Reactions

Business intelligence for the global insurance market

Proof Positive

How CEO Chris Gallagher's pragmatic approach to risk selection helped Sompo International Commercial P&C weather the COVID-19 tsunami

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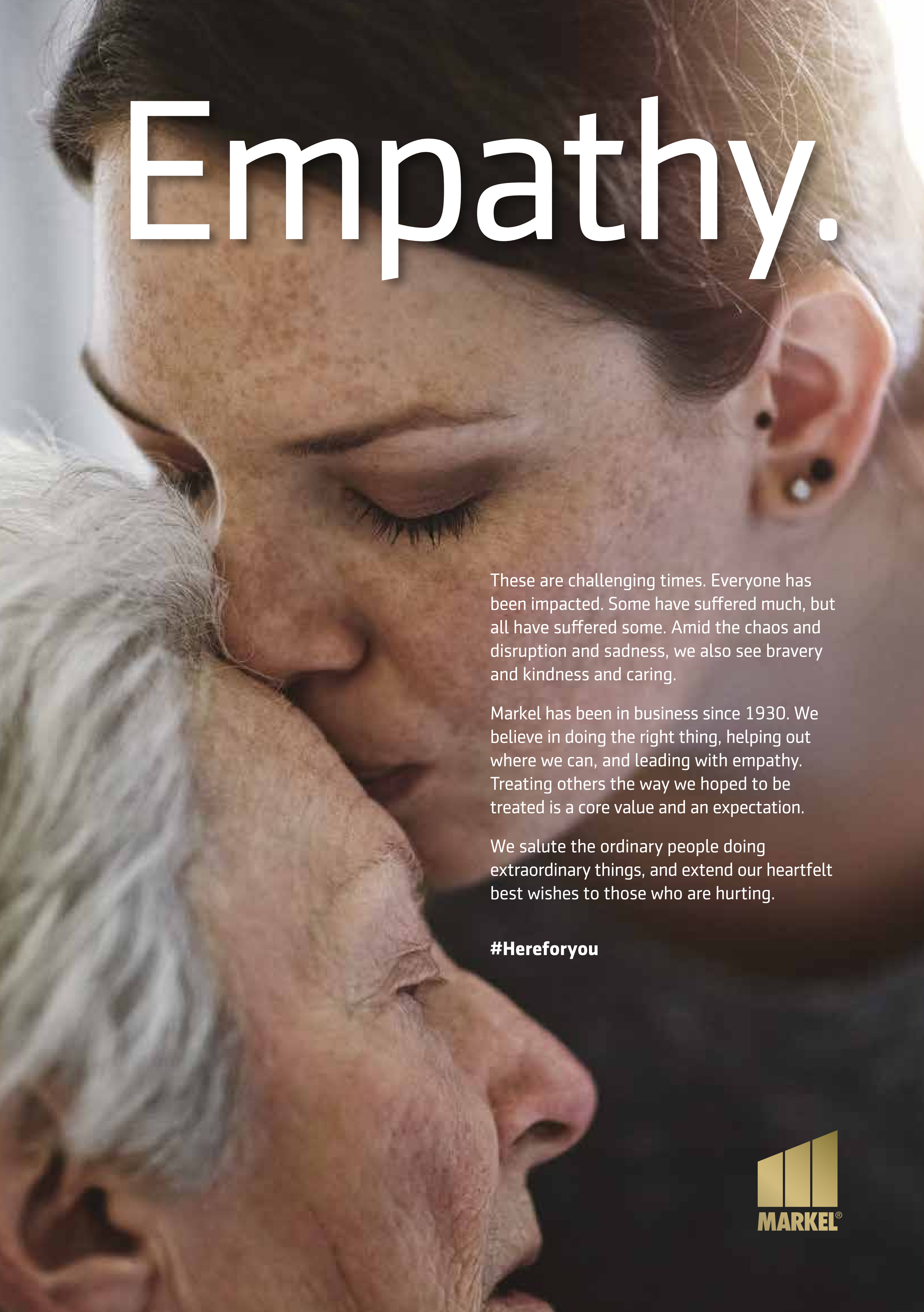
Empathy.
These are challenging times. Everyone has been impacted. Some have suffered much, but all have suffered some. Amid the chaos and disruption and sadness, we also see bravery and kindness and caring.
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Adapt and thrive

A career in journalism teaches you many things.

One of them is how to be flexible, to be versatile. As a news reporter, one learns to adapt, to become adept at writing about different topics every day. One day you're riding a circus elephant for a story; the next, you're interviewing Gene Simmons. (Yes, I've done both.)

The key is, you have to be constantly learning, always challenging yourself. The rate at which you acquire knowledge and new skills – and in turn, improve your performance – will greatly determine the pace at which you evolve as a professional.

I'm happy to report that even in the face of a global pandemic, I'm part of a team that continues to adapt, evolve and grow stronger with each passing day.

That's not to say it's been easy. While nearly every insurance executive I speak with will state on the record that the transition to working remotely has been virtually seamless for their organisation, I think we all know better than that. We all face the same challenges and distractions: the important meeting for which you're now late because you overbooked yourself or can't find the Outlook invite (or you've just missed the call altogether); having to get your kids ready for another round of remote learning; trying to keep your focus (and by extension, your sanity) while constantly reprioritising tasks as your inbox fills up – the list goes on.

Hopefully, however, you have those moments when you peek up from your foxhole and realise all the work you're putting in is paying off.

In August, *Reactions* took the step of hosting our London Market Awards as a virtual ceremony – something we'd never done before. Months back when we realised we had to convert all of our in-person events into webinars, we thought, could we present the awards online? Should we do so?

Turning conferences into a series of webinars is one thing. Getting people to tune in to a virtual awards ceremony? That's a horse of another colour. Would our readers watch that? Could we make it entertaining and offbeat enough to warrant their time?

The amazing thing is, we did. And so did they.

My colleague Mark Richardson, *Reactions*' London Editor, was nominated to host. Mark had never attempted such a thing, but he was game for it. (As it turns out, he was a natural).

How would we open a ceremony like that? Could we do something amusing? *We're all working from home*, we thought. *Let's not pretend we're at the Ritz. Let's take the piss out of it.*

It was decided that I'd write a parody of Oasis' "Wonderwall" – complete with reinsurance-themed lyrics – and sing and play the song to open the show. Did it work? I certainly thought so. (Hey, you try rhyming "policies are binding" with "terms are tightening" and you tell me how easy you think it is.)

In the end, I'm proud to say the results were tremendous, and we're building on the momentum from that event and our London Market Webinar Series, which was equally successful. With our Latin America Awards and North America Awards virtual ceremonies set for 10 and 24 September, respectively, the bar is set for me to ensure those online events are as entertaining as we can possibly make them. The entire *Reactions* crew will be there to assist. We hope you'll join us.

In the meantime, stay as healthy and sane as you can. I'll leave you with a valuable reminder I received this week from my 10-year-old son, Declan.

Just days before this issue was going to press, things were getting intense as our deadline approached. My boy had been in and out of the kitchen throughout the day, and he could see – and hear – that I was stressed out. (The Irish are particularly challenged at hiding such things.)

He walks in the room, hugs me about the head and says, "Hey, Dad – why did the chicken cross the road?"

"Why, Dec?"

"To get to the idiot's house."

I smiled.

"Knock-knock," he says.

"Who's there?"

"The chicken."

The lesson: stay in the ring, but don't take it all too seriously. After all, if the past few months have taught us anything, no one here gets out alive.

Shawn Moynihan
Editor-in-Chief

INSIDE

September 2020

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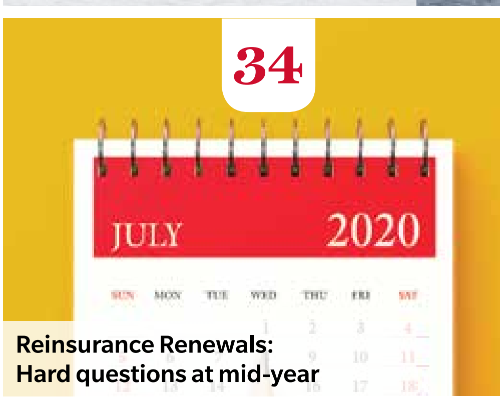

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Editor-in-Chief
Shawn Moynihan
+1 212-224-3474
shawn.moynihan@euromoneyplc.com

London Editor
Mark Richardson
+44 (0)20 7779 8142
mark.richardson@euromoneyplc.com

Associate Editor
Marc Jones
+44 (0)20 7779 8105
marc.jones@euromoneyplc.com

Copy Editor
Jamie Gallagher
+1 212 224 3322
jamie.gallagher@insuranceinsider.com

Contributing Editor
Garry Booth

Publisher
Goran Pandzic
+1 212-224-3711
gpandzic@euromoneyny.com

Head of Programming & Events
Elizabeth Wu
+1 212-224-3713
elizabeth.wu@euromoneyplc.com

Sales Manager
Patrick McCulloch
+44 (0)28 95912905
patrick.mcculloch@euromoneyplc.com

Production Editor
E wan Harwood
ewan.harwood@insuranceinsider.com

Divisional Director
Jeff Davis

Managing Director
Tim Wakefield

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Leaders stand firm in reinsurance top 50

One new entrant joins the top 10 global reinsurers in AM Best-compiled list.

By Mark Richardson, London Editor

AM Best has released its latest top 50 rankings of global reinsurance groups, with one change to the constitution of the top 10.

Based on combined P&C and Life premium written in 2019, PartnerRe grew by 16% to jump two places to number 10, as Korean Re and GIC Re both slipped a place to 11th and 12th with growth of 2% and 4%, respectively. The top nine remain the same.

Besides Qatar Re, which fell 17 places to 43rd due to corrections in the data reporting to exclude intercompany reinsurance, the biggest faller was Tokio Marine, which fell six places to 36th. This was largely put down to the sale of two European reinsurance units in 2018. The acquirer of these units, RenaissanceRe, itself climbed one spot to 16th, switching places with MS&AD.

"The interesting part is you can see the consolidation in the list and how top heavy it is," says AM Best financial analyst Dan Hofmeister, who helped to compile the rankings.

"RenRe, even though they are growing 45% with that acquisition, still only moved up one spot in the rankings, whereas Tokio Marine is moving down six. There is a real consistency to that top 10."

The top 10 make up 69% of the total reinsurance premium written by the top 50, up one percentage point on last year's share.

The two biggest climbers were Validus and W.R. Berkley each moving up five places – Validus from 33rd to 28th, and W.R. Berkley from 50th to 45th. Peak Re moved up three spots, with IRB, Sirius, Deutsche Rueck and QBE all climbing two spots.

"Over the last three to five years, growth in the Asia markets have been really pronounced," Hofmeister adds on the biggest trends affecting growth.

Top 50 World's Largest Reinsurance Groups

Ranked by Unaffiliated Gross Premium Written in 2019		Reinsurance Premiums Written ($m)			
		Life & Non-Life		Non-Life Only	
Ranking	Company Name	Gross	Net	Gross	Net
1	Swiss Re	42,228	39,649	26,095	25,135
2	Munich Re	37,864	35,282	24,742	23,455
3	Hannover Re	25,309	22,096	16,555	14,333
4	SCOR	18,302	16,176	8,005	6,826
5	Berkshire Hathaway	16,089	16,089	11,112	11,112
6	Lloyd's	14,978	10,433	14,978	10,433
7	China Re	13,161	12,196	5,218	4,820
8	Reinsurance Group of America	12,150	11,297	N/A	N/A
9	Great West Lifeco	10,149	10,055	N/A	N/A
10	PartnerRe	7,285	6,909	5,792	5,439
11	Korean Re	6,963	4,785	6,157	4,079
12	GIC	6,862	6,229	6,735	6,109
13	Everest Re Group	6,356	5,732	6,356	5,732
14	XL Bermuda	5,010	4,252	5,010	4,252
15	Transatlantic Holdings	4,946	4,495	4,946	4,495
16	RenaissanceRe Holdings	4,808	3,381	4,808	3,381
17	MS&AD Insurance Group Holdings	4,188	N/A	4,188	N/A
18	MAPFRE RE	3,313	2,690	2,716	2,100
19	AXIS Capital Holdings	3,223	2,280	3,223	2,280
20	R+V Versicherung	3,160	3,160	3,160	3,160
21	Arch Capital Group	3,078	2,136	3,078	2,136
22	Toa Re	2,878	2,472	2,878	2,472
23	Generali	2,646	2,646	1,093	1,093
24	Sompo International Holdings	2,441	1,972	2,441	1,972
25	IRB - Brasil Resseguros	2,114	1,561	2,114	1,561
26	Pacific LifeCorp	2,072	1,625	N/A	N/A
27	Taiping Reinsurance Co.	2,040	1,787	1,255	1,064
28	Validus Reinsurance	1,991	1,296	1,991	1,296
29	Odyssey Re Holdings Corp.	1,849	1,783	1,849	1,783
30	Caisse Centrale de Reassurance	1,688	1,541	1,446	1,304
31	Peak Reinsurance Company	1,665	1,258	1,531	1,125
32	Aspen Insurance Holdings	1,486	1,251	1,486	1,251
33	Sirius International Insurance Group	1,351	1,112	1,351	1,112
34	Deutsche Rueckversicherung	1,241	825	1,139	775
35	QBE Insurance Group	1,179	984	1,179	984
36	Tokio Marine & Nichido Fire Insurance Co.	1,174	921	1,174	921
37	Markel Corporation	1,114	965	1,114	965
38	American Agricultural	1,079	385	1,079	385
39	Qianhai Reinsurance Co.	930	563	333	294
40	Hiscox	867	217	867	217
41	African Reinsurance Corporation	844	682	787	632
42	Allied World	821	736	821	736
43	Qatar Reinsurance Company	749	654	749	654
44	Chubb	719	649	719	649
45	W.R. Berkley	678	N/A	678	N/A
46	Nacional de Reaseguros	662	529	553	421
47	Asia Capital Reinsurance Group	656	565	656	565
48	Third Point Reinsurance	632	623	632	623
49	Central Reinsurance Corporation	558	518	458	423
50	Wilton Re U.S. Holdings	543	420	543	N/A

Source: AM Best

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Executive-level stabilising for D&O

While pricing stabilises in Directors & Officers coverage, the full effect of COVID-19 is still to be realised, according to a new Aon report.

By Marc Jones, Associate Editor

Directors and Officers (D&O) liability insurance pricing increased 74.4% in the second quarter for Aon's clients – a slight increase over the percentage reported for the first quarter, according to the company's latest Quarterly D&O Pricing Index report.

Aon said that D&O liability insurance pricing had increased 73% in the first quarter (when adjusted for certain items) and that the price per million for clients that renewed in both the 2020 and 2019 second quarters increased 61.2%, compared with the 82.9% reported in the first quarter.

Primary policies renewing with the same limit and deductible experienced a price increase, while 96% reported a price increase, according to the report. During the first quarter, all primary policies renewed with the same limit and deductible.

The overall price change for primary policies renewing with the same limit and deductible was up 23.4%, compared with the 26.2% increase reported in the first quarter.

According to the report, a total of 87.4% of primary policies reported with the same limit in the second quarter; 54.5% renewed with the same deductible; 48.3% renewed with the same limit and deductible; and 93.7% renewed with the same insurer. In the first quarter, all primary policies renewed with the same limit and deductible.

Peter M. Trunfio, Chief Information Officer for Aon's U.S. Financial Services Group, told *Reactions* that D&O prices displayed a continuation of the price firming the market has seen over the past 10 quarters.

"In 2011 after reporting the 32nd consecutive quarter of decreases in the overall index, some of the primary D&O carriers both in the U.S. and in London started calling 'foul' and saying, 'Hey, we're getting price increases on the primary, and yet you're reporting these big decreases because overall the total programmes were getting decreases because they are so hyper-competitive on the excess.' So in 2012 we started tracking the primary layer only, looking at those primary policies that renewed in the same period and with the same limit and the same deductible," says Trunfio.

"As the market has hardened, we noticed, especially starting around the beginning of last year (2019), that carriers were restructuring programmes, reducing limits and increasing deductibles," he adds.

The limit changes, Trunfio explains, have started to stabilise: 87% of the clients' primary policies that renewed in the second quarter renewed with the same limit – but the number of those that renewed with the same deductible is still hovering around 55%. "The combination of the two means that for the first time, less than 50% of our primary policies renewed with the same limit and the same deductible."

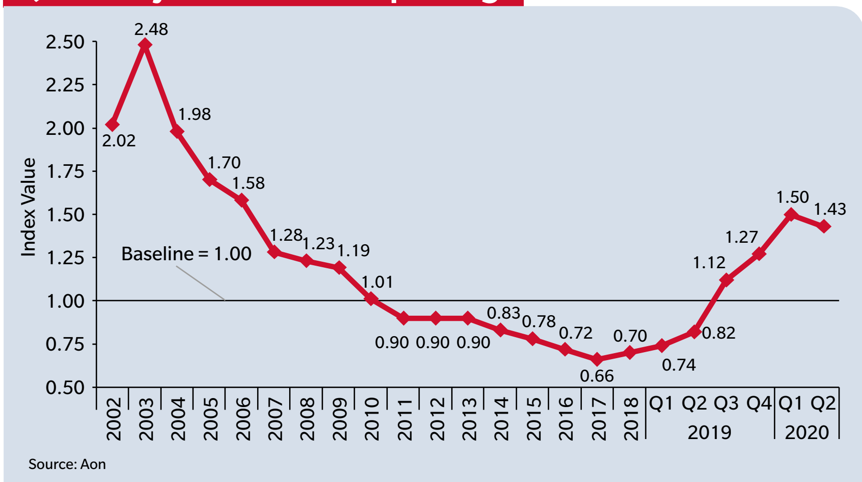
One aspect that was not immediately apparent was whether there had been any impact from COVID-19 that has caused such widespread disruption to companies all over the world, with firms having to shut down in some cases or institute widespread workplace changes such as employees working from home on a large scale.

Christine Williams, CEO of Aon's Financial Services Group, said that it was still early days when it comes to assessing what the coronavirus' impact will be on the D&O market. She said that Aon had seen a handful of notices and claims for the D&O market itself but that it's still too early to say just what the exact fallout will be.

"However, it's worth noting that it's another event-driven litigation exposure that insurers are worried about," says Williams. "Just to put it into perspective, insurers are always concerned about event-driven litigation. Historic examples over the past 24 months of business include cyber breaches that have resulted in claims that have come under a D&O policy. There have also been claims that were from the wildfires and other events that saw litigation afterward, so transparency and financial impact have been on the minds of a lot of clients."

Looking forward, the Aon report quoted the Stanford law school's securities class action clearing house, which said that in Q2 2020 plaintiffs filed 84 new federal securities class actions cases, 18 fewer than in the second quarter of 2019 (a decrease of 18%).

Quarterly index of D&O pricing



Source: Aon

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Aon pegs H1 2020 nat-cat payouts at $30bn

The estimate is above the 20-year average of $28bn.

By Mark Richardson, London Editor

Insurers paid out over $30bn in H1 2020 due to natural catastrophes, according to Aon.

In the broker's Global Catastrophe Recap: First Half of 2020 report, it reveals global natural disaster events during the first six months of the year caused total economic losses estimated of $75bn – 25% lower than the 2000-2019 average of $98bn.

The insured losses estimate of $30bn was 5% higher than the 20-year average of $28bn. Aon cautioned these totals are preliminary and will change as losses continue to develop.

Cyclone Amphan, which killed 133 people in India in May, was the costliest economic event of H1 2020, causing an estimated $15bn in direct damage loss. A severe weather event in the U.S. from April 10-14, which killed 38 people, was the costliest insured event, with claims totalling nearly $3bn.

Aon found the first six months of the year were marked by many smaller and medium-scale disasters, which impacted a large number of communities globally. From a peril perspective, there was an unusually low number of significant earthquakes in H1 2020, the report stated.

Steve Bowen, director and meteorologist on the Impact Forecasting team at Aon's Reinsurance Solutions business, said in a statement, "The first half of 2020 was challenging on a number of fronts given the ongoing effects of COVID-19 and a series of impactful weather and climate-related events around the world.

"Much of the natural disaster impact came via the severe convective storm peril. A record 10 individual thunderstorm-related events had more than $1bn in economic losses in the United States alone during the first six months of the year; while Australia and Canada each dealt with severe hailstorms that prompted billion-dollar damage bills.

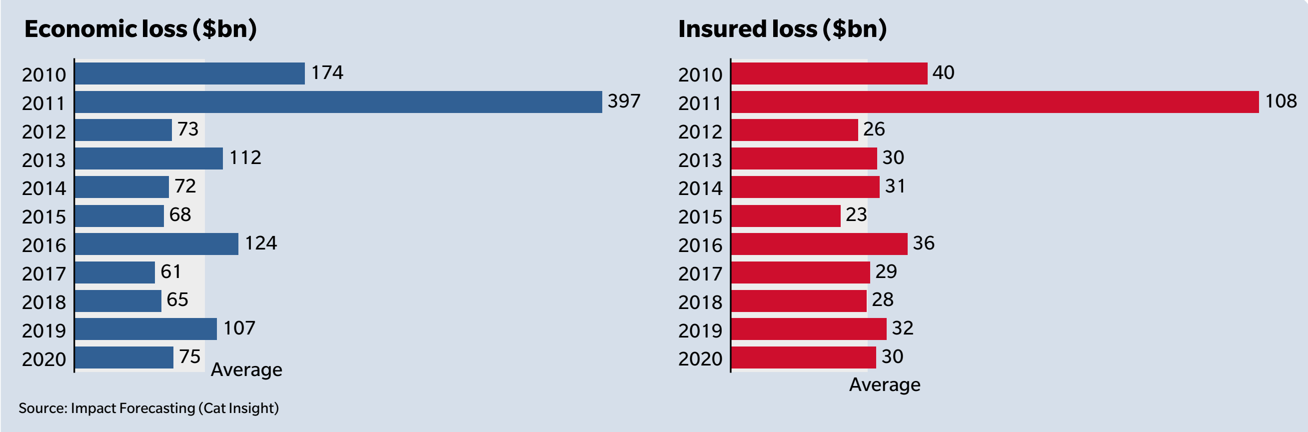
"Early season tropical cyclones such as Amphan in India and Bangladesh, wildfires in Australia, windstorms in Europe, and record-setting heat in the Arctic Circle were also notable in the first half of the year.

"While first-half losses do not show a direct correlation to the second half of the year, the looming peak of Atlantic Hurricane Season as La Niña conditions are anticipated to arrive, only enhances the need to be mindful of natural hazard risk in the months to come."

The report found natural disasters were responsible for approximately 2,200 fatalities during the first half of 2020, significantly below the long-term (1980-2019) average of 39,800 and the median of 7,700. Flooding was the deadliest natural peril during the period, having been responsible for 60% of the death toll.

The total of 207 global natural disaster events recorded by Aon's Impact Forecasting unit for H1 2020 was above the 20-year average of 184 and the median of 189.

There were at least 20 separate billion-dollar economic events during the first half of the year – led by the U.S. with 10 events; Asia Pacific (APAC) with five events; Europe, Middle East and Africa (EMEA) with three events, and the Americas with two events.



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Insurance M&A deals up in H1

Report records 201 completed deals in H1 2020, compared to 197 in H2 2019.

By Mark Richardson, London Editor

Mergers and acquisitions in the global insurance industry rose in the first half of 2020, with 201 completed deals worldwide up from 197 in the second half of 2019, according to Clyde & Co's "Insurance Growth Report" mid-year update.

This was only the second six-month period in the last five years in which the volume of transactions exceeded 200.

Ivor Edwards, Partner and European Head of the Corporate Insurance Group at Clyde & Co, noted that the deals completed in the first half of 2020 would have been negotiated and agreed to in 2019, pre-pandemic.

"The impact of COVID-19 on insurance M&A will only become clear in the coming months, and we expect it to be stark in the short term," said Edwards. "For many, responding to the pandemic has meant putting growth ambitions to one side, in order to take stock of the impact on operations, claims and investment returns.

"The last few months have been plagued by a level of uncertainty – the enemy of deal-making – rarely seen before," he continued. "This will be reflected in the number of completed deals in the second half of the year. But as the economy moves toward a state of stability that could be defined as 'the new normal,' opportunities will arise – and we expect re/insurance transactions to make a comeback in 2021."

The report found H1 2020 saw a slowdown in mega deals, with just six valued at over $1bn, compared with 20 in the whole of 2019. Clyde & Co said this was evidence of a more measured approach to deal-making that the firm expects to continue.

Technology continues to be a primary growth driver worldwide. Deals completed in H1 2020 included investments into U.S.-based start-up Openly, Belgium's Keypoint and yallacompare in the United Arab Emirates.

"The impact of COVID-19 on insurance M&A will only become clear in the coming months, and we expect it to be stark in the short term. For many, responding to the pandemic has meant putting growth ambitions to one side, in order to take stock of the impact on operations, claims and investment returns."

Ivor Edwards, Partner and European Head of the Corporate Insurance Group at Clyde & Co

Capital raising has been a feature of the post-pandemic market, reaching $16bn in H1 2020 according to Willis Towers Watson. Clyde & Co said this presented opportunities for organic growth that could depress appetite for M&A.

By region, the report found activity in the Americas was flat in H1 2020, with 90 deals compared to 89 in the preceding six months, although deals in the U.S. dropped from 73 to 64, marking the third consecutive period of decline.

Asia Pacific made steady gains, with an uptick in M&A from 31 to 38 deals in the first six months of the year. Japanese acquirors again led the way, ahead of Taiwan and South Korea.

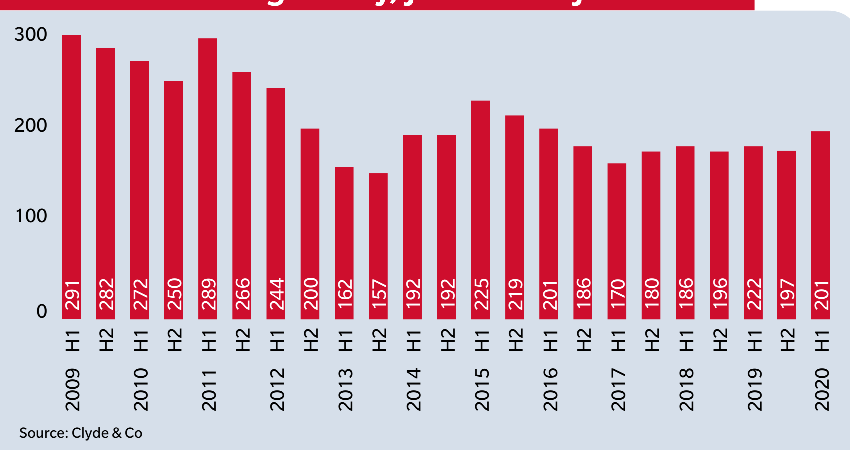
In Europe, the report found that Brexit, combined with difficulties in reaching agreement on valuations, pushed M&A to a three-year low with 53 deals completed, down from 67 in H2 2019.

Activity up in all regions except Europe

Region	H2 2019	H1 2020	% change
Global	197	201	+2.0%
Americas	89	90	1.10%
Europe	67	53	-20.90%
APAC	31	38	22.60%
MEA	7	15	114.30%

Source: Clyde & Co

Volume of deals globally, Jan 2009 – June 2020



Source: Clyde & Co

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Adam Schnell
Casualty GL and Construction
646-956-1560
adam.schnell@ethosspecialty.com

David Malcom
Property
404-419-2124
david.malcom@ethosspecialty.com

Navine Aggarwal
M&A Insurance
646-956-1562
navine.aggarwal@ethosspecialty.com

Rory Cline
Ethos Chief Executive
646-356-8102
rory.cline@ethosspecialty.com

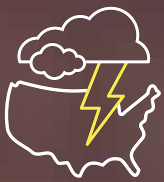
THE SCORE AT HALFTIME

Global insured losses: **2020's first half**

$31 bn - The Swiss Re Institute's estimated global insured property losses from catastrophes in first half of 2020 (mostly from secondary perils) That's up from **$23 bn** a year earlier

$75 bn - Global economic losses from natural catastrophes and man-made disasters in the first half of 2020, according to preliminary sigma estimates – up from **$57 bn** for the same period a year earlier but well below the average of first-half economic losses of the previous 10 years ($112 bn)

Natural catastrophes accounted for **$28 bn** of the insured losses (again, most resulting from secondary-perils events)



Severe convective storms (thunderstorms with tornadoes, floods and hail) in North America caused insured losses of more than **$21 bn**, the highest since 2011's first half

Of the economic losses, around **40%** ($31 bn) were covered by insurance

$36 BN

In the previous 10 years, first-half insured claims **averaged $36 bn** annually

The main driver of the first-half losses **were secondary perils**, with thunderstorms in North America playing a significant role

Source: Swiss Re Institute

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Estimates emerge from Hurricane Laura

Cat 4 hurricane tied an 1856 record for the strongest hurricane on record to make landfall in the U.S. state of Louisiana.

By Marc Jones, Associate Editor

Initial estimates from Hurricane Laura have placed insured losses between $4bn and $12bn after the Category 4 storm system wreaked havoc on southwestern Louisiana and southeastern Texas.

Catastrophe risk modelling firm AIR Worldwide estimated that industry insured losses to onshore property resulting from Laura's winds and storm surge will range from $4bn to $8bn.

