though reinsurance market conditions are challenging, he believed Scor still had growth opportunities.

In non-life, expansion is focused on the US, where the group saw growth of 10 percent in treaty and specialty volume in 2017, he said.

Some 62 percent of this growth is focused on property lines, he noted, adding that relative to its peers Scor is still underweight in the business it generates from large national cedants.

Scor also holds a resilient life reinsurance business, Ritchie added.

"In conclusion, the approach from Covea has served to remind us that Scor is unique amidst the European reinsurers as being a potential participant in industry consolidation as a target," he wrote.

CONTINUED FROM PAGE 01

broker, was the biggest winner at 1 January.

It was the flag broker on the main US occurrence cat cover, the sole broker on the aggregate deal and co-broker on the "cat and agg".

The global insurer also dropped the retention on its per-risk cover from around $125mn to $75mn, with the deductible on its marine treaty slashed from $50mn to $10mn.

Duperreault is under pressure to demonstrate to investors that he and his team have made progress in turning around AIG's underwriting performance, with disappointing results dragging the shares down almost 10 percent in the year to date.

He has been widely credited for assembling a quality team including the likes of Zaffino, general insurance chief underwriting officer Tom Bolt, CEO of international general insurance Chris Townsend, Lexington CEO David McElroy and chief actuary Mark Lyons.

However, market sources have suggested the team has found AIG's issues more entrenched and fundamental than expected.

On the firm's second-quarter earnings call, Duperreault said he was confident AIG would deliver an underwriting profit "as we exit 2018".

After a second-quarter calendar-year combined ratio of 101 percent that was flattered by low cat losses, the executive said the company expected to deliver 2 percentage points of improvement from new efficiency savings.

With Validus set to dilute the combined ratio by a further percentage point, AIG would look for the remaining improvement to come from a combination of "underwriting actions" and "reinsurance strategies".

"Looking ahead to 2019 and beyond, our goal is to deliver top-quartile financial performance relative to the industry," he said.

And as Duperreault moves into 2019 – his third full year in charge – investors will expect the delivery phase to begin.

AIG did not respond to a request for comment.

State Farm leads home and auto cover in Carolinas

As Hurricane Florence continues to track across the Atlantic, data from SNL has found that State Farm has the biggest market share for both homeowners' multi-peril and private auto across North Carolina and South Carolina.

Taking the states together, the carrier has a 19.44 percent share for homeowners' risks and 18.72 percent for private auto, making it potentially the most exposed insurer to losses from Florence.

As with any cat event, the ultimate exposure any one carrier holds is dependent on location and geography, but market share data can serve as a good proxy.

USAA ranks second for homeowners' policies, with an 8.29 percent stake across the two states, followed by Nationwide (8.26 percent), Allstate (7.92 percent) and North Carolina Farm Bureau Insurance (7.52 percent).

In auto, Geico has the second largest market share across the Carolinas, at 11.98 percent. Allstate ranks third with 9.33 percent, followed by Nationwide with 9.20 percent and USAA with 8.18 percent.

State Farm's share is greater in South Carolina, where it has a 21.2 percent market share for homeowners' and a 23.88 percent market share for auto.

State Farm, USAA and Nationwide all run retentions in the hundreds of millions of dollars, meaning Florence may not cause losses to reinsurers. However, the cat programmes for USAA and Nationwide did attach after last year's California wildfires.

As of midday UK time on Monday, Florence was tracking across the Atlantic between Bermuda and the Bahamas as a Category 2 storm.

The US National Hurricane Center (NHC) predicts the storm will make landfall in the Carolinas at 02:00 local time on Friday. Long-range forecasts from Tropical Storm Risk indicate the storm will make landfall in the vicinity of Wilmington, North Carolina, at a strength of Category 4.

Forecasters at JLT Re have predicted that after making landfall, Florence will cause prolific rainfall in a region which has already been saturated over the past two months.

Strong winds in conjunction with one to two feet of rain from Florence will cause major flooding and increased risk of treefall, the broker said on Monday.

Sources speaking to this publication during the Monte Carlo Rendez-Vous suggested that carriers have been enquiring with brokers about securing live cat trades, but most are unwilling to pay the prices currently quoted by reinsurers.

Industry loss warranties are being quoted at around 40-50 percent rate on line for a $20bn industry loss, and reinsurers are reluctant to provide cover for much cheaper.

At the time of going to press, this publication had been unable to verify any live cat deals that had traded in the last 24 hours.

Both the Carolinas have a residual insurer – or insurer of last resort – for homeowners who are unable to secure insurance in the private market.

The North Carolina Joint Underwriting Association and the North Carolina Insurance Underwriting Association have previously sponsored a cat bond called Tar Heel Re, which provided them with aggregate cover, but this expired in 2016.

Information on any cat reinsurance programme the residual insurers buys is not publicly disclosed on its website.

The South Carolina Wind and Hail Underwriting Association holds a 2018 cat programme which offers a total $740mn of cover above a $10mn retention. The stack will provide cover for up to a 1-in-250-year wind event.

The Lloyd's market is also said to have major exposure to South Carolina beachfront property risk, written on an excess and surplus lines basis.

Major historical hurricanes that have struck the Carolinas have caused average damages of $31.9bn, according to the Icat damage estimator.

With only a few such storms having impacted the North Carolina and South Carolina coasts in the historical period covered by the Icat tool, the most recent parallel is 1989 storm Hugo, which caused total economic losses of $27.4bn in 2018 dollars.

In a recent update the NHC said the storm was about 625 miles (1,005 km) south east of Bermuda, with maximum sustained wind speeds of 105 mph (165 km/h).

North and South Carolina homeowners' multi-peril market share

Rank	Company	Direct premium written ($000s)	2017 market share (%)
1	State Farm	827,860	19.44
2	USAA	353,105	8.29
3	Nationwide	351,681	8.26
4	Allstate	337,165	7.92
5	North Carolina Farm Bureau Insurance	320,172	7.52
6	Travelers	163,402	3.84
7	Erie	140,756	3.31
8	Auto-Owners Insurance	118,317	2.78
9	Liberty Mutual	117,866	2.77
10	Foremost Insurance Company	101,013	2.37

Source: SNL

North and South Carolina private auto market share

Rank	Company	Direct premium written ($000s)	2017 market share (%)
1	State Farm	1,865,378	18.72
2	Geico	1,194,047	11.98
3	Allstate	929,070	9.33
4	Nationwide	916,524	9.20
5	USAA	815,163	8.18
6	National General	590,035	5.92
7	North Carolina Farm Bureau Insurance	566,514	5.69
8	Integon	565,023	5.67
9	Progressive Agency Pool	357,799	3.59
10	Progressive Direct Holdings	321,321	3.23

Source: SNL

Property cat pricing increases set to fade: JLT Re

Property cat rate increases from last year's hurricanes will peter out ahead of the January renewals, according to a report released by JLT Re at the Monte Carlo *Rendez-Vous*.

However, the broker expects some areas of hardening in the casualty market, as reserve releases become unsustainable.

In addition, the potential for a rise in interest rates could lead to casualty claims inflation.

Ross Howard, JLT Re's executive chairman, predicted casualty could become a problem for the market if interest rates rise, describing the outlook for pricing in the segment as "spotty".

"We all sit here at Monte Carlo and talk about cat and property, but really there's a huge book of casualty business out there. There are a lot of different factors out there that may come home to roost," he said.

Keith Harrison, CEO of UK and Europe at JLT Re, said the outlook was broadly positive for reinsurance buyers.

He added: "As our report shows, any future market turn is likely to come about only if capital withdraws, and no such development is likely in the short term."

The report noted that where pricing has dampened most, in areas such as property cat, a key driver had been the speed and volume with which alternative capital has come in.

> "We all sit here at Monte Carlo and talk about cat and property, but really there's a huge book of casualty business out there"
> *Ross Howard*

David Flandro, head of analytics at the reinsurance broker, told journalists at the *Rendez-Vous*: "I've never seen the capital markets reload that quick."

JLT Re noted that $8.5bn of capital had flooded into the ILS market in H1 2018.

Much of this capacity has been deployed at low rates of return by historical standards, particularly in areas where ILS markets are most active, such as Florida.

Flandro added that relatively limited loss development from hurricanes Harvey, Irma and Maria was also suppressing rates. Harvey losses have increased by around 11 percent from estimates on landfall, while Maria costs have risen by 25 percent.

This compares to a 71 percent claims development from Hurricane Sandy in 2012.

He said Irma is likely to develop further, with losses increasing by 15 percent thus far.

"Loss development in the main has stabilised after 300 days, [but] Irma could be an exception to that," Flandro explained.

Finally, on facilitisation in the London market and ongoing regulatory pressure, Michael Reynolds, global CEO of JLT Re, said: "I think when you get to a situation where there's nothing the facility brings to the market in terms of expertise, all it is, is just volume. I think when you get to that point, that sort of broker income does need to be questioned. JLT doesn't do that kind of business."

UK motor reinsurers likely to score modest rate rises at 1.1

UK motor excess of loss (XoL) reinsurers look to be headed for modest single-digit rate increases at the 1 January renewals as Ogden limbo continues, industry sources have predicted.

The 3.25-point reduction in the discount rate in March 2017 had triggered motor XoL rate rises of as much as 120 percent at 1 January this year, having earlier prompted an industry outcry that led to a government climb-down just six months after the original cut.

However, the April renewals marked the first year-on-year period of status quo with the new, lower Ogden rate and motor XoL price increases scarcely made it into the double digits.

Some primary insurers even managed to secure flat rates, sources said.

One underwriter said given that reinsurers still have to reserve for an Ogden rate of minus 0.75 percent they will resist pressure to cut prices. The source predicted rate rises of between 3 percent and 8 percent in January 2019.

A broking source concurred: "I am sure reinsurers will be saying, 'Why would we give up rate when still don't have clarity on rate?'"

Another broker remarked that the motor XoL market was still a challenged one and was suffering from too much capacity.

The Ogden rate is the amount shaved off lump-sum personal injury compensation to account for assumed investment growth.

Ogden reforms have been in the works since September 2017. At the time, the UK government said its changes would result in an Ogden rate of between 0 and 1 percent, and industry observers had originally anticipated the reforms would kick in by this autumn.

The Ogden changes sit alongside more contentious changes to whiplash compensation within the Civil Liability Bill. The legislation was due to enter the committee stage in the House of Commons on 11 September, when tweaks to be discussed include a government amendment to ensure whiplash savings are passed on from carriers to customers.

In July, the government delayed the whiplash reforms until April 2020. However, most industry observers expect the first review of the Ogden rate could kick in a year earlier, assuming Brexit does not delay the legislation.

Motor market protagonists said the Motor Insurers' Bureau (MIB)'s decision in July to reassume ground-up liability for terrorist attacks using vehicles will have no effect on rates in January.

Reinsurers had not begun charging for the potentially unlimited liability from such attacks. However, some, including Hannover Re, had threatened to exclude the events from cover from 1 January.

One interesting development could come from the MIB, which said in July it would seek a reinsurance broker to advise it on the purchase of cover for its terrorist liability.

One source said reinsurers' appetite to step into the breach was uncertain, given the disquiet among carriers after the pool had offloaded the liability onto individual insurers in March last year.

Non-life rates reach 'inflection point': Swiss Re CUO

Global non-life reinsurance rates have bottomed out but the industry is still some distance away from achieving sustainable returns, Swiss Re group chief underwriting officer Edi Schmid has said.

Speaking at a press conference at the Monte Carlo *Rendez-Vous*, the executive said: "We believe an inflection point in the pricing cycle for non-life insurance has been reached."

The reinsurer broadly expects stable rates in 2019.

But Schmid added: "Underwriting margins in major non-life insurance markets need to improve more to deliver sustainable returns on equity.

"To get back to a reasonable level of profitability we must see a 5-6 percent increase in underwriting margin."

Schmid added that current turbulence in the primary market was likely to filter through to Swiss Re's quota share business.

Schmid said the carrier had seen some improvement within marine and US construction business following losses stemming from natural catastrophes in the second half of 2017.