Karen Clark & Company (KCC) said that based on its high-resolution U.S. and Caribbean Hurricane Reference Models, the insured loss to onshore properties from Hurricane Laura will be close to $9bn. This breaks down to $8.7bn in the U.S. from wind and storm surge and $200m in the Caribbean.

The KCC estimate includes the privately insured wind and storm surge damage to residential, commercial, and industrial properties and automobiles. It does not include National Flood Insurance Program losses or losses to offshore assets. This estimate does not include any potential impacts on losses due to COVID-19.

CoreLogic placed its estimate for insured wind and storm surge losses for residential and commercial properties in Louisiana and Texas between $8bn and $12bn, with insured storm surge losses expected to contribute less than $0.5bn to this total.

"Although comparisons between Laura and Hurricane Rita have been made, they differ in two important ways: Rita was a larger storm and hit a more populous area than Laura did," said Dr. Cagdas Kafali, Senior Vice President of Research for AIR Worldwide. "Rita made landfall west of where Laura did, impacting population centres of Texas; Laura made landfall well east of Houston and west of New Orleans, keeping losses lower."

According to AIR Hurricane Laura was fuelled by high sea-surface temperatures in the Gulf of Mexico after passing through the Caribbean. Laura made landfall near Cameron, La., close to the Texas border, on 27 August as a Category 4 hurricane, bringing catastrophic winds, around 15 feet of storm surge, and widespread heavy rain across the Gulf region, with wind and rain continuing north into Arkansas. AIR expects the combination of Laura's track through relatively lower populated areas and its size to keep insured losses down somewhat, despite its major-hurricane status at landfall.

CoreLogic also pointed out that the storm's centre struck a more sparsely populated area of the Louisiana and Texas coast. "There is never a good place for a hurricane to make landfall. But this was the best possible outcome because it spared the major population centres of Houston and New Orleans," said Curtis McDonald, meteorologist and senior product manager of CoreLogic.

Furthermore, CoreLogic noted that in addition to property damages, the ability to make loan payments also can be affected following a hurricane. Overall home mortgage delinquency rates (30 or more days past due, including those in foreclosure) in the Beaumont, Texas (9.3%) and Lake Charles, Louisiana (9.5%) metropolitan areas were already above the national rate (7.3%) based on the May 2020 CoreLogic "Loan Performance Insights" report. CoreLogic data has shown that natural disasters cause a spike in mortgage delinquencies, which suggests Hurricane Laura will add to the economic hardship families are already experiencing during the COVID-19 pandemic.

According to AM Best, Louisiana accounts for less than 2% of U.S. premium for the lines that would be affected (commercial multiperil (non-liability), fire & allied lines, homeowners/farmowners and auto physical damage). State Farm has the largest market share in Louisiana for these four lines combined, over 22%, while 10 companies account for almost 60% of the market.

However, the rating agency added that very few companies have significant exposures to these four lines relative to their total direct premiums written (DPW). More than 88% of companies have exposures of less than 10% of their total DPW; just over 4% have exposures of more than 50%.

Louisiana homeowners multiperil market share

Overall rank (DPW)	Company name	Direct premiums written ($000)	Market share (DPW) (%)
1	State Farm Group	509,075	25.96
2	Allstate Insurance Group	212,629	10.84
3	USAA Group	121,149	6.18
4	Liberty Mutual Insurance Companies	109,098	5.56
5	Louisiana Farm Bureau Mutual Ins Co	92,586	4.72

Source: AM Best

Texas homeowners multiperil market share

Overall rank (DPW)	Company name	Direct premiums written ($000)	Market share (DPW) (%)
1	State Farm Group	1,861,663	18.32
2	Allstate Insurance Group	1,348,756	13.27
3	USAA Group	1,017,411	10.01
4	Farmers Insurance Group	1,005,685	9.89
5	Liberty Mutual Insurance Companies	646,261	6.36

Source: AM Best

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Marsh: COVID-19 fuelling global tensions

The pandemic is straining already tense relationships throughout the world, according to the broker's latest political risk report.

By Marc Jones, Associate Editor

The latest edition of Marsh's Political Risk Map 2020, its Mid-Year Update, was dominated by the impact of the COVID-19 coronavirus – which has turned up the heat on an already volatile political risk landscape.

The pandemic's geopolitical flashpoints that Marsh highlighted in its March 2020 update have not gone away, the broker notes, adding that in the coming months, many of those flashpoints may be intensified by the pandemic as some governments seek to distract from domestic issues by ramping up foreign policy assertiveness, amping up the risk of violent confrontation.

COVID-19's economic and social impacts are driving significant shifts in global political risk, says Marsh — introducing new dynamics and accelerating existing geopolitical megatrends, such as trade protectionism and the transition to a multipolar world order. The deepening Sino-American rivalry, in particular, has accelerated since the onset of COVID-19. The politicisation of trade and investment relationships has extended to public health, with leaders in both countries routinely blaming the other for the pandemic.

"Cooperation between China and the U.S. on the pandemic has been weak, and tensions have risen over Hong Kong SAR, Taiwan, and the South China Sea," Marsh notes. "Our expectation that tech firms will be increasingly caught in the crossfire is playing out, while countries find themselves under geopolitical pressure to choose sides." In July 2020, the report points out, the UK government announced that Chinese firm Huawei's technology would be banned from its 5G networks. As the U.S. presidential election approaches, the broker adds, "relations are likely to deteriorate further."

The report also points out that recent months saw other flashpoints in Asia, such as the Sino-Indian confrontation in the Himalayas in which at least 20 troops were killed. Tensions on the Korean peninsula also look set to grow, with North Korea severing communication lines with the South and blowing up a joint liaison office in June.

The international focus on COVID-19 may also be masking simmering tensions between Iran and the U.S., says Marsh. Relations between the two countries remain weak, following the January 2020 U.S. drone strike that killed a leading Iranian general.

Economic risk

With so many countries forced to instigate lockdowns to control the spread of COVID-19, the economic impact has been severe in many regions.

The report makes clear that since January 2020 all 197 countries rated by Marsh JLT Specialty's World Risk Review have seen their national economic risk increase, compared to just 60 countries in the same period in 2019. Moreover, risk ratings have increased by a larger magnitude compared to the same period last year.

Between January and July of 2019, 97% of the economic risk ratings that increased did so by between 0.1 and 0.4, compared to just 7% in 2020. In 2020, 40% of ratings increased by between 1 and 1.4. No scores rose by this magnitude in January-July 2019.

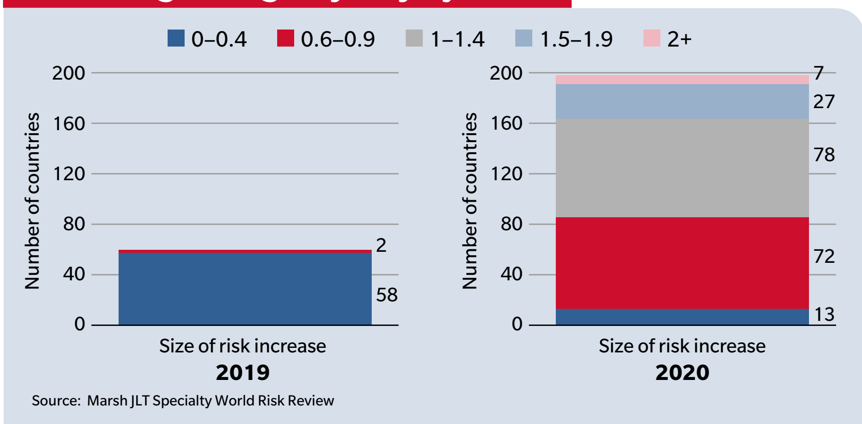
Marsh also points out that the International Monetary Fund forecasts that the global economy will shrink by 4.9% in 2020. With many governments looking to ease lockdown measures, attention is focused on the shape and size of an economic recovery.

An economic recovery, Marsh explains, is difficult to forecast, given the significant uncertainty over governments' ability to contain and manage COVID-19, particularly without a vaccine. "While economic data from Europe showed a tentative move toward recovery, fears of a second wave of infections may yet undermine momentum," the report says.

As a result, the post-COVID recovery is likely to be uneven across countries and sectors: "Countries that entered the crisis with weaker fundamentals are likely to face deeper economic scars, while those able to deploy large fiscal packages and effectively manage the virus are best placed for recovery.

"However, long-term debt sustainability in many EMs will be weakened by the pandemic, as governments deploy additional spending and weak economic activity drags on revenues."

Magnitude of country economic risk rating changes, Jan–July



Source: Marsh JLT Specialty World Risk Review

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Mean season

Insurers pay out A$3.85bn following bushfires, floods and hailstorms in the 2019/20 Australian summer.

By Mark Richardson, London Editor

Insurers have paid A$3.85bn to customers affected by bushfires, floods and hailstorms around late 2019 and early 2020, according to industry data released by the Insurance Council of Australia (ICA).

The body revealed the industry had received more than 297,780 claims from four ICA-declared catastrophes during the Australian 2019-20 summer, with losses of almost A$5.4bn.

This A$3.85bn paid out includes for property repairs and rebuilding works, emergency accommodation and support, replacement of contents, new and repaired vehicles, plant and equipment, and financial settlements.

ICA CEO Rob Whelan said the industry was well ahead of its normal natural disaster response in spite of COVID-19, with more than 83% of bushfire claims already closed.

"The pandemic complicated our industry's ability to physically respond in a timely manner, to get assessors and tradespeople into affected areas, overcome logistical challenges, source materials and labour, and to begin repairs and rebuilds," Whelan said in a statement.

"However, insurers have worked tirelessly since the summer catastrophes and during the COVID-19 crisis, managing lockdown and social distancing constraints to continue their work to help customers and communities across southern and eastern Australia. This was the worst natural disaster season I have experienced in my 10½ years as chief executive of the Insurance Council.

"The industry's efforts to help their customers through the emotional, physical and financial blows caused by these catastrophes is the best I've seen, despite the complications of COVID-19, and insurers continue to fine-tune their response.

"The insurance industry will continue to work to assist affected communities and policyholders and work through the remaining open claims to help people move on and rebuild their homes and lives."

The latest industry figures show:

Summer bushfires (VIC, NSW, SA, QLD):
- 38,416 claims received with losses estimated at A$2.33bn
- More than 83.5% of 9389 home building claims have been closed (repairs and rebuilding works completed, payments made)
- More than 93.7% of 14,237 contents claims have been closed (items repaired or replaced, or payments made)
- More than 88.5% of 1613 domestic motor vehicle claims and 90.5% of 1332 commercial motor claims have been closed (vehicles repaired or replaced, or payments provided)
- More than 81% of 8738 commercial property claims and about 81% of 1285 business interruption claims have been closed

November hailstorms (SE QLD):
- 29,782 claims received with losses of A$481.92m
- More than 82% of 9858 residential building claims and 86.2% of 1677 contents claims have been closed
- About 94% of 15,259 domestic motor claims and 1801 commercial motor claims have been closed
- More than 84% of 1125 commercial property claims have been closed

January hailstorms (ACT, VIC, NSW):
- 129,201 claims received with losses estimated at A$1.625bn
- About 90% of claims lodged were for household losses, with 10% commercial claims
- 4% of 38,793 residential building claims and 73.5% of 10,462 contents claims have been closed
- Almost 85% of 67,435 domestic motor claims and 75.5% of 6954 commercial motor claims have been closed
- More than 66% of 5214 commercial property claims and 52.7% of 146 business interruption claims have been closed

February East Coast storms and floods (QLD, NSW):
- 100,384 claims received with losses estimated at A$958m
- More than 70% of 58,845 residential building claims and almost 75% of 26,901 contents claims have been closed
- Almost 92% of 5954 domestic motor claims and 79% of 306 commercial motor claims have been closed
- 65% of 8758 commercial property claims and 63% of 351 business interruption claims have been closed.

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Global macroeconomic resilience falls by one-fifth

A new report from the Swiss Re Institute details COVID-19's global impact.

By Marc Jones, Associate Editor

The COVID-19 pandemic is expected to reduce global macroeconomic resilience by about 20% in 2020 from 2019 levels as stimulus packages deplete countries' fiscal and monetary buffers around the world, according to the Swiss Re Institute's annual Macroeconomic Resilience Index.

The Index claims that the UK, Japan and the U.S. will experience the greatest falls in resilience among major economies. Switzerland, Finland and Canada remain the world's three most resilient countries, reflecting their comprehensive economic strength against future crises.

Global economic resilience held up in 2019 compared with 2018, but the world entered the COVID-19 crisis with less shock-absorbing capacity than before the 2008-09 financial crisis.

Government responses to COVID-19 are expected to significantly lower global economic resilience this year. The world index value drops to 0.5 in the initial estimate for 2020, which aims to capture the impact of the fiscal and monetary stimulus in response to COVID-19 on economic resilience. While such stimulus packages have cushioned the blow to the global economy, they have run down many countries' fiscal and monetary reserves.

This has caused their resilience scores to fall, including drops of more than half in some economies, the E-RI found. The research finds that monetary policy buffers will be largely exhausted in most advanced economies, leaving fiscal headroom as the major determinant of resilience. Of the countries in the top half of the 2019 resilience rankings, the UK, Japan and the U.S. are expected to see their fiscal buffers depleted most and their index scores decline furthest. China's resilience will likely remain relatively unchanged, primarily because a swift response enabled it to reopen its economy earlier than many others.

"The fiscal and monetary stimulus response to COVID-19 was key to cushioning the economic impact of government-ordered lockdowns," Jerome Jean Haegeli, Group Chief Economist at Swiss Re, said. "However, the reality of wartime-like spending is that it leaves much less room for future policy manoeuvre. What's more, the key economic policy risk is that these temporary government measures are too challenging to unwind and become permanent, leaving economies dependent on ongoing stimulus. A focus on replenishing resilience by reinstating fiscal and monetary buffers, through structural reforms to improve long-term growth prospects, will be critical."

Insurance resilience against three major risks – mortality, health spending and natural catastrophes – weakened in 2019, the indices show. The combined global protection gap for the three perils is calculated as reaching a new high of $1.24trn. Globally, mortality resilience declined the most, driven by a widening of the mortality protection gap in the Asia-Pacific region, where China's protection gap expanded due to rapidly growing household debt. Health resilience was stable despite some deterioration in emerging markets. The global health protection gap widened by more than 5% to $588bn. Natural catastrophe resilience was lowest of the three risk areas. Swiss Re Institute expects that health and mortality protection gaps will widen as households grapple with lower incomes, higher healthcare costs and the financial consequences of losing a breadwinner as a result of the pandemic.

SRI Insurance Resilience Indices (I-RIs)

	SRI Insurance Resilience Indices (I-RIs) (in %)			Protection gaps (in $bn)		
	2008	2018	2019	2008	2018	2019*
SRI Composite Insurance Resilience Index	**55.6**	**54.0**	**53.7 ▼**	**799**	**1201**	**1243 ▲**
SRI Health Resilience Index	**94.2**	**93.5**	**93.4 ▼**	**354**	**559**	**588 ▲**
North America	96.1	97.3	97.4 ▲	103	107	107 =
Latin America	85.2	88.9	88.6 ▼	47	52	56 ▲
Advanced Europe	97.9	96.9	96.8 ▼	38	56	58 ▲
Emerging Europe	85.3	82.8	82.3 ▼	53	79	85 ▲
Advanced Asia-Pacific	97.4	95.8	95.7 ▼	17	39	42 ▲
Emerging Asia-Pacific	67.8	76.0	75.9 ▼	97	226	240 ▲
SRI Mortality Resilience Index	**47.2**	**44.4**	**43.6 ▼**	**290**	**420**	**427 ▲**
North America	59.8	57.3	57.3 =	48	59	61 ▲
Latin America	33.6	40.9	43.6 ▲	31	33	31 ▼
Advanced Europe	52.3	53.8	53.6 ▼	72	79	73 ▼
Emerging Europe	49.5	37.4	35.4 ▼	51	70	73 ▲
Advanced Asia-Pacific	53.3	67.5	66.9 ▼	29	24	24 =
Emerging Asia-Pacific	15.4	23.8	22.6 ▼	59	155	165 ▲
SRI Natural Catastrophe Resilience Index	**25.4**	**24.2**	**24.1 ▼**	**155**	**222**	**227 ▲**
North America	39.2	40.4	39.8 ▼	36	55	59 ▲
Latin America	23.4	7.5	6.4 ▼	15	22	22 =
Advanced Europe	34.7	42.5	42.8 ▲	22	19	18 ▼
Emerging Europe	9.2	8.9	8.8 ▼	29	33	34 ▲
Advanced Asia-Pacific	20.9	22.5	23.0 ▲	36	43	44 ▲
Emerging Asia-Pacific	4.9	3.7	3.5 ▼	17	49	51 ▲

Note: I-RIs are based on research into protection gaps and measure the relation between protection needed and available. The value ranges from 0–100%. The greater the value, the greater the protection relative to the needs and the higher the resilience. Some historical values have been changed due to data revision or revised estimates. For Latin America, the scope of countries has expanded. Protection gaps are measured in premium equivalent terms.
*Upward arrows in this column only are red to denote negative movement, namely widening of protection gaps. Please see sigma 5/2019 – Indexing resilience: a primer for insurance markets and economies, for the methodology. Source: Swiss Re Institute

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Reactions 2020 London Market Award winners revealed

Best of the best honoured during virtual ceremony.

Reactions' 2020 London Market Awards were held virtually on Wednesday for the first time – and if the ceremony was different this year by being an exclusively online affair, it retained its reputation as an entertaining event honouring the insurance industry's best and brightest.

London Editor Mark Richardson emceed the awards, which were broadcast as a paid event that saw Aon pick up four honours, while Lancashire and Fidelis received two honours apiece.

Reactions Editor-in-Chief Shawn Moynihan set the tone for the ceremony with an acoustic parody of Oasis' "Wonderwall," which included lyrics about tightening terms and conditions in the London Market.

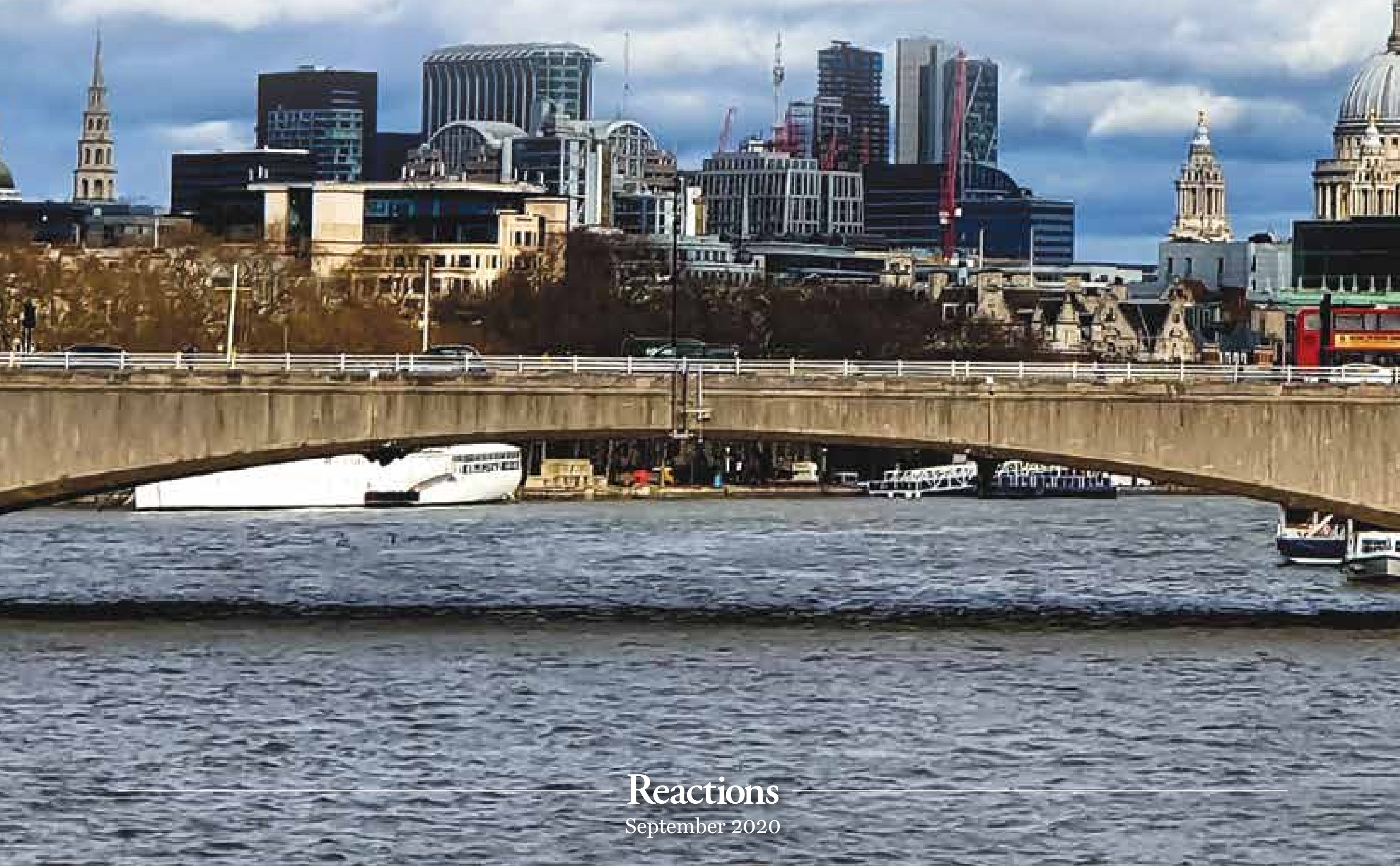
The evening's most prestigious honour, the London Market Lifetime Achievement Award, was bestowed upon Charles Franks, former CEO of Tokio Marine Kiln. In a video interview appearing in the centre of the ceremony, Franks enthusiastically noted the increase and diversity in the skill sets of individuals coming to work in the London market.

When asked if he thought the market should have done anything differently, Franks responded, "I think we really should have addressed our technological shortcomings sooner. The market has been struggling for years to develop the technical side of what we do ... that efficiency is important from an expense point of view, and is critical in terms of giving better value for the product that we sell."

Peak Re's Franz Hahn received the Reinsurance CEO of the year award. In his video acceptance speech, he humbly accepted the honour on behalf of the entire Peak Re team, adding, "Without my team, I would be nowhere – and this is a super team."

In addition to their award statuette, the winners received by mail an exclusive, *Reactions*-branded, custom-label bottle of wine with which to celebrate their honours in true 2020 social-distancing style.

The complete list of winners follows:



Reactions London Market Awards 2020 winners

- **Insurance team of the year:** Fidelis' bespoke underwriting team
- **Insurance broking team of the year:** Lockton's cyber team
- **Marketing PR team of the year:** Haggie Partners
- **Legal firm of the year:** Browne Jacobson
- **InsurTech of the year:** Akinova
- **Run-off company of the year:** DARAG
- **Coverage innovation of the year:** Auction by Aon
- **Reinsurance broking team of the year (Treaty):** Capsicum Re's cyber team
- **Reinsurance broking team of the year (Facultative):** BMS property fac team
- **London Market deal of the year:** BCI and PCP investment in BMS
- **Insurance broker of the year:** Marsh
- **Reinsurance broker of the year:** Aon's Reinsurance Solutions business
- **Up-and-coming underwriter of the year:** Charlotte Marsden, AXIS Capital
- **Up-and-coming broker of the year:** Jamie Warwick, Excess Weather
- **Insurance broking CEO of the year:** Jason Collins, Tysers
- **Reinsurance broking CEO of the year:** Andy Marcell, Aon Reinsurance Solutions
- **Reinsurance team of the year:** Lancashire property treaty team
- **Financial advisory firm of the year:** Evercore
- **Re/Insurance company innovator of the year:** CFC Underwriting
- **Excellence in claims service award:** Beazley
- **InsurTech incubator of the year:** Lloyd's Lab
- **Risk modeller of the year:** Aon Impact Forecasting
- **Insurance asset management firm of the year:** Conning
- **ILS fund manager of the year:** RenaissanceRe
- **Diversity and inclusion award:** @londoninsurancelife (London Market Group)
- **Diversity and inclusion champion of the year:** Jaya Handa, Liberty Specialty Markets
- **Innovator of the year:** Jon Hancock, Lloyd's
- **Insurer of the year:** Fidelis
- **Insurance CEO of the year:** Alex Maloney, Lancashire
- **Reinsurer of the year:** Munich Re
- **Reinsurance CEO of the year:** Franz Hahn, Peak Re
- **London market lifetime achievement award:** Charles Franks, Tokio Marine Kiln

Ian Burford, Chief Executive of Fidelis Underwriting Limited, accepts Fidelis Insurance's award for Insurer of the Year.

Ruth Taiwo, Talent & Career Events Co-Ordinator for the London Market Group (LMG), accepts the Diversity & Inclusion Award on behalf of @ londoninsurancelife.

Chris Lay, CEO, Marsh UK & Ireland, holds aloft Marsh's statuette for Insurance Broker of the Year.

Dr. Henri Winand, CEO and co-founder of Akinova, is ready to celebrate his company's win for InsurTech of the Year.

AXIS Capital Cyber Underwriter Charlotte Marsden received the honour for Up-and-Coming Underwriter of the Year.

Beazley was the recipient of the Excellence in Claims Service Award, which was accepted by Group Head of Claims Beth Diamond.

Chief Innovation Officer Graeme Newman, left, and Jon Fletcher, Chief Technology Officer at CFC Underwriting, celebrate CFC's win for Re/Insurance Company Innovator of the Year.

DARAG received the award for Run-off Company of the Year. Pictured are, clockwise from top left: Group CEO Tom Booth; James Insley, Group Chief Financial Officer; Dan Linden, CEO of DARAG North America; Group Chief Operating Officer Andrew Hill; and Group Chief Strategy Officer Alexander Roth.

Excess Weather's Jamie Warwick was named 2020's Up-and-Coming Broker of the Year.

Capsicum Re's cyber team received the honour for Reinsurance Broking Team of the Year (Treaty). Pictured is Capsicum Re Partner Ian Newman.

Insurance CEO of the Year honours were bestowed upon Alex Maloney, Group CEO of Lancashire Holdings Limited.

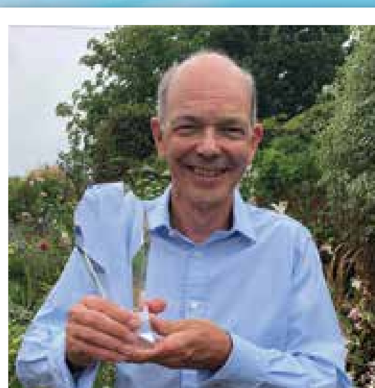
Lloyd's Lab was named 2020's InsurTech Incubator of the Year. Pictured are, from left: Ed Gaze, Senior Manager, with Femi Williams, Innovation Associate, and Head of Innovation Trevor Maynard onscreen.

Peter Rigby, Partner, accepts Haggie Partners' award for Marketing PR Team of the Year.

Nick Cook, Chief Executive of BMS Group, with the statuettes celebrating BMS' wins for Reinsurance Broking Team of the Year (Facultative) for its Property Fac team and for London Market Deal of the Year.

Russell Büst, CEO and Chief Investment Officer for Conning's European operations, accepts Conning's statuette for Insurance Asset Management Firm of the Year.

Dominic Tillyard, Savannah Thompson and John-Paul O'Hare of Fidelis' bespoke underwriting team received honours for Insurance Team of the Year.



Former Tokio Marine Kiln CEO Charles Franks was delighted to be named the London Market Lifetime Achievement Award winner.

Holistic solutions are a must for Swiss Re

Kaspar Mueller, President of Reinsurance for Latin America for Swiss Re, talks with *Reactions* about the reinsurer's plans and strategy for success in the region.

What has been accomplished in the region, and what is on your radar as a focus?

Swiss Re has been doing business in Latin America for more than 100 years and is strategically committed for the long term. We will continue working with consumers and our insurance company clients and brokers to develop the reinsurance products and services that will help keep the market growing. Over the last several years, Swiss Re has invested significant resources in re-working our value proposition, from things as simple as improvements in response time to a greater commitment to develop holistic solutions to address the technical and commercial challenges our clients are facing. These efforts have helped Swiss Re become a strategic partner and therefore more relevant across the region.

The COVID-19 pandemic we are facing and the ensuing recession has made our continued focus on our clients even more critical. While the human and economic suffering is very hard to see, we also see opportunities to support our clients and increase societal resilience. This can range from partnering with clients by expanding their digital offerings to mitigating capital or liquidity challenges. We're also seeing increased traction with our data analytics products, as insurers seek ways to better use data to price and classify risk. So despite a challenging environment, I am positive about the region and the prospects for Swiss Re.

Having a regional team means dealing with different cultures. Although the common point is Latin America, culture is certainly different in every country in the region. How can you engage everyone for one goal?

My first priority after assuming my role last November was to visit our clients and offices across the entire region. Before the lockdown hit, I had meetings with many of our regional and global clients, as well as brokers, and continue to be impressed by how open the welcome has been. In addition to spending time with our business partners, I also connected with our local Swiss Re teams and gained a better understanding for the different offices and how they work. While at the time it felt as if I had overloaded my travel schedule, in hindsight I am very glad that I had that opportunity now that we have moved to a working from home environment. While video chat works great, it is even better if there is a pre-existing personal connection.