Schmid's comments come as multiple market sources canvassed by this publication said they were expecting catastrophe reinsurance rates to fall at 1 January.

A range of reinsurers and brokers suggested privately to this publication that the balance of power would be tilted in favour of buyers at year-end renewals, assuming there is no major cat loss.

Meanwhile, following news last week of a takeover attempt by French mutual Covea, target Scor was bullish on rates and talked about the start of a new pricing cycle.

A glut of capital in cat lines has left capital chasing insufficient risk, with the market averting any significant contraction in capacity following last year's natural catastrophe losses, including hurricanes Harvey, Irma and Maria and Californian wildfires in the second half.

Swiss Re's comments come as reinsurers use the Monte Carlo *Rendez-Vous* to talk up rates and argue for a flattish renewal.

Responding to questions at the *Rendez-Vous*, Swiss Re's reinsurance CEO Moses Ojeisekhoba added that the (re)insurance industry needed to further tackle the cost of doing business and that cost ratios were too high.

"You have to look at every aspect of the (re)insurance chain and see what value we bring," he added.

The executive said that although the market needed to take a very close look at existing profit structures, brokers would continue to be an integral part of the carrier's business model

"Our position as a firm is that we've always accepted risks however customers want them to be placed.

"Half of our business on the P&C side comes directly to Swiss Re and half of it comes from brokers," he said.

Reinsurers continue to argue that a period of respite on rates is required after years of steep reductions and with cat pricing still around 40 percent below 2012 levels.

Hannover Re predicts uplift in Japanese cat pricing

Hannover Re anticipates potential property cat reinsurance rate increases on Japanese accounts following a series of typhoons.

Speaking at the Monte Carlo *Rendez-Vous*, head of global reinsurance Juergen Graeber said that because several Japanese carriers bought aggregate cover, the recent spate of typhoons to hit the country would lead to "detailed discussions" with Japanese clients and potential rate increases in 2019.

This comes after a relatively uneventful renewal at 1 April this year.

AIR Worldwide has estimated that industry insured losses from Typhoon Jebi could reach between 257bn yen and 507bn yen ($2.3bn-$4.5bn), according to a statement released yesterday.

Hannover Re also expects increased premium and rates in international property cat primary insurance in 2019, Graeber said, particularly in the Caribbean and Latin America.

However, further price increases after the sharp rises seen in the current year were rather unlikely if no additional losses were incurred.

European rates would also be suppressed by the lack of recent major cat events in the region, he added.

In the US, Hannover Re anticipated increasing demand for property treaty as the broker market expands, according to Michael Pickel, who is responsible for North America and continental Europe.

He said public initiatives to increase flood and terror cover in the US would provide a chance for the carrier to grow further there.

However, CEO Ulrich Wallin warned that the assignment of benefits crisis in Florida would continue into 2019.

Wallin added that the crisis had not been taken into account at the 1 June renewal, where rates were flat, despite the loss creep on Hurricane Irma. This, he said, was due to an oversupply of capital due to Bermudian and ILS interest in the state.

Pickel added that the recent flurry of M&A activity made Hannover Re "happy" as some of the acquiring companies in the latest deals were Hannover Re clients, providing an opportunity for expansion of existing contracts.

In Germany, Pickel said, Hannover Re's motor business was under pressure as competition between major players continued and repair costs increased.

He added that if there was no increase in primary motor rates in the near future, Hannover Re would need to "discuss" contracts and pricing further at the Baden-Baden conference in October.

Sven Althoff, head of specialty lines worldwide, said there had been positive developments in general aviation insurance as capacity left the market, which he believed would continue into 2019.

However, he added the same was not true of global airline covers, where he described rates as "unsustainable".

In marine, Althoff said that following hurricanes Harvey, Irma and Maria, Hannover Re had seen price increases on excess of loss policies, particularly for cargo and pleasure-craft, as well as in primary hull.

Wallin concluded by saying the company anticipates an increase of more than 10 percent in its gross premium volume and net income in excess of EUR1bn ($1.2bn) for its total business.

And while Brexit would affect Hannover Re's reinsurance bottom line, the carrier expected that doing business in the UK after Brexit would be similar to the situation in Canada and Australia.

Cyber premiums to increase fivefold by 2025: Munich Re

Worldwide cyber insurance premiums will grow from $4bn today to $9bn by 2020 and $20bn by 2025, Munich Re has predicted.

However, CUO Stefan Golling said the carrier did not believe any insurer should underwrite the risk of a cyber attack taking out major infrastructure such as power networks, as the market lacked the necessary capacity.

Torsten Jeworrek, chairman of Munich Re's reinsurance committee, added that risks that could accumulate large losses across the industry were not insurable.

Nonetheless, Jeworrek, speaking at a press conference at the Monte Carlo *Rendez-Vous*, insisted that the market could provide adequate coverage for a great deal of less-correlated cyber risk, despite not all significant players writing cyber as a specific class.

"When you have something new, do you seriously expect everyone to jump on at the same time?" he said.

He added that most significant players were on board although many were holding back on writing cyber until they could analyse the experience of earlier adopters.

Golling highlighted Munich Re's push into cyber over the past five years, with gross written premiums rising from just over $100mn in 2013 to $400mn in 2018.

Jeworrek added that the risk was linked to the growing number of connected devices in use, which is expected to increase fourfold to reach 125 billion in 2030.

Golling said Munich Re would continue to focus on cyber cover for small businesses, because although larger companies suffered nominally higher losses, their better preparedness meant those losses impacted them proportionately less.

Therefore, he said, the insurance cover for smaller businesses was more valuable.

Smaller businesses also presented Munich Re with the opportunity to offer clients a bundle of services such as cyber security consulting and post-loss assistance.

He noted Munich Re had established cyber teams in the US, Europe and Asia and hired more than 20 cyber experts from outside the industry to help bolster its cyber offering.

Golling said that insurers must ensure their policy wordings were clear enough to exclude war risks, in case of a "mega-risk" terror-related cyber-attack that could be construed as an act of war.

Cyber strategy aside, Jeworrek said Munich Re had seen a strong trend of cedants increasing their non-catastrophe treaty covers in order to "execute capital management policies".

He added that increasingly, quota-share business that cedants bought to bring down their required capital was placed with between one and three reinsurers rather than more carriers.

Jeworrek also reaffirmed Munich Re's commitment to supporting climate change initiatives, following its August announcement that it would no longer cover risks linked to coal.

He said "supporting policies and business models" to protect against climate change was "in our genes".

Jeworrek added that the carrier did not want to undermine "political decisions" on climate change such as the 2015 Paris Agreement, which commits signatory states to planning and reporting their actions on mitigating global warning.

ILS investors may push for more return in 2019

ILS investors may push for more return from the sector if this year disappoints or is a break-even year, said Pioneer ILS analyst Chin Liu at the Munich Re ILS roundtable in Monte Carlo.

Market dynamics had slightly changed in recent weeks, he added, with the Japanese typhoon and Hurricane Florence heading for the US. "We will be facing some losses," he said, adding that more capital could be trapped if Florence produces another $10bn industry loss.

Liu also noted that this year had produced decent returns for equity strategies, if not strong fixed-income returns, meaning other asset classes were presenting attractive alternatives.

"I don't expect investors would move in [to ILS] as aggressively as in 2018."

World Bank executive Michael Bennett said he had been told to expect repricing of risks after a major US hurricane loss year, but he had been pleasantly surprised to find that the organisation was able to place its diversifying South American earthquake cat bond this year at attractive rates.

"Now people warn me one loss year won't [change rates], but two years in a row will," he added.

The bank is currently working on famine risk covers, building on last year's pandemic bond, as it attempts to source insurance cover for other humanitarian disasters.

Axa Global Re executive Guy van Hecke said that it was not surprising that there had been a muted price reaction to last year's losses, as there had been an equilibrium in terms of supply and demand with reinsurance capital withstanding claims.

"When an event has really hit capital, the cycle will come back," he forecast.

Speaking on the topic of future ILS market growth, Citi ILS banker John Modin said that where products are pitched in terms of a reinsurance market tower could change, opening up avenues for expansion.

He referenced the Canadian regulator's plans to monitor insurance company risk for 1-in-500-year loss events.

However, as these would be very low risk-return deals, possibly investment-grade securities, developing this market could rely on appealing to a new set of investors that see the asset class as a fixed-income alternative, Modin said.

The panel also discussed the trend on M&A markets to see insurance carriers tying up with ILS platforms, such as the Nephila-Markel deal and AIG-AlphaCat.

KBW analyst Christopher Campbell said the trend raised the prospect of the ILS market disintermediating the reinsurance channel.

But Munich Re's member of the board of management Peter Roeder said that the firm did not view this competition as any different to a wave of Bermuda start-ups. In addition, using ILS capacity permitted Munich Re to offer more capacity in capital-expensive catastrophe perils than it otherwise could, he noted.

Modin concluded that it was important for insurers to have access to capital market capacity, whether this was via using cat bonds, sidecars or asset management divisions.


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AM Best: loss-making property dominates Lloyd's reinsurance GWP

Lloyd's worst-performing class of reinsurance made up 57 percent of reinsurance premiums written in the market across 2017, according to data by AM Best's reinsurance market report.

Property, which reported a combined ratio of 130.3 percent for the year, made up the largest proportion of global reinsurance business accepted by carriers in the market.

Gross written premiums (GWP) for the line of reinsurance increased by 19.3 percent to £6bn ($7.8bn).

Lloyd's results published this March revealed a major deterioration in profitability of the line of business as its combined ratio deteriorated by 38.5 percentage points to 130.3 percent. This included four points of reserve releases, down from 9.4 points released the year before.

Casualty was the second-largest class of reinsurance business by volume, making up £2.2bn (21 percent) of reinsurance premiums underwritten by syndicates in 2017.

According to Lloyd's figures published in March this year, casualty reinsurance also made a loss in 2017 albeit with a healthier combined ratio of 102.1 percent.

This marked a deterioration of four percentage points year on year. Reserve releases accounted for 1.8 percent of net earned premium, down 5.3 points on the previous year.

Marine was the next largest line of reinsurance underwritten by syndicates at Lloyd's, reporting gross written premiums of £1.2bn, or 11 percent of overall reinsurance premiums written.

Energy business accounted for 7 percent, or £740mn of reinsurance business written in the market, while aviation made up 4 percent – or £420mn – of reinsurance placed in the market.

Following its results earlier this year, Lloyd's said the frequency of large facultative reinsurance losses in most specialty sectors had continued in 2017.

In treaty business, marine excess-of-loss reinsurers were hit by cargo and yacht losses arising from the third-quarter hurricanes.

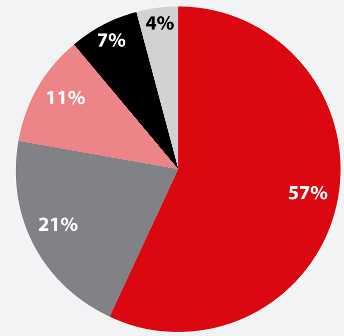
In its report, AM Best said catastrophe losses across property and marine segments, including losses from Hurricanes Harvey, Irma and Maria, wildfires in California, earthquakes in Mexico and cyclone Debbie in Australia.

Casualty treaty results were also affected by the decision in the UK to reduce the Ogden discount rate, the ratings agency added. Lloyd's as a whole ceded 26 percent of its GWP in 2017.

AM Best revealed last week that Munich Re had reclaimed the top spot among the world's 50 largest reinsurance groups in terms of GWP.

Munich Re's GWP increased 14 percent to $37.8bn, while second-placed Swiss Re's top line fell 2.5 percent to $34.8bn.

Lloyd's reinsurance premium distribution, 2017



Note: Life (0.2%) not shown. Source: AM Best data and research

Deployment options make reinsurers attractive: AIG CEO

Recent acquisitions of reinsurance specialists by major insurance carriers are a recognition of the quality of the Bermudian reinsurance industry, according to AIG CEO Brian Duperreault.

Speaking at a PwC breakfast briefing in Monte Carlo on Monday, the executive said recent deals in this mould include the firm's own acquisition of Validus, and Axa's purchase of XL Catlin.

However, Duperreault cautioned against reading too much into the recent developments, saying: "This isn't a new trend, it comes and goes.

"The reinsurance market is a bit of an accordion – [it goes through] waves of formations and consolidations."

From a reinsurance buyer's perspective, such deals should be seen positively, he went on, as putting a wholesale reinsurer into a huge insurance balance sheet gives cedants more faith in the stability of that carrier.

For AIG, the attraction of the Validus deal was that it gave the firm capital flexibility and a source of market intelligence.

"There are times when the reinsurance market is where you want to deploy," he explained. "If you don't have both [insurance and reinsurance capabilities], you can't move the capital around."

The reinsurance market is here to stay despite being in a phase of transition, driven by InsurTech and ILS disruption, he concluded.

Duperreault said within the operations of a risk originator, ILS platforms could take on an even greater life than they had by developing within reinsurance businesses.

AIG's acquisition of Validus provided the insurance giant with its own ILS platform: AlphaCat.

Duperreault went on to say that AIG could "experiment" with going into the market with ILS products in the future.

He also raised the prospect of the ILS market adapting itself to longer-tail risk via parametric transactions.

The AIG CEO touched on the topic of cyber risk, which he described as one of the insurance market's hottest risks, even though pricing was only "so-so".

But a bigger concern for the industry was hidden or silent exposures, which he said the sector had to address.

Legacy risks were another hot area in the market, he noted, prompting investor interest after AIG set up legacy carrier DSA Re initially to warehouse its liabilities.

"It gives me great optionality," he said of the vehicle, now part-owned by Carlyle.

Duperreault sounded a cautious note on how long it would take DSA Re to set up independent infrastructure to allow it to compete in taking on third-party legacy risks, saying it could be an 18-month process.

This same patience would be needed when it came to completing AIG's turnaround, he said. "These are not overnight fixes. These are fundamental changes that need to take place."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Swiss Re sounds warning over insurers' future profitability

An improved economic environment will not be enough to drag western insurers' margins back to acceptable levels of profitability, according to the latest Sigma study from Swiss Re.

In a report released on Sunday, the reinsurance giant explained that while higher interest rates and investment returns will contribute positively to non-life insurers' balance sheets, it will not be enough to boost returns on equity (RoEs) to 10 percent or more.

Insurers must also improve their underwriting performance if the current RoE shortfalls are to be redressed, the carrier said, with underwriting margins at western insurers needing a 6 to 9 percentage point improvement to get returns back to double digits.

In 2017, RoE for the nine markets in the analysis slipped by 1 point year on year to 6 percent, while over the last decade, the average RoE was just 6.5 percent, reflecting a period that included the global financial crisis and unusually high catastrophe losses in 2011 and 2017.

The 2017 result was driven by three main factors: soft underwriting conditions, low investment yields and large numbers of natural catastrophe losses in the US.

In addition, the reinsurer warned that an improved macroeconomic outlook is likely to have a negative impact on reserve adequacy.

"We expect that accelerating claims inflation will erode the adequacy of claims reserves, which have already worn thin," Swiss Re said.

"This further affirms that to achieve sustainable improvement in sector profitability, insurance premium rate increases in excess of rising claims trends will be needed."

The concern is particularly prominent in key western markets, such as the US. Reserves from the hard-market years are waning and the reserve adequacy of more recent loss years is unclear, Swiss Re said.

This is in part because key liability lines' reserves look deficient and weaker than in 2016, while downward pressure on liability rates continued through to the end of 2017.

Weak labour markets reduced headline and claims inflation over the previous 10 years, and lowered demand for casualty insurance, but a moderate reflation of mature economies, especially looking to healthcare inflation, is likely to lift claims severity trends gradually and weaken reserves adequacy, Swiss Re noted.

Global commercial insurance rate index: Q1 2018

Rate changes in %	Global	US	UK	Europe	Latin America	Asia	Pacific
Property	2.7	2.9	-1.6	0.1	-1.0	-1.4	12.5
Casualty	-1.7	-3.0	-2.1	-1.6	4.3	-2.7	5.7
FinPro	1.8	0	3.3	-1.6	1.5	-2.2	15
Composite	0.9	-0.5	0.2	-0.8	0.8	-1.8	11.6

Source: Marsh

The changing legal environment around consumer protection may be another factor contributing to rising claims from product liability and securities actions citing deceptive conduct, breach of duty and negligence.

Commercial auto also still appears deficient despite significant rate increases during 2016 and 2017.

Significant reserve releases in 2017, in combination with still-falling premium rates, are also likely to have weakened overall reserves adequacy.

Furthermore, Swiss Re flagged that benign loss trends had prevented significant loss ratio deterioration.

"All in, we expect reserve releases will eventually morph into a need to strengthen reserves, but it is difficult to project when that will happen," said Swiss Re.

Turning to the pricing outlook, Swiss Re noted that global commercial insurance rates were slightly higher in late 2017 and in the first quarter of 2018 due to an improvement in property lines.

However, the reinsurer said it is uncertain how long that rate hardening might continue for.

In addition, Swiss Re has spotted that underwriting cycles are becoming more correlated globally, driven by the increased integration of capital markets.

While writing non-life business across lines and countries still adds diversification to an insurers' underwriting portfolio, there is evidence of cross-country correlations of combined ratios increasing over the past two decades, amid deregulation in insurance and capital markets.

"International correlation of underwriting cycles was stronger over the past 20 years (1996–2017) than over the two decades previous (1975–1995)," Swiss Re noted.

"On average, correlations are higher between categories of property lines – due to common exposures to cat losses – and between categories of casualty lines. As expected, correlations are lower between P&C lines as groups.

"Additionally, the average duration of the cycle seems to have lengthened since the early 1980s, when central banks changed their policy focus toward fighting inflation and large parts of the financial services industry were deregulated."

Tech innovation

More positively, the reinsurance giant noted that the increased pressure on insurers' bottom lines has heightened interest in innovation.

Investments in technology have led to efficiency gains and compressed margins for the distribution system of commoditised business. In some lines technology has also helped to lower claims costs.

Telematics have reduced claims frequency and severity in some markets, as well as reducing instances of fraud.

In Italy 20 percent of motor policies are now sold on a telematics basis, the report found.

Swiss Re also found that globally, about 32 percent of P&C personal lines insurance sales advice and quotes are now provided via digital channels.

"Initially, the benefits for insurers' profitability are clouded by the gains being partially passed on to consumers, and also by the cost of the investment," the carrier said.

"In the long run though, investments in data and advanced analytics improve underwriting and insurability of increasingly complex commercial risks, be it through improved affordability, access or better ability to underwrite new and hard-to-quantify risks."

Auf Wiedersehen, Wallin

As the Hannover Re CEO prepares to retire after 34 years at the company, *The Insurance Insider* asks the executive to pass on some words of wisdom

The German word for retirement is *Ruhestand*.

Unlike the English, it conveys – in a way only German can – that after years of hard work, the retiree is now entering a period of well-deserved peace and quiet.

And after more than 35 years at Hannover Re, Ulrich Wallin is hanging up his hat to enjoy his own *Ruhestand*. He officially stands down on 8 May next year, after which time Swiss Re's Jean-Jacques Henchoz will take the reins.

Like many in this industry, Wallin did not enter (re)insurance straight out of education. He first trained as a lawyer, and before he joined the (re)insurance market, he was working a wide and varied role at a law firm.

However, the tedium and stress of dealing with speeding tickets and divorces led him to look for a new career direction, and he went on to join HDI Global in 1982.

Two years later, he entered the reinsurance world as a treaty specialist at Hannover Re unit E&S Rueck, and quickly rose through the ranks.

Wallin first became CEO of Hannover Re in 2009 after the company had made its first-ever loss because of credit crisis-related write-downs.

Under his leadership, Hannover Re has expanded its gross written premium from roughly EUR10.3bn ($11.9bn) to around EUR17.8bn and boosted its group net income from EUR700mn to around EUR1bn.

It became a company renowned for delivering above-average returns on equity. Some analysts have gone so far as to say Wallin transformed Hannover Re into the most profitable reinsurer to trade throughout the most recent cycle.

However, when *The Insurance Insider* speaks with the CEO to ask him what his greatest career achievement was, he goes back to 2000, when he took on the leadership of the facultative business.

"When I took [that] business over, it was loss-making and very small, no one was congratulating me getting the role!" he laughs. "But in 2004 we ran a EUR100mn underwriting profit, so I was pretty proud of that."

> "A business model that works on the basis that following major losses rates will rise and business will become more profitable might be challenged going forward"

After a successful and long reinsurance career, many would say Wallin deserves some peace and quiet, and time to do the things he enjoys out of work.

Wallin lives in Hannover, just a seven-minute commute from the office. It's a very green, user-friendly city, he says, and a great place to raise a family.

"Though it might not be as exciting as New York or Berlin!" he adds.

The executive is an active man; he enjoys outdoor sports such as tennis, golf, and cycling. He likes to travel but most loves spending time in the European Alps: skiing in winter, and hiking and swimming in the summer.

"I actually prefer that to going to the Mediterranean and just sunbathing," he says.

Pricing theme

However, before he gets to put on his hiking shoes, there's one more Monte Carlo *Rendez-Vous* as Hannover Re CEO to attend.

Once again, pricing will likely be the theme of the conference, he tells *The Insurance Insider*.

It's true that the market will have much to discuss following $140bn of cat losses the previous year. But despite 2017 being one of the heaviest cat years on record, property cat rates barely flinched, smothered by the sheer volume of reinsurance capacity in the market.

Reinsurers will now be questioning where to take their business from here.

"If you want to see it positively, the market has shown very good resilience following the losses, reinsurance has proved itself to be a very reliable product and for the client," says Wallin.

CONTINUED ON PAGE 16

CONTINUED FROM PAGE 15

"But if you want to look at it in a negative way, you can say that the cyclicality of the market has not been there to the same extent we have seen it in the past. A business model that works on the basis that following major losses rates will rise and business will become more profitable might be challenged going forward."

Wallin believes that losses will need to have an unexpected or surprise element in order for the market to react.

The soft market has been in force for so long, even if carriers get significantly increased prices, it is not certain if rate adequacy has actually improved, he says.

"In general, it will take a lot more to turn the market in the current day and age compared to before," he explains.

The insurance-linked securities (ILS) and collateralised markets are still a real competitor to the traditional market, with capital having quickly reloaded after the 2017 cat losses.

However, Wallin does not think the traditional market is at a competitive disadvantage to the collateralised ILS model.

"If you have a collateralised product, you need a conclusion, such as commutation clauses which create basis risk for the reinsurance buyer," he explains. "The leverage of the capital base of the rated reinsurer is also definitely at least as good as the leverage that these ILS funds can provide."

> "If you can find ways to better tailor the product, automate the claims management and also improve the risk selection by using data and technology, I think quite a lot can be done"

The product mix of the traditional market is also a lot wider, the executive adds.

"The ILS market, in a unique capacity, is quite helpful for the ceding companies – of course, if you look at the retro market that is at least 50 percent, if not more, being placed in the capital markets," he says.

"The basic transfer of risk and the basic pricing and exposure structures are not too dissimilar between the two, but I would say that the traditional market probably still has the better leverage."

Generally, traditional reinsurers are growing, and they have reasons to be positive.

> "In general, it will take a lot more to turn the market in the current day and age compared to before"

Wallin notes that, in general, premiums ceded in 2018 have increased compared with the previous year.

"You can see that trend across the top 10 or even 20 reinsurers; they are all showing healthy growth," he says. "I haven't found anyone who is shrinking their book or exiting the market."

The growth in cessions is largely proportional business, which buyers are using both for earnings volatility and for freeing up capital to use elsewhere in their business, Wallin explains.

He adds: "This is partly also defensive because some of the primary markets also have some questions on whether the original rating is sufficient."

However, reinsurers should keep one eye on reserving. So far, reserves have been quite stable as far as the confidence level is concerned, Wallin explains.

But there is some concern around areas like US commercial auto, which is clearly under-reserved, he adds. "One thing, more generally, is if you look at the inflation risk, I don't think you will find it is completely included in the loss reserves for long-tail business."