In addition to staying connected with clients and brokers, one of the more challenging aspects of the pandemic is keeping and further evolving the corporate culture when everyone is working remotely. We held an in-

person meeting with the Swiss Re LatAm team in early February, just before the various lockdowns hit, where we set our strategy for the year. We now hold monthly touch points where we share recent successes and business updates, and equally important provide time for the team to ask questions. This is something we might not have done if we were still in the office together. Through these meetings, we can share our progress and keep everyone focused on meeting our objectives. Everyone knows that they play a crucial part in our success, and these touchpoints provide a way to align and demonstrate success in the face of these unprecedented challenges.

What are your plans to reach your Swiss Re's targets by 2025?

Swiss Re continues to take a long-term view on opportunities in parts of the world that are poised to experience economic growth over time. Latin America falls squarely into this category. Economies are unfortunately struggling more now because of the pandemic. If the macro economic projections are correct, the recovery will take an extended period of time. We firmly believe that long-term economic growth in the region will lead to increases in per capita GDP, the assets that people acquire, and the need for risk management for all forms of exposure. We want to be there to support that growth.

The protection gap continues to be high across the board, with some prominent examples being motor, the SME space and health. Working with our clients, we are looking to narrow this gap and increase resilience. Also, in an increasingly connected world, we are seeing new risks emerge and the nature of risk being transformed. However, we are also finding new ways to mitigate risks, often with the help of technology. We have a significant opportunity to work with insurers, brokers and governments to mitigate existing risks and address new exposures in the years to come.

What are the challenges of Swiss Re in Latin America?

We know that affordability, product design and access to products play a major role. The fact that consumers aren't aware of, or have limited interest in the true value of insurance products doesn't help. These issues must be addressed to close the ever-growing protection gap. We need to help our clients improve the customer's journey, provide easier access and continue to simplify our products. Simplification does not preclude customising products to an individual's needs and lifestyle, which will further make the product more relevant for consumers. Furthermore, we must create ways to use our insights to prevent or mitigate risks from happening and more accurately price remaining risks. Increasing customer transparency and easily demonstrating the impact of a policy on the person's risk profile will be key.

We are seeing the coming of age of a generation of digital natives – individuals who have been immersed in the use of technology from the beginning of their lives – and the increasing digitisation of much of our daily lives. This is sparking new types of innovation in the insurance industry and will help facilitate access to insurance products. Innovation in product development combined with the analysis of new data sources will expand the scope of insurance and create new opportunities and growth. At the same time, we are looking to attract this generation to join the insurance industry. As an industry, we need to evolve and move towards today's future talents to ensure that we are an attractive space for them to grow.

What are the company's plans for the continent?

Swiss Re is leveraging its risk expertise, capital strength and new technologies to help our Latin American clients expand their business and grow profitably through the development of innovative consumer and capital solutions. Beyond just offering a service, Swiss Re is further committed to supporting its clients by participating in the risk.

Specifically, regarding new technologies, we are introducing tools to facilitate our client's insurance daily activities. To name one example, we are making life insurance simpler with our Magnum Go solution – a suite to automatise underwriting solutions – which is helping insurers to simplify the application process and reduce the time it takes to issue a policy. Magnum Go is enabled for mobile, so customers can interact with their insurer or agent anywhere. Insurers benefit from improved take-up rates; better, faster underwriting decisions; and more tailored products. This in turn creates more engaged, satisfied consumers.

In evaluating Swiss Re's product portfolio in LatAm, where do you identify the best opportunities?

Given the Nat Cat exposure of the region, there will always be an opportunity to participate in and mitigate these risks, which is core to Swiss Re's reinsurance offering for LatAm. At the same time economic, technological and geopolitical developments are bringing significant changes to business. These changes create new opportunities, but also new risks. As a result, a growing number of insurance solutions aim to protect cash flows and financial stability. Some of the risks previously considered uninsurable in some jurisdictions can be insured today with the emergence of new coverage triggers, parametric structures and data insights. Examples of risks that can be covered in an innovative way include cyber risks, product recall and reputational risks, as well as climate and energy risks.

In some countries, parametric insurance is also a good opportunity for us to reduce the protection gap, e.g., by helping farmers effectively manage the economic impact in the event of flooding, drought or low temperatures. Using satellite images and weather data, we monitor growing conditions, and if certain triggers are met farmers receive an instant payout.

> "Swiss Re is leveraging its risk expertise, capital strength and new technologies to help our Latin American clients expand their business and grow profitably through the development of innovative consumer and capital solutions"
>
> *Kaspar Mueller, President of Reinsurance for Latin America for Swiss Re*

Getting energised

The growing scope and influence of renewable energy merits deeper understanding of its insurable risks.

By Richard Carroll, AXIS Insurance

The renewable energy industry continues mostly unabated in its march forward, anticipating limited long-term negative side effects from the COVID-19 pandemic. With the continued announcements of new projects and advancing technology, it makes for a bright outlook for the renewables industry.

But peek beneath the surface, and it is not difficult to see how the industry's advancement is directly tied to increased risk and new disruptions. Projects on unprecedented scale face unique challenges in construction, general maintenance and repair – all of which can affect profitability. Insurance for renewables is necessary, but for it to work appropriately and as intended, collaboration between developers and insurers will only become more important.

In many ways it has been a difficult few years for parts of the renewable energy industry. Looking at the wind energy industry first, turbine manufacturers often report higher sales, yet simultaneously report decreasing margins. Earlier this year turbine manufacturer Senvion filed for insolvency, while Enercon — seen as a model of technological prowess — is seeking to restructure its debt after a fall in installations in Germany, its primary market. For photovoltaic (PV) manufacturers, margins have also been an issue and there have been selloffs or splits between parts of their businesses, so that one business line does not create undue burden to the others.

While the backstory is not the same, the insurance market for renewable energy has seen similar levels of turbulence. In the last few years, several providers of this specialist insurance have either left the market completely or dramatically changed how they view the market. Why has this situation occurred? In some cases, there is a lack of understanding and appreciation of the technology and therefore the associated risks. The story though, cannot be completely told without discussing the soft cycle of the insurance market. Throughout the 2010s, there was more supply than demand, leaving many companies to simply compete on pricing, at a time when claims seemed to be increasing both in quantity and amount.

At the same time, the world has seen the effects of natural catastrophes rise to unprecedented levels. We have seen Hurricanes Harvey, Irma, Maria and Matthew; a devastating earthquake in Mexico; and in California and Queensland, Australia, some of the worst wildfires on record. Add to that an increase in the average in overall U.S. hail insurance loss (an estimated \$8bn - \$12bn in 2008; approximately \$19bn in 2019) and we can see quite clearly how the picture has changed.

In addition to an increase in weather-related risk, the renewable energy industry itself is changing. Turbines are increasing in size and weight, creating new logistical issues and increasing the cost of individual claims. In solar PV, thermographic inspections are giving us more insight into the amount of damage PV panels suffer at all stages of the lifecycle.

These twin effects of changing weather and evolving technologies can often lead to issues that stretch the imagination of all involved. Areas that were previously deemed safe for construction and installation of new projects are suddenly facing exposure to natural perils, in many cases resulting in localised flooding.

Turbine blades have become so large only a few cranes can lift them or require all-new maintenance infrastructure to repair and preserve. Severe hailstorms that destroy PV projects, again incredibly localised to where these assets are being installed.

Risk has always been prevalent when building and managing any type of asset, but what has changed though is that today developers can no longer simply plan by assessing the relevant risks of the past. Instead, they must plan for the full lifecycle of the project, which can frequently extend 25 years, or they move into an increasingly unpredictable future, which may be impacted further by climate change itself.

As the renewables industry grows in both project size and its scope of influence in the global energy market, not only does it need more insurance capacity, but those providing the capacity must have a better understanding of the technical risks involved. In the future, only closer collaboration between the different risk stakeholders will enable a true understanding of all potential risks.

Whether it's insurers trying to better understand the effects of changes in technology, or developers and equipment manufacturers using the experience of insurers to understand the wider risk profile, it's crucial that all stakeholders work more closely together to ensure that risks are understood and mitigated effectively.

Richard Carroll is Global Head of Renewable Energy for AXIS Insurance.

"As the renewables industry grows in both project size and its scope of influence in the global energy market, not only does it need more insurance capacity, but those providing the capacity must have a better understanding of the technical risks involved"

Richard Carroll, Global Head of Renewable Energy for AXIS Insurance

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The Changing Nature of Risk: The Cyber Risk Landscape

The insurability of systemic risk is going to be one of the defining issues of the next decade for the re/insurance sector. Rapid technological changes, digitalization in particular, have already transformed the characteristics of risks assumed by the re/insurance market. COVID-19 will only accelerate these trends.

As cyber risk is one of the most dynamic perils in the industry, carriers must carefully manage exposures – and not only for competitive advantage. As regulators formalize capital requirements and quantitative and qualitative measurements of risk appetite in this rapidly evolving market, companies must enhance cyber underwriting and reinsurance strategies, leverage innovative modelling capabilities and develop technical and underwriting risk talent to continue offering clients the best security possible.

Re/insurers face many challenges in formulating a cyber risk management strategy, including divergent views of the potential silent cyber exposure of property, casualty, aviation, transportation, marine and other policies. This is compounded by the fact carriers must constantly re-evaluate underwriting strategies to stay abreast of the latest cybersecurity innovations, software patches and attack vectors, all while market demand for cyber products is increasing.

> “Cyber risk is constantly evolving and at an increasingly rapid rate, causing insurers, businesses and nation states difficulties in measuring, assessing, communicating and responding to cyber events”

As companies depend more on technology to conduct business, they are also increasingly subject to technology's unique vulnerabilities. These are wide-ranging and can include system or supply chain disruption or failures, distributed denial of service, hacking and ransomware attacks that may result in increased costs and lost revenue. The timing and severity of these issues can be difficult to predict, with companies increasingly looking to their insurance policies to cover business interruptions stemming from these events, creating an increasing demand for cyber re/insurance.

Potential New Attack Vectors and Technology Impacts

For the insurance industry, cyber and technology risks pose a number of opportunities, challenges and threats. Cyber risk is constantly evolving and at an increasingly rapid rate, causing insurers, businesses and nation states difficulties in measuring, assessing, communicating and responding to cyber events.

Increasing reliance on technology makes us more vulnerable to risks inside and outside the organization. The common trends emerging are:

- The proliferation of big data and cloud computing - confidentiality,

integrity and availability of data are critical to organizational survival, whether nation state secrets, industrial intellectual property (IP) or sensitive personal data.

- Cyber-attacks on mobile devices are increasing and are likely to become a primary phishing vector for credential attacks in 2020. As a result, dual-factor authentication will move to multi-factor authentication.
- The continued use of social engineering through phishing and smishing.
- An increase in the proliferation of malware and ransomware.
- An increase in opportunities for organized crime.
- A lack of global governance and agreement, which creates a unique opportunity to exploit vulnerable individuals, companies and nation states.
- The increasing use of artificial intelligence.
- Increasingly interconnected supply chains vulnerable to multi-party cyber security incidents.
- Voice-based cybercrime, which is growing along with the explosion of voice-directed digital assistants.
- Global adoption of 5G infrastructure technology.
- Newer technologies like deep fake video and audio technology.

The Impact of COVID-19 on Business Models

As companies and their employees continue to adjust to working remotely, changing product demands and supply chain interruptions are forcing them to adapt their business models. This has resulted in increased potential for cyber risk events, and we have observed the following cyber risk amplifiers:

Insurer Growth Strategies

Despite the challenges cyber presents for the industry, particularly in light of the COVID-19 pandemic, a variety of growth strategies exist for insurers looking to explore the space. Some companies are targeting only large corporate risks, while some are looking exclusively at small- and medium-sized enterprises (SMEs), as they do not want to take the chance of the larger corporate claims destabilizing their portfolios. Others are looking into how to balance their large corporate cyber with SME business through white-labeling or supporting managing general agents.

Target Segments

The number of companies purchasing cyber insurance continued to increase in 2019, driven by growing recognition of cyber threats as a critical business risk and appreciation for cyber insurance's role in mitigating its economic impact.

Prior to 2019, manufacturing and data intensive industries led the growth in cyber sales, however, in the United States the prominent buyers of cyber insurance in 2019 were the education, healthcare, hospitality and gaming, media and telecommunications industries.

How Changes in Cyber Risk Could Drive a Hard Cyber Insurance Market

As the threat landscape continues to evolve, we have already seen shifts in ransomware attack behaviors. These attacks are no longer just ransomware, and are often combined with data theft or credential harvesting. This carries the potential to increase cyber claim-related costs, and given the impact this is having on SME cyber portfolios, we are seeing corrections in pricing and terms and conditions.

Cyber Risk Amplifiers

- Alternate modes of working*
- Different technology utilization
- Less familiar modes of data movement and exchsnge
- Rebalancing of supply chain dynamics and third party reliance
- Key personnel risk
- Management and staff distraction
- Facility access and collaboration constraints
- Ability to deal with a 'double whammy' crisis of COVID 19 and cyber attack
- Rogue actor motivation

* Between Febuary 4, 2020 and April 7, 2020, there was an estimated 70% increase in remorte working (Source: Carbon Black)

Non-Affirmative Modeling and Guy Carpenter Solutions

Moving away from affirmative cyber coverage, the non-affirmative, or silent cyber modeling space has also developed in recent years, following the NotPetya and WannaCry attacks, which highlighted the potentially catastrophic impact of silent cyber within non-cyber lines of business. This underlying exposure's potential for aggregated loss is currently one of the major issues being considered by the re/insurance industry.

Global regulators, including the European Insurance and Occupational Pensions Authority and the National Association of Insurance Commissioners in the United States, have issued similar statements and guidelines on managing silent cyber risks.

To address this challenge, re/insurers require an effective means of qualifying and quantifying the risk of silent cyber across entire portfolios. Guy Carpenter has established relationships with cyber risk modeling platforms CyberCube and RiskGenius, an insurtech firm that utilizes artificial intelligence to evaluate potential silent cyber exposure at an individual policy level. This provides clients with a means of assessing corporate silent cyber exposure at scale, while generating deeper risk insights.

GC Cyber Analytics has also developed an in-house solution that combines the RiskGenius tool with an in-house modeling tool for silent cyber - GC SCOPE℠.

We are working with our clients to help them to proactively address both affirmative and non-affirmative cyber risks, including silent cyber in property, casualty and several other lines of business.

Siobhan O'Brien
International Cyber Center of Excellence Leader, Guy Carpenter

Erica Davis
North America Cyber Center of Excellence Leader, Guy Carpenter

Reinsurance renewals: Hard questions asked at mid-year

While the hardening market presents opportunities for growth and tightening conditions, some reinsurers remain cautious in a world still riddled with uncertainty.

By Mark Richardson, London Editor

As reinsurers and insurers hurtle toward what is assured as being one of the most unique 1.1 renewals of all time, it must also be classified as one of the most notable. Not merely due to the cancellation of staple dates in the calendar such as Monte Carlo and Baden-Baden, or the extreme need to embrace digital trading – but also because of the longer-term implications on terms and pricing over the next few years.

After years of heavy losses, evidence the reinsurance market was starting to harden was first seen at the January 2020 renewals. At that time Swiss Re reported a rate increase of 3.5%, and Munich Re saw a 1.2% increase, and by April those percentages rose to 8% and 3%, respectively.

The key factor influencing pricing since then has been the coronavirus. Fitch's recent report "European Reinsurance – Peer Review" states that due to the pandemic, the reinsurance sector finally entered into a "hard market" phase in Q2 2020.

"Financial market volatility, rising claims across various lines of business and heightened uncertainty has led to a rise in demand for reinsurance cover while capping available capacity at the same time," the report notes.

Fitch, however, is not the only voice describing the current reinsurance sector as being in a hard market.

"Reinsurance markets are hardening as they haven't for a pretty long time," Joachim Wenning, CEO of Munich Re, said on the group's recent Q2 results call. "You have never heard me or us here in this room saying so before corona, but we have seen this in the most recent 1.7 renewal, and we will continue to see this in future renewals."

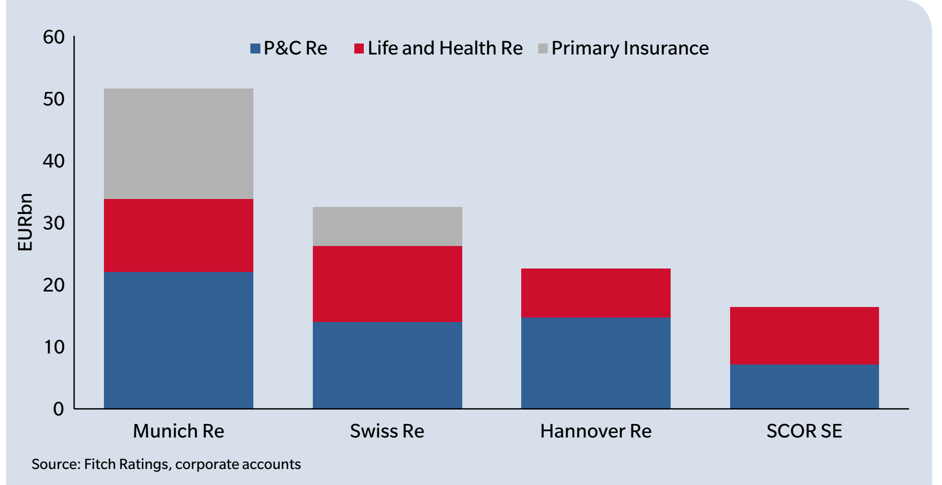
At July renewals, Munich Re reported prices increased by 2.8% on a risk-adjusted basis. Wenning said that while this doesn't sound like a lot, there was much to be cheerful about.

Certain lines of business have seen rates climb to double-digit percentage points, he said, and it wasn't just in programs that had been losing money for some time.

"We also now see a spillover from loss-making into non loss-making areas or lines of business," Wenning said. "And that's a new and good development from our perspective. That is what describes a hard market, and the 2.8% that you apply across on the whole portfolio of the P&C business. If you translate this into amounts, those are good amounts."

Optimism among reinsurers around upcoming renewals is

Gross Written Premiums by Segment – 2019



Source: Fitch Ratings, corporate accounts

not universal, however.

On Swiss Re's Q2 results call, the group's Chief Underwriting Officer Edi Schmid remarked that reinsurance pricing had experienced a nominal 6% increase, largely offset by falling interest rates and changes to loss assumptions. On a risk-adjusted basis, pricing was flat.

Schmid said that with two-thirds of its book proportional business, where price rises are related to the underlying primary policies, the rate hikes needed to be greater.

"In economic terms, our P&C liabilities have a duration of six or seven years – so if interest rates drop to the extent we have seen and they're likely going to stay that low, it's very important to factor this in," Schmid added. "This is also the reason why the industry, and also we, need to drive underwriting margins up quite a bit further."

Weighing options

Whether "hard" or "hardening," the movement in rates and overall increase in demand are resulting in expanding books.

While Swiss Re grew its premium volumes by 6% at the July renewals, Schmid commented that the group was putting the focus firmly on the quality of business being written. Over time, he said, Swiss Re would deploy more capital at these better rates.

Munich Re grew its premium volume by 8.3% at the July renewals, something Wenning said combined with the rating uptick was "by far the best development for not only many, many quarters, but even many years."

The group has suspended its share buybacks to increase the amount of capital it can deploy toward growth in these positive conditions.

"We are benefiting from this with all the capital we can now employ and with the capacity that we offer to the markets," Wenning added.

Approaches vary as to how much additional risk is taken on, but across the reinsurance sector more capital raising is taking place – whether to grow their books and take advantage of market hardening, or simply to shore up their solvency positions.

QBE was an early mover, raising $825m in April. QBE Re Managing Director Stephen Postlewhite told *Reactions* at that time his unit would attract its "fair share of that additional capital raise" as it looked to take advantage of rates and take on new business.

He said that was a pivotal moment in the cycle where the power in negotiations was shifting back to reinsurers after years of rate adjustments lagging behind primary and retro.

RenaissanceRe has since raised $1.1bn in equity capital and $250m in third-party capital; Lancashire $340.3m in equity capital; and Fidelis $800m in equity capital.

"The current hardening of the reinsurance market is attracting reinsurance equity and debt investors in the midst of the COVID-19 pandemic," Emmanuel Modu, Managing Director & Global Head of Insurance-Linked Securities, AM Best, tells *Reactions*. "The motivation to raise capital ranges from their desire to exploit a hardening reinsurance market to the need to shore up their capital base in order to meet regulatory or ratings agency requirements.

"Regardless of each reinsurers' motivation for raising capital, the fact that investors are willing to support these companies speaks to the confidence they have in the future of the traditional re/insurance industry even with the overhang of the pandemic."

At mid-year renewals, Willis Re found insurers were able to secure sufficient reinsurance capacity supported by adequate reinsurance capital.

Capital levels were only 5% down on where they were at the end of December 2019, having been reduced by 30% at the end of March 2020 – signalling a rapid capital replenishment since the crash in financial markets.

In its"1st View" Report for the June and July renewals, Willis Re put this restoration down to more than $16bn of new COVID-19-related capital raises in addition to investments recovering and other cash-conservation strategies.

The broker recognised that only around $7bn of COVID-19 losses have so far been reported against top-down industry loss estimates of anywhere between $30bn and $130bn. It found that collectively, reinsurers are realising that reserving related to the pandemic may need to be spread over several years to cover the final bill.

Shifting sands

Mike van Slooten, Head of Business Intelligence for Aon's Reinsurance Solutions division, says even before COVID-19 a tightening of reinsurance capacity was anticipated.

"There has been some reduction in capital adequacy

CONTINUED ON PAGE 36

"The current hardening of the reinsurance market is attracting reinsurance equity and debt investors in the midst of the COVID-19 pandemic. Regardless of each reinsurers' motivation for raising capital, the fact that investors are willing to support these companies speaks to the confidence they have in the future of the traditional re/insurance industry, even with the overhang of the pandemic."

Emmanuel Modu, Managing Director and Global Head of Insurance-linked Securities, AM Best

across the reinsurance sector because of the catastrophe losses seen in the last few years, and because they've grown," says van Slooten. "That was an underlying trend that was already in place."

He also highlights pre-existing disruption in the alternative capital space, impacting the availability and cost of retrocession capacity.

"These are all things that were already in play at the beginning of the year, and we thought that was enough to begin to change the dynamic in the reinsurance space as 2020 progressed," he adds.

"What's happened is that many of those trends have been exacerbated or accelerated by COVID-19."

Yet when looking toward 1.1, van Slooten says there are still a number of variables that will determine the path of negotiations.

A number of start-up re/insurer vehicles are rumoured to be in the works to profit from the hardening conditions, and van Slooten says if they all come off, that might introduce another $4-5bn of capital to the market.

And more capital raises could yet be on the cards from established players.

"To the extent that you get new capital coming in that is specifically looking to play in the property cat or retrocession area, then that would cap any potential rate increase," van Slooten says. "So new capital coming in to compete in that space should have the impact of taking the sting out of the situation, but it remains to be seen how much of that capital gets deployed into the market."

The prospect of a busy hurricane season is an additional dynamic van Slooten points to that presents no small amount of uncertainty. This is creating further demand for cover, he adds, due to the desire to guard against heavy losses by de-risking portfolios.

As well as giving reinsurers increased power over pricing, it allows them to dictate further on terms and conditions. Pandemic exclusions have been widely inserted across the market, and van Slooten says a big difference this year is that terms are being tightened on some loss-free accounts.

In casualty lines too, reinsurers are tightening the reins.

Chaucer's Head of U.S. Casualty Treaty Mike Clifton says in this class there have been a number of more restrictive terms introduced across the industry, designed to reduce the amount the reinsurer has to pay out in the event of a claim.

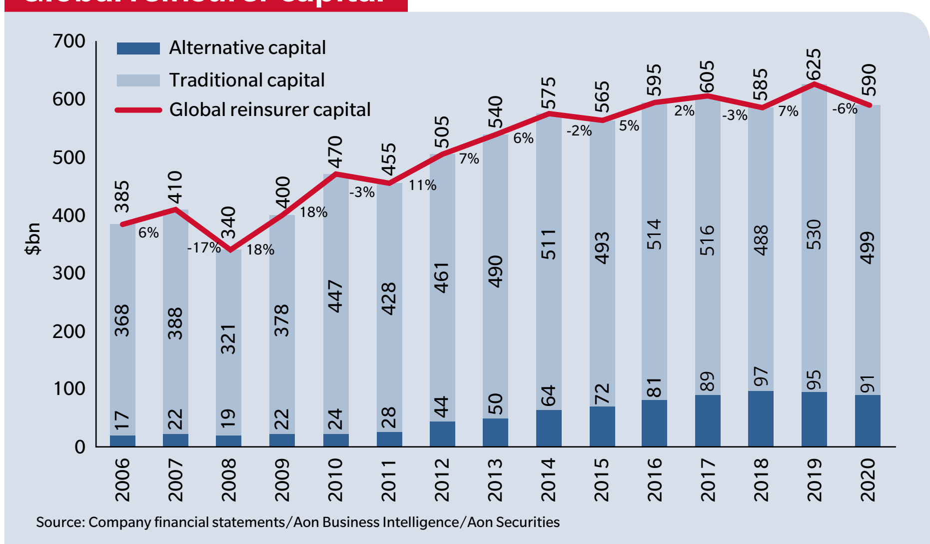
"Some of the softer elements have been the change in the clause, the event definition, and sole-judge language where the client is the judge of what an event is – those wordings are now getting challenged," Clifton says. "While that won't be reflective as a rate change, the removal of those types of words like 'sole judge' will have a big impact in the ultimate loss cost."

In spite of these actions on terms and pricing, multiple ratings agencies have declared that the reinsurance sector will again not meet its cost of capital this year, having failed to do so for the last three years due to heavy catastrophe losses. Van Slooten agrees with this sentiment, but maintains that experience varies widely among individual reinsurers.

"Some companies have done very well and have produced good earnings and been very resilient, and there are some others that have found the going quite tough," he says. "That adds to the pressure, because already we can say the sector won't be covering its cost of capital in 2020. So for any company that has been struggling over the last three to five years this is another year of pain, which is likely to add to the external pressure that will come from investors and rating agencies."

> "Some [reinsurers] have produced good earnings and been very resilient, and there are some others that have found the going quite tough. For any company that has been struggling over the last three to five years this is another year of pain, which is likely to add to the external pressure that will come from investors and rating agencies"
>
> *Mike van Slooten, Head of Business Intelligence, Aon's Reinsurance Solutions division*

Global reinsurer capital



Source: Company financial statements/Aon Business Intelligence/Aon Securities

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www.millire.com

Insurance Steps Up

The value of philanthropy and creativity in a pandemic.

The past several months have been filled with anxiety and new concerns fueled by the COVID-19 pandemic, but when reflecting on the actions of our industry, we see the good that can arise from contributions to the community in the most challenging of times.

Extraordinary generosity and unwavering dedication do not even begin to describe the exceptional ways in which the insurance industry has banded together to support their communities and families and children in need as this pandemic has shaken our country and the world.

Globally the insurance industry was quick to respond to this unprecedented crisis, with U.S. insurers and their charitable foundations donating $280 million and an additional $150 million internationally, according to estimates by the Insurance Information Institute, based on data collected by the Insurance Industry Charitable Foundation (IICF).

At IICF, we work to unite the industry through philanthropy, understanding the strength that comes from pooling our knowledge and resources. When the COVID-19 crisis emerged, our industry – individuals and companies alike – was quick to respond by donating funds and volunteering time.

The IICF COVID-19 Crisis: Children's Relief Fund, created to help children and families made vulnerable by the pandemic, raised $1.3 million in the U.S. and UK, including donations from 40 companies and more than 1,000 individuals. Lloyd's in particular led by example, stepping out early with an exceptional contribution of $500,000. And, as those funds have come in, the IICF has been diligently working to award grants to 14 nonprofit partners across the U.S. to quickly deliver vital services to children at risk. Already, more than 700,000 meals have been delivered as the IICF nears its goal of distributing one million meals with this campaign.

Getting Creative

The IICF, individuals and companies have stepped up, not just by writing checks but by thinking outside the box. In July, the IICF launched its first International Step Up Challenge in which more than 800 insurance industry professionals and their families and friends teamed up in an exercise challenge to raise funds for the IICF Children's Relief Fund while promoting wellbeing and teambuilding. The winners will have the chance to award grants to the charity of their choice.

Insurance companies have gotten creative as well, giving in meaningful ways to those in need during this pandemic, including:

- Donating more than 2.4 million masks to front-line healthcare workers
- Offering no-cost life insurance policies to front-line health care workers
- Pledging to deliver more than one million meals to families in need (in addition to the IICF's meal commitment)

Individuals have also stepped up to support the greater good. This spring, Craig Dunn, Executive Vice President and branch leader for AmWINS Brokerage of Texas, Inc. promised to shave his head if his team met their goal of raising $10,000 for the IICF Children's Relief Fund. With $16,000 raised, he surrendered to the clippers.

A Year of Pivoting

For all of us, 2020 has been a year of pivoting. Businesses and nonprofits have had to think: How can we change our view and our approach?

The IICF chose to focus on two internal resources: its ability to band the industry together in raising funds with the IICF Children's Relief Fund and its Every Day is a Reading and Writing Day (EDRWD) program created in conjunction with Sesame Workshop. This spring, the IICF distributed its EDRWD early literacy resources to industry professionals, for the benefit of those facing challenges at home balancing work and childcare/school as well as to nonprofits working with children and families and the general public.