Looking ahead, the interview moves onto InsurTech, and whether reinsurance will ever be at threat of disruption from this new breed of competition.

Wallin is of the opinion that reinsurers are natural partners to personal lines-focused InsurTech companies, which tends to be the preferred hunting ground for start-ups at this moment.

Reinsurers can provide these firms with capacity and know-how, the executive says.

"In an area where there is no competition from the reinsurers, the relationship is more symbiotic, at least for the time being," Wallin says, adding the caveat that in future, that doesn't mean it's impossible for InsurTech firms to develop business models to disrupt reinsurance as well.

"If you can find ways to better tailor the product, automate the claims management and also improve the risk selection by using data and technology, I think quite a lot can be done," he says. "Just at this point in time the InsurTechs are not focusing on that."

For the time being, the ILS market is going to be the more prevailing non-traditional competition for the traditional reinsurers, he adds.

So, as the interview starts to come to a close, any final reflections on the industry or parting words of wisdom?

Wallin explains that the most important thing for the industry in his view is that it continues to provide value to its clients.

"So, I'd like to see reinsurance industry being held in high esteem by its clients by the time I retire."

He advises that you should always be aware that there is more than just the logical argument in both your professional and private life.

"In your professional life, there are a lot of external and internal politics which can actually be quite frustrating," he says.

And finally, one for the up-and-coming reinsurance practitioners: "Don't make too many mistakes, as they can be very, very expensive."

Curriculum vitae

Career

Since 2009: CEO of Hannover Rück SE, Hannover, Germany

2001-2009: Member of the executive board of Hannover Rück SE, Hannover, Germany

2000-2001: Managing director, Hannover Re Group, Hannover. Responsibility for Hannover Re's worldwide facultative property and casualty business in addition to worldwide aviation and marine business

1996-2000: Vice president, Hannover Re Group, Hannover. Worldwide aviation and marine business

1987-1996: Integration of E+S Rück's foreign section into Hannover Re's group of US departments: Various responsibilities primarily in the areas of aviation and space as well as US liability business

1984-1987: E+S Rückversicherung AG, Hannover, Germany. Treaty specialist in the foreign section, establishment of the aviation reinsurance portfolio

1982-1984: HDI Haftpflichtverband der Deutschen Industrie V.a.G., Hannover, Germany

Education

1974-1982: Law studies at Hamburg University. Second Final Exam in Law (Assessor)

DIVERSIFICATION

Senior (re)insurance market protagonists ponder the benefits – and drawbacks – of branching out

How big a role will diversification play in future-proofing the reinsurance model following the structural reductions in property cat reinsurance returns caused by ILS money?

Andrew Newman, president and global head of casualty, Willis Re: The more enlightened have already started their strategic planning, and recognise that the challenge of pivoting away from cat and into non-cat classes is a critical, strategic requirement. However, it is a logical fallacy that diversification in and of itself can easily "future-proof" a reinsurer's position.

It won't do so in isolation, and in fact it imposes considerable challenges for reinsurers who seek to reduce their dependency on a buy-and-hold catastrophe business model. They now need to acquire skills and capabilities which are in short supply, at a time when barriers to entry are high and the technical tools (such as third-party vendor models) either don't exist, or are so nascent as to provide scant support.

The current problem is the rise of securitisation. Reinsurers are increasingly competing with capital-market portfolios that are inherently more diversified across various asset classes. There is no way that reinsurers can "out-diversify" the ultimate capital-market portfolio. That's not to say that reinsurers should not diversify, but the conviction that diversification will future-proof the industry is a dangerous one.

Stephan Ruoff, CEO, Tokio Millennium Re: The diversification of profits comes most easily with scale. The large globally diversified players have an advantage over smaller players, but only where the business they assume, or that they continue to write, is profitable.

Without a doubt, ILS money is putting more pressure on the global reinsurance markets to consolidate, and reinsurers are looking for ways to remain competitive in the current soft, challenging market. For the majority of reinsurers to compete, a certain level of the diversification of profits within their business is essential.

The commoditisation of catastrophe business does not make it unattractive but does have an impact on the business model a reinsurer adopts for assuming or managing that business. Today, other specialist lines where barriers to entry are higher arguably carry an equal value as catastrophe business.

Laurent Rousseau, deputy CEO, Scor Global P&C: In (re)insurance, one must either be the best at a particular function or be best at assembling the functions across the value chain. Diversification will not save undifferentiated, sub-scale, market-following capacity providers.

For a large global reinsurer, diversification is highly valuable. Diversification benefits have significantly helped us to hit our financial targets year after year.

Edi Schmid, group chief underwriting officer, Swiss Re: True diversification in the way we talk about it in reinsurance is difficult for ILS. The licences ILS funds commonly hold only allow them to do fully collateralised transactions, which means they must hold capital up to their maximum liability under each and every transaction, at any point in time until the liability is commuted. Traditional (re)insurers, on the other hand, only have to hold capital up to a certain risk level prescribed by regulators, allowing them to leverage their balance sheets multiple times. Although in theory many types of (re)insurance business are accessible to ILS funds, in practice the collateralisation requirement shuts them out as the business does not generate adequate returns on capital.

Steve Arora, CEO, Axis Re: For decades, property cat has been the centrepiece of reinsurer portfolios, at times cross-subsidising other lines of business. What is imperative going forward is that we get the right risk/reward balance for all aspects of the market. Equally important, we also must think about client portfolios – what clients truly need as their risks evolve – rather than basic, off-the-shelf product portfolios.

Megan McConnell, director of underwriting, London, Hiscox Re & ILS: Diversification needs to be done for the right reasons. Our goal is to achieve smart growth – not growth for growth's sake. We prefer to be specialists in areas where we believe we can offer real value.

Diversification can help in the short-term but firms have to resist the temptation to chase lines of business that they don't fully understand. There are few lines of business with any significant margin for error. Longer term, we would be naive to think that ILS money isn't already expanding out of property cat. Reinsurers can't outrun the capital; they have to find a way to adapt.

CONTINUED ON PAGE 21

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Sven Althoff, member of the executive board, Hannover Re: For us, diversification is very important and that will not change. Investors buy our shares because they appreciate the stability of our earnings and the predictability of our dividend payments. We would not be able to meet these requirements if our business were more volatile and less diversified.

The buying behaviour of many of our clients is supporting this today. Many clients want to deal with strong but fewer reinsurers today and this is naturally requiring reinsurers to develop a product offering which can satisfy most, if not all, of the solutions requested by clients in all product lines.

Brendan Barry, chief underwriting officer, Greenlight Re: Diversification of profitable income streams has become more important now that property cat can no longer subsidise unprofitable reinsurance business. While diversification does bring the benefit of balance to any portfolio, it has also resulted historically in the underpricing of non-peak risk. In order for the reinsurance model to reap the benefits of diversification, every risk must be accretive to the overall portfolio and cover the cost of its own capital.

Is there any benefit at all to being a pure-play reinsurer? Or will every reinsurer in future look to write primary business?

Waleed Jabsheh, president, IGI, executive director, IGI UK: No, they won't – nor will they need to. Increasing over the last decade, the lines have blurred between primary insurance and reinsurance, with more and more companies offering both, but a pure-play reinsurer can continue to perform well in the market if they are diversified. A reinsurer can be as diversified as a primary market insurer can be.

Newman: Being pure-play is not a magical "get out of the competition jail card". The challenge for pure-play reinsurers is whether the attributes outlined above are apportioned enough value by clients to ensure a supply, over the long term, of reasonably well-priced portfolios of risk in large enough volumes with enough diversification.

The industry's value chain is rapidly transforming from the 19th century industrial model that placed capital at the centre (given its scarcity), and gave a secondary role to the originators of opportunity (considered plentiful). Those roles are now reversing in the insurance sector.

Meanwhile, technology and ideas are now more likely to drive performance than capital management alone, so it will be interesting to see the extent to which insurers are willing to share those ideas – and their success or failure – with potential competitors.

Torsten Jeworrek, member of the board of management, Munich Re: Most companies with so-called hybrid underwriter models focus more on either insurance or reinsurance. Quite often, profitability stems predominantly from the key focus area, and is not shared equally between the two business segments. Furthermore, one prerequisite to doing business in both primary and reinsurance are explicitly defined information barriers that need to be set up for regulatory reasons.

However, insurance risk and market-cycle diversification will be improved if hybrid underwriter models are established at the holding level of companies. Synergies in terms of technology and know-how transfer are also possible.

Ruoff: There is always room for specialist reinsurers. If you are a specialist in your field with superior knowledge and risk selection, there will always be the opportunity to outperform and there will always be a space in the market for such.

Toby Esser, chairman, AFL Insurance Brokers: Particularly given the relatively steady pricing in the market and lack of significant cycle hardening possibilities, it is more important than ever to have diversification, and to not be a pure-play (re)insurer.

Without a well-diversified business, it is incredibly difficult for (re)insurers to actually make money –to succeed in this marketplace, they will need to continue to branch out and have as much of a mixed book as possible.

Schmid: This isn't a black or white issue. There's probably always going to be a role for a pure-play reinsurer, especially one who is willing to scale down in a disciplined way when markets are not supporting reinsurance.

Our mission is to make the world more resilient. That means that sometimes we look to participate in or develop new primary business where we think we can add differentiated value to what is in the market today, in particular with technology-enabled solutions.

Arora: We take great pride in having both insurance and reinsurance capabilities, and the ability to steer our portfolio into the segments where it is most appropriate. Regardless of the business model, however, it is critical that reinsurers focus on executing well and delivering value for their customers. If you build good businesses, with a strong client franchise and solid returns, good things will happen.

James Few, global managing director of reinsurance, MS Amlin: As developments in InsurTech continue to streamline the distribution chain, and the barrier between reinsurance and primary business reduces, having a stake in both markets will become increasingly essential for the future sustainability of any insurance business.

McConnell: In the current environment, the appeal of primary business is undeniable. Across the cycle, maximum optionality is achieved by having multiple platforms that deploy capital. However, primary insurance business, particularly small-ticket retail business, is not for the faint-hearted. It can be slow and expensive to get into retail business, and the market is much less tolerant of opportunistic underwriting over time.

Althoff: We think there is a benefit in focusing on our core competencies and we see ourselves as one of the purest reinsurance firms in the market. We expect the reinsurance market to grow slower than the primary market in terms of premium but it is fundamentally growing.

Barry: Even though many reinsurers have moved to an insurance/reinsurance platform and more vertical integration, we continue to believe that a focused specialist reinsurance company can avoid channel conflicts and deliver without conflict for our clients in the insurance sector.

Chris Jarvis, director of underwriting, AmTrust at Lloyd's: Pure-play reinsurers will always attract investors because of the potential for comparably attractive returns, however only a few of these type of reinsurer players remain. Certain

CONTINUED ON PAGE 23

CONTINUED FROM PAGE 21

jurisdictions, such as Bermuda or Switzerland, are a natural fit for pure-play reinsurers, although other domiciles continue to make the model a less attractive proposition.

How important could mortgage and life reinsurance be over time for reinsurers?

Newman: Some view mortgage risk as adding, rather than diversifying risk, given the potential correlation with the asset side of insurers' balance sheets. Notwithstanding tail risk dynamics, caution over net risk tolerance, and correlation with asset risk, the underlying risk is relatively similar to other P&C risks, such as directors' and officers'.

At the same time, many capital markets players specialise in analysis of mortgage risk, so reinsurers' skillset in this risk class is not unique. Additionally, the market for mortgage insurance is limited to several countries, and often exposed to changes in the political and regulatory environment.

The life side is more challenging for traditional P&C reinsurers to really move the needle, as some of the skills required to evaluate and underwrite a portfolio of life or annuity business are not the natural domain of P&C reinsurers.

Jeworrek: Both mortgage and life reinsurance are interesting opportunities to diversify an existing P&C portfolio. We see mortgage reinsurance as a line of business that requires experience and local market know-how, as well as disciplined limit and cycle management.

Life business requires an in-depth understanding, as these risks will be on the books for decades. Munich Re has been building up expertise in this area for a long time: life business is mainly driven by joint business development and an outstanding database.