Further, with a pandemic that is requiring us to socially distance and encouraging those with vulnerabilities to stay home, nonprofits have been challenged to reconsider how they operate without the possibility of hosting events. IICF divisions have pivoted in response, offering a virtual softball tournament, online trivia events, and virtual boxing classes, among other activities.

The IICF has also had to transform its bi-annual Women in Insurance Regional Forums, which focus on diversity, inclusion and leadership. With these issues in the forefront of the national conversation, the IICF recognized the tremendous value in continuing the series and has decided to proceed with a three-day national Inclusion in Insurance Forum on Oct. 27-29.

Further, the IICF's Week of Giving, a celebration of the culmination of year-round volunteerism, will continue this year on Oct. 10-17 with both virtual and select, socially distanced in-person volunteer projects. The IICF's Northeast Division Benefit Dinner will be hosted virtually for the first time this year, honoring Gallagher, on Dec. 9.

Moving Ahead

This has been an unprecedented year for all of us as individuals and as a professional community. As an industry, we accepted the challenges before us, and moved ahead boldly, swiftly and with open hearts to not only continue, but to bolster our efforts to help the community, particularly children and families in need. By uniting as an industry through the IICF, the insurance community will continue to provide the support and hope our communities need now more than ever.

Bill Ross is Chief Executive Officer of the Insurance Industry Charitable Foundation.

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Is There Anything but COVID-19 Right Now?

While the daily information overload concerning the pandemic inundates all corners of the insurance industry, Kroll Bond Rating Agency (KBRA) continues to monitor ongoing fundamental insurance trends to help inform our credit assessments across the property/casualty (P/C) and reinsurance sectors.

This article revisits several prominent themes circulating in the insurance industry before COVID-19 took center stage.

U.S. Storm Season Continues to Churn

Beginning with Tropical Storm Arthur on May 16, the trend of increased named storms has continued unabated. Even before the start of the 2020 Atlantic hurricane season, forecasters were predicting higher numbers of events with greater severity. Fueled by heavy thunderstorm and hail activity in North America, global insured catastrophe losses have already topped $30 billion for the first half of 2020, exceeding the 20-year average.

Weather forecasters have continued to revise their prior estimates upward, which suggests even greater risk for the industry. Given the early start to the storm season, there is now a significant chance that the total number of storms will exceed the World Meteorological Organization's annual list of 21 allotted storm names, something which has occurred only once, back in 2005. On August 5, the Colorado State University (CSU) Tropical Meteorology Project team—one of the leaders and pioneers of hurricane forecasting—updated its Atlantic hurricane seasonal forecast to "extremely active" from "very active." The NOAA's forecast was also updated in August and calls for 19 to 25 named storms.

“Fueled by heavy thunderstorm and hail activity in North America, global insured catastrophe losses have already topped $30 billion for the first half of 2020, exceeding the 20-year average”

U.S. Insured Catastrophe Losses 2000-2019

Note: Figures stated are adjusted to 2018 dollars, except for 2019 estimates.
Sources: Insurance Information Institute, KBRA

2020 Forecast and Historical Atlantic Hurricane Season

	1950-2000 Historical Avg	1981-2010 Historical Avg	2016 Actual	2017 Actual	2018 Actual	2019 Actual	CSU Forecast			Remainder of 2020 Season
							April	July	August	
Named Storms	9.6	12.1	15	17	15	18	16	20	24	15
Hurricanes	5.9	6.4	7	10	8	6	8	9	12	10
Major Hurricanes	2.3	2.7	4	6	2	3	4	4	5	5

Source: Colorado State University & NOAA

Probability for at Least One Major (Category 3-4-5)

Coastal Location Description	Last Century Historical Avg	CSU Forecast	
		July	August
Entire Continental U.S. Coastline	52%	69%	74%
U.S. East Coast Including Florida Peninsula	31%	45%	49%
Gulf Coast From Florida Panhandle westward to Brownsville	30%	44%	44%

Source: Colorado State University

The revision includes five major hurricanes out of a total 12 hurricanes forecasted this year. CSU is also forecasting 10 hurricanes for the remainder of the 2020 season. The probability for major hurricanes making landfall along the continental United States coastline was also increased.

While storm trackers continue to monitor weather patterns, insurers will undoubtedly keep a close eye on the calendar as we are in the peak of the storm season (mid-August to late October). KBRA notes that carriers have seen significant shifts in reinsurance availability and sharp price increases as well as structural changes that provide less overall coverage than on expiring programs. Smaller, less diversified property writers will need to proactively manage their exposures and consider significant premium increases and/or policy reductions.

> "The current environment is a stark reminder that while a specific capital model may or may not identify the complete range of risk concentrations, analysts who are thinking 'beyond a capital model' are more likely to identify and stress test for a more comprehensive range of risks"

Ever Challenging Capital Modeling Just Got Harder

As KBRA has noted in other forums, while capital models can be valuable risk management tools, their usefulness is limited not only by the quality of inputs, but the interpretation of the outputs. Furthermore, using a single capital model as the primary analytical driver of insurance company strategy can lead to an incomplete view as overreliance on any one factor or tool introduces bias that may be better identified using a more holistic and balanced analysis. While pandemic events were undoubtedly embedded into many operating company capital models, in many instances, the scope and far-reaching consequences of COVID-19 serve to highlight the difficulty in accurately reflecting risk for extreme scenarios for which there are limited historical precedents.

The current environment is a stark reminder that while a specific capital model may or may not identify the complete range of risk concentrations, analysts who are thinking "beyond a capital model" are more likely to identify and stress test for a more comprehensive range of risks. A model is a tool and the information it provides is vitally important, but it should be viewed as one (and not the only) input to how a company runs its operations. Rather than providing an "answer," the output of quantitative tools should be assessed through the lens of users' broad experience—the critical lens through which insurance managers evaluate the outputs. When not constrained by a capital model "box," management teams are more likely to engage in deep, thoughtful analytical review of all key risk aspects of a company, including the implications for its capital position.

KBRA's approach to ratings is inherently holistic and explicitly flexible to capture the bespoke risk profile of each insurer. For this reason, KBRA does not utilize a standardized capital model for insurance companies; rather, it relies on a multifaceted framework to assess each aspect of an insurer's credit and financial profile. The methodology incorporates both quantitative and qualitative analyses, as well as forward-looking expectations and projections. In KBRA's view, capital models are not "one size fits all," and by not being beholden to a singular capital model, we analyze capital (and all material elements) based on each company's unique characteristics.

ERM and Management Experience Will Emerge as the True Stars

As insurance leaders continue to think broadly about any potential material risk to their business (as well as any new opportunities), effectively going above and beyond the limitations of capital models noted above, robust and comprehensive risk management processes will provide companies with the foundation to emerge from the current global crisis. Companies with experienced management teams who have navigated through prior economic downturns will clearly have an edge, but so will those firms that are not afraid to think creatively and demonstrate a willingness to modify their operations and strategy to adapt to new market realities.

To move beyond COVID-19, some insurers must reconsider the roles and responsibilities of the individuals involved in the risk management function, the scope of risks to be managed, as well as the processes, systems, and procedures to manage those risks.

ERM systems will undoubtedly undergo an overhaul as the pandemic provides a wealth of new data points for management teams to consider, again giving a distinct advantage to organizations that have risk processes in place that are sufficiently comprehensive to incorporate all elements of the insurer's business profile. By the same token, markets move in the blink of an eye. ERM that is both nimble and flexible will pay handsome dividends for companies that have invested time and money in their risk management platforms.

These are just some of the issues that will continue to compete for attention in the months ahead. For the time being, COVID-19 will rightfully dominate all conversations in the insurance industry. But the myriad effects of the pandemic will only heighten other aspects of insurance risk management and financial conditions.

Proof Positive

How a pragmatic, insightful approach to risk selection helped Sompo International weather the COVID-19 tsunami – and is elevating its profile in a market searching for answers.

By Shawn Moynihan, Editor-in-Chief

Chris Gallagher, Executive Director of Sompo International Holdings Ltd. (Sompo International) and CEO of Sompo International Commercial P&C, could perhaps best be described as an insightful pragmatist – and his organisation's futures are brighter for it.

In February, just weeks before the COVID-19 pandemic wreaked havoc on the world economy (and, by extension, re/insurers' investment results), Gallagher spoke with *Reactions* about how capacity across the board had already been shrinking – how the all-out, high-limits strategy in gaining market share was no longer an option for most P&C insurers.

"Particularly in the large corporate solutions business, carriers thought they could go 100% or control accounts with very big limits – but those markets are now starting to disintegrate, and capacity's being withdrawn or restricted," he said. Increased prudence in the limits offered and addressing the price of risk were becoming far more common, he added.

Then the coronavirus began to spread across the globe.

Now, reconvening in a much different world, Gallagher reflects on how the underwriting and investment choices made at Sompo International pre-pandemic have proven fortuitous in protecting the company's interests – and given it an advantage in a market where the margin for error is perhaps smaller than ever.

"When we spoke last time, I was talking very much about management teams looking in the rearview mirror about contraction and stress on balance sheets, and all COVID-19 has done is just magnify that in a more accelerated fashion," he says. "And we're fortunate enough to say that we don't have those issues."

A global specialty provider of P&C insurance and reinsurance, Sompo International was established three years ago after the acquisition of Endurance Specialty Holdings Ltd. by Sompo Holdings Inc. All commercial property, casualty and specialty insurance and reinsurance outside of Japan has been brought together under Sompo International's Commercial P&C platform.

Sompo International's mindful investment approach helped it weather the financial storm, Gallagher notes, while many other insurers weren't as fortunate. The company's investment portfolio is heavily fixed-income and high-credit-quality oriented, without excessive focus on equities or alternatives.

"We were conservative in our investment philosophy, our asset allocations," he says. "When the markets are going up, we don't see that accretion from the investment side. Because we are positioned to take risk we actively do think about tail risk correlations, and we aren't willing to bet the asset portfolio just to make up for lack of return on the underwriting side.

"And so we were conservative," he continues. "Our book value change in Q1 was muted and I can fortunately say the same for Sompo Group as well. It's a relatively modest change in our solvency positions, and I know that's not the case for others."

Prescience pays off

It wouldn't be accurate to call Sompo International's approach to insuring risks "conservative," however, as that term implies that the company is risk-adverse – which isn't the case.

"It can appear conservative, but – as we've seen it proven, it's just sensible," says Gallagher. The "really poor pricing environment" over the last three to five years, he adds, created a market in which many risks "to some extent or another" just were not being priced properly. And there's only so long you can do that, so you inherently get very selective in what you write.

"You can still grow and make the best of navigating that, because the market is the market and there will be inevitable swings – but particularly in reinsurance there's a flight to quality to those cedants that have navigated this market better than others, and that's what the industry will figure out over the next few years," he continues. "What might appear conservative, I would say, is rather us just being selective and respectful in our exposure management, and building out a portfolio in a balanced way."

Decisions made around its risk portfolio proved prescient as well, once the pandemic hit and some key lines of business – event cancellation, for example – saw mounting claims.

"There's nothing wrong with [writing] event cancellation," he says. "It's just the aggregations and the tail-risk potential that are out there and the pricing for that risk just weren't attractive to us, so we didn't have that in any material way. We also didn't really have the SME affirmative-coverage grants that you're seeing play out, whether it's in Canada, in the UK or in certain parts of the U.S."

Although they are currently paying off, Gallagher acknowledges that the decisions not to write certain lines of business could have seemed too careful at the time.

New talent joining Sompo International, he explains, "have to buy into what we're doing here: the peer review, the governance, the oversight, the construction of underwriting portfolios, the involvement of senior leadership on a day-to-day basis on the underwriting side. While it can sometimes seem frustrating to people when they come into the organisation, it's by design – and it's kept us away from a lot of the areas that you're seeing clients suffer very badly in terms of COVID-19 losses.

> Other organisations "will fight fires in 2020 – but I truly expect not everyone's going to make it. I think balance sheets were overleveraged, either on the asset side or combined with the underwriting side. There isn't a lot of headroom in there to weather the storm"

"We're exposed to ... let's call it the economic uncertainty of just how product lines react in a volatile economic downturn," he adds, "but other than that I would say we're in very good shape. I'm not trying to say we have zero losses. Of course we will have losses, but certainly not that first wave headline-type exposure that you've seen from others."

Sompo International, Gallagher notes, started from a strong capital position "because we understand the volatility of commercial (re)insurance business and where we were in the cycle. We were building patiently for the long term, not trying to manufacture short term ROE through buybacks and the like, certainly not from a commercial P&C perspective. So we did have a conservative balance sheet position for growth, and that's played out. That's why we're able to take an unchanged appetite – if not, even expand that appetite going forward – in response to the market environment we face and continue to look forward, not backward."

Appetite for reconstruction

Sompo International enjoys the advantage of having firsthand perspective on both primary-side and reinsurance business, as it writes both. As such, Gallagher understands well how the two exist in symbiosis.

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Of numbers and leadership

Gallagher, who was selected to lead Sompo International Commercial P&C in April 2019 after having served as Chief Risk Officer since 2015, possesses an actuarial background that serves him well – but he's experienced enough to acknowledge that numbers are just part of the greater equation.

"Bringing those analytical skill sets to the floor certainly helped me in my role, but I'm very conscious that it doesn't run companies, it doesn't gain success on its own," he says. "We've seen others try to do it from an analytical perspective – and unfortunately in our business, you know the policy language alone is quite complex if you consider any one contract.

"The solutions we've provided are highly differentiated depending on the client, and I don't think this is a business that can be run by numbers," he adds. "It's still about underwriting acumen, it's about making the right decisions in terms of the portfolios we want to pursue, it's about having the expertise and the people to go and develop those solutions and distributing our products accordingly.

"So yes, while it's complementary, I don't see it as the key part of the [CEO] role," says Gallagher. "That's different now to being an actuary or a CRO – and I have very capable people that do that for me now."

The appetite for reinsurance has been on the rise of late, as primary-side companies look to shore up their balance sheets and transfer increasing amounts of risk – creating opportunities for Sompo's International's global reinsurance business.

"There has definitely been an increased demand for traditional reinsurance products," he says, "particularly from some of the very big global insurers – which, you can imagine, if they put even a small percentage of their portfolios into the reinsurance market those are big individual contracts in themselves. Our submission count is up quite considerably, which tells you where the market is in some respects. But our ability to respond to that, from an operational perspective, to actually clear those submissions, and then ultimately for underwriters to quote on them, has been stellar.

"A lot of the players that chose to try and retain more risk as margins were falling was a strategy that's proven tough for some people to live through," he adds. "So we are seeing an increased demand for us. I would say we've been at the front face of quoting, of structuring, and to meet that increased demand; we have participated in a lot of that new business coming into the reinsurance market."

As long as Sompo International sees the ability to make a fair return, Gallagher adds, "we're prepared to take a leading role in meeting clients' needs. And we haven't changed our appetite in reinsurance, whereas as you see this increased demand you're seeing a restriction in capacity and supply, because not all the reinsurers are reacting. Some have concerns on individual segments of the market, and for others it's just a general retreat while they become internally focused and possibly figure out what their next steps are.

"The motivations are different for each," he continues. "I don't want to try and characterise everyone in the same way. But I think for our team, it's allowed us to be completely stable, and if anything, be willing to consider enhanced positions within some of these individual treaties that are coming to the market. And I would say we are very much displaying the characteristics and behaviours of a top-tier reinsurer."

Gallagher believes that "flight to quality" has allowed Sompo International to differentiate itself in some very uncertain times – an advantage the organisation intends to leverage going forward, especially as a "one-stop" provider of both primary cover and reinsurance.

"We think there's room for us," he says, flatly. "I very much think that the insurance and reinsurance markets both are something that we can continue to penetrate and deliver solutions to clients that provide an alternative to what's already there."

Much of that is about responding to claims, and Gallagher is particularly proud of Sompo's efforts in that front as its talent continues to operate remotely.

"On the claims side, everything we've been asked to do in the midst of a pandemic takes more time because of remote working, and we've gotten through that, but there's a different question being asked of our people," he says. "It's not just a repeat of what we've all seen before. We're having to think a lot harder, to clarify policy language, to think about terms and conditions, and to implement pricing in a much more meaningful way, and both our front and back office have responded well.

"I do think that positions us very, very well, as Sompo International will continue to invest to meet those demands, but in a responsible way," Gallagher adds. "And I think that's a theme that you're going to continue to see. We'll figure things out, and people will fight fires in 2020 – but I truly expect not everyone's going to make it. I think balance sheets were overleveraged. There isn't a lot of headroom in there to weather the storm, so you're going to see capital raising continue. They'll face rating downgrades, or they'll contract, so they won't look the same as they are, but a few will emerge stronger and more relevant going forward. I think you'll see, as we go into 2021 and '22, just quite how things emerge – and I think it will be different."

> "We did have a conservative balance sheet position for growth, and that's played out. That's why we're able to take an unchanged appetite, if not even expand that appetite going forward in response to the market environment we face"

Retro active

While the subject of retro cover seldom seems to garner headlines, Gallagher possesses some interesting perspective on its value both as a product and as a solution.

"We write retro. We're happy to do it, and we buy it as well," he says. "But we're not majorly reliant on retro to determine what our strategy is going to be. It helps us manage volatility and we have some very long-term retro partners, which we enjoy, but we very much have a gross underwriting philosophy that would carry us through in any case. That's our position, from an internal perspective."

Speaking to the overall state of the retro market, Gallagher says that while various reinsurers have exhibited changing appetites for it, one thing is certain: pricing has accelerated significantly, in part because the amount of retro capacity currently available isn't what it was a year ago.

"I see a couple of dynamics there," he says. "It's really changed month on month, as you've gone through the year, in what people's requirements have been. You've got reinsurers that, as COVID has emerged, are looking for protection. So, you've got the new buyers or the top-ups, I would say, to existing ones. And really, the price of risk has gone up, and so retro pricing was absolutely going up.

"I believe it's a complete dislocation, if I could characterise it as that, in the retro market, as to the motivations in what people were buying and what people were willing to sell," he adds. "It's ended up a very fragmented retro market right now, where buyers are changing their view of what they're going to buy – and sellers have changed their view on price."

Earthquake Insurance: Should California be more like New Zealand?

By Michael Drayton, Head of New Zealand Office, RMS.

California has eight-times the population of New Zealand (40 million compared to 5 million), and more than ten times the Gross Domestic Product. California is also geographically around sixty percent larger. Both regions are seismically active. But did you know there is more insured residential earthquake exposure in New Zealand than there is in the state of California, making it one of the most important earthquake insurance markets globally.

Look at two major seismic events. For California, the last major event was the 1995 Northridge earthquake, a Mw 6.7 event that affected the metropolitan area of Los Angeles (population approx. 20 million). The area of strongest shaking was roughly 50 kilometers (30 miles) in diameter and encompassed southern Ventura and northern Los Angeles counties.

Overall about 4,000 buildings were severely damaged or destroyed; another 8,500 were moderately damaged. Communications, water, power distribution and roads were badly affected—seven major freeway bridges in the area collapsed, and 170 were damaged, disrupting traffic in the Ventura-Los Angeles region for weeks following the earthquake. Insured losses at the time was US$12 billion to US$15 billion, or US$22 billion to US$34 billion today.

For New Zealand, Kaikoura in 2016 was a Mw7.8 event, but let's examine the Canterbury Earthquake Sequence of 2010/2011 which affected the city of Christchurch (pop. ~500,000). Most of the damage was caused by the Mw6.2 event on February 22, 2011. According to the Insurance Council of New Zealand, insured loss for the sequence is in excess of US$20 billion.

So, a larger magnitude event near a city of 20 million in California produced a very similar insured loss to a smaller event near a city of half a million in New Zealand. Why? The similarity in loss has little to do with the physics of the ruptures or details on the engineering of the built environment. The similarity in loss has far more to do with the levels of insured exposure in the two regions, and for (re)insurers with global portfolios, this needs to be explored and understood.

> "Earthquake insurance in New Zealand is commonplace as nearly every dwelling is insured and earthquake cover is automatically included in domestic policies"

(Near) Blanket Coverage

If a property is not insured, it would obviously not result in an insured loss, and only around 10-15 percent of Californian homeowners choose to take out earthquake insurance which is deemed expensive and deductibles are high. In contrast, earthquake insurance in New Zealand is commonplace as nearly every dwelling is insured and earthquake cover is automatically included in domestic policies. Deductibles are low and premiums are generally, affordable, thanks in large part to the existence of the state-backed Earthquake Commission (EQC). The EQC takes a levy on every domestic policy and provides cover for the first NZ$150k of earthquake loss.

This difference in insurance penetration explains why New Zealand has more insured residential earthquake exposure. RMS analyzed the economic and insured exposure of California and New Zealand, and estimated the economic cost of replacing residential exposure in California is 15 to 20 times higher than that in New Zealand; commercial and industrial exposure 8 to 12 times higher. In terms of insurance though, nearly every dwelling in New Zealand is insured for the full replacement value with a small deductible so when we apply insurance penetration, limits and deductibles we find the residential insured limits at risk are marginally higher in NZ.

For commercial lines, in California, penetration rates are higher than those for residential lines; the state has more commercial insured limits at risk than New Zealand. Even so, while California has 8 to 12 times the commercial economic exposure, it has only three to four times the commercial earthquake-insured exposure.

You would expect more similarities between California and New Zealand, as both regions sit on the Pacific Rim of Fire and experience regular earthquakes. Both communities have well established academic ties in seismic and engineering disciplines; both have modern and well enforced seismic building codes. California's seismic risk is higher because both its major metropolitan areas sit on top of active faults whereas New Zealand's largest metropolitan area, Auckland, is situated in a relatively lower seismic setting - but on top of an active volcanic field.

However you look at California and New Zealand, the similarity in exposure does come as a surprise. It is just one of the reasons why RMS spends considerable effort keeping its earthquake models and exposure data for both regions up to date. The RMS New Zealand HD Earthquake model has been updated and will be relaunched on Risk Modeler in the coming months.

Why risk-aware strategies are as important as ever

With the COVID-19 crisis continuing to lead to economic turmoil, insurers are taking a more risk-aware approach to their investment strategies, according to BlackRock.

COVID-19 has caused a huge amount of disruption all over the world, varying from workplace dislocation to triggering steep recessions in many countries. One thing is clear: inaction is not an option and thoughtful solutions seemingly require a combination of data and analytics as well as the investment capabilities and personnel.

In July, BlackRock broadcast a webinar that shared the results of its proprietary Peer Risk Analysis of the insurance industry, looking at what the crisis might mean for insurers' investment strategies.

According to Donald Lin, Head of Insurance Solutions for the Americas, BlackRock looked at the results of insurers at the company level, allowing strategic discussions about asset allocation and how the decision each insurer makes translates into income generation, portfolio risk, capital consumption and potential stress scenarios.

Beyond the impacts of COVID 19, a longer standing and more pervasive trend influencing insurance company investment strategies is the low interest rate environment. "The market is telling us today that it is increasingly challenging to navigate the unprecedented environment of low rates and headwinds related to Asset Liability Matching," Lin said. "We are also seeing more nuances across business lines as the recent pandemic, the ensuing measures and market response have impacted not only the broad industry categories but down to the business lines. This has brought the importance of constructing portfolios that are differentiated by insurance segments to the forefront; with many insurers seeking a tighter integration of enterprise and other considerations."

Lin added that, in addition, many are utilising technology and analytics to help quantify measures like income, total return and capital. Part of the BlackRock findings looked at enterprise profitability metrics to better assess the historical drivers of liquidity and income generation. Earlier this year, BlackRock arranged its team covering insurers into distinct Practices Areas based on insurance company type – Life & Annuity, Property & Casualty and Reinsurance, and Health, to ensure the client coverage teams maintain fluency in developing issues, considerations or insights within each sector. The Practice Area Leads report into the Head of Relationship Management and meet regularly to ensure broad as well as deep industry perspectives are appreciated.

Changes

Over the past five years BlackRock estimates that net investment income has declined while the liability yields or the required crediting rates had remained broadly consistent for the life industry, putting pressure on investment teams to increase portfolio yield.

Looking to the P&C industry, Lin said that fair value return surplus has been fairly robust over the past five years due to the strong total returns on fixed income as yields had considerably declined during this period. BlackRock's findings clearly show the reliance of the P&C industry on investment returns to drive profitability with the caveat that future profitability could be challenged in a low return environment.

Wrapping up his introductory remarks, Lin noted that for health insurers the Affordable Care Act had introduced some volatility on the financial results in recent history. Despite this, the industry was turning a corner when COVID-19 arrived, introducing a whole set of new challenges for the industry. According to BlackRock, while health insurers came into this crisis with a strong liquidity position, the uncertainty surrounding COVID-19 coupled with the unprecedented nature of this crisis is likely to prompt many health insurers to rely on their investment portfolios for stability.

Broadly, insurers had been actively combating the low yield environment since the global financial crisis and BlackRock has seen a clear shift in asset allocation strategies across the insurance industry. Allocations to public fixed income have declined over the past several years across the industry and BlackRock expects this trend to continue especially as central banks globally have initiated unprecedented levels of asset purchases in response to COVID-19.

The P&C picture

David Holdreith, BlackRock's Lead for Commercial P&C, Multi-line, and Reinsurance clients, noted in his segment that 2019 was a very good year for the P&C market, with a return on average surplus well above the cost of capital in the 17-19% range across the segments with Workers' Compensation leading the way at 19%. According to Holdreith what is most notable and not necessarily new in this

> "The market is telling us today that it is increasingly challenging to navigate the unprecedented environment of low rates and headwinds related to Asset Liability Matching"

Donald Lin, Head of Insurance Solutions for the Americas, BlackRock

area was the contribution from the investment portion being very large and little from the operating side, especially in commercial lines.

Holdreith pointed out that the market will have to see how things go in 2020, adding that this is looking to be probably worse than 2019 with combined ratios above 100, making it likely that there will be a need for an even greater contribution from investments in order to sustain Return on Equity targets.

"2019 was a year where everything worked," said Holdreith. "We had contributions from every segment of the portfolio. In 2020 so far fixed income returns are tracking quite well, although risk asset returns remain challenged. We still have a little way to go but we think it's unlikely to quite achieve the levels from the previous year."

Holdreith also emphasised that investment leverage is really a key component driving enterprise returns - the industry tends to run at about 2 times leverage in personal lines at the lower end of that due to higher operating leverage whilst on the other hand, commercial lines have higher investment leverage at about 2.65. This could have implications for asset allocation shifts to private markets.

Navigating the storm

In the next segment of the webinar, Andrew Stack, BlackRock's Lead for Life & Annuity clients, pointed out that the single biggest driver that has been reshaping the life and annuity industry over the last decade or more - and trending at an accelerated pace more recently - has been the persistently lower new money yields year over year compared to portfolio book yields.

Stack pointed out that BlackRock's findings showed that the industry's average total portfolio net investment income yield for 2019 was 4.4% versus 5.7% in 2007 and that liability yields have been trending down at the same time.

"We are obviously living in a different world today than we were even in 2019," said Stack, "and because of this we think it's become increasingly important to understand the drivers of net investment income and how they've changed and continue to change in response to the broader macro environment."

He added that the industry has shifted allocations over the last five years away from public fixed income in favour of private assets, with the most pronounced being within the private equity backed cohort on a percentage basis. This trend is consistent across the Mutuals and the largest Life companies.

The penultimate segment of the webcast was by Chris Parisi, BlackRock's Lead for Health, LTC, Specialty, and Insurance Consultants. He pointed out that the health insurance industry comprises $285bn of general account assets, involving the 'big six' providers or publicly listed health insurers, represented by their Statutory entities in the analysis.

"The health insurance industry came into the crisis with a positive tailwind from strong total returns over 2019 as well as over the five year period," he began. "This has strengthened the capital position overall. If you look at the total returns, which are comprised of strong investment income in 2019, income was a big driver of return, and we also see differentiation in unrealised gains attributed to equity exposure."

Parisi said that coming into the COVID-19 crisis the health insurance industry held positions with a significant amount of cash and high quality fixed income and that when you typically break down asset allocation to examine how liquid these portfolios are, around 90% of these portfolios are in liquid assets which BlackRock defined as cash, public equity, and public fixed income.

Parisi added that what is interesting to see at the moment is the increasing contribution from alternatives to investment income and, as BlackRock look at the allocations today, there is a belief that the health insurance sector will continue to see growth in these private market assets that can generate income and enhance portfolio returns while diversifying or complementing existing portfolio risk exposures.

> "Based on what we hear from our clients, in order to make informed asset allocation decisions, insurers need the ability to project income generated by their investments reflecting both interest rate and credit risk but also incorporate a market view"
>
> *Georgette Anderson, Insurance Specialist, BlackRock Solutions*

The big picture

In the final part of the webcast Georgette Anderson, Insurance Specialist within BlackRock Solutions, further described the Aladdin technology that all speakers leveraged to generate these analytics.

Anderson said that the business development team, that she is a member of, specialises in providing various technology solutions to insurance companies.

"Given the sensitivity of earnings to rapidly changing macroeconomic environment, more companies are interested in how their income, credit risk and market risk are impacted by economic factors," Anderson explained. "Based on what we hear from our clients, in order to make informed asset allocation decisions, insurers need the ability to project income generated by their investments reflecting both interest rate and credit risk but also incorporate a market view."