Ruoff: This comes back to the capital question. Both mortgage and life are also generally speaking longer tail lines of businesses, so they would be a good diversifier to property and casualty lines.

However, they require different underwriting skills, different capital management and different asset management skills than traditional reinsurance.

Rousseau: Life reinsurance is nearly 60 percent of Scor's business. It is a difficult segment for new entrants to penetrate in an intelligent way, and it takes years and billions in capital and cash to grow a book that slowly releases embedded value and cash over time.

Mortgage reinsurance seems to be much more accessible and contestable at scale. With a limited number of primary carriers plus only two government-sponsored enterprises in the US, the questions for reinsurers appear to be how much to take, whether to take it as reinsurance or investments in mortgage-backed securities, and how to manage exposure when and if the housing market turns.

Schmid: Given the long duration nature of the business, life reinsurance is a risk pool in which small errors or adjustments to beliefs can create enormous balance sheet implications – and as such, it is very difficult to build a rigorous underwriting capability if it's not in your DNA.

If you mean reinsuring the actual credit risk of a mortgage, there are reinsurers who do this, but I'd argue this is not really taking insurance risk but mainly systemic financial markets risk. If you mean the property insurance that goes with mortgages, that's normally (but not always) a personal lines product that is unlikely to be huge for reinsurers.

Althoff: We have put a lot of effort in the past in the expansion of our life reinsurance book in order to help us diversify. That has made our business more stable, predictable and less capital-intensive.

Life reinsurance is also attractive as the barriers to enter the market are significantly higher than in traditional P&C business.

For the time being, we have decided to stay out of mortgage reinsurance for a number of reasons and continue to concentrate on our traditional credit and bond business.

The latter has grown significantly and successfully over the last 10 years for our portfolio.

Barry: Mortgage reinsurance continues to offer a solid risk-reward trade and can continue to be a growth area for many reinsurances in the near future. However, correlation with financial markets and other more mainstream lines of business needs to be monitored. In regard to life reinsurance, it does offer the benefit of reduced capital charges relative to premium and the potential to create ballast in the overall portfolio.

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Blockchain: the future of shipping and marine reinsurance?

In May this year Denmark-headquartered shipping giant Maersk launched Insurwave, a blockchain platform that uses the immutability and transparency of distributed ledgers to allow clients and carriers to monitor assets in real time.

To insurance blockchain specialists, this is known as a "track and trace", a set-up that follows resources as they move – containers, oil tankers, trucks – and can adjust premiums as the nature of the risk changes.

Tracking the movement of cargo is one thing, but for marine reinsurers trying to work out if the technology will change the secondary insurance market the questions are myriad: can such a system be transplanted from the primary market to support reinsurance treaty contracts? What will this look like and how will it work?

Insurwave also processes facultative proportional reinsurance contracts – the first system of its kind for the marine market. However, for reinsurers it is unclear whether this technology will be extended to all types of marine treaty reinsurance business and how it could change the reinsurance business proposition.

Speaking to *The Insurance Insider*, Ernst & Young financial services insurance partner Preetham Peddanagari explains that Insurwave hinges on the use of smart contracts across the board. These are digital contracts that use algorithms to track and change data such as whether or not a vessel has entered or exited a war zone, valuation and the ship's flag. In this system these data points are linked to reinsurance contracts as well as primary contracts using a predefined set of rules.

"These rules record endorsement and additional or returned premium for the vessels on the distributed ledger, where appropriate," he says.

He adds that Insurwave will be developed to support quota share, surplus and non-proportional reinsurance contracts by the end of 2018.

A cost-cutting aid or the future structure of transactions?

A programme such as Insurwave has the potential to allow a carrier to slash the costs of administering a reinsurance treaty by cutting the resources spent adjusting risks that make up a portfolio of business.

Marine reinsurers canvassed by *The Insurance Insider* have expressed broad support for research and development strategies, with the majority identifying a blockchain system as a potential cost-cutting strategy.

"There's definitely something in these systems that allow the many different working parts and assets to be tracked like this," one underwriter said.

> "Insurwave processes facultative proportional reinsurance contracts – the first system of its kind for the marine market"

"We have so many assets and counterparties involved in the treaties we underwrite that we see blockchain as a possible way of handing off the multiple data transactions required for each contract," they added.

However, in addition to the potential return to be gained from investing in technology that helps slash operating costs, using a distributed ledger to track transactions instead of manually held contracts is also key in helping underwriters adapt to the future of the industry.

Peddanagari is adamant that the benefits for marine reinsurers are myriad.

"Blockchain platforms don't just reduce costs for reinsurers, but should allow for new and enhanced distribution models to be set up, improved products and more accurate underwriting."

Dirk Siegel, partner at Deloitte's blockchain institute in Germany, cites the progress of the reinsurance industry body B3i, launched at the Monte Carlo *Rendez-Vous* 2017, and says marine reinsurers must also consider including distributed ledger technology as part of future business plans to remain relevant.

"It's about anticipating the future ecosystem structure within the industry," he says.

"The same principle applies within the marine reinsurance industry. These companies will want to make sure that they have a stake in the future of the industry."

The consortium includes industry players Aegon, Allianz, Munich Re, Swiss Re and Zurich. It announced in August it is set to expand into commercial insurance in 2019.

Christopher McDaniel, president of the RiskBlock Alliance – a Pennsylvania-headquartered insurance industry consortium that includes Munich Re, The Hanover Insurance Group, Liberty Mutual and RenaissanceRe – agrees. But he says it is clear that immutability and transparency are the principal factors that make blockchain attractive to marine reinsurers.

"Distributed ledger technology is not meant to be an asset management tool.

"We strongly believe that having the same framework – the same plumbing – is really important," he adds.

The RiskBlock Alliance is a separate consortium that has developed a system called Canopy, a "plug and play" set-up built on R3's Corda platform that allows participants to link it to their own systems.

McDaniel tells *The Insurance Insider* that partners within its consortium are likely to launch a marine reinsurance solution as soon as the end of the year.

Sharing the benefits

Reinsurers canvassed by *The Insurance Insider* were supportive of exploratory work being carried out by research and development (R&D) teams at their respective carriers but were concerned whether a distributed ledger system could deal with the volumes of shifting data required across proportional and non-proportional marine insurance contracts.

Deloitte's Siegel explains that the data capacity of a distributed ledger system is unlikely to be a sticking point.

"There is more likely to be an issue at the points of the system where data flows across boundaries – whether marine insurers feel comfortable with reinsurers seeing so much of their information, for example," he says.

A distributed ledger system used for placing and managing reinsurance treaties could have more moving parts, but the prospect of insurers having to share more information with reinsurers at a time when market conditions are becoming tougher and tougher will not always be appealing.

"For reinsurers sitting above marine insurers, accumulating risk, the possibility to also accumulate more granular information is very attractive. The primary insurers may not necessarily have the same view," Siegel adds.

CONTINUED ON PAGE 27

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While the implementation of a distributed ledger system could help carriers cut costs and improve loss ratios in the face of a soft market, the prospect of sharing more proprietary data with reinsurers – who already have vast troves of information allowing them to accurately price the risks they assume – may not be an appealing one.

This could be heightened in classes of reinsurance business such as the yacht and general aviation markets, where risks can be less carefully controlled.

The data available to a reinsurer across an entire portfolio could have the effect of giving away an insurer's competitive advantage to their reinsurer.

However, Siegel points out that distributed ledgers themselves may hold an answer:

"We observe this competition for the data in the many situations across different industries that see sudden technological progress," he says.

"Some of the private blockchain platforms around now have very good visibility restrictions – participants have precise control of who gets to see which element of the data on the distributed ledger."

RiskBlock Alliance's McDaniel also thinks that blockchain brings with it a solution to the intransigent problem of who has access to the proprietary data.

"Canopy is built on R3 Corda, and Corda is strongly based on permissions. One large broker is building a system on Canopy that they want certain carriers to use but don't want other carriers to have," he says.

Challenging relationships

A distinguishing feature of the Insurwave project has been its ability to establish cross-industry consensus. While the platform has been developed for Maersk by EY, software company Guardtime and technology giant Microsoft, it is also used by insurers MS Amlin and XL Catlin. Significantly, broker Willis Towers Watson is also a participant.

This is surprising at a time when brokers are pivoting their business models to focus more intently on consultancy and data analysis as demands for legacy insurance broking services from clients fall away.

It is all the more surprising given the platform enhances Maersk's ability to sell risk and insurance products directly to its customers – a step further towards the disintermediation of both (re)insurer and the broker, according to some in the market.

Given the sustained pressure over expense ratios and the prospect of disintermediation, a distributed ledger system may well help carriers and brokers to adapt to a new reality.

EY's Peddanagari points out that while the role of brokers in a marine blockchain platform is key "to a certain extent it will see them change to a more risk adviser role".

He says: "On the whole, the broking industry is supportive of distributed ledger technology as it can offer huge opportunities to reduce the cost of administrating contracts. In addition to cost benefits, it gives brokers the opportunity to innovate on their distribution model and their range of products."

> "For intermediaries, taking a central role in a distributed ledger platform is key to remaining embedded within the reinsurance ecosystem"

RiskBlock Alliance's McDaniel agrees, but says so far the size of a broker's business has determined its reaction to a blockchain platform: "From my perspective, the big brokers get it. Their models are changing and they have to explore areas and to some extent accept the reality of disintermediation."

McDaniel cites examples of recent RiskBlock working groups where one of the Big Four brokers led discussions despite not being involved in finalising the technical details for one element of the project.

It seems that for intermediaries, taking a central role in a distributed ledger platform is key to remaining embedded within the reinsurance ecosystem.

Siegel is clear that some kind of tussle over the standards used are always going to be an inexorable part of progress in introducing a technological shift of this kind into the insurance industry.

"Whenever you set up a consortium that seeks to make progress with a new technology, you always go for the low-hanging fruit first," he says.

"Moving to more complex products or processes can get tricky because in any Blockchain ecosystem you have to agree common standards. The more complex a product and the more variant the market, the more work will have to go into these standardisation activities."

He draws a parallel with the world of trade finance, where banks and lessors are also developing blockchain schemes to facilitate the smart financing of vessels.

"We have seen the use of similar marine blockchain systems within the world of trade finance. With such technology, banks and lessors will, for example, be able to track how close a ship sails to a hurricane or storm, which gives them almost real-time knowledge about an asset such as an engine or cargo, and to allow them to adjust a financing facility accordingly."

Marco Polo is a blockchain platform developed by software companies R3 and TradeIX, which facilitate pre- and post-shipment trade finance transactions. AIG is understood to have provided trade credit insurance for one of the first transactions to take place on the system.

Batavia is another blockchain trade finance consortium built on an IBM platform that has facilitated the sale and shipping of vehicles between European countries.

Both schemes have undertaken initial transactions and are convinced the set-up represents an indelible shift in the fabric of the industry segment. Citing the B3i consortium, Siegel adds that systems like this can also change the way funds are raised within areas of an industry, whether it is marine trade finance or reinsurance.

He imagines the possibility of expanding an ecosystem where risks become tradeable to other sources of capital and perhaps the general public. "One could see this in analogy to the ICO market, which opened what used to be a closed shop venture capital domain to the general public."

For marine insurers fighting for business in a segment of the industry already awash with capital, this is a chastening reality.

For underwriting executives working out how to deploy a research and development (R&D) budget amid pressure on the bottom line, the dilemma is tri-fold: what distributed ledger partnerships would be worth negotiating with fellow competitors? How can primary carriers be persuaded to part with more of their data? And what will the use of these platforms mean for existing broker relationships?

These are existential questions already under the spotlight as reinsurers face increased M&A and strategic cost-cutting amid soft market conditions and reduced profitability for many lines of business.

It is clear, however, that the new technology brings together company markets and forces the kind of collaboration and syndication of information that has taken place in the Lloyd's of London market for more than 300 years.

What is certain is that decisions made by marine reinsurers in 2018 will determine the future of a primary marine insurance market worth at least $27.5bn.