Anderson also stressed that the market is currently in an uncertain macroeconomic environment largely attributable to the global pandemic, the persistently low interest rate environment, financial market volatility and rising geopolitical instability.

She explained that BlackRock has developed a series of proprietary market-driven scenarios, economic forecasts and market views, leveraging a wide range of firm constituents, across the Risk & Quantitative Analysis Team, the BlackRock Investment Institute and the portfolio management and sector specialist teams, who identify market events and their potential implications. These scenarios are meant to capture geopolitical and market event risks that impact the financial assets insurers invest in but wouldn't be adequately reflected in the traditional risk models.

To view the BlackRock webinar, please visit this link: https://event.webcasts.com/starthere.jsp?ei=1346753

Asset acceleration

Insurance assets managed by third-party investment managers show sharp rise, observes David Holmes of the Insurance Asset Outsourcing Exchange.

Insurance assets managed by third-party investment managers are growing. Forty-six investment managers posted unaffiliated general account (GA) assets totaling $2.64trn on a global basis as of year-end 2019. A "same sample" of investment managers reporting their unaffiliated insurance assets both this year (2019 YE) and last year (2018 YE) report 19% AUM growth over the course of the year.

Behind the numbers

The high double-digit growth occurred despite headwinds from insurance company mergers and acquisitions, which sometimes result in manager terminations. Three factors contribute to the high AUM growth rate.

1. Some very large mandates sought third-party manager solutions in 2019, and found homes with investment managers having the scale and services to meet the needs of large insurance companies.
2. Insurers have significantly increased outsourcing to specialised investment mandate solutions over the past several years, particularly in specialised fixed-income strategies and alternative investments, according to Insurance Asset Outsourcing Exchange data. These mandates are often funded with cash flow, and their growth has become more apparent in reported outsourced AUM year-over-year.
3. "Inorganic growth" has occurred over the course of 2019, including divestures such that assets formerly managed for affiliated insurance companies are now reported as unaffiliated, and from mergers/acquisitions between investment management firms.

BlackRock remains at the top of global rankings with AUM totaling $396bn at the end of 2019, up from $247bn the previous year. Goldman Sachs ranks a distant second with $250bn, up from $193bn a year ago. DWS and Amundi are joined by JP Morgan to comprise the remainder of the top five. JP Morgan reported $175bn in AUM, increased from $113bn last year. The top-ranked managers' substantial AUM growth results from large insurance companies outsourcing core investment mandates to achieve investment and operational scale alongside insurance investment expertise.

Investment managers outside the top five also show high AUM growth, including Allianz Global Investors (57% over 2019), Morgan Stanley (39%), Neuberger Berman (28%), Robeco (27%), and Vanguard (26%). These managers are largely gaining assets in specialised, "satellite" mandates that enhance yield and diversify risk.

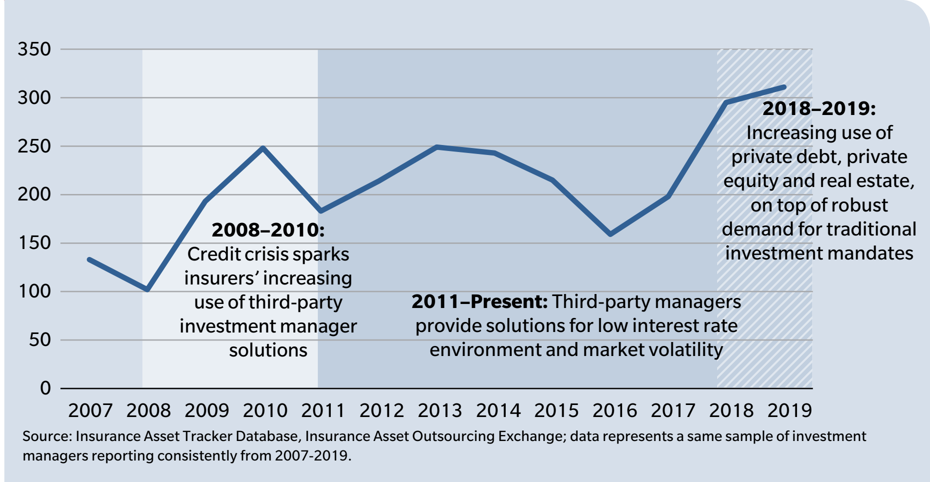
Other managers down the global rankings show significant AUM growth or decline. Readers perusing the AUM ranking tables are advised to avoid drawing strong conclusions from each manager's year-over-year AUM growth. AUM changes can be affected by manager acquisitions, insurance company mergers/acquisitions, organisational changes that shift AUM from one affiliate to another, or spinoffs of a former affiliate insurer that becomes unaffiliated but retains the manager.

Third-party manager AUM poised for high future growth

Insurance-focused investment managers have become a go-to solution for insurance companies in time of need. The credit crisis of 2007- 2008 was a catalyst to an unpreceded move toward third-party insurance asset management.

As shown in Figure 1, new mandates outsourced in 2010 were double the rate outsourced in 2008 on a global basis, and outsourcing has continued at that high level. Indeed, the number of new outsourced mandates increased again in 2019. Observes David Holmes of the Insurance Asset Outsourcing Exchange, "The investment management industry has proven a nimble and reliable resource in response to

Figure 1: New Mandates Outsourced Each Year



Source: Insurance Asset Tracker Database, Insurance Asset Outsourcing Exchange; data represents a same sample of investment managers reporting consistently from 2007-2019.

Category No. 1 Rankings

Global Non-Affiliated General Account Insurance Assets ($ Billions)			
Rank	**Investment Management Firm**	**12/31/2019**	**12/31/2018**
1	BlackRock	396.3	246.8
2	Goldman Sachs	249.6	193.0
3	DWS	180.8	160.4
4	Amundi	176.6	173.5
5	J.P. Morgan Asset Management	174.5	113.0
6	Aberdeen Standard Investments	146.0	140.1
7	Wellington Management Company	127.5	110.9
8	PIMCO	98.2	88.0
9	Macquarie Asset Management	78.8	65.5
10	Conning	75.0	67.8
11	New England Asset Management	74.3	70.3
12	MetLife Investment Management	73.2	108.2
13	HSBC Global Asset Management	67.0	NR
14	Western Asset Management Company	64.3	56.4
15	Wells Fargo Asset Management	53.6	51.0
16	Generali Insurance Asset Management SGR SpA	53.1	NR
17	Guggenheim Investments	50.3	45.6
18	Morgan Stanley Investment Management	41.2	29.6
19	Neuberger Berman	37.0	28.9
20	Invesco, Inc.	36.7	31.6
21	Schroders	33.9	37.2
22	Barings	30.1	NR
23	AAM Insurance Asset Management	27.8	24.5
24	Insight Investment	25.6	26.4
25	AXA Investment Managers, Inc.	24.9	20.2
26	PGIM Fixed Income	21.3	20.9
27	Northern Trust Asset Management	20.6	18.1
28	Vanguard	20.5	16.3
29	Mellon	20.2	18.6
30	Robeco	19.7	15.6
31	Payden & Rygel	19.2	16.4
32	Ares Management LLC	16.8	14.1
33	Voya Investment Management	16.3	4.3
34	Allianz Global Investors	15.2	9.7
35	Loomis, Sayles & Company, L.P.	13.7	8.3
36	AllianceBernstein	12.2	13.0
37	Sun Life Capital Management (U.S.) LLC	11.8	11.9
38	T. Rowe Price	10.6	10.3
39	Income Research & Management ("IR+M")	10.2	9.1
40	MFS Investment Management	4.7	3.4
41	Securian Asset Management, Inc.	3.5	3.3
42	Victory Capital Management Inc.	3.3	NR
43	Madison Scottsdale Insurance Asset Management	3.3	3.0
44	Opus Investment Management	3.0	2.6
45	Fort Washington Investment Advisors	1.2	1.5
46	Stone Harbor Investment Partners LP	0.7	1.0
	Totals ($Billion)	**$2,644.20**	**$2,090.10**

Source: Insurance Investment Outsourcing Report

insurance companies' changing investment needs. As was the credit crisis in 2017, COVID-19 is likely the next catalyst."

Regional differences

In North America, BlackRock once again finds itself at the top of the list, growing its assets to $225bn from $125bn a year ago. Goldman Sachs once again places second with $155bn. JP Morgan improves to third with $114bn. Long-time insurance asset managers Wellington and DWS hold their traditional spots among the top five in North America, with $100bn and $92bn respectively. Each of these top five managers offer multi-sector fixed income capabilities at a large scale, coupled with insurance expertise and the ability to add value through specialised investment strategies.

MetLife Investment Management, reporting unaffiliated North America insurance AUM for the first time, ranks sixth. New England Asset Management's $61bn and Conning's $59bn, both long-time insurance-focused investment managers, rank seventh and eighth. Wells Fargo and PIMCO round out the North America top 10. Each of these managers (ranking seven through 10) show steady AUM growth over the year.

Outside of North America, with Europe and APAC being the principal ex-US regions, Amundi holds the top spot, but with just 2% asset growth over the previous year. BlackRock jumps up the rankings to second place with $171bn, increased from $122bn in 2018. Aberdeen Standard shows flat growth over 2019 and falls to third place. Goldman Sachs places fourth with a strong increase over the prior year with $95bn. DWS holds a spot in the top five despite flat growth over the year.

Of the investment managers claiming the ex-North America six through 10 spots, JP Morgan and Macquarie reported significant gains in assets, PIMCO achieved steady growth, while HSBC and Generali did not report AUM for the prior year. Most other managers down the rankings show steady to strong increases in AUM.

David Holmes is founder of the Insurance Asset Outsourcing Exchange and Partner at Eager, Davis & Holmes LLC in Louisville, Ky. The Insurance Investment Outsourcing Report is published by the Insurance Asset Outsourcing Exchange; visit www.assetoutsourcingexchange.com for the full report.

Investment grade private assets in P&C insurance portfolios: leveraging excess liquidity to improve investment outcomes

The persistently low rate environment has challenged all insurers' ability to meet their return and income objectives while balancing the risk they take within their investment portfolios. This dynamic has resulted in a search for yield that has pushed insurers to add credit risk and allocate to higher-yielding asset classes beyond public fixed income. In fact, U.S. P&C insurers have nearly doubled their allocation to BBB rated public fixed income over the past decade (from 9% to 16%) and have continued to make allocations to higher-yielding assets in high yield bonds, public equities, and other alternative asset classes within their surplus portfolios.

While they can achieve enhanced returns, the addition of higher-yielding assets to insurance portfolios is constrained by a matrix of regulatory, capital, accounting and rating agency considerations. When compared to public fixed income, most of these asset classes are subject to higher risk-based capital and rating agency risk charges, as well as the volatility of fair value accounting.

Rather than simply continuing to add risk through surplus portfolio allocations and dropping lower in credit quality, we believe many insurers can improve their overall investment outcomes and increase income by adding to private market investment grade strategies. Two of the options are investment grade private credit and commercial mortgage loans, both of which can be utilized in liability-backing and surplus portfolios.

By allocating to investment grade private market asset classes, insurance companies have the potential to enhance returns and income, while optimizing their asset allocation in a capital efficient way. One of the many benefits of moving to private market investment grade offerings is the ability to increase yield without significantly increasing credit risk but rather adding liquidity risk. We often see significant levels of excess liquidity when analyzing portfolios, which can be deployed by most companies to capture this additional yield while avoiding unnecessary credit risk.

In order to gain comfort adding illiquidity to the portfolio it is important to model downside risk to fully understanding the liquidity needs of the portfolio. We recommend using an in-depth, enterprise based framework for evaluating this liquidity risk that stresses both the operational and investment sides of the business in tandem.

While insufficient liquidity is a major operational liability, excess liquidity is a missed opportunity. Based on our analysis, we believe that most insurers have excess liquidity and, subsequently, the capacity to re-deploy a portion of their public fixed income holdings into higher-yielding, less liquid investment grade asset classes like investment grade private credit and commercial mortgage loans.

Industry outlook

There are a few reasons we believe that insurers can take additional liquidity risk. First, the industry has increasingly become better capitalized with improving operating metrics and risk management practices. Life, Health and P&C insurers have all reduced balance sheet leverage while growing capital positions since 2000. With stronger balance sheets, insurers have room to examine asset allocation refinements.

Many P&C insurers have recognized their strong capital positions, including the ability to take liquidity risk, and have re-deployed assets into higher-yielding strategies (see Chart B). One asset class that hasn't been broadly adopted is investment grade private credit. As of year-end 2019, the P&C industry average allocation to investment grade private credit (excluding 144a securities) was just 1.4% of total assets. We believe there are significant income benefits left on the table by excluding the asset class given the investment yield for P&C companies invested in the asset class versus those who were not was nearly 60bps higher (3.79% vs. 3.23%).[1]

Chart A: Insurance leverage ratios

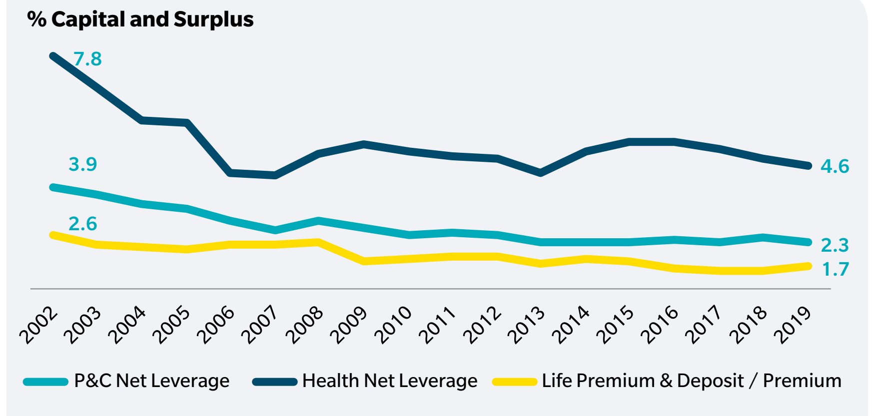
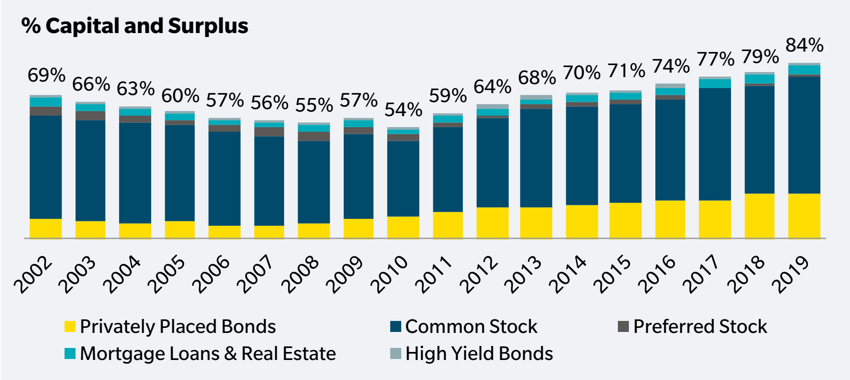


Chart B: P&C insurance risk asset ratios



Risk management framework – a case study

We believe that an in-depth understanding of liquidity needs serves as the foundation for optimizing *capital efficient* asset allocation. These decisions are unique to each company's operating profile and we will demonstrate our framework using a case study. Company ABC is a ~$6B P&C insurer which we believe is a good representation of the industry at large.

In summary, our framework consists of the following steps:

Step 1: Model the available capital – identify the reserve (liability backing) and unconstrained (surplus) assets

Step 2: Model liquidity needs – stochastically forecast inflows and potential outflows to highlight stress points

Step 3: Identify sources of liquidity – analyze areas of available liquidity to meet potential shortfalls

Step 4: Optimize *capital efficient* asset allocation – use enterprise-based analysis to highlight portfolio constraints

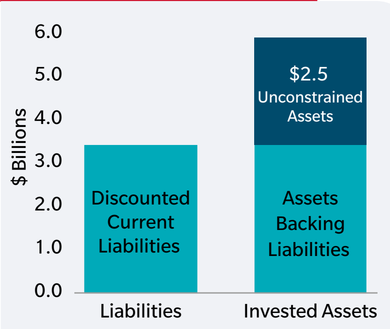
Step 5: Recommendations for asset allocation changes – include impact on regulatory and solvency

Step 1: Modeling available capital

Our first step is a customized balance sheet analysis to identify assets required to support liability obligations (the reserve portfolio).

In our example, Company ABC has $3.4B of discounted liabilities, and therefore, $2.5B of non-core assets available for optimization (the surplus portfolio). This is a meaningful percentage of overall assets and is a common characteristic with many P&C insurers. As the industry has

Chart C: Model of available capital



Based on data as of 10/31/2019.
Liabilities include PV of loss, LAE, and loss embedded in UEP reserve. Invested assets include cash and fixed income.
Sources: AM Best, S&P Global Market Intelligence, and NAIC. Data as of December 31, 2019

experienced a decline in balance sheet leverage, there has been a related growth in surplus portfolios.

Surplus portfolios can be used to enhance portfolio returns while reserve portfolios should be constrained by duration, cash flow, volatility and asset classes. Along with public fixed income, investment grade private credit and commercial mortgage loans are commonly used in both surplus and reserve portfolios to diversify credit risk and enhance returns.

Step 2: Modeling liquidity

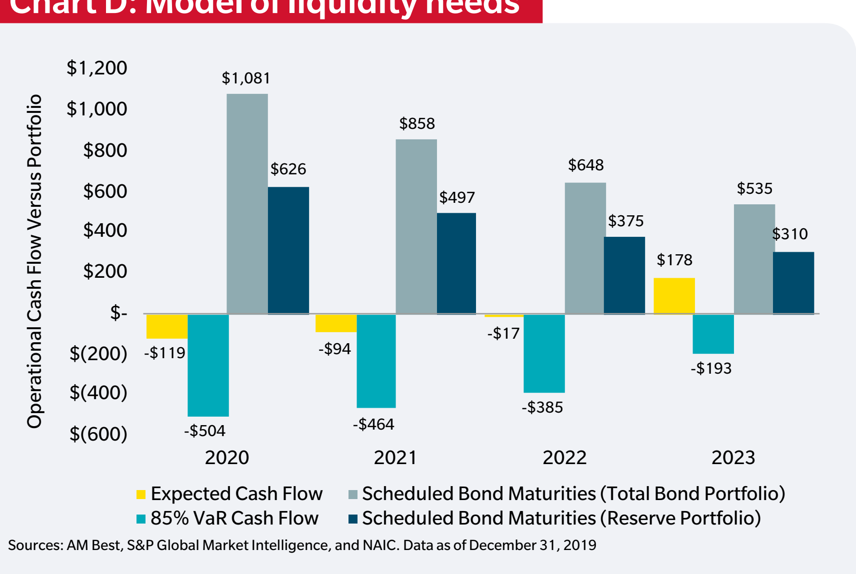
Once we understand the size and nature of the reserve and surplus portfolios, stochastic cash flow modeling is used to forecast liquidity needs and highlight areas of operational stress, including reinsurance limits, CAT risk and premium collection rates. Based on the modeling outcomes in our case study, Company ABC can meet operational liquidity needs through current portfolio maturities and income.

The modeling reveals that Company ABC can meet operating cash requirements using a portion of the reserve portfolio. Specifically, the insurer is expecting a cash outflow of $119M in 2020, and in a VaR 85, would anticipate an outflow of $504M (85th percentile value at risk is defined as a worse case expected net cash outflow of $504M in 85% of tested scenarios). Reserve portfolio maturities are projected to be $626M.

Stress testing a range of scenarios can give insurers confidence to increase portfolio yield by reducing excess liquidity and allocating to higher-yielding assets beyond public fixed income.

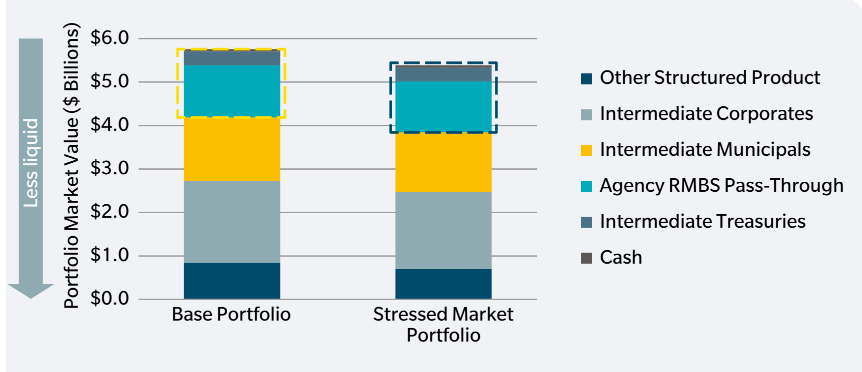
CONTINUED ON PAGE 52

Chart D: Model of liquidity needs



Sources: AM Best, S&P Global Market Intelligence, and NAIC. Data as of December 31, 2019

Chart E: Model of portfolio liquidity



Step 3: Identifying sources of liquidity

Depending on liquidity forecasts, insurers should examine all sources of liquidity to mitigate the risk of forced liquidations. Typical sources of liquidity include:

1. Premium collection and operational cash
2. Cash and cash equivalents
3. Line of credit / FHLB advance
4. Maturities, prepayments, coupon income
5. Forced liquidation of portfolio holdings

Cash, Treasuries and other government-backed debt are typically the only truly liquid assets during a market downturn. Therefore, we recommend that insurers' stress test their holdings to understand their true liquid holdings and anticipate potential impairments or losses. Company ABC has $1.5B of government-backed securities and should anticipate a $400M decrease in portfolio market value in a stress scenario.

Step 4: Capital aware portfolio allocation process

Once operational, investment and liquidity constraints and objectives have been determined, we begin to examine a range of relevant asset classes based on a matrix of factors, including those below. This assessment is directly related to our downside modeling in previous steps, which indicates the capacity for higher-yielding assets.

Asset class characteristics:

- Risk and return profile
- Risk-based capital charges
- Rating agency risk charges, limits and concerns
- Valuation for statutory reporting
- SAP Schedule
- Statutory limits

It is critical for insurers to evaluate asset class alternatives using factors beyond risk/return profile to avoid the risks and potentially deteriorating economics of sub-optimal asset allocations.

Step 5: Developing an asset allocation recommendation

By following our framework and partnering with Company ABC's management team, we recommended that Company ABC:

- Maintain a significant allocation to public fixed income in order to meet required liquidity needs in a range of economic and operational scenarios
- Continue to fund projected cash outflows using only a portion of its reserve portfolio
- Leverage excess liquidity to increase exposure to higher yielding asset classes with close consideration to regulatory and rating agency limits to avoid deteriorating economics
- Add an allocation to investment grade private credit (from 0% to 6% of total assets) and commercial mortgage loans (from 0% to 7.6% of total assets). These shifts can provide additional spread premium and diversification to the portfolio.

Figure E: Recommended portfolio allocation changes

Asset Class	Current Portfolio	Peer Group Avg.
Cash	4.00%	3.90%
Taxable Bonds	59.70%	53.50%
Tax-Exempt Bonds	14.90%	19.20%
High Yield Bonds	0.00%	2.60%
CLOs	0.00%	1.20%
Private Credit	2.50%	0.20%
Commercial Mortgage Loans	0.00%	0.00%
Emerging Market Debt	0.00%	0.00%
Preferred Stock	0.00%	1.20%
US Equity	17.30%	16.50%
International Equity	1.70%	2.00%
Core Real Estate Fund	0.00%	0.00%
Expected Return	**3.77%**	**3.79%**
Expected Volatility	**3.70%**	**3.86%**
Sharpe Ratio	**0.68**	**0.66**

→

Constraint	Minimum	Maximum
Duration	3.5	5
Risk assets (% of Surplus)	0.00%	45.00%
Liquid Assets (% of Assets)	10.00%	20.00%
BBB Restriction	0.00%	35.00%
Avg Credit Quality	A+	AAA

→

Asset Class	Optimized Portfolio
Cash	2.60%
Taxable Bonds	44.60%
Tax-Exempt Bonds	12.50%
High Yield Bonds	1.80%
CLOs	0.50%
Private Credit	6.60%
Commercial Mortgage Loans	7.90%
Emerging Market Debt	0.40%
Preferred Stock	0.50%
US Equity	12.60%
International Equity	2.40%
Core Real Estate Fund	7.60%
Expected Return	**4.20%**
Expected Volatility	**3.70%**
Sharpe Ratio	**0.80**

> “Insurers should optimize their capital efficient asset allocation by modeling downside risk to ensure they fully understand their liquidity needs. Many insurers have excess liquidity and a meaningful capacity to allocate to higher-yielding asset classes beyond public fixed income – and unused liquidity presents a missed opportunity”

Conclusion

Insurers should optimize their capital efficient asset allocation by modeling downside risk to ensure they fully understand their liquidity needs. Many insurers have excess liquidity and a meaningful capacity to allocate to higher-yielding asset classes beyond public fixed income – and unused liquidity presents a missed opportunity. Changes to asset allocation should carefully consider the matrix of regulatory, capital, accounting and rating agency implications.

For most insurers, we see significant benefits to re-allocating a portion of excess liquidity to investment grade private credit and commercial mortgage loans within reserve and/or surplus portfolios. Adding investment grade private credit has no regulatory, capital, accounting or credit risk implications, addresses certain risks (diversification, better recovery rates and senior debt to public bonds in default), enhances yield and expands the portfolio's efficient frontier.

To learn more, please contact Brett Lousararian, CFA, Head of Insurance Business Development, SLC Management at Brett.Lousararian@SLCManagement.com.

Endnotes

1 S&P Market Intelligence as of 12/31/2019 and NAIC as of 12/31/2019

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There is no assurance that the objective of any private placement strategy can be achieved. The principal risks associated with the Advisor's private placement strategies are described as follows. As with any strategy, the Advisor's judgments about the relative value of securities selected for the portfolio can prove to be wrong.

(1) Interest rate risk involves the risk that interest rates will go up, or the expected spread to the benchmark will widen, causing the value of the portfolio's fixed income securities to go down. This risk can be greater for securities with longer maturities and the widening of spreads can continue for an extended period of time. (2) Credit risk is the risk that the issuer of fixed income securities will fail to meet its payment obligations or become insolvent causing the market value of the securities to decrease. Private placements are not rated by the credit rating agencies. Any ratings assigned to this debt is the product of analysis performed by the Advisor and or Advisor's affiliates. (3) Liquidity risk is the risk that Advisor may be unable to sell a given security at an advantageous time or price or to purchase the desired level of exposure for the portfolio. At times this market has experienced severe illiquidity and/or significant price impacts. (4) Counterparty risk involves the risk that the opposing party in a transaction does not fulfill its commitments.

Investment grade credit ratings of our private placements portfolio are based on a proprietary, internal credit rating methodology that was developed using both externally-purchased and internally developed models. This methodology is reviewed regularly. More details can be shared upon request. Although most U.S. dollar private placement investments have an external rating, for unrated deals, there is no guarantee that the same rating(s) would be assigned to portfolio asset(s) if they were independently rated by a major credit ratings organization.

The relative value over public benchmarks estimate is derived by comparing each loan's spread at funding with a corresponding public corporate bond benchmark based on credit rating. Loans that are internally rated as “AA” are compared to the Bloomberg Barclays U.S. Corporate Aa Index, loans rated “A” are compared to the Bloomberg Barclays U.S. Corporate A Index, while loans rated “BBB” are compared to the Bloomberg Barclays U.S. Corporate Baa Index. For certain power and utility project loans, a best fit approach of a variety of Bloomberg Barclays' indices was employed prior to September 30, 2016. After this date, these types of loans were compared to Bloomberg Barclays Utilities A Index and Bloomberg Barclays Utilities Baa Index, for “A” and “BBB” internally rated loans, respectively. Relative spread values obtained through the above methodologies were then aggregated and asset-weighted (by year) to obtain the overall spread value indicated in the piece.

Unless otherwise stated, all figures and estimates provided have been sourced internally and are as of March 31, 2020. Unless otherwise noted, all references to “$” are in U.S. dollars.

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Constrained growth outlook for ILS at 1.1?

Investor confidence in the ILS market was already shaky after three straight years of cat losses. Now, COVID-19 deals another wild card.

By Mark Richardson, London Editor

Capital market investors have thus far endured a bumpy 2020.

The unforeseen crash in global financial markets created by COVID-19 in February and March caused widespread losses and served as a wake-up call of sorts for the insurance-linked securities (ILS) sector. Unlike in previous downturns, during which ILS assets have remained resilient due to being non-correlative with traditional markets, this time that was not wholly the case.

Quentin Perrot, Vice President, Willis Capital Markets and Advisory, tells *Reactions* that while cat bond investors will have been mostly satisfied with 2020 so far, sidecar investors would be far less pleased.

"Correlation between financial markets and insurance losses manifested during COVID-19 – and in some cases was significant, dramatically reducing the diversification benefit, as well as limiting returns," he notes. "Both of the two selling points of ILS were impeded by the pandemic."

This correlation of COVID-19 insurance losses with capital-markets volatility was unexpected, Perrot says, and has made these instruments much less attractive. "Uncertainty remains over the potential for trapped capital in sidecars and collateralised contracts, which have been an important destination for ILS capital," Perrot adds. "It points to a much bigger question, one that COVID-19 has brought to the fore: do specific ILS structures transfer targeted risks adequately and no others, while providing adequate returns to investors?"

In the case of sidecars and collateralised re, Perrot thinks the answer seems to be no, and that the market needs to work on forging better structures that would prove less susceptible to surprise losses.

Fitch Ratings Senior Director Jeff Mohrenweiser says this unanticipated exposure of investors to trapped capital is one of several outstanding unknowns that is making it difficult to predict how much ILS capacity will be available at 1.1 reinsurance renewals.

Other unknowns he points to are losses arising from the forecasted active hurricane season, progress on vaccine development and deployment, and the outcome of the U.S. elections, all of which could have an indirect influence on the odds of further turmoil in the financial markets.

Nevertheless, so far in 2020, Fitch has seen strong investor appetite for catastrophe bonds, with nearly $10bn issued through July.

Mohrenweiser says many observers see a healthy pipeline for the rest of the year, with many deals so far oversubscribed. However, he tempers this with the fact a lot of activity is replacing maturing cat bonds, meaning the "overall ILS pie is not expanding compared to the pace in previous years."

Guy Carpenter estimated third-party capital diminished by about 2.7% as of June 2020.

AM Best's Emmanuel Modu, Managing Director & Global Head of Insurance-Linked Securities, points at these figures when explaining why he believes growth in ILS capacity will be constrained this year.

"The increase in redemptions, persistence of trapped capital, and the additional uncertainty introduced by the COVID-19 pandemic do not portend well for overall growth of ILS funds," he says. "There appears to be some level of investor fatigue given multiple years of losses."

While financial markets are recovering, Modu thinks the more opportunistic investors in ILS are still eyeing distressed credit, private lending and emerging markets as alternative investments.

Although there may be pockets of growth among certain funds – particularly reinsurer-backed ILS funds which have succeeded in raising capital to deploy in the hardening market – he does not expect meaningful growth in third-party capacity, if any all, by 1 January 2021.

Investor confidence in the ILS market after three straight years of catastrophe losses was already shaky, says Modu, adding that COVID-19 has capped this off.

"Some ILS investors are willing to sit on the sidelines, as evidenced by the fact that assets under management of ILS specialist funds dipped approximately 2.7% in the first half of 2020 from year-end 2019," he says.

An emerging concern for ILS fund managers and investors alike is that some cedants are considering the COVID-19 pandemic an ongoing event, and therefore trapping investor capital without necessarily declaring any substantive reserves.

"Ordinarily, the ability to trap capital in ILS-related reinsurance transactions is through the mechanism of a buffer loss factor table, so this is an unusual move that is causing

further consternation among some participants in the ILS universe," Modu explains.

But Mohrenweiser maintains that growth is being held back more by a lack of supply from cedants, rather than a lack of demand from investors.

"There are few new sponsors providing fresh opportunities and existing sponsors are simply replacing their cat bonds that are maturing," he says. "The market is still heavily U.S. peak peril, with EMEA and APAC deals lacking any significant quantity. If you strip out the mortgage-insurance-linked security deals (nearly $9bn for 2018, 2019 and 2020), the amount outstanding has decreased over the prior two years versus a positive growth rate."

Perrot notes that different reinsurers have taken different approaches to using ILS markets as a capital-raising measure to take advantage of upward rate momentum.

Of the two largest reinsurers, Swiss Re has issued four cat bonds this year, while Munich Re has not done so.

"Each ceding reinsurer has different justifications for their approach," says Perrot. "In other cases, reinsurers that are distressed may wish to use ILS capacity more than those who are adequately capitalised. Over the longer term, however, we expect well-structured instruments to gain even greater traction among reinsurers and direct insurers alike."

Luca Albertini, CEO of Leadenhall Capital, says the coronavirus has sustained a hardening trend in ILS rates that existed pre-pandemic, which was attracting investors.

But he also attributes the market crash caused by the virus as being responsible for a number of redemptions earlier in the year, due to opportunities to take advantage of under-priced assets elsewhere.

Albertini says this was a major factor up until July. He is not aware of any further major redemptions due to alternative opportunities since then and believes it may be too late for more redemptions driven by this motivation. Yet he adds it is early days, and there could be further turbulence in the markets if there is a second spike of the virus.

Currently he recognises there are a mixture of positive and negative forces acting at the same time on the ILS sector. "On the positive side the improved pricing conditions coupled with tighter terms and conditions make the risk/reward of ILS very appealing to investors, and we do expect new capital to be allocated to the space," Albertini says.

"On the negative side, in 2020 ILS is competing with other assets which have repriced due to the market crisis and existing capital has been tested by a few years of lacklustre returns and potential for further trapped collateral due to the business interruption claims linked with the COVID-19 pandemic."

As a result, Albertini thinks at 1.1 there will be a stable level of ILS capacity, with some fresh capital, some redemptions and some collateral trapping.

Perrot says the rate hardening seen so far has not been sufficient to justify a flood of new investment into ILS. As long as uncertainty over loss development remains, he thinks investors will be reluctant to reload.

He says to grow the sector, the market needs to work on better structures which won't give rise to surprise losses – and produce faster, more accurate loss reporting that can remove uncertainty for investors. He says modelling also needs dramatic improvement if the sector is to expand coverage beyond a handful of well-known perils.

"The ILS market will continue to grow significantly only after these issues have been addressed," he adds. "We think they will be, and are actively working on those challenges."

Modu agrees new solutions are needed to encourage growth in ILS funds, with much dependent on finding a resolution to collateral trapping. He believes that ILS capital attracted to the sector will likely be where most dislocation has been experienced: the retro segment.

"This segment, which is only about $20bn in limit, is overwhelmingly supported by the ILS market and has already experienced a double-digit rate increase and stricter terms and conditions in 2020," Modu notes. "In addition, it is poised for further increases pursuant to the 1 January 2021 renewal date when much of the ILS retro capital is deployed. This new business, we are told, will be accompanied by higher rates."

Mohrenweiser says that any increase in ILS capacity at 1.1 this year will only be modest, and will differ widely across the reinsurance spectrum: "For cat bonds, there is sufficient investor appetite to fill most, if not all, cat bond deals that may come to market – but this has been the smallest component of reinsurance capacity.

"Collateralised reinsurance and sidecars that cover a broader risk may see a flat or slight decrease depending on claim experience," he continues. "Barring significant catastrophes, traditional reinsurers – which comprise the largest portion – have an opportunity to take advantage of the hardening toward profitability by raising additional capital or utilising their longstanding relationships."

An emerging concern for ILS fund managers and investors alike is that some cedants are considering the COVID-19 pandemic an ongoing event, and therefore trapping investor capital without necessarily declaring any substantive reserves.

Why recent Central Bank actions could make U.S. and European real estate debt potentially more attractive to insurers

By Marlon Rockenfeller, Head of Insurance Strategy & Advisory, EMEA & APAC

Thomas Gillmann, Insurance Strategy & Advisory, EMEA & APAC

Patrick Kennelly, Portfolio Manager, U.S. Real Estate Debt

Lloyd Ayer, Head of Client Solutions, Americas

There are many ways in which insurers invest into the real estate sector

Real estate has been a popular asset class among insurance companies for a long time. Today, insurers can access real estate markets in various ways, ranging from traditional direct real estate investments to mortgage loans or real estate investment trusts (REITs). As outlined in Figure 1, real estate capital markets can broadly be categorised into four segments.

Why private commercial real estate debt has become a popular asset class among insurance companies over the last decade

Until the subprime mortgage crisis of 2007/2008, commercial mortgage-backed securities (CMBS) were a popular way to gain access to the commercial real estate (CRE) debt market. This has changed with the CMBS market seeing less new issuance in the years since the crisis. At the same time, many banks have

Figure 1. Real Estate Capital Markets

	Equity	Debt
Private / Illiquid	Private real estate equity / direct ownership	Private real estate loans, mortgages
Public / Liquid	Real Estate Investment Trusts (REITs) and other types of property companies	Securitized mortgages (mortgage-backed securities, MBS) or bonds issued by property companies

Source: DWS International GmbH. As of: July 2020

Figure 2

Market conditions
Strong fundamentals and low delinquencies; increasing property values; rising interest rates; healthy lending spreads.

Investment strategy
– Favor floating-rate subordinated debt, non-IG CMBS.
– Greater tolerance for leasing and credit risk across sectors.

GROWTH

SLOW DOWN

Market conditions
Strong fundamentals; slowing capital appreciation; flat yield curve; tighter lending spreads.

Investment strategy
– Favor fixed-rate senior and lower-LTV subordinated debt, IG CMBS.
– Apartments and commercial properties occupied by credit tenants on long-term leases.

Market conditions
Stabilizing fundamentals, delinquencies, prices, and interest rates; steep yield curve; wide lending spreads.

Investment strategy
– Mix of fixed- and floating-rate senior and subordinated debt, IG and non-IG CMBS.
– Distinguish early- from late-recovery markets.

RECOVERY

Market conditions
Deteriorating fundamentals and rising delinquencies; slumping values; falling interest rates; wide lending spreads.

Investment strategy
– Favor fixed-rate senior debt and IG CMBS
– Apartments and commercial properties. occupied by credit tenants on long-term leases.

CONTRACTION

Source: DWS Real Estate Research/DWS International GmbH. As of: July 2020

been forced to cut back on their leverage and boost their regulatory capital to comply with the regulatory reforms implemented in the wake of the financial crisis. This has created opportunities for insurance companies to engage in the private lending market.

Well-structured and underwritten CRE loans can offer a number of qualities to insurance companies. These include:

- **Illiquidity/complexity premium:** Compared to public debt instruments with similar risk profiles, CRE loans can offer higher spreads reflecting an illiquidity or complexity premium.
- **Backed by real assets:** The underlying property serves as collateral for the loan providing protection through security packages and financial covenants. In case of default, this can also result in higher recovery rates compared to unsecured loans. In some jurisdictions, this principal preservation feature is also reflected in lower solvency capital charges for CRE loans compared to unsecured loans.
- **Portfolio diversification:** Private real estate debt can provide low correlations to traditional asset classes.
- **Source of duration:** CRE loans may be an attractive source of duration to match both shorter and longer-dated insurance liabilities. This makes the asset class attractive for life and P&C insurers alike. However, due to their floating nature in general, interest rate overlays may be necessary.
- **Customisation:** As a private asset class, insurers may negotiate bespoke terms for each loan in order to meet specific duration and cash flow needs as well as regulatory requirements.
- **ESG investments:** In recent years, ESG disclosures in respect of real estate assets (such as energy certificates) have improved significantly. This makes it easier to identify potential ESG investments in the CRE debt space.

The current commercial real estate lending market and the impact of COVID-19

The commercial real estate debt market is currently in the classic late stage of its cycle, described in the upper right quadrant of Figure 2, but with some unique attributes.

From a credit perspective, delinquencies continue to be low. We have not seen excessive loan-to-value (LTV) creep or undisciplined underwriting standards, which is a very positive sign at this point in the cycle. We believe the cycle still has more time to run.

Historically, CRE debt was mainly provided in the form of whole loans. However, from the end of the 1990s more granular risk profiles started evolving and loans were broken down into senior and subordinated or junior loans (sometimes referred to as 'mezzanine loans'), taking incremental risk behind the senior loan.

Moving into the early part of 2020, typical senior margins on European prime offices sat at around 100 to 150 basis points at LTVs of up to 60% to 65%, and junior margins at 600 to 800 basis points at LTVs of up to 80%. In the U.S., those ranges for comparable senior loans sat between 150 and 225, and trading in a wider range for junior debt in a range between 500 and 900.

Given that the effect of COVID-19 on the market has varied significantly by property type, the spread of lending terms between sectors is likely to have widened. Based on our experience, we would estimate that margins on senior lending have increased by 25 to 30 basis points on average since the beginning of the year in both regions. Equally, for junior loans, we would estimate that margins have risen by around 100 basis points on average, as the upper sections of the capital stack are now deemed to be more at risk.

However, for senior loans in areas such as retail and hotels, the increase is likely to be much greater. Even before the current crisis, underlying issues in the retail real estate market were already beginning to push up margins on retail debt.

This year, we would expect that with a significant drop in real estate transaction volumes, new lending activity will also fall. However, transaction activity has not stopped entirely, and there will continue to be a large number of refinancing requirements. With this in mind, there may be opportunities,

CONTINUED ON PAGE 58

particularly for insurance companies, to take advantage of lower levels of competition and to capitalize on an increase in loan pricing.

Commercial real estate lending will likely remain attractive for insurance companies

Market dislocations caused by the COVID-19 crisis have enabled insurance companies to invest into plain vanilla asset classes such as investment grade credit at compelling spread levels for the first time in many years – at least for those that were able to benefit of the opportunity.

In the short term, the current market situation therefore represents an opportunity for insurers even if spreads have already tightened significantly again. Moreover, with the various measures put in place by monetary authorities the “lower for much longer” interest rate scenario will be the most likely outcome.

Given this outlook, in our view insurance companies necessarily will have to continue to evaluate private markets in search of higher yields. Hence, DWS believes that real estate debt, both senior and junior, will remain a highly compelling asset class for insurance investors.

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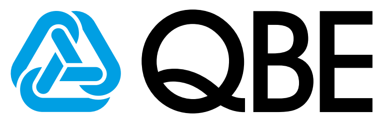

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CEOS ARE READY FOR REINVENTION

It's being said that the insurance industry will never be the same again, after COVID-19. Maybe the same applies to the CEOs that lead the risk industry; maybe they will be changed forever too.

Being the CEO of a re/insurance company was already one of the most demanding jobs in the realm of financial services, requiring a wide breadth of skills. In 2020, the arrival of COVID-19 added a new dimension to the role ... arguably several new dimensions.

Insurance CEOs have had to respond to crises before, such as after 9/11 or the financial crisis of 2008, for example. But with COVID-19 it must feel like several events are happening at the same time, affecting customers, employees, as well as insurance and financial markets.

Meanwhile, none of the external business factors that existed before COVID-19 have gone away. If anything they have been magnified.

On the geo-political front, Brexit is nearing its endgame while other regions suffer the fall-out from rampant populism; worse, tensions are being ratcheted up between superpowers threatening not only trade relations but peace.

Worryingly, lack of coordinated action on carbon emissions means that a tipping point for climate change seems ever closer, but is already bringing more intense and less predictable weather events.

On top of all this, at a time when internal and external communication and cooperation is most needed, almost everyone is working from home for the foreseeable future.

And yet, amidst the gloom, a recurring message from leaders writing in this year's CEO Risk Forum is that the existential crisis caused by COVID-19 could be the catalyst for radical change in the industry.

They believe that the pause in business-as-usual should be an opportunity for the industry to re-set its priorities, to re-tool and also re-invent its workforce. Most importantly, resilience now has new meaning and by taking bold steps they think that insurers can start to exert their influence on both society, commerce and policymakers.

It seems like a new generation of CEO is being forged in the crucible of COVID-19.

Garry Booth,
Editor *CEO Risk Forum*

REBUILDING FOR THE NEW RESILIENCE

Re/insurers have the tools to help create more resilient societies: but public, private and industry leaders all need to play their part as well, says **Christian Mumenthaler**, Swiss Re CEO

As we rebuild a fragile economy, the need to prepare for future risks takes on a new urgency. And since we are confronted with risks that don't respect borders – whether it's a pandemic or climate change – there's a pressing need to strengthen not just the resilience of our economy but also of our societies themselves. A science-based world view, fact-based policy making and public-private partnerships are all essential for that effort.

The COVID-19 pandemic's deep impact on the global economy should not surprise us. As Swiss Re Institute's Resilience Index shows, central banks' low to negative interest rates, insufficient macroeconomic reforms, high debt levels and lower economic growth all meant that countries were already less resilient to shocks of this magnitude even before COVID-19.

Since the crisis began, government aid packages have helped to soften the economic blow. But resilience is likely to weaken and protection gaps are set to widen even further as households struggle with lower incomes or higher healthcare costs.

For decades, the insurance industry has warned of the potentially devastating effect of a pandemic. Thirteen years ago, I co-authored a paper on influenza pandemics together with other chief risk officers from the insurance industry. We looked at the circumstances under which the 1918 Spanish flu broke out and asked what the impact would be if a global influenza pandemic happened again.

Many of the predictions we made in 2007 sound almost prophetic today: we thought that an outbreak would likely start in Asia, and quickly spread to other regions; the rapid spread could hamper timely preventive measures; central banks would react by lowering interest rates.

So why was the world not ready when the pandemic hit?

Part of the explanation lies in behavioural economics: it requires a big effort to act on risks that you haven't experienced yourself in the past. Solutions were on the table, but the risk of pandemics was considered too remote by many companies and governments.

We now have an opportunity, and an obligation, to rebuild resilience taking into account both societal and economic considerations – with sustainability at the core.

A safe harbour in uncertain times

The insurance industry must play a role in reshaping a more resilient future by sharing its risk expertise and improving response mechanisms. Although the pandemic has made several challenges more acute for re/insurers – such as ultra-low interest rates, more instability in financial markets, operational weaknesses from outdated systems or cyber threats – re/insurers have so far done well in finding strategies to deal with these disruptions. The next challenge is to respond to the need to foster innovation, improve customer experiences, enhance productivity and, crucially, find new areas of growth.

Perhaps the biggest opportunity for the insurance industry is presented by increasing risk awareness and recognition that our societies need to strengthen resilience at a more fundamental level than in the past. In today's interconnected world, many individuals and businesses are now more attuned to the vulnerabilities.

One example: risk considerations and public policy interests are likely to play a greater role in how

businesses organise their supply chains in the future, especially for life-saving products like personal protective equipment, vaccines or medical supplies. Although supply chain redundancies will make them more costly, a shift towards diversification will strengthen resilience.

Transforming tomorrow together

While the insurance industry contributes to stability by taking on risk, it's clear that even the combined resources of the entire industry are not enough to bear the financial burden of global shock events. Something we didn't foresee in our CRO paper in 2007 was the unprecedented wave of lockdowns that swept across the globe and significantly increased the economic loss from this pandemic.

To build on lessons from COVID-19, we must therefore intensify public-private cooperation and integrate economic impacts, including business interruption, in our pandemic risk models. Risk-sharing arrangements between the public sector and the re/insurance industry can address the accumulation potential of a pandemic, similar to the agreements which exist for threats like flood or terrorism. They would give customers clarity about what is or isn't covered and provide protection at an affordable price that would otherwise not be possible.

But more steps are needed to improve resilience over the longer term. A renewed global push to mitigate climate change is one – and it must remain a top priority. COVID-19 lockdowns have reduced air pollution momentarily, but they will not stop global warming nor reverse the harm greenhouse gas emissions are causing to our planet and its natural ecosystems, as so dramatically exhibited by Siberia's melting permafrost. Considering the huge importance of ecosystem services, environmental degradation is an existential threat, not least to the global economy.

The relative ease by which many service companies transitioned to virtual platforms during lockdown has shown that cutting back on flights for professional meetings is indeed possible. At Swiss Re we are vigorously reducing air travel and introducing an internal levy on carbon emissions to achieve "net zero" in our operations within the next 10 years.

Call to cut emissions

Similar to pandemic preparedness, the transition to a net-zero economy requires broader political, technological and behavioural changes. It calls for innovation in sectors such as energy, agriculture and forestry, manufacturing, transportation and construction, which combined are responsible for 90% of all emissions. Through the WEF Alliance of CEO Climate Leaders, which I'm privileged to be co-chairing, we're mobilising action across these and other industries to reach net zero by 2050.

And while more re/insurers, including Swiss Re, are expanding their exclusion policies beyond coal to the most polluting sectors of oil and gas, a new generation of sustainability solutions – innovations such as revenue insurance covers for no-sunshine or no-wind – are accelerating the energy transition.

"Insurance is an important element, but public, private and industry leaders all need to play their part. Success will depend on our collective resolve to put resilience front and centre of our actions and make it a priority at the very outset of our long road to recovery"

One such solution is Swiss Re's extended warranty product for New Energy Vehicles in China covering battery failure. It will also be crucially important to support the growth of entirely novel technologies like carbon removal. Enabling the carbon removal industry to expand to the size of today's oil and gas sector by 2050 – which is needed to meet the world's 2°C target – is indeed a formidable challenge.

When it comes to financing sustainable infrastructure – which besides energy and transport includes housing, schools, hospitals and other social infrastructure – investors are increasingly asking for climate impact assessments. Insurers and reinsurers offer the risk insights needed, especially as they embed increasingly sophisticated data into their natural catastrophe underwriting models. Such data-driven approaches allow the insurance industry to better strengthen resilience and create value for society through digital innovations. For example, Swiss Re uses satellite data and algorithms in its flood models to make flood insurance affordable and available to households in the U.S. that had never been covered before.

Securing the gains

The lessons from the COVID-19 pandemic are numerous and far-reaching. As we work to restore our economy, they must inform how we as an industry and as a society think about risk. Newer, stronger forms of resilience will be vital to secure the gains we make along the way and carefully manage the wider economic and social changes that are beginning to take hold. Insurance is an important element, but public, private and industry leaders all need to play their part. Success will depend on our collective resolve to put resilience front and centre of our actions and make it a priority at the very outset of our long road to recovery.

PANDEMIC POSES A NEW CATASTROPHE PARADIGM

The question of how to tackle systemic risk is at the top of risk professionals' agenda, following the shock losses produced by COVID-19, says **Peter Hearn**, President and CEO of Guy Carpenter & Co

This time last year, Guy Carpenter released a report titled The Changing Nature of Risk. The premise of the paper was based around the growing complexity of risk, and the opportunities and challenges confronting the re/insurance sector as it navigates one of the most significant periods of change in recent times. Although written in the context of loss accumulation, the changing climate and digitalisation, events in 2020 have reinforced the key takeaways from our report: the reality of a rapidly evolving risk environment and the potential for catastrophes to become systemic in nature.

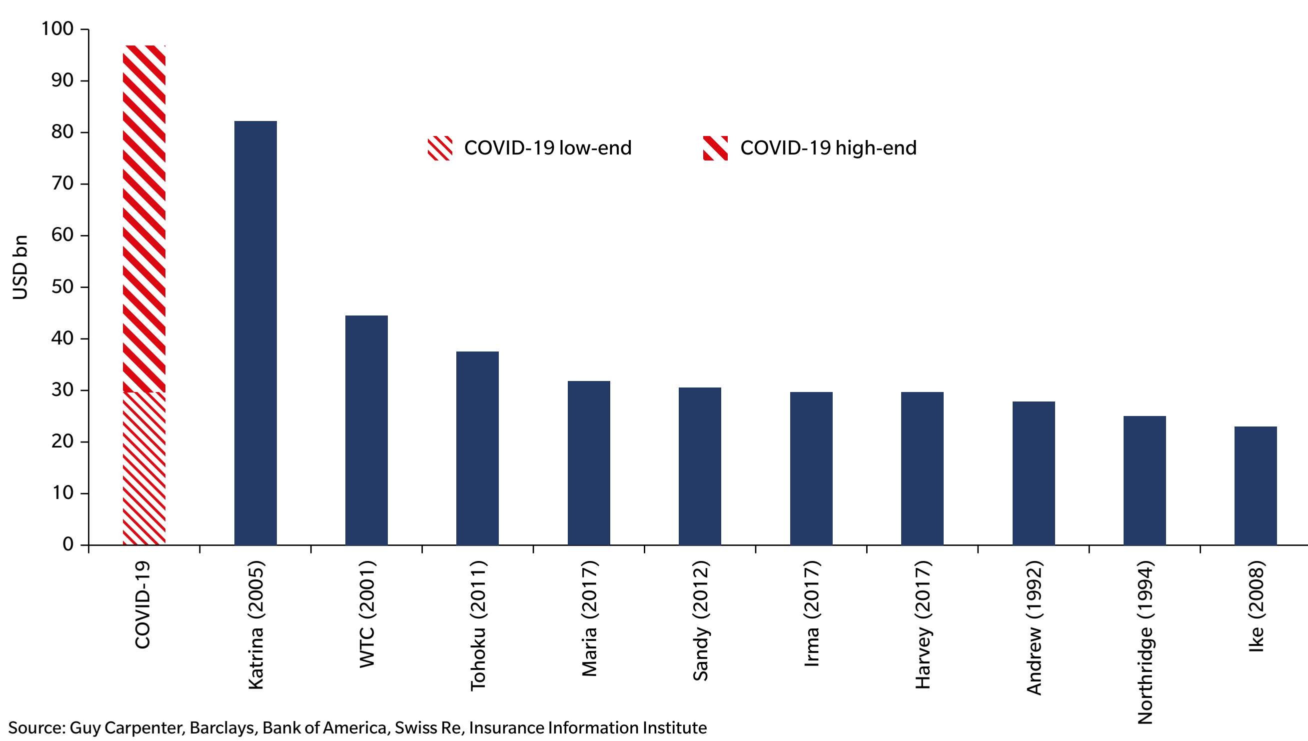
These two trends are encapsulated in the COVID-19 pandemic. Despite pandemic risk being a known threat, who could have predicted at the turn of the year that, within three months, governments worldwide would simultaneously impose quarantines, travel restrictions, business closures and a variety of other measures in an attempt to mitigate the spread of a virus?

Countries across the globe are having to deal with a lack of preparation and planning. While lockdowns have helped to flatten the infection curve in some countries, the economic consequences are considerable. This may not be the end of the matter, either: localised lockdowns are already being reintroduced in several countries amid a resurgence in infections. Further financial market volatility and unanticipated consequences cannot be ruled out at this stage.

Loss perspective

The crisis has introduced significant uncertainty into the re/insurance market. Figure 1 shows how industry loss estimates for COVID-19 put forward by a number of entities compare with other major insured events, in inflation-adjusted terms. As ultimate losses are largely unknown, there is substantial variability within and between estimates for COVID-19, ranging from a low end $30bn to close to $100bn. COVID is unique for its significant multiline underwriting loss and its global breadth. It will be months, or even years, before claims develop fully, given the complexity of coverage disputes and potential liability consequences.

Figure 1: Top 10 largest insured losses vs projections for COVID-19



Source: Guy Carpenter, Barclays, Bank of America, Swiss Re, Insurance Information Institute

Should claims from COVID-19 settle at the higher end of current market estimates, and/or another major event occurs in the third or fourth quarters, losses could reach unprecedented levels for the full year and seriously test the limits of carriers' capital resilience.

Ensuring insurability

But even at the high end of COVID-19 loss projections, re/insurance will cover only a small fraction of the huge economic cost, which is expected to run into the trillions of dollars. COVID-19 should therefore serve as a warning to both our industry and governments about the changing nature of risk. The increasingly complex risk landscape, along with the interconnected global economy, is challenging long held assumptions around (un)correlated exposures and it's raising questions about the insurability of certain systemic perils.

Capital and pricing adequacy are being (and will continue to be) reassessed, as risk carriers and investors adjust their underwriting strategies and appetites to adapt to this new operating environment. This, however, is not a journey re/insurers can embark on alone: the sheer scale and indefinite time horizons associated with COVID-19 and other systemic risks are beyond the financial capabilities of the re/insurance sector. Although insurers and reinsurers assessed a range of pandemic scenarios pre-COVID, its unforeseen consequences have prompted most to recalibrate risk models by considering new loss scenarios and introducing exclusionary language. Guy Carpenter therefore believes that any viable, long-term solution for perils that threaten societal and economic stability require some form of government participation (more on this shortly).

Cyber catastrophic potential

Pandemics are just one example of how low probability, extreme events can cause economic (and insured) shocks. There are others: catastrophic cyber attacks, a nuclear, biological, chemical or radiological (NBCR) terrorist attack and climate change are capable of bringing consequences that challenge (or call into question) the provision of re/insurance.

The insurability of systemic risk is going to be one of the defining issues of the next decade for the sector. Rapid technological changes, digitalisation in particular, have already transformed the characteristics of risks assumed by the re/insurance market. COVID-19 will only accelerate these trends.

We are living in the age of intangibles, with risks becoming more insidious and pervasive. Today, some 90% of the S&P 500's market capitalisation is intangible – whether data, intellectual property, brand and the like. This massive shift presents challenges but also exciting opportunities for re/insurance. Cyber is a working example of how the risk transfer sector is capable of responding to transformative developments, and it provides a glimpse into the growth potential on offer as new risk pools emerge.

There are nevertheless concerns that a catastrophic cyber event carries systemic risk that could result in hundreds of thousands of simultaneous claims. Cyber catastrophes such as a cloud service provider failure or targeted attacks on power grids pose theoretical, but real, threats to the re/insurance sector due to high risk aggregation.

Guy Carpenter and CyberCube last year estimated that a long-lasting outage at a leading cloud service provider could cost the standalone U.S. cyber market alone close to $15bn. The loss potential from a power grid attack is equally stark. A London market study carried out in 2017 simulated a scenario where households and businesses in 15 U.S. states suffer blackouts lasting several days, resulting in power outages to 93 million people and causing estimated insured losses of at least $45bn across multiple lines of business.

Public-private partnerships

Catastrophic cyber attacks and pandemics share a common characteristic in that they present threats with the potential for no geographical boundaries. This trait removes the certainty of diversification and makes both perils difficult to model and price. They also bring elevated correlations with financial markets, raising the prospect of simultaneous shocks to the underwriting and asset sides of balance sheets, as demonstrated by COVID-19. Trends around globalisation and digitalisation exacerbate the impact by creating interconnected vulnerabilities that transcend sectors and regions and escalate accumulations.

This challenges the whole provision of insurance and reinforces the need for state involvement in finding sustainable solutions for complex systemic risks. Discussions to address this issue are continuing in several countries, but regional or global cooperation should also be explored longer-term to reflect multinational companies' cross-country exposures and the borderless nature of the risk.