Driving the market forward

Ahead of this year's Monte Carlo *Rendez-Vous*, *The Insurance Insider* caught up with Odyssey Group president and CEO Brian Young for his perspective on what we can expect in the coming months and the factors that will drive the market forward.

With the lack of price increases post-Harvey, Irma and Maria (HIM) and the 2018 hurricane season upon us, what is your take on the cat market?

The pricing environment for cat business showed little sign of meaningful recovery despite more than $100bn in losses in 2017 and significant rate cuts in recent years. While the lack of movement is disappointing, it's frankly not surprising given the abundance of capital in the market and the expanding risk appetites of many (re)insurers. We've seen the most corrective action in the Caribbean as more than 20 years of regional industry profits were wiped out from the combined effects of Irma and Maria. In the US, while the cumulative impact of HIM and the California wildfires was substantial, rate increases were more modest than they otherwise could have been for two reasons: most reinsurers are still holding sizeable profit balances since Katrina, Rita and Wilma in 2005, and the rolling multi-year structures of many US cat placements had a dampening effect on rate increases. Elsewhere around the world, pricing was largely flat. While this was frustrating following five years of heavy rate reductions, at least prices didn't fall further as they were expected to in the absence of any losses in 2017.

Beyond property cat, what was the impact on other lines?

The hull and cargo market has been hit hard and prices are rising in this sector. Rates are increasing in the health sector due to poor results and rising medical inflation. Select motor markets are experiencing price corrections as a result of increased loss activity. In other lines, pricing and commission terms have improved modestly, but not enough to move the needle all that much. Casualty business remains very challenging after more than a decade of intense competition. Prices more than halved over that period, while coverages expanded and commission levels rose by 5 percent to 7.5 percent. Casualty is the sector in greatest need of a correction; without it, we are heading towards another debacle similar to what the market experienced at the turn of the century.

Are there any bright spots in the market?

In a globally diverse market there are pockets of opportunity in many parts of the world – you just need the network and the capability to take advantage of them. Odyssey Group fortunately has both of these. Last year we grew our top line by 18 percent, and through the first six months of 2018 our gross premiums written rose by 25 percent. We have seen profitable growth in crop, health, credit, property quota share, cyber and niche segments of the casualty market, but perhaps the largest area of expansion for us has come from our motor business. There has been considerable dislocation in the commercial and non-standard motor sectors in the US and in other motor markets around the world. This has created opportunity for us on the direct side, through our US insurance division Hudson, as well as on the reinsurance side for OdysseyRe in the US, UK and Europe, Middle East and Africa.

"Casualty is the sector in greatest need of a correction; without it, we are heading towards another debacle similar to what the market experienced at the turn of the century"

What are your expectations at the next 1 January renewal?

I expect incremental improvement in insurance pricing globally. We have seen a modest uplift in pricing in many markets in 2018 and there is too much pressure on underwriters' bottom line for it not to continue. The degree of improvement will vary by class, territory and results, but there is no doubt in my mind that we are in a rising insurance market.

Assuming there are no material cat losses between now and year-end, I would expect reinsurance pricing to be flat at 1 January. Any increases will be loss-driven. Casualty placements have met increasing resistance from reinsurers in 2018 and this will likely continue as the tail starts to wag on the more recent accident years. Consequently, I would expect commissions to improve another point or two as they have this year.

Why, after more than 20 years, have you rebranded from OdysseyRe to the Odyssey Group?

When Fairfax Financial Holdings Limited formed OdysseyRe more than two decades ago, we were exclusively a reinsurance business. Today, the Odyssey Group writes more than $1.5bn of insurance business through our Hudson and Newline platforms. By rebranding, we are clarifying that we are more than just a reinsurance company. We chose Odyssey Group as our new corporate identity so we can more easily demonstrate the diversity and power of our three franchises: OdysseyRe, Hudson and Newline. OdysseyRe is our global reinsurance business, Hudson Insurance Group is our US insurance division and Newline Group is our international casualty insurance arm and Lloyd's vehicle. While we will continue to convey the unique qualities and capabilities of each of our three businesses separately, we think it is important for our clients and business partners to appreciate that the value of Odyssey Group is greater than the sum of its parts.

Brian Young
President and CEO, Odyssey Group

Was 2017 unusual, unlikely, or both?

TigerRisk's head of analytics Nathan Schwartz considers whether 2017 was an unusually busy year for catastrophes, or whether other factors simply made it seem more eventful than usual

What does it mean for a random outcome to be "unusual"?

We all have a sense that if the lottery came up with the numbers 01, 02, 03, 04, 05 and 06, then that would be fantastically unlikely. But at the same time, we all know that an orderly string of numbers is no more or less unlikely than the normal-looking 03, 11, 38, 44, 58 and 02 – the actual Powerball lottery outcome on 4 August 2018.

The US aggregate insured loss for 2017 had around a 20- or 30-year return period depending on how it is modelled. Most people would agree that it was more unusual than that. The question is why.

Was it because we've entered a new age of detailed media coverage? Or was there something different about the events of the year? Perhaps it was the mix of events? You don't have to play with the numbers much to conclude that 2017 was unusual. It was. But was it unlikely?

There are at least three lenses through which we measure likelihood: size of events, number of events and characteristics of events.

According to industry loss estimates, US insured losses in 2017 were around $100bn – an unremarkable number on its own. But how those losses came about, in a parade of moderate to large events, was what made 2017 stand out.

Adding to the eccentricity were the large losses stemming from California wildfire – a peril which has been slow to earn its catastrophe status and not well represented in the standard cat modelling frameworks. We can expect new models to be released soon, but in 2017 wildfire was a wildcard.

Current industry standard tools are not designed to predict the events of a single year across all perils, but when we start to look at the likelihood of the loss distribution of 2017, we can begin to quantify unlikeliness.

In 2017, the US experienced 12 $1bn+ events across the wildfire, hurricane and severe convective storm/winter storm perils. If we ignore the specific peril distribution of those events, the return time for all of those events occurring in a single year is around 60 to 150 years.

Not only did 2017 witness a dozen $1bn events, but there were also three $10bn events. The return period for this many or more $10bn events is 75 to 100 years. From this perspective, how the losses stacked up was much more unlikely than the size of the total loss. If it seemed like there was a constant barrage of catastrophes last year, it's because there was.

> "Just 10 years ago, cascading coverages were either too expensive or non-existent, but the market has grown to address these needs"

Now that 2017 has passed, will we see another year like it? Since 2000, on an aggregate loss basis, only 2005 experienced slightly more losses, and no other year saw as many $1bn events.

Interestingly, there have been three occurrences of 10 or more $1bn events in a year, and they all occurred in the past seven years. Our speculation is that the distribution of property exposure is trending toward higher risk, whether it be driven by concentration, more coastal exposure or continued expansion into wildfire-prone areas.

With all this historical and modelled information at hand, it's no wonder that pinning down a specific return period for 2017 is challenging. Despite the wide range of values, we can be confident in saying that 2017 was indeed both unusual and unlikely, offering insurers and reinsurers a great learning opportunity.

Last year's events allow us to evaluate our clients' reinsurance programmes using more than just models. We know that in a high frequency year with many multi-billion-dollar events, a traditional reinsurance occurrence tower leaves many insurers with a lot more retention than desired.

Furthermore, if a programme does attach, limit on lower layers can quickly be exhausted. Even having reinstated layers could lead to a lot of retained losses if the frequency of 2017's events was repeated.

Insurers that purchased cascading or aggregate structures were well served in 2017 by coverage that became more effective after the first few events rather than less. Just 10 years ago, these coverages were either too expensive or non-existent, but the market (with some prodding) has grown to address these needs. Today a reinsurance programme should protect you in a cost-effective way against years with one loss or many.

As we are reminded all too frequently, catastrophe models aren't designed to replicate exact events, but to give us an understanding of possibilities. Those possibilities aren't immune to blind spots like 9/11, the Tohoku earthquake and tsunami, Hurricane Sandy, Harvey-related flooding and last year's Northern California fires.

Last year was without a doubt unusual and unlikely. Looking ahead will there be years that have even more perplexing characteristics? Absolutely. One thing we know for sure: insurers must be ready to face all possibilities.

Author bio

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Balancing risks with opportunities

Ahead of this year's Monte Carlo *Rendez-Vous*, *The Insurance Insider* spoke with Laurent Montador, deputy chief executive of reinsurer CCR Re

As a relatively new player to the open reinsurance market, what lessons did you learn from last year's catastrophe activity and the (lack of) impact that it had on market rates?

We set up CCR Re two years ago, but we have 70 years' experience through the mother company. One of the lessons from last year's natural catastrophe events is that climate change has conflated with the perils. There are more extreme events, more often.

Prices are not adequate to meet this. Except for particular loss-hit accounts, we have not seen a major pricing reaction. The reaction was smoother than anticipated because of market forces, excess capacity and also risk transfer's inter-mixing between pure reinsurance and alternative capital.

Central banks' role in financial markets has pushed potential investors looking for better returns, directing more and more capacity towards our sector. That's part of the reason those climate-change uncertainties have not been the immediate focus because of market forces.

Will rates dominate discussions at Monte Carlo this year? Or something else?

We see mixed messages on different markets and the different parties among the cedants and intermediaries. It is important pricing reflects the risks, and it's not sufficient at the moment. As individuals, we all are more and more conscious of the already current visible effects of climate change. Risk awareness is there and should be recognised as well as business people as reinsurers, but also as insurers or brokers, but the market dynamics of playing the game still lead to different results. We also expect that pressure on margins, cost reductions, making greater use of technology, and the role of different risk-transfer tools will also be important themes in Monte Carlo, on top of the M&A activities.

You have been operating in specialty reinsurance since the 1980s. Which emerging risks in specialty reinsurance provide the most opportunity? And which cause the most headaches?

Digitalisation of our society is an important subject. It is changing the insurance model, but if you have new means of reducing claims, you will also have less premium. This is why there is a need for an integrated service provision, and we see more services added in some different specialty lines.

Cyber risk is at the same time a headache and an opportunity. Demand is rising, but there is difficulty in assessing the risk and controlling accumulation. This means risk selection and deep understanding are necessary. We can study cyber proposals, but we want to know our clients understand the risks themselves. There are possibilities, but when you see the claims arising in the insurance industry, you also need to be cautious.

You have spoken in the press about the importance of Asia in CCR Re's growth plans. How much of your business currently originates from Asia, and how big a proportion of CCR Re's book do you see coming from the region in five years?

Asia represents one-fifth of our book and we expect it to be one-third within the next five years. Growth is important, but there's a need for profitability to expand and evolve our financial capabilities. We are dedicated to the bottom line, to our reserves, and our duty to clients because we are dedicated to be with them for the future. We see opportunities, but there's a need to clearly understand the different dynamics of Asia's many markets and their levels of insurance penetration for life and non-life. Risk selection and deep understanding of clients are vital. It's all built on trust, and we have a long-term view to support clients' development.

You have also been quite vocal on the impact of technology on (re)insurance. What do you see as the key short- and long-term applications for artificial intelligence (AI) in reinsurance?

Insurance should be a source of innovation for AI. The technology is available to squeeze several layers within value chain delivery. There's a need to rethink business models to integrate AI and to connect with new tools such as blockchain for some products throughout the risk-transfer chain.

Agricultural insurance, for example, can improve its offer through mobile phones and the internet of things, for example, with risk analysis, easy subscription and delivery connected through bank accounts, with claims automatically calculated and well understood by clients. That can be continued through reinsurance, continuing the blockchain from the direct client through to reinsurers. That is coming in the future and our internal processes need to be ready.

In 2018, many of the natural disasters that have occurred so far have happened in areas with low insurance penetration. Sister company CCR acts as a state reinsurer in France. What lessons has the group learned about working with governments to help close the insurance gap when it comes to mitigating risk from natural disasters?

Governments are aware of the protection gap and want to put solutions in place. We have learned there's a need to measure not only insured losses but to estimate the economic impact. You've got to measure the gap and treat it, through prevention and mitigation, through (re)insurance markets, and also to recognise that not all risks are insurable.