This is not to say that re/insurers should pull back entirely. There is a crucial role for the private market to play as stakeholders, including policyholders, re/insurers and governments, come together to develop response mechanisms for future events. Clearly, government-led backstops will be required for the more catastrophic loss scenarios, but it should fall to private risk carriers to offer accessible and affordable coverage around these facilities.

Terror pool precedent

There are precedents for these situations. The public-private partnership model is one that has worked particularly well for more established risks that are capable of causing systemic economic shocks. The terrorism market serves as a fine example of how the security of central government backing can mitigate the withdrawal of re/insurance capacity following significant

CONTINUED ON PAGE 66

events and facilitate the growth of a private market that is both resilient and innovative.

Several pools around the world provide backstops for terrorism events, particularly for perils where systemic risks lie. This has largely been their purpose since their respective creations, and governmental involvement remains imperative, given that private market capacity alone is not sufficient to cover (for example) catastrophic NBCR events in large cities. The modelled loss of $800bn for a nuclear bomb detonation in New York City is testament to this.

Certain pools have gone even further recently and taken bold steps to narrow protection gaps by extending coverages to include new risks such as cyber. Over time, this is likely to stimulate further competition in the private market and increase the supply of new forms of cover.

Calm before the systemic storm?

This is a model the re/insurance sector could follow for pandemics and other systemic perils more generally. Such agility may be needed for major natural catastrophes, as trends associated with climate change and globalisation combine to complicate and enhance the magnitude and scope of loss potential.

The diverse and dispersed events over the last three years show that carriers and governments need to be prepared for higher levels of catastrophe loss potential in the future, as climate change and the continued appeal of living in areas exposed to weather-related risks influence the frequency and severity of events.

Impacts will inevitably be amplified in the event of a "super nat cat". What would the consequences be if a powerful earthquake or a major hurricane or typhoon were to strike near a global manufacturing hub today? Should we expect (unmodelled) national or even global ramifications that could potentially disrupt supply chains, hit financial markets and lead to business interruption or higher unemployment far beyond the point of occurrence?

Resolve & resilience

COVID-19 has offered a first look into the sheer scale of systemic perils. As the risk landscape continues to shift, there is an opportunity, indeed an imperative, for governments and the risk transfer sector to find new means to collaborate. By leveraging risk management and risk transfer expertise, this partnership can help communities build greater resilience and recover more quickly when the unexpected happens.

Important progress has already been made, with Marsh & McLennan Companies and other industry leaders at the forefront of conversations worldwide to create forward-looking solutions. A spectrum of risk pooling models has been proposed, ranging from limited private partnerships to pure state-financed solutions. Perhaps an optimal landing point would be a combination of these two extremes, so that all key stakeholders have "skin in the game".

Conversations are further advanced in counties where government pools already exist, given the enhanced appreciation of the role public-private partnerships play in supporting financial resilience. As the biggest global intermediary with access points across the re/insurance value chain, Marsh & McLennan Companies sees it as our responsibility to take a leading role of engagement, and we will be a passionate advocate for any initiative that helps build resilience and provides coverage clarity to businesses.

The risk transfer sector often does itself a disservice in failing to communicate the huge value of re/insurance: I feel this unprecedented period of risk transition is actually an opportunity to demonstrate the benefits our industry brings to societies. The level of sophistication and expertise developed over decades of dealing with major catastrophes puts our industry in an unrivaled position to drive the agenda and strengthen economic resilience. Marsh & McLennan Companies and Guy Carpenter looks forward to working with governments and markets to do just that.

"The risk transfer sector often does itself a disservice in failing to communicate the huge value of re/insurance: I feel this unprecedented period of risk transition is actually an opportunity to demonstrate the benefits our industry brings to societies. The level of sophistication and expertise developed over decades of dealing with major catastrophes puts our industry in an unrivaled position to drive the agenda and strengthen economic resilience"

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THE PRICE OF POLITICAL INTERVENTION

COVID-19 losses underline how government decisions are intensifying uncertainty in the risk universe, writes **Denis Kessler**, Chairman and CEO of SCOR

The current health crisis will remain a dark chapter in world history, due to its violence, its resonance, and its universality. The COVID-19 pandemic could be described as a "fractal shock", i.e. a shock with extensive ramifications that generates multidimensional impacts – whether health-related, economic, financial, social or geopolitical – and triggers a chain reaction on a global scale, by fragmenting and re-fragmenting into a multitude of aftershocks.

Half of humanity has been under lockdown, the world is entering a recession of unprecedented proportions, public and social deficits are exploding, central banks are struggling to put out the fire through massive interventions and democracies are increasingly worried. The violence of this major crisis and the magnitude of its multifaceted consequences are confronting our modern societies with unprecedented challenges, and sorely testing their overall resilience.

Re/insurers globally – be they P&C and/or Life risk carriers – are fully mobilised to manage this historic shock and its impacts.

The impact on reinsurers

Notwithstanding the high uncertainty surrounding the estimated "ultimate" re/insured cost of this pandemic – whether at an individual or sector-wide level – it's clear that there will be major direct and indirect impacts on the re/insurance industry. Already, we have seen two distinct patterns emerge from the H1 2020 earnings season.

First, very few – if any – risk carriers globally have been spared by this event. This is unprecedented. Most shocks – natural catastrophes for instance – have very localised effects. Hence, they only impact a limited subset of the industry: on the one hand, the local/regional/national insurers operating and covering exposures in the damaged area, and on the other, the reinsurers and large corporate risk insurers, which for the most part have a global footprint.

But the COVID-19 crisis is the perfect example of a truly serial risk, unrestricted by space and time. It is a global event in the broadest sense: it does not have one specific geolocation, it cannot be dated, it unfolds over time and, consequently, it affects many lines of business and virtually all geographical areas, creating a significant clash of exposures that is likely unprecedented in scope. Ultimately, virtually the entire industry will be impacted by this shock.

Second, the overall estimated P&C re/insurance market exposure – which is concentrated on event cancellation, contingency, credit & surety, property business interruption and casualty lines of business – looks set to be several times greater than the overall estimated exposure for the Life re/insurance market in terms of mortality, critical illness and medical expense coverage.

In other words, the COVID-19 pandemic will be much more of a P&C event than a Life event in terms of the sums involved. This is probably the biggest surprise of the crisis, because it's the exact opposite of what, broadly speaking, had been anticipated and modeled for pandemic risk.

New data for pandemic models

Before the rampant progression of COVID-19 made pandemic risk truly tangible, a huge proportion of the global population and of public decision-makers were either unaware of this risk, or at best underestimated it.

The last images we have of a situation on this scale were taken during the Spanish flu epidemic a century ago, and show hospital wards filled with iron beds and nurses in caps – so it's hardly surprising that, in the modern collective unconscious, pandemic risk was seen as a kind of illusion from the past.

But most re/insurers did have this low-frequency, high-intensity risk on their radar. Pandemic shocks are known. Intermittent outbreaks of infectious diseases have had profound and lasting effects on societies throughout history. They have wreaked havoc on human communities since ancient times and serve as historical markers.

As an actuary might say, the historical data set is far from empty!

Understandably, emerging infectious diseases figure prominently in the risk maps re/insurers and risk specialists draw up each year. It has been many years since risk carriers – most often with the support of specialised modelling firms – first began developing pandemic risk models for pricing, reserving and capital requirement calculation. So, the industry clearly cannot be accused of having been unaware of the pandemic threat.

That said, the industry needs to critically examine the quality and accuracy of certain modeling approaches to

this risk in light of the emerging knowledge gained from the COVID-19 pandemic, as the outcomes derived from some of these models are nowhere near what we have seen in the current COVID-19 context.

Crucially, many of these models had missed the fact that pandemic risk may have a greater impact on the P&C market than on the Life market.

Many of the pandemic models developed and/or used so far by re/insurers have focused on one aspect, namely the probability distribution of the number of victims, whether deceased or sick. Excess mortality, which is then translated into a financial impact on the risk carrier's portfolio of Life biometric risks, has traditionally been the main variable used to derive and quantify the impact of a pandemic on a re/insurance book of business.

Admittedly, the modeling technique has evolved over the years – from parametric models to compartmental epidemiological models governed by a system of differential equations, and to probabilistic, event-based models using Monte Carlo simulations – but the main object of interest per se has not changed.

Hence, the enhancements progressively added to these models – e.g. to distinguish between types of disease in terms of propagation dynamics, to reflect the effects of global travel, to make adjustments between excess mortality in the general population and in the re/insured population so as to factor in age, health and socio-economic status, and so on – have mostly centred on refining the calibration of the excess mortality distribution curve.

In other words, the modeling approach for this risk had a very strong Life focus, with the P&C component and macroeconomic effects being treated in a much more simplified way.

In a nutshell, pandemic had traditionally largely been considered a Life catastrophe risk, admittedly impacting P&C lines of business and the financial markets, but only through secondary collateral effects. Having said that, the effects on P&C books of risks and asset values appear only when the pandemic is extremely severe.

As a result, in the vast majority of cases, only risk carriers with a significant Life book of business had traditionally tried to develop an in-depth knowledge and understanding of pandemic risk, and to closely monitor and manage their estimated pandemic risk exposure.

Incidentally, it's quite telling that the (rare) Insurance-Linked Securities (ILS) re/insurers issued to provide specific pandemic risk protection have so far only taken the form of extreme mortality bonds, which specifically cover excess mortality risk.

The COVID-19 crisis has demonstrated that, broadly speaking, most of the industry previously viewed pandemic risk through too narrow a prism. This is exemplified by the fact that some pure P&C players are now faced with a COVID-19 impact whose magnitude is comparable to that of a major natural catastrophe!

Once the outcome of the COVID-19 pandemic becomes clearer, the industry will need to carefully consider the lessons learned from it and factor them into the toolsets they use to assess and quantify pandemic risk in the future.

Endogenous political uncertainty

The key to understanding the current situation is to grasp the fact that, overall, a significant share of the developments in the COVID-19 pandemic, and consequently a large share of the exposures borne by the

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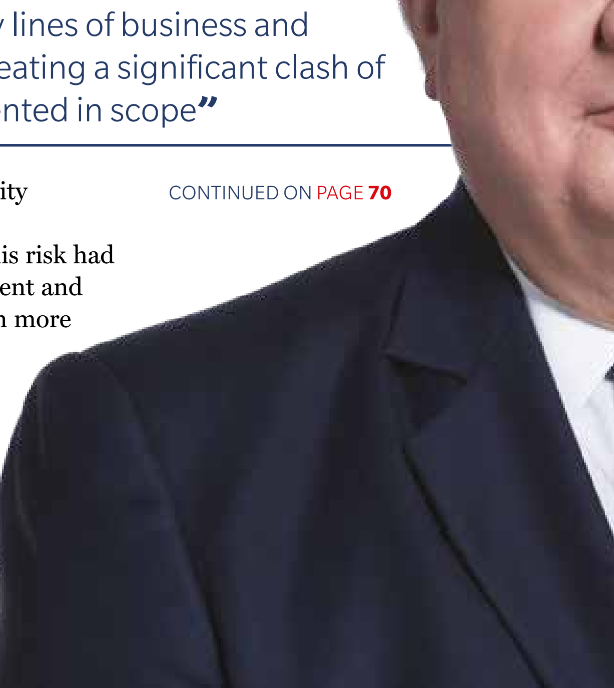

re/insurance industry, are due to endogenous and not exogenous factors.

Exogeneity is the fact of an action or object originating outside of the "system" in question – in the present case human populations and property, in the broadest sense. It is of course the opposite of endogeneity, the fact of being influenced from within the system.

For instance, for the most part a natural catastrophe is a fully exogenous risk. Human societies have no influence whatsoever over the frequency or severity of earthquakes. Damage to property and loss of lives are largely driven by the physical parameters involved, over which we obviously have no control: moment magnitude, depth of the epicenter, local geology etc.

Strictly speaking, there is also an endogenous component here in the sense that human societies can choose to increase their resilience to earthquakes, notably by adopting stringent seismic building codes. However, in the modeling this aspect could also be considered exogenous, in the sense that these choices are made ex ante. To put it plainly, the design, structure, and safety of buildings cannot be changed while an earthquake is in progress! So, when modeling earthquake risk, it's easy to take these variables into consideration. This exogenous determination of earthquake risk means that it can be measured and specified in probabilistic terms – principally through statistical observations of past events – and that its probability distribution may be described by a fundamental, "natural" law.

"All else being equal, the poorer the public risk management, the higher the economic losses associated with the handling of the pandemic, and – in all likelihood – the higher the P&C market exposure to the pandemic event"

The COVID-19 situation, however, is radically different. Populations, public authorities, governments, and central banks have all modified their behaviour, taking specific actions and/or adopting ad hoc measures to prevent propagation and to manage the impact of the pandemic and its consequences as they have unfolded. Public authorities throughout the world have implemented lockdown and stay-at-home orders that have heavily restricted freedom of movement and the ability to work, largely putting social and economic life at a standstill in many countries.

Such unprecedented measures have had major economic repercussions. They have simultaneously reduced supply and contracted demand on a global scale across a wide range of economic sectors, significantly impacting many businesses and, in turn, greatly magnifying the exposures of the P&C re/insurance market.

(In)efficient public risk management

While the impact on the Life market is caused by pandemic risk per se (i.e. the pure biometric risk), the impact on the P&C market is mostly caused by the handling of pandemic risk by public authorities. In this respect, credit & surety and property business interruption exposures are striking examples since they result, to a very large extent, from the lockdown orders and their negative economic consequences.

For these risks, the endogenous factor is clearly predominant, as their magnitude is driven by a myriad of variables directly controlled by public authorities: the timing in terms of adopting and implementing containment measures; decisions on which businesses can continue to operate, fully or partially, and which businesses must shut down; the timing in terms of relaxing containment measures; the extent of intervention measures by governments and central banks to dampen the economic impact of the crisis; and so on.

Even the level of preparedness when the pandemic occurs – for example, the availability of masks and medical equipment, the effectiveness of the health care system, etc. – play a critical role. The lower the level of preparedness, the greater the need to implement very stringent containment measures, e.g. long lockdowns across the board, which is the costliest solution in economic terms.

The greater the level of public authority denial regarding the actual risk posed by the pandemic from the start, the higher the ultimate economic cost of handling it. Lockdown orders came too late for COVID-19 in most countries, which led, ceteris paribus, to longer and more stringent lockdowns, with heavier economic consequences. From this perspective, the economic cost of this crisis will de facto be much less significant for the best prepared and most responsive countries.

All else being equal, the poorer the public risk management, the higher the economic losses associated with the handling of the pandemic, and – in all likelihood – the higher the P&C market exposure to the pandemic event.

Political decisions, risk trade-offs

In retrospect, most of the re/insurance market exposure to the COVID-19 pandemic is directly driven – or at least heavily influenced – by endogenous measures taken by public authorities and central banks. This is obvious for P&C, but it also applies to Life, insofar as these measures have had a strong influence on the mortality and morbidity risks linked to COVID-19.

Each country has made explicit or implicit trade-offs when deciding the extent to which it should prioritise public health or the economy. Some countries have clearly decided to prioritise health above all else. And the COVID-19 pandemic shock has shown that the value placed on the absence of suffering, and on life, has risen very substantially throughout the world.

Physical integrity has made a historic leap in the scale of values. Conceptually, government-imposed containment and mitigation measures to control the spread of COVID-19, and hence to save as many lives as possible whatever the economic damage, have led – to some extent – to a substitution of Life mortality risk exposures with P&C risk exposures, notably in terms of credit & surety and property business interruption coverage.

Endogenous political decisions were not fully captured by many of the pandemic models. Many of those models focused on the exogenous component of pandemic risk through a purely biometric risk prism – namely the probability of a new pathogen emerging, the properties and transmission of the virus, the likelihood of a global pandemic developing from a localised outbreak, and so on.

To give credit where it's due, the more sophisticated pandemic models did factor in a certain amount of endogeneity, for instance by allowing for the implementation of countermeasures such as vaccination or non-pharmacological interventions, which would adjust the transmissibility of the pathogen (and hence the excess mortality) in some of the simulated pandemic scenarios. But most of them did not go much further than this.

Most notably, the extent and far-reaching nature of the lockdown measures implemented worldwide were largely missed or under-appreciated. This is the main reason why the predictions of many of those models have turned out to be completely off the mark in the present context!

Whilst some of the learnings of the pandemic already appear to be emerging quite clearly, only the next phases of COVID-19 will allow us to understand its other lasting consequences. For example, how will the increased awareness of pandemic risk and improved public hygiene impact the spread of infectious diseases over the longer term? How will the severity of future pandemics be affected by the vast improvements in scientific knowledge and the massive expansion and acceleration of the development of treatments and vaccines?

Re/insurers will need to carefully and comprehensively analyse the knowledge gained by the important new data point which COVID-19 provides and take it into account for their quantification of future pandemic risk.

The stochasticity of political decisions

The significant endogeneity in the re/insurance market exposure to COVID-19 shows how political interventions may structurally modify and alter the risk universe for risk carriers.

Most decisions taken by public authorities are very difficult to foresee, so it is not straightforward to model such developments, especially since what we can learn from past observations is limited. Further proof of the stochastic nature of public decisions can be found in the fact that public reactions have been quite different from one country to the other, even though they were facing similar sets of data. It appears difficult to infer from one country's experience what another country is going to do. The ongoing COVID-19 pandemic clearly shows this!

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More importantly, the impact of political uncertainty on re/insurers has arguably been increasing over the years. A growing part of the attention, energy and resources deployed by the industry is dedicated to dealing with the strategic consequences of political developments.

The long list of examples proves the point: the Base Erosion and Anti-Abuse Tax (BEAT) provision of the U.S. tax reform enacted in the very last days of 2017, which heavily taxes reinsurance premiums ceded to affiliated foreign subsidiaries and has obliged many global risk carriers to heavily restructure their operations; the UK government's surprise swing change on the Ogden rate – which determines how compensation is set for people who are seriously injured in accidents – at the end of 2016; the multiplication and continual back-and-forth of sanctions and embargoes, placing re/insurers under the unpredictable threat of a constantly moving compliance risk; the accelerating trade-war rhetoric that could set the entire economic and financial world on fire; the potential dismantlement of multilateral agreements, and so on.

Much more recently, the regulatory cacophony in Europe in terms of allowing/not recommending/ forbidding dividend distribution by re/insurers for the 2019 fiscal year – marked by surprise announcements without prior notice and a non-alignment of views between the different European countries – is another illustration of the political entropy with which the re/insurance industry is confronted.

The industry will have to cope with such additional uncertainties regularly in the foreseeable future, as political entropy – to be understood in the broadest sense – is arguably growing. It would be great if the reinsurance industry could focus on risks and not be distracted by political uncertainties, but I'm afraid that's just wishful thinking. Judging by the trend observed in this regard over the last few years, the ability of risk carriers to integrate endogeneity in their risk management analyses is becoming increasingly – and critically – important.

WHAT COVID AND CLIMATE CHANGE HAVE IN COMMON

The world needs to take climate science seriously because time really is running out, warns **Torsten Jeworrek**, Member of the Board of Management of Munich Re and Chairman of the Reinsurance Committee

The coronavirus pandemic remains a global challenge and we as a society have to admit that we were not sufficiently prepared for it. Worse still, we could have been because the know-how was already there. We should not make the same mistake with another risk that has systemic elements: climate change.

This latter threat will still be with us long after COVID-19 has been defeated, and it will primarily affect our grandchildren and great-grandchildren. It is long-term by nature and so there can never be a quick-fix vaccination for it.

The pandemic and climate change have at least two things in common. First, all the experts knew they were coming and that their impact would be extreme. And second, we still did little or nothing about them. Despite all our knowledge and scenario analyses, the coronavirus caught the world more or less unaware.

What can the pandemic teach us about how to deal with climate change? Risks that are complex and difficult to understand require us to take science more seriously and implement action more consistently. We need to prepare in order to limit the impact of such risks. "Resilience" is the oft-cited and appropriate term in this context.

The facts on climate change are there for all to see. Here are just a few of them: 2019 was the second-warmest year on record. All of the 19 years since 2001 were among the 20 warmest ever. Sea levels have risen by some 20cm over the last 100 years. Researchers see in all of this the indelible mark of climate change. Higher temperatures mean that more water is evaporating and that our weather systems are running at full tilt.

Lessons learned

There is still a lot to be learned about climate change, but we've learned something already: severe thunderstorms in Europe and North America, often accompanied by hail or tornadoes, are increasing. And so are the losses they cause, even allowing for the rise in values. In the first half-year of 2020, severe thunderstorms in North America dominated the loss figures at $27bn.

While we cannot attribute individual events to climate change, our data shows a clear trend towards increased losses from severe thunderstorms, particularly in North America. This demonstrates the need to improve building resilience to mitigate losses. This is especially relevant because climate change is likely to play a role in increasing thunderstorm risk in North America in the long term.

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It is the same story with heatwaves, droughts and wildfires. The latter reached record levels in Australia in the 2019/2020 summer season. Fuelled by an exceptionally severe drought and high temperatures, bushfires produced unprecedented losses. Although bushfire risk was elevated due to natural climate oscillations during the southern hemisphere summer of 2019/2020, a number of studies suggest that climate change is also making bushfires in Australia more likely in the long term. The fire season also produced record loss amounts: overall losses came to around $2bn.

As for tropical cyclones, we are unlikely to see a rise in their overall number, but climate researchers have evidence suggesting that the proportion of severe storms is likely to increase. There are also indications that such storms are more likely to bring torrential rain. This was the case last year when Typhoon Hagibis caused widespread and devastating floods in Japan. It was the same with Hurricane Harvey in 2017, as it left large parts of the city of Houston submerged under water.

Unlike a pandemic, natural hazard losses are invariably regional in nature, even if the losses involved are immense and many people can lose their lives. But natural catastrophes are becoming more systemic and

global in nature, as they hit increasingly vulnerable societies and the global economy becomes ever-more interconnected and reliant on supply chains.

Since 1990, global trade has increased by 350%, twice as much as global economic output. Economists see this as an indicator of increasing interdependencies.

We have already seen the effects of this. In 2011, floods in Thailand resulted in a global shortage of computer parts for hard drives, as many of the key suppliers were located in the flooded areas north of Bangkok. In the same year, the earthquake in Japan and the subsequent nuclear accident at Fukushima resulted in a global paint shortage for certain car colours, as the production of a special pigment had to be temporarily halted following the catastrophe.

Overwhelming evidence

Coming back to the changing climate risks and their influence on weather-related disasters, it seems irresponsible to me that the overwhelming evidence on climate change and its consequences are being dealt with so half-heartedly. What makes climate change so dramatic are its long-term effects: its consequences can no longer be prevented, only mitigated.

In the financial sector, many companies are now scrutinising their investments and their long-term business, simply to check whether they will be of value in the future or whether there could be a surge of loan defaults, for example in areas threatened by rising sea level or increasing floods. International companies that rely on the prompt delivery of special parts are analysing their supply chains to find alternatives in areas threatened by weather-related disasters. And they are right to do so, as this reduces their vulnerability to the consequences of extreme events.

Nevertheless, a large insurance gap still exists. Even in high-income countries, only slightly more than 50% have insurance coverage against losses from natural disasters. While the share of coverage has risen over the last few decades here, the situation for people in emerging and developing countries is dramatic – still fewer than 10% have coverage there. Globally, the insurance gap is higher for flooding and earthquakes than for windstorm-related events like thunderstorms and hail.

We know what needs to be done from a political and social perspective: mitigate climate change as much as possible and prepare economies and societies for its consequences. That is one reason why Munich Re has been supporting various research institutes for many years, including the Insurance Institute for Business & Home Safety (IBHS) in the U.S. IBHS operates a research centre in which full-scale houses are destroyed by hurricane-strength winds, bombarded with hailstones, or flooded with torrential rain, in order to identify more robust construction methods. The aim is to achieve better protection for human life and to avoid losses. Loss and other data also show that often even quite affordable measures can have a great impact, e.g. by using stronger building materials.

Insurance is also a major part of resilience. Unlike pandemics, it is easier to insure against natural catastrophes, as they typically do not occur simultaneously around the world. An earthquake in California is not related to floods in China or hailstorms in Europe; the probability of any synchronicity is quite low. This means we can diversify and hedge these risks in a way that is not possible for a pandemic, which affects the entire world by definition. Therefore pandemic risk has to be addressed with public engagement as well.

Insurers must contribute

The insurance industry also has to play its part as an enabler of new technologies that can substantially and sustainably change the global carbon footprint. Insurance has already proven this by pioneering insurance solutions for photovoltaics, wind power and others: getting providers' and investors' risks from new technologies off their balance sheets and thus making market entry possible.

Munich Re's latest step in this direction is our support for the hydrogen initiative in the European Union. We have to have the ambition to drive similar projects and bring more solutions to the market at affordable prices. This engagement is also needed on the asset side, where we have taken initial steps – though more have to follow.

The industry has to invest in new, low-emission technologies, step-by-step and consistently. The other side of the coin is also to incrementally withdraw from investments in traditional energy at the same time. Let us be honest: all of these structural economic changes will have their price - but avoiding them would be even more expensive for the world community.

We now need to finally and consistently address the challenge of climate change, so that it does not remain a risk that we simply did not want to believe. The world needs to take vigorous action now to reduce greenhouse gas emissions in order to prevent losses and ensure we are not taken unawares by the consequences of climate change, as we were with the current coronavirus pandemic. This will require consistent, resolute action from as many countries as possible, even if that may appear to be wishful thinking at this present time. Nobody can do this alone.

ADAPT TO DIFFERENTIATE

Scott Gunter took over as AXA XL CEO just as the COVID-19 lockdown began. He and the industry climbed a steep learning curve

"Change is the only constant in life. One's ability to adapt to those changes will determine your success in life." These are wise words from U.S. founding father and statesman Benjamin Franklin and are as meaningful in 2020 as they were when first spoken in the late 1700s.

It may have taken a global pandemic to remind many that adaptability in life, and in business, is a vital survival skill. The ability to adjust to continuous change is more important than ever. Those that can adapt have a solid competitive advantage in whatever market they operate. For an industry like ours, adaptability can be a real gamechanger. COVID-19 has given us the opportunity to see just how.

When I assumed my new role with AXA XL in February, a global pandemic was certainly not in my 90-day plan. But this event quickly shaped how my leadership team and I are leading today. And undoubtedly, it will continue to influence how we lead in the future. We are looking at how we shift our business, so we remain agile in how we serve our clients – many of whom are also implementing significant changes to their business models and operations.

Working differently

New to the job, I had plans to physically visit offices to meet my new global colleagues when COVID-19 put a halt to that. Fortunately, we did not allow it to stop much else.

Commercial insurance, especially the large complex risks that we underwrite, is very much a relationship-driven business. In a pandemic, where even a handshake is not advised, we were forced to find new ways to connect to business partners, clients and even fellow colleagues across the globe. A phone call or video conference might not be quite the same as an in-person encounter, especially if you are not a familiar face. Over time, however, we made it work. In fact, hearing children or dogs barking in the background meant we got to know each other on a different level.

Despite office shutdowns and imposed limitations, many businesses, including our own, still had to make things happen. Across the world, fast moving consumer goods had to be delivered. Shelves had to be filled. Projects had to be completed. For us, clients' coverages had to be renewed and claims had to be addressed. Risk assessment had to get done to determine adequate pricing.

For me, having assumed this leadership role, I still had to build my leadership team and adapt a new operating model for an organisation that was quickly evolving. Fortunately, with travel restrictions, the hours that my leadership team and I saved not sitting in airports were invested elsewhere, meeting virtually with our key business partners and each other to continue to serve our clients and design a new operating model.

The pandemic pushed us to operate differently. Now we're seeing big benefits from that and we're asking – what else can we do differently? What can we do that brings more value to our brokers and clients? Even in the face of social distancing, nothing halts our commitment to innovating when we need to adapt old processes – even some of the industry's oldest – to perform under current circumstances.

Consider how Lloyd's of London adapted to enable trade to continue, even while the historic underwriting room remains closed. As a workaround to make amendments to line slips that previously would have been made in ink, in person, one of our colleagues developed an electronic stamp and scratch to enable underwriters to do this on screen. This is another great example of our colleagues thinking on their feet to hasten innovation.

Leaping into digital adoption

While it may have taken a pandemic to push some to change, we were fortunate to be early adapters on several fronts. Digital transformation is one of them.

Recent data from McKinsey & Company research illustrates that the oldest insurance market in the world isn't the only one making digital transformation progress. Consumers and businesses took a major leap ahead in digital adoption due to COVID-19, jumping some five years forward in a matter of weeks, according to McKinsey. Schools went to remote learning. Telemedicine became more commonplace. Groceries and retail boosted online operations quickly. As a result, McKinsey's data suggests behaviours and preferences have been altered significantly. Having grown more comfortable with technology and digital interactions, we likely won't take a step back. In fact, 75% of people using digital channels for the first time say they will continue to use it, according to McKinsey's research.

Digital transformation is at a pivotal point and COVID-19 may have contributed to getting it there. It's been on our minds for quite some time, however, transforming our own operations to ditch legacy systems and finding new ways to deliver products and services. Our investment in strong IT infrastructure, online tools and business continuity preparedness allowed our operations to transition to remote working without a glitch. Others see more advantages to tech adoption too.