It's difficult to co-ordinate the many governmental entities involved. There is a real need for better communication between local government and municipalities and centralised government. They know their local risks best. It should be bottom up as well as top down. It needs the right framework and policies, to put incentives in place, and to develop a culture of risk awareness within government and the population.

Laurent Montador
Deputy CEO, CCR Re

Does Bermuda have a future?

Almost a year ago, many in the reinsurance market were confidently predicting 2018 would see the start of a broad market correction in reinsurance pricing.

Speaking on the company's Q3 2017 earnings call, Axis president and CEO Albert Benchimol said he expected "meaningful price increases in the property and property cat reinsurance renewals coming up at 1 January".

Meanwhile, Everest Re president and CEO Dom Addesso said on the firm's third quarter conference call that he believed the 2017 cats would "lead to a general market firming across all lines and territories". He also predicted "well-rated capacity will be in demand, and this will drive better rates, terms and conditions across the spectrum".

Though there has been some improvement, it is fair to say the market has been disappointed with the level of overall pricing response. What we have seen has been a confirmation of what textbook economics would have predicted. Lower barriers to entry and an abundance of capital on the sidelines have reduced the likelihood of a capacity shortage in property catastrophe reinsurance.

At 1 January, US property rates for loss-hit cat accounts were up by 10-20 percent, while loss-free cat pricing renewed between flat and 5 percent up, according to JLT Re. Despite predictions of this being the start of a broader hardening, pricing momentum waned as the year progressed, with just a 1.2 percent average increase at the mid-year renewals, according to the broker.

After a year with more than $100bn of cat losses, this brings the industry's through-the-cycle earnings power into razor-sharp focus. It might be reasonable to ask investors to look past your heavy cat years, but it's a harder sell to get them to look past your lacklustre peak earnings.

This was neatly summed up by Everest Re's reinsurance CEO John Doucette. "A key lesson so far in 2018 that is already well known, but perhaps underappreciated, is that reinsurers cannot rely on hard markets to offset subpar results in non-loss years," he observed on the firm's Q1 conference call.

To understand the market's disappointment, some historical context is useful. Though the circa 10 percent price increase in 2018 was actually similar to the last "hardening" market in 2012, it is important to remember it is not just about the change in pricing but also the absolute value of pricing adequacy.

Industry pricing remains more than 25 percent below its previous peak – and substantially below prior troughs in 2005, 2008 and 2011 (see chart, left).

This tallies with comments by then Arch COO Marc Grandisson on the firm's Q4 2017 conference call. "To get back to historical returns we would want from a property cat perspective, precisely because of the volatility around it… about 30 percent increase," he said.

"And now where we are, we probably gained anywhere between 5 percent to 10 percent. So we would still need not an insignificant amount of rate increases."

There are two factors worth keeping in mind when considering the lack of pricing response in 2018. The first is the trailing loss experience in cat-exposed lines, particularly wind-exposed regions in the US.

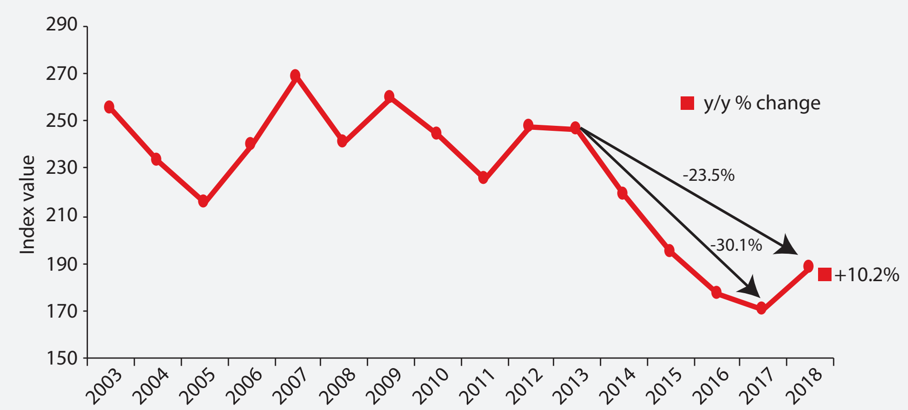
Unlike recent large loss years this century, the 2017 events came after a long stretch of benign cat losses for coastal property in the US (in 2011, large losses were largely driven by international and earthquake risks).

This was a point raised by Alleghany CEO Weston Hicks in his Q3 2017 letter to shareholders shortly after the impact of hurricanes Harvey, Irma, and Maria.

"What is surprising is not how active 2017 was, but rather how benign the period from 2007 to 2016 was – there were no major hurricanes making landfall in the US during this time period," he explained.

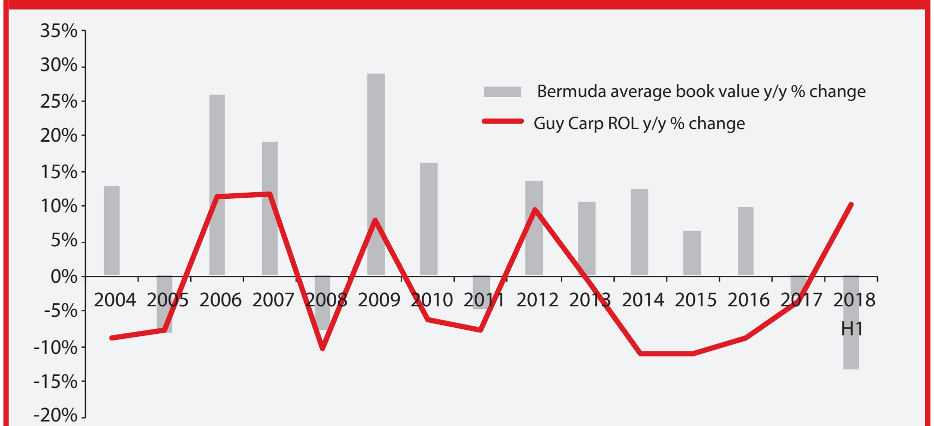
"In fact, in 13 of the 16 prior decades ending in 2010, at least one Category 3 or worse hurricane made landfall in the US every two years, on average. By contrast,

Guy Carpenter property cat RoL



Source: Guy Carpenter, *The Insurance Insider*

Book value erosion vs pricing cycle



Sources: company statements, S&P Global, *The Insurance Insider* the 10-year period from 2007 to 2016 was a period in which only five hurricanes, none of them major, made landfall in the US."

Between 2004 and 2017, there were three high loss years that subsequently generated increases in property cat pricing and ultimately returns: 2005, 2008 and 2011. These high-loss years were fuelled by some of the most active hurricane seasons in history, with storms hitting the US mainland in peak exposure areas for Bermudians (2005 and 2008), as well as a spate of international cat events in 2011 including earthquakes in New Zealand and Japan, flooding in Thailand and record tornado losses in the US.

> "Between 2004 and 2017, there were three high loss years that subsequently generated increases in property cat pricing and ultimately returns: 2005, 2008 and 2011"

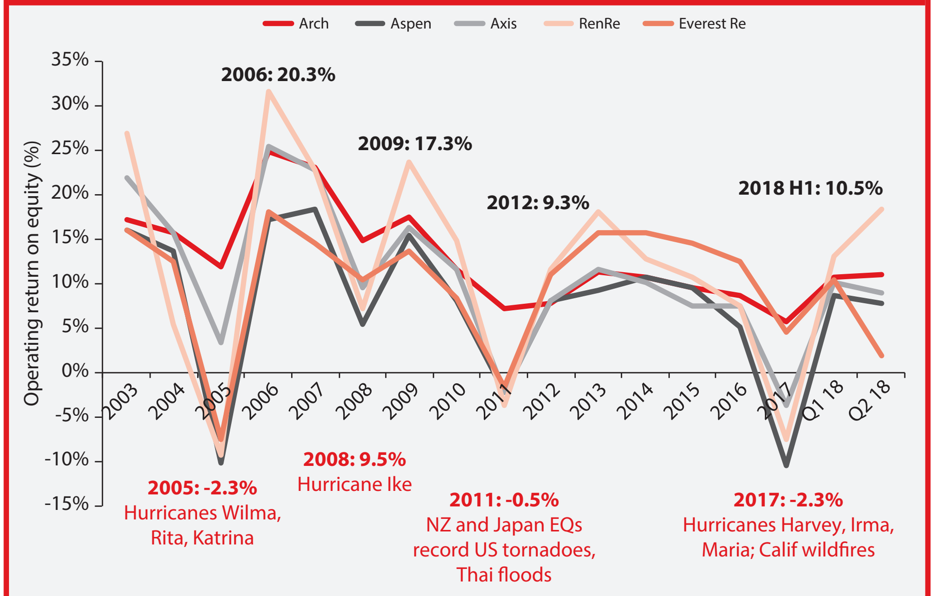
The returns generated in years following these events were substantially higher a decade or so ago than in recent peak earnings years (see 15-year timeline chart, right). The heavy 2005 cat year was followed by a highly profitable year, with the simple average operating return on equity (RoE) for the (re)insurers in our composite reaching 20.3 percent. Note, there is some "survivorship bias" in this sample by focusing only on reinsurers to have continued as going-concern independent companies, but the results are still illustrative.

However, this peak earnings phenomenon appears to have broken down following loss events in 2011 and 2017, with operating returns for the group barely scraping into double digits. Of course, 2012 operating results were suppressed by Superstorm Sandy losses. But this does not negate the point as the 2013 peak remained subdued relative to prior years.

The volatility of returns across loss-free and loss-heavy years makes it hard to speak to the true underlying earnings power of reinsurance business.

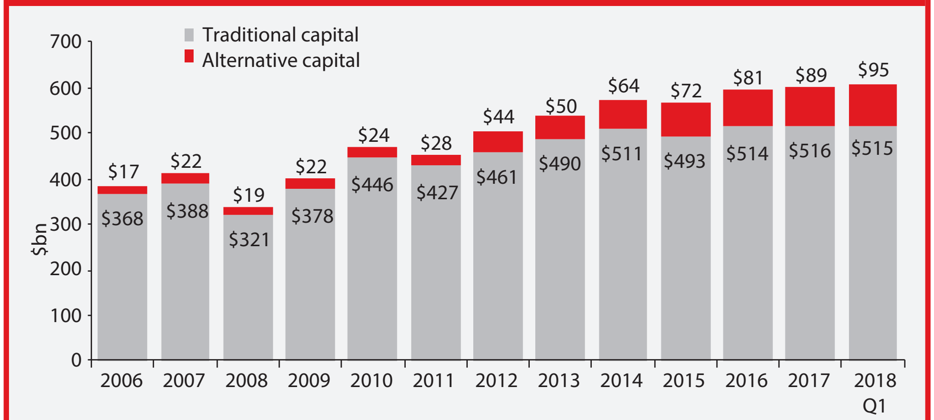
If anything, the average results observed across the cycle are probably overstated due to a heavy bias in the data sample to have a cluster of outcomes around the modal value (essentially loss-free years) but a heavy skew of potential but low-probability outcomes with very large losses. Put more simply, we have plenty of data on what a good year looks like but less on what a truly bad year looks like, which makes it challenging to estimate what true expected earnings are as an external analyst.

Bermuda: 15-year timeline of peaks and troughs



Sources: company statements, S&P Global, *The Insurance Insider*

Global reinsurer capital



Sources: company statements, S&P Global, *The Insurance Insider*

But with peak years barely reaching double digits, it is a fairly safe assumption to peg industry earnings power in the single digits.

"The returns on capital, return on equity of the industry, in general, as you all know, has been in the mid-single-digit for a period of time," estimated Everest Re's Addesso. "And therefore, these types of events [in 2017] are unsustainable, with mid-single-digit RoEs in times of low to no cat activity."

A second and well-discussed factor is the growing role of alternative capital in reinsurance markets. Though alternative capital had been a factor in the market for more than a decade prior to 2011, that segment of the market grew around 60 percent following 2011 losses (see alternative capital growth rate chart, p36).

Essentially, with 2017 losses, we now have two consecutive data points on the market's response to large losses and weak trailing returns. And what we have learned is capital destruction is – on its own – not enough to create conditions of scarcity for capacity.

The easy flow of new money into the alternative capital space has prevented this, unlike in prior years where a market re-load involved slow-moving equity raises and new company formations.

CONTINUED ON PAGE 36

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"The reloading of some alternative capital, in addition to competition from traditional players, had a muting impact on 1 January renewals, highlighting that alternative capital has become an enduring reality," explained Everest's Doucette.

Future of Bermuda

Considering all the above, we see three feasible avenues regarding the future of the Bermudian (re)insurer.

First, existing capital needs to be put to work in a smarter way, using multiple platforms and increasing access to business without needing to use extra capital.

This strategy is best evidenced by RenaissanceRe, one of the best performing reinsurers on the island.

"Long ago, we recognised that changes to our market are more secular than cyclical, due to the increasing efficiency of the reinsurance marketplace.

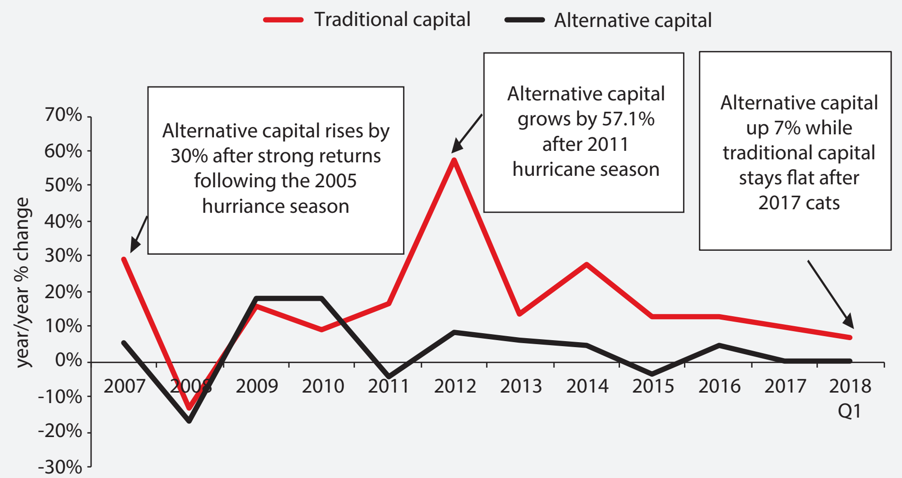
"Consequently, we built a business model that can compete as long as prices remain above expected loss," said president and CEO Kevin O'Donnell on the carrier's Q2 2018 conference call.

"Of course, better pricing makes things easier. But to succeed in this market requires not just great underwriting, but increasingly great portfolio construction. It also requires having great partners and the ability to deploy all forms of capital," the executive concluded.

This can be seen in the firm's expansion into casualty reinsurance with the acquisition of Platinum and growth in non-correlated lines like mortgage reinsurance. The carrier's ratio of net premiums written to tangible equity rose from 35.6 percent in 2012 to 49.9 percent in 2017, demonstrating that this growth has been achieved by using capital more efficiently.

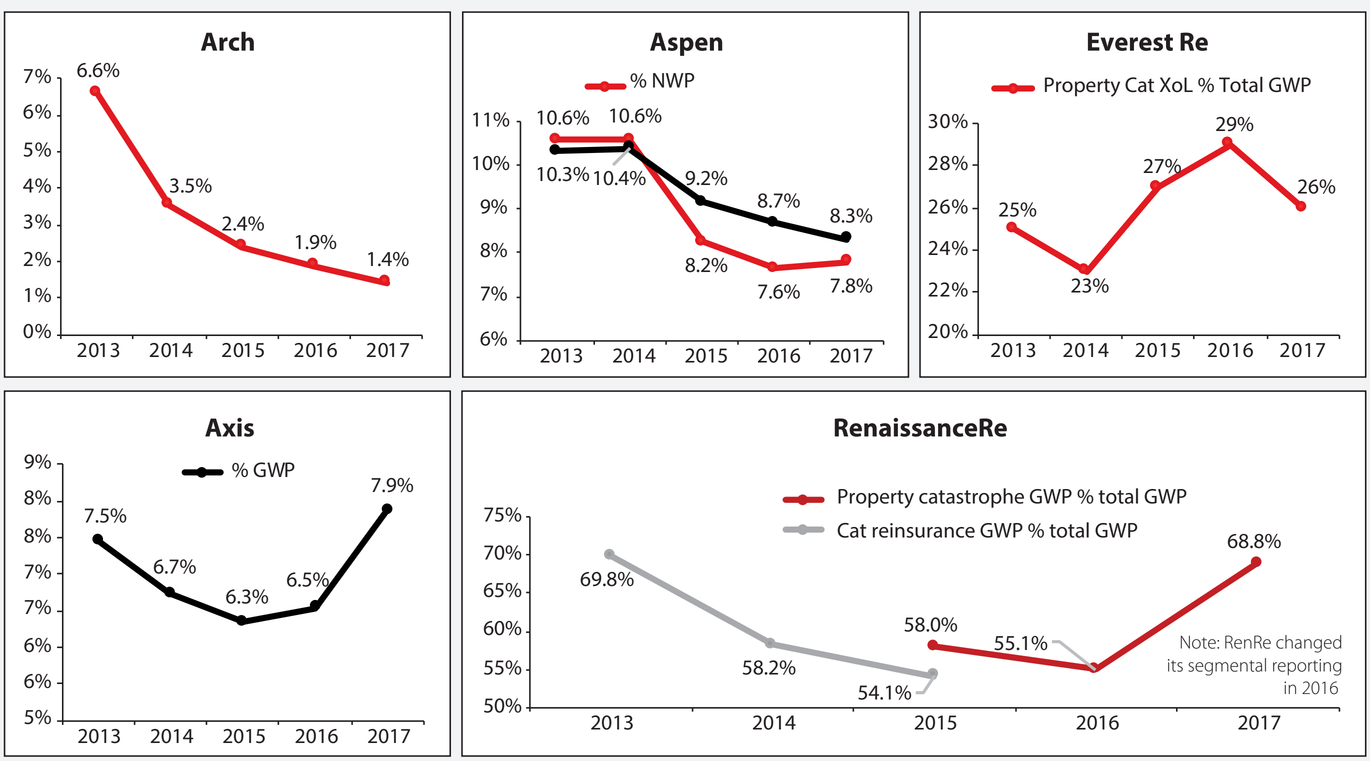
Second, as the island has been diversifying

Alternative capital growth rate versus traditional capital



Sources: company statements, S&P Global, *The Insurance Insider*

Bermuda: property catastrophe premiums as a % of total premiums



Sources: company statements, S&P Global, *The Insurance Insider* into new lines of business it has also been reducing existing exposure to large catastrophe losses and earnings volatility. Theoretically over time this should translate into a lower cost of equity.

Over the past five years, Bermudians have been changing their portfolio mix away from property cat due to market conditions shrinking risk-adjusted returns. Arch and Axis have both reduced their property cat exposure on a net premiums written basis over the past five years (see chart, bottom left).

> "Last year's hurricanes prompted increased use of reinsurance and retro in loss-affected risk areas"

In the case of Everest Re, Axis and RenRe, their property cat portfolios grew in the period but disclosure is unavailable on a net basis. However, the trio significantly reduced their retention at group level, which is an indicator of increased use of third-party capital, as mentioned above.

The decrease in net property cat exposures was also evidenced by the lower probable maximum losses (PML) in peak risk areas recorded by the companies. Every Bermudian with PML disclosures showed a reduction in its peak 1-in-250-year PML relative to equity over the 2013-2017 period, with Everest Re the only exception as its ratio remained flat.

Last year's hurricanes also prompted increased use of reinsurance and retro in loss-affected risk areas.

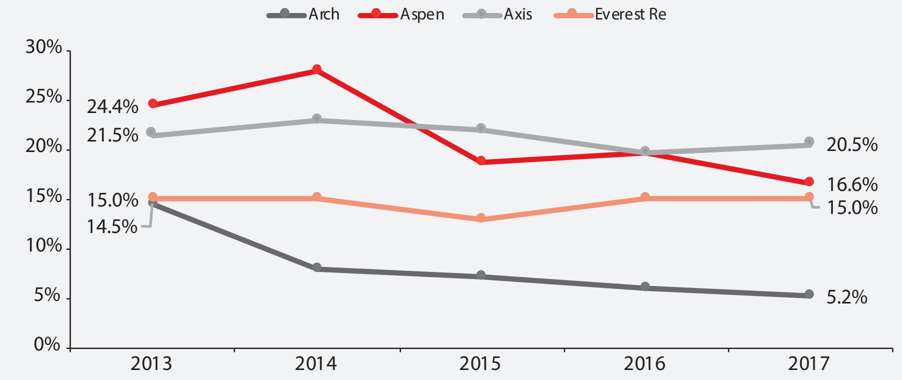
For example, Axis' 1-in-100-year Southeast US hurricane PML fell by 20 percent year on year to have a 10.4 percent impact on the carrier's equity base at the end of 2017. In 2013, the same metric stood at 17.1 percent.

Commenting on the cat reinsurance book on the Q4 2017 conference call, CEO Benchimol said the company's exposure was being taken down overall.

"Let's be honest. Where the world is right now, with the alternative markets driving the price for cat, cat is no longer offering insurers strong double-digit returns. And so we have to make sure that we allocate our capital appropriately for the risk and returns that are provided by the cat business," he explained.

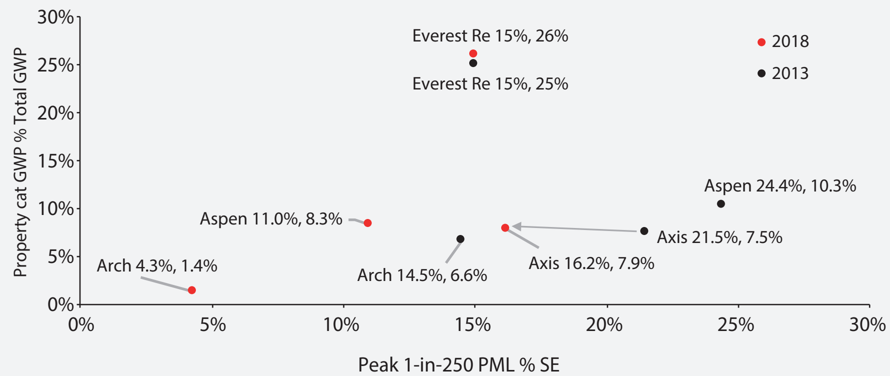
The third, and perhaps most speculated path for reinsurers on the island, is M&A. Over the past few years, Bermudian (re)insurers have been acquisition targets for global insurers looking to diversify.

Bermuda peak exposure 1-in-250 PML % shareholders' equity



Sources: company statements, S&P Global, *The Insurance Insider*

Property cat % GWP against peak PML exposure: 2013 vs 2018



Note: For Arch, Net Premiums Written were used; For Aspen, the US all wind PML was used for 2013 and California EQ was used for 2018
Sources: company statements, S&P Global, *The Insurance Insider*

Bermuda M&A

Date	Acquirer	Target	Consideration	Valuation
Aug-15	Exor	PartnerRe	$6.9bn	1.10x
Oct-16	Sompo	Endurance	$6.3bn	1.36x
Dec-16	Fairfax	Allied World	$4.9bn	1.34x
Jan-18	AIG	Validus	$2.1bn	1.58x
Mar-18	Axa	XL Group	$15.3bn	1.51x
Aug-18	Apollo	Aspen	$2.6bn	1.10x

Source: Company statements, *The Insurance Insider*

This year's flurry of deals fuelled market scepticism over an independent future of the small-to-medium sized Bermudian (re)insurer given secular changes described above.

This trend is likely to continue as reinsurers continue to struggle with high expenses versus lean competitors with low fixed costs at alternative capital asset managers.

Essentially, the extra cost of underwriting and transaction expenses at traditional reinsurers is not showing enough outperformance relative to more passive strategies to justify the costs.

Moreover, earnings volatility and a trend towards a preference for diversified and stable earnings (versus lumpy but higher returns) gives global insurers a cost of capital advantage that allows them to add companies like Bermudians at a relatively low return on investment and as an income-diversifying play.

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