Some attribute the growing comfort levels with buying insurance via online platforms to the recent initial public offering success of renter-and-homeowner insurer Lemonade, an early InsurTech investment of AXA XL.

We have found that other digital platforms have allowed us to extend our commercial coverages to more segments of business. By teaming up with tech partner Vindati, we're able to quote, bind and issue coverage for small to medium-size cargo risks in minutes. Similarly, the InsurTech Slice Labs developed an easy-to-use platform to give small and midsize business access to cybersecurity assessments and cyber coverage.

From payer to partner

We expect tech adoption will gain even more traction post-pandemic. We plan to be ready for it. For instance, there is plenty of speculation that businesses will look to employ greater autonomous technology that would help keep workers at a safe distance and avoid business disruptions resulting from future lockdowns.

Both clients and insurers have seen the potential in autonomy; in March, just as the pandemic was taking a hold in broader segments of the world, our underwriting team announced an available insurance solution designed to cover the risks associated with autonomous vehicles.

The availability of bespoke risk transfer solutions, especially before such technology is fully tested and employed, allows companies to develop and test autonomy because it removes liability concerns that could stand in the way.

Technology is driving more than our insurance products; it's affording us new ways of managing our own risk in tandem with our clients. That's the idea behind our Construction Ecosystem, a first-of-its-kind integrated digital platform that links together innovative construction technologies to monitor and aggregate data. It provides our clients with unique insights to help manage risks on their jobsites and across their organisations. We pulled together curated technologies, which we feel could have significant risk-reducing impact on our clients' operations and reduce losses to our book of construction business. While our first Ecosystem is designed for our construction clients, we're already adapting the idea so that it can be deployed across other lines of business.

Operational adjustments

During the pandemic, few operations remained in business-as-usual mode. Most of our clients had to operate in a new way or chose to do so.

Now we're helping clients adjust to their "new norm" of operating, often having to adapt our operations to do so. When our risk engineers couldn't be on-site for risk assessments, we launched remote capabilities. Thus far, they have performed more than 600 remote consultations to help clients adjust for social distancing and other changes. We helped many clients adjust their operations so that they could pivot. For example, a coat manufacturer switching to make hospital gowns, or a distillery shifting its operations to make hand sanitiser. Even remotely, we helped clients assess new risks that were accompanying the new normal.

Not surprisingly, new ways of operating often need new insurance protection. When the need was immediate, I think we as an industry quickly adapted to meet it. As part of their COVID-19-changed business models, restaurants and other businesses adjusted quickly to offer delivery to customers. In partnership with Marsh, we accelerated the launch of a customisable usage-based insurance policy for U.S. businesses to address the increased demand and liability associated with delivering their products.

And very recently Lloyd's announced the creation and in principle approval of its newest "syndicate in a box". Syndicate 1796 was set up to insure the storage and transportation of a COVID-19 vaccine, once developed, to emerging economies. Syndicate 1796 has been developed by Parsyl, an insurance technology company and Lloyd's Lab alumni, in close partnership with Ascot as managing agent, and in cooperation with AXA XL, McGill and Partners and Gavi, the Vaccine Alliance. The Syndicate forms the foundation of the new Global Health Risk Facility (GHRF) at Lloyd's, which aims to provide comprehensive insurance and risk mitigation services to support the manufacturing and distribution of COVID-19 vaccine development efforts. It aims to start writing business from 1 October 2020. I think this is a great initiative and a fine example of the industry responding to the global health emergency.

Taking the risk out

Like us, because of COVID-19, our clients needed to be able to mobilise quickly and operate differently.

As a result, many have uncovered new ways of conducting business and perhaps new opportunities altogether. As insurers, we have to be ready to take the risk out of clients' changing operations and remove the risk that can stand in the way of new opportunities.

The global pandemic will go down in the history books as a one-in-a-100-year event to remember. From an insurance industry perspective, COVID-19 losses will impact our results, but they will also reinforce our value.

We will find many silver linings in this experience. One will be how we have proven, even to ourselves, just how adaptable we could be - how quickly and seamlessly we have adapted has set us apart. Our adaptability differentiated us.

A RENEWED SENSE OF PURPOSE

The pandemic gives new meaning to the re/insurance industry's longstanding social purpose. By **Albert A. Benchimol**, President and CEO, AXIS Capital

Most will agree that the impact of the COVID-19 pandemic on lives and livelihoods around the world has been without precedent. At the time of writing there have been over 20 million confirmed cases and nearly 800,000 confirmed deaths reported to the World Health Organization (WHO). Furthermore, we cannot even begin to gauge the long-term effects of the pandemic on personal and organizational behaviour, from working remotely to shopping digitally. Entire industries are rethinking and reworking their operations and business models, including commercial real estate, retailing, travel, hospitality, healthcare, and re/insurance itself.

COVID-19, though unique in its broad-ranging effects, is the latest in a long list of disruptive forces that have arisen in recent years to challenge individuals, organizations and our industry. Such forces include the ravages of climate change and extreme weather events, increases in cyber security breaches, the economic and market turmoil triggered by developments such as Brexit and trade tensions, the impact of social inflation, and the opportunities presented by digital technology and artificial intelligence.

Any single one of these forces – and certainly all of them collectively – have the potential to profoundly change the shape and severity of risk. While change on a global scale poses a challenge for our industry, it also will lead to opportunities. Innovation is often the by-product of market dislocation, as successful start-ups are founded to solve new problems during times of technological, social and economic upheavals.

Helping society manage risk

As we think about how re/insurance will respond to these dramatic changes and uncertainties, we must remember that the social purpose of our industry has not changed: we exist to help society manage risk. That social purpose must serve as our compass – pointing the way forward for our industry as we strive to meet the needs of a society in the throes of massive change.
If we lose sight of our purpose, we risk making decisions based on the priorities of the moment. In doing so, we fail to meet our obligations to society and squander our potential to advance our business and profession.

If we keep our purpose firmly in view, however, we will see that our industry has an important opportunity in these changing times to demonstrate its tremendous value to society – helping to facilitate an economic recovery, enabling new business models to flourish, and strengthening our own financial performance in the process.

Our industry's social value proposition consists of three components, which we must keep top-of-mind:

- mutualising risk;
- leveraging our expertise to help customers avoid risk, resolve complex situations, and recover from unexpected accidents, losses or litigation;
- leveraging our accumulated data and knowledge to advocate for conditions that lower the potential frequency and severity of loss events.

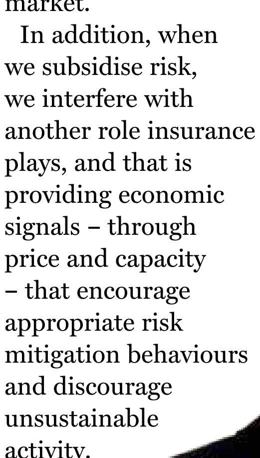
Mutualising, not subsidising risk

As an industry, we mutualise risk. We create pools of similar risks and share the costs equitably among members of the pool, so all members can absorb and recover from what would otherwise be debilitating loss events.

That said, we must remember that our role is to mutualise risk, not to subsidise it. We forget this at our peril. When we subsidise risk, by allowing aggregate losses to exceed net premiums for an extended period of time, it ultimately places a strain on insurers, our customers, and the overall insurance market.

Insurers who subsidise risk for too long must eventually correct the pricing imbalance or they will fail. Customers then have the unpleasant choice of absorbing significant unexpected cost increases or going without sufficient coverage. If insurers and customers cannot agree on appropriate pricing, capacity will exit the market.

In addition, when we subsidise risk, we interfere with another role insurance plays, and that is providing economic signals – through price and capacity – that encourage appropriate risk mitigation behaviours and discourage unsustainable activity.



Today, we're seeing a natural response to our industry subsidising the risks of our customers for too long. The correction we are seeing is likely going to require a couple more renewal cycles before we get back to a balanced and sustainable mutualisation of risk. I am not advocating excessive profits for our industry, but if we can sustain appropriately priced re/insurance, our customers will confidently go about their business, secure in the knowledge that a sound insurance industry can both efficiently help them manage their risks and invest in new products to provide protection for emerging risks.

Leveraging our expertise

The second component of our purpose is to leverage our expertise to help clients resolve adverse situations. For most of our customers, a claims event is a one-in-10, one-in-20, or even a once in a lifetime occurrence. They rely on our experience and knowledge, earned through years of claims resolutions, to guide them through a loss event.

In a sense, claims management is our true product. We sell a promise, and claims service is the delivery of that promise. For this reason, we must have empathy towards our customers and people affected by the loss event and must use our expertise to achieve the best outcome for our customers while settling claims fairly and quickly.

Because claims management is our true product, we need to deliver better value to our customers. In the aggregate, our industry returns around 60% of the gross premium payments to our customers in the form of claims payouts. We spend substantially all of the balance, and often more, on distribution, administration, loss engineering, loss adjustment, and regulatory expenses. I believe our industry must look to technology to increase the efficiency and cost-effectiveness of such functions.

Imagine if we were able to deliver up to 75% of the gross premiums back to our customers in the form of claims payments, and still ensure that all participants in the risk transfer chain made an adequate return on their capital. By making investments in digital technology and improving our processes, we have the potential to achieve such an outcome – while putting the emphasis on claims management and the benefits of our expertise.

Data and experience

The third component of our social purpose is to leverage all the data and experience we have acquired to advocate for conditions that will reduce the likelihood or severity of loss events. Our industry has distinctive knowledge and experience that we can apply to advocating for safety features, building codes, processes, and judicial reform.

In this regard, there is no more urgent cause for our industry – and no better use for our data and experience – than advocating for actions to mitigate the effects of climate change. As an industry, we are uniquely positioned to share data, risk models and other information with companies, institutions and governments to help them better understand and address climate impacts. Taking a decisive stance on climate change is an important way to fulfill our social purpose, while enhancing the value of our business for the long-term.

If our social purpose is to help society manage risk, but not subsidise it, then we must also educate society to the fact that there are some risks our industry cannot fully insure. The economic impact of COVID-19 is a dramatic illustration of this fact. Unfortunate as it is, most insurance policies do not cover the economic loss incurred by businesses and organizations as a result of the pandemic and associated shelter-in-place orders issued by governmental authorities. The reason is simple: there isn't enough capital in our industry to pay out the potential aggregate losses associated with national or global catastrophic events. COVID-19 highlighted the issue, but other catastrophic weather events, cyber crime, and terrorism also fall into this category.

New mutual models needed

As society struggles with new forms of exposure and aggregations, we will need new models of mutualising risk. I believe that, increasingly, such models must include partnerships between insurers and government. In such a partnership, our industry would contribute its expertise in assessing and managing risk, and in matching risk with capital, while government resources would serve as a necessary backstop for exceptionally large loss events.

We have seen examples of such partnerships across the world before, such as the Pool Re terrorism reinsurance fund in the UK in 1993 and the Terrorism Risk Insurance Act in the U.S., frameworks that share public and private compensation for insured losses due to acts of terrorism.

Initiatives are now being explored around the world in response to COVID-19 and other risks, including a Pandemic Risk Insurance Act in the U.S., the Federation of European Risk Management (FERMA) proposal in the EU addressing pandemics and cyber incidents, and more. Such approaches should be further developed in a partnership between our industry and government, and we should not limit these discussions to pandemics.

Let's get ahead of the next potential disaster scenario – for example a cyber virus – before it happens, so we can address the next crisis better prepared than we were for COVID-19.

The risks our society faces are changing dramatically – but our industry's social purpose remains constant and enduring. As long as we remember that our purpose is to help society manage risk – and remain committed to achieving that purpose in innovative, adaptive ways – the insurance industry will be a relevant, valuable contributor to the security and progress of our society.

GEAR UP FOR DIGITAL SURGE

COVID-19 has added momentum to change that was already underway – and now is not the time to put on the brakes, says **Jean-Jacques Henchoz**, CEO of Hannover Re

More than five billion people around the world have rearranged their everyday lives in the interest of protecting the health of the entire population. It has meant giving up on mobility, the familiar work environment and social life. This has been an unusual first in human history. As a result, the coronavirus pandemic has further accelerated transformation processes in society, with implications for the insurance and reinsurance industry too.

Digitalisation, in particular, has gained enormous added impetus from the far-reaching restrictions put in place in public life to slow the spread of the virus. We will notice this manifested in various ways in our industry, including in the form of increased working from home, in the development of digital insurance ideas and also in more widespread partnerships across multiple sectors. Technology has now progressed to such an extent that computer systems can analyse huge quantities of data and provide ever more useful support in numerous areas of life and work.

Hybrid forms of working

Hannover Re faced a challenge back in mid-March when it expanded its capacity for simultaneous mobile working within a very short space of time to its global workforce of more than 3,000 people spread across over 150 subsidiaries, branches and representative offices.

Under normal circumstances such a move would probably not have happened in this form. Yet the changeover went smoothly. The rapid transition was made possible by the available technical facilities, such as communication channels that had already been digitalised early on, a secure network infrastructure and hence workplaces not tied to any specific location.

Some 50% of employees were already routinely working from home, while a further 25% to 30% had already done so from time to time on an ad hoc basis. Hannover Re's employees are making much more intensive use now of telecommunication and collaboration software, and the exchanges between them are working far better than initially anticipated. Our operation readiness for the benefit of our clients and sales partners is thereby assured.

Expertise, counselling and service can be tailored to meet requirements even under these conditions. What is more, our partners have responded positively to our virtual approach. The more complex and challenging an issue is, however, the more pressing the need for personal contact. Nevertheless, we shall consider whether a face-to-face encounter is absolutely essential for some meetings or whether the matter can be suitably discussed or presented in other formats going forward.

> "Technology has now progressed to such an extent that computer systems can analyse huge quantities of data and provide ever more useful support in numerous areas of life and work"

In many instances it is also possible to simplify routines that tend to be unproductive through pattern recognition, thereby facilitating a superior quality of work overall and enabling an even greater focus on higher-value and innovative activities. Lifelong learning based on such changes is fundamental.

We are still gathering experience as to how in-house structures and hybrid forms of work and communication can be harmonised in tomorrow's world of work, with a focus on customer and environmental considerations. My expectation, though, is that things will be more self-determined and team-oriented in the future, and that control over one's time and workplace will play a greater role. Ultimately, whatever brings greater success will win out.

Crisis drives digital designs

Hannover Re is in the fortunate position of already being able to draw on a rich culture of innovation and considerable digital curiosity. This is underscored, for example, by the in-house solution pioneered by our subsidiary E+S Rück in the field of automotive telematics, which can be used as a smartphone app. Next we will make the application available in a market-ready version to our insurance clients, initially in Germany.

The es|Tmatik app emphasises the rating criteria of mileage and regional classification rather than – as has otherwise been standard practice – the driver's assessed behaviour behind the wheel. The programme is thus grounded on more objective data and is particularly attractive to smaller insurance companies that

frequently shy away from the investment expenditure associated with offering proprietary products.

Statistically more reliable results can be generated from the mass of data produced in the form of a pool, thereby injecting fresh impetus on the pricing side in the interests of equitable risk spreading. This could serve to further boost the acceptance of telematics tariffs. Based on our insights, we may be able to expand the functionality of our solution or indeed extend it to other countries. Furthermore, we are working on other prototypes in connection with the increased use of artificial intelligence (AI) and would also like to step up our activities in digital form when it comes to the management of partnerships, with a focus on the customer.

The smartphone as a medium

Anyone seeking greater digitalisation has no choice but to develop apps. It is common knowledge that a particularly large group of users can be reached via their smartphone. Statista – a German online portal for statistics – forecasts that by 2021 almost 64% of mobile telephony users worldwide will have a smartphone. In the current conditions the significance of this communication tool has continued to grow and hence this percentage may well go even higher.

Digital insurance solutions can be offered to a larger audience using this medium, which has enabled some target groups to take out insurance protection for the first time. The potential for losses is particularly high in Asia: the Asian Development Bank estimates that natural disasters have cost this region $1.5trn over the past 50 years and the anticipated costs of such losses relative to gross domestic product are rising. Yet private individuals have scarcely had any coverage.

A first major step forward, therefore, would be even more effective awareness-raising of the need for insurance protection among those living in at-risk regions. Given that many people in Asia, and especially in India, are also digitally minded, the smartphone can be an appropriate tool here. At Hannover Re, we see a chance to play a part in a positive trend towards increased insurance penetration – first and foremost through our cooperation with InsurTechs.

With this in mind, we launched an initiative in Southeast Asia, where we work with and for our insurance clients so as to respond to shifting customer habits and simplify consumer access to products via alternative sales channels, for example online or over the counter at banks. In view of the prevailing circumstances, however, new fields of application in telemedicine and healthcare as well as areas such as smart cities, smart homes and future mobility may also experience appreciably stronger growth.

Parametric insurance covers are similarly likely to take on greater significance. Such covers provide for loss payments triggered by measurable meteorological

CONTINUED ON PAGE 80

or geophysical indices or the exceeding/undershooting of previously defined threshold levels. The availability of datasets – including those acquired by satellites – is making it easier to design innovative digital coverage concepts for numerous lines of business around the world.

Small farmers in emerging and developing countries, for example, can receive a quick and straightforward payout in the event of drought or flood losses with the aid of satellite-supported claims settlement. We are working to expand our range of offerings globally and we are increasingly assisting our insurance clients with product development and the implementation of innovative approaches driven by data analytics and automation.

Partnership-based approaches

Primary insurers and reinsurers play a pivotal role in minimising risks for society. Along with natural catastrophes and the consequences of global warming, pandemics are explicitly included among the most prominent risks. The risk models used by re/insurers during the COVID-19 crisis may perhaps have overestimated the impact on mortality and health while at the same time underestimating the economic knock-on effects of government countermeasures. It remains to be seen whether this current assessment will still hold true a year from now.

> "Now is not the time for putting on the brakes nor continuing on blindly – it is the moment to shift into a new gear"

Nevertheless, in view of their global nature and the enormous costs that can result worldwide, the coverage of systemic risks depends in part now more than ever on partnership-based approaches if we are to cope with the increasingly frequent upheavals seen around the world. It is unclear at this moment in time just how such a solution for pandemic risks might look in concrete terms. But we stand ready to lend our expertise in support.

That is why, for example, we – as an industry – participate in the Global Reinsurance Forum. It also means engaging in a dialogue with partner institutions such as the World Bank so as to enable people to afford insurance protection in the first place. Highly complex fields and issues are interconnected: climate models, agricultural and landscape information, nutrition, health data and how to interpret them are all topics that will be relevant going forward.

What can help in such cases in the future is the smart analysis of information chains to draw even more accurate conclusions than in the past. Methods for using data with the aid of AI are therefore a central concern for the re/insurance industry in a range of areas, even though systems are still in the process of maturing and can certainly become more robust. After all, we have only just begun to incorporate what is still the very young discipline of digital systems and the field of big data.

Growing cyber risk awareness

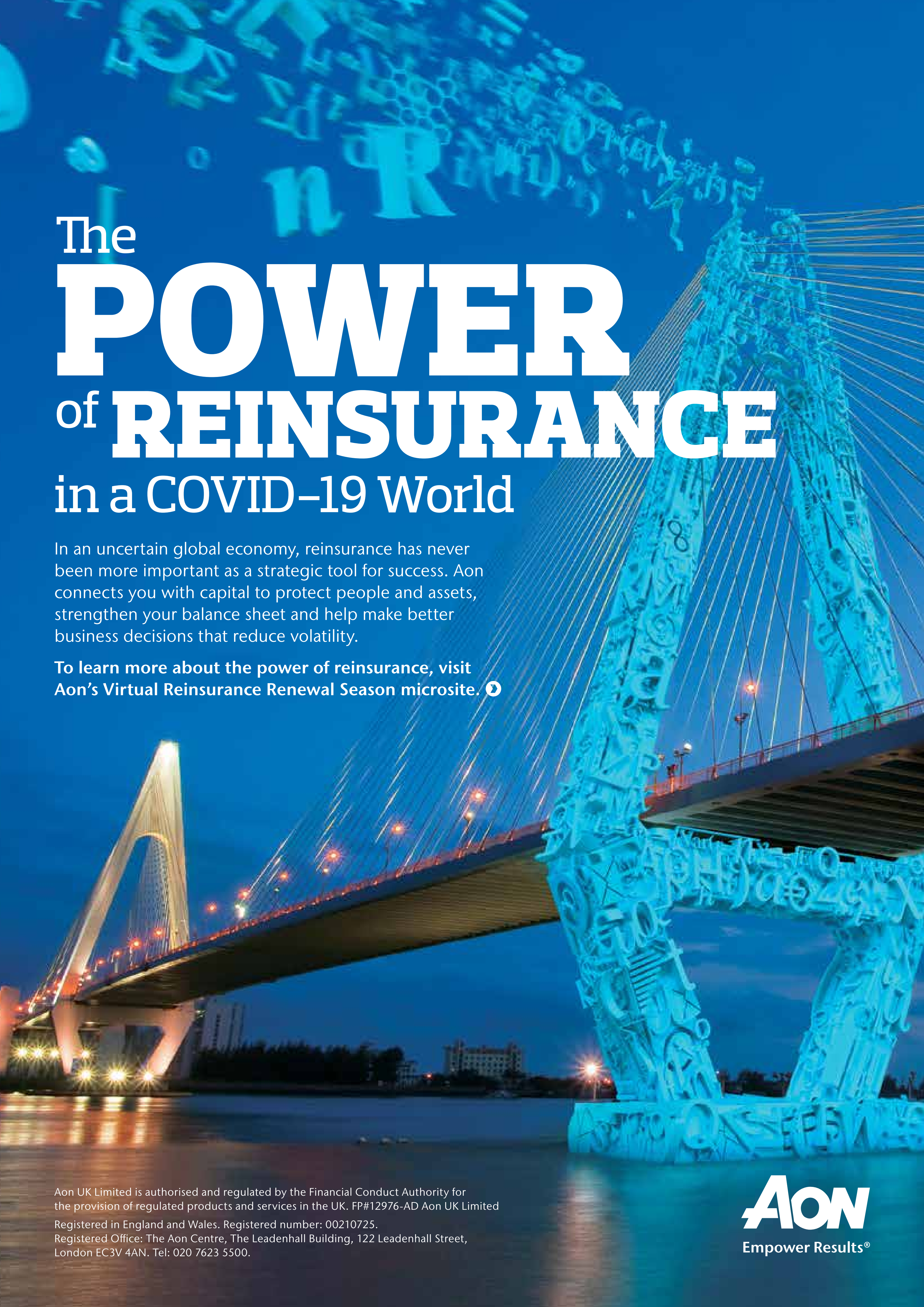
When we discuss digitalisation and the handling of (customer) information and data analytics – we cannot underestimate the risks of cybercrime. A growing and particularly notable threat that we, too, face as a company is malware and spyware that launches digital attacks on companies, spies on them and hijacks data or systems – frequently accompanied by ransom demands.

The coronavirus crisis has prompted sharply heightened awareness of the seriousness of these concerns, especially among small- and mid-sized businesses. On the one hand, stronger safeguards are necessary to protect against the growing risk from such social engineering, while at the same time additional products are being created to meet the increased demand. Our industry can deliver valuable tailor-made services here that go beyond the mere transfer of the financial risk. Hannover Re, for example, is currently working on a new analytics tool that is intended to make it easier for its primary insurance clients to identify the maximum potential for cyber losses in their portfolios.

In the present circumstances, then, the digital transformation not only secures Hannover Re's business operations, it also offers considerable potential for innovation. Furthermore, it opens up opportunities for us to demonstrate our relevance to society as a reinsurer. These are positive takeaways that have already emerged from this crisis.

Facing up to the challenge posed by issues such as health and demographics, globalisation and climate resilience is something that we see as an opportunity. A primary concern for us is the development of poorer countries and their social welfare systems. In Asia, for example, we have enhanced our market intimacy through our branches with a view to having more direct contact with existing and potential clients for the cultivation of these markets.

Here, in particular, digitalisation can also serve as a very helpful tool for risk management and risk prevention in light of population density, demographic prospects and the potential for natural catastrophes. That said, I have no wish to make light of the current crisis, not least because many people have lost family and friends to the virus or been impacted in other ways. Yet if we learn the right lessons, the resulting opportunities presented by this global transformation can be a useful addition for Hannover Re. Those who embrace these changes and play a part in shaping the new landscape will have an easier time. Now is not the time for putting on the brakes nor continuing on blindly – it is the moment to shift into a new gear.



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THE CURRENCY OF CONFIDENCE IN A DECADE OF UNCERTAINTY

By **Julian Enoizi**, CEO, Pool Reinsurance

We are all living in uncertain times. But 25 years in the insurance industry has taught me that uncertainty is nothing new; indeed, if it heralds positive change, sometimes it is to be welcomed. The uncertainty of our current circumstances, however, feels to be of a different order of magnitude to anything in recent history.

This was brought home in July when the UK's Office for Budget Responsibility (OBR) published its latest Fiscal Sustainability Report, aiming to assess the future sustainability of the country's finances. Even the rosiest of their scenarios show that the UK is on track for the largest annual decline in GDP for 300 years, and unprecedented peacetime rises in borrowing and debt.

Behind these statistics lie highly challenging, unusually uncertain times for individuals, families, businesses and governments across the world. Pandemics have joined the everyday realities of environmental disaster, cyber-attacks, and geopolitical turbulence at the start of a new decade which for many seems to threaten more than it promises. We enter it collectively weakened. COVID-19 is crippling economies and placing a heavy burden on national healthcare and social protection systems, making us more vulnerable to the compounding effects of further disasters in the near or medium term.

Against this backdrop, there was something affecting about outgoing OBR chairman Richard Chote's closing remarks to accompany the July report: "Now more than ever, it is important to cherish the institutions that can give people confidence in good government and good economic management. That confidence is hard to build and all too easy to erode."

Crisis of confidence

I believe that an enduring characteristic of insurers is that they are purveyors of good economic management. Over several centuries we have gained society's trust in our ability to understand and manage risk, which has placed us at the heart of the way people travel, trade, build, work, play, and grow old with a reasonable degree of protection and confidence.

However, there is an accelerating divergence between businesses' risk transfer requirements, and the appetite or indeed practical ability of insurers to cater for them. Airmic, the UK corporate risk management association, is one of several prominent voices warning in no uncertain terms that this pandemic has laid bare the inadequacy of business interruption policies in the modern world. Last year, the World Insurance Report found that less than a quarter of businesses globally felt that their insurance coverage was adequate. Only around a fifth of (known) corporate risk is insured, and the indemnified proportion of the real economy is shrinking.

Why is this? A host of factors are at play. For me, a significant one is the dizzying speed at which human behaviours are evolving. The accompanying rate of change in our built, natural and virtual environments disclose new vistas of vulnerability and potential size of loss which sit outside what commercial insurance can manage alone.

This is bad news for society as much as insurers. The Geneva Association amongst others have published strong evidence to show that countries with widespread market-based coverage tend to recover faster from the financial impacts of extreme events, with uninsured losses driving the type of macroeconomic costs shown in the OBR's July report.

Our industry urgently needs to find a way to be at the heart of the recovery from the next systemic event, rather than at the margins. To weather future events more successfully, governments and businesses urgently need us to succeed. I believe that our key currency in the decade ahead will be the confidence we can inspire in each.

Systemic risk solution

There is growing acknowledgment from insurers, politicians and regulators that commercial insurance will only ever be able to support a small, societally sub-optimal sliver of pandemic risk. There is also a broad consensus that only governments have the financial resources capable of putting enough resilience into the system. As natural catastrophe and terrorism pools around the world have demonstrated, state guarantees can facilitate the creation of viable insurance markets that can offer broad, affordable coverage for risks that are rightly considered "uninsurable" without governments' involvement.

However, creating a public-private facility for pandemic risk alone, significant as this would be, would only see

a familiar pattern play out next time a systemic risk manifests and a crippling protection gap is revealed. It is not the trigger, but the systemic consequences that government and industry must partner more ambitiously to address.

The current situation has been spurred by a viral infectious disease. However, it could just as easily have been a digital virus or cyber-attack, the collapse of a delicately balanced natural ecosystem, or an as yet unreckoned consequence of climate change or increasingly sophisticated artificial intelligence.

In recent months, various figures and working groups within the industry have promoted the idea of evolving Pool Re into an "umbrella" facility, perhaps a "Resilience Re". Such an entity would benefit from economies of scale not only by uniting existing state-supported pools, but in time creating further pools to facilitate insurers' participation in risks for which there is currently little or no commercial market.

Whether or not this transpires, nearly three decades of managing terrorism risk through public-private partnership has given Pool Re a practical insight into the ingredients necessary for underwriting private market solutions to society's biggest risks.

Skin in the game

The first ingredient is sufficient capacity. Analogous to today, in the early 1990s insurance for commercial losses resulting from terrorism evaporated, leading to great uncertainty for businesses and the wider economy. Pool Re was created to bridge the gap, enabled by an uncapped loan facility from HM Treasury, which today underpins £2.2trn of UK infrastructure and businesses of all sizes. The guarantee means that after a catastrophic event, or even series of catastrophic events, insurers can be confident of solvency, liquidity to pay claims, and stable rates post-loss.

The pool is not run for profit. The premiums ceded by insurers have gradually accrued to build a large buffer, which we supplement with a sophisticated risk-financing programme. This includes the world's largest terrorism retrocession placement, and its only terrorism catastrophe bond.

There was no way to prevent COVID-19 from being an economic disaster. However, a well-designed public-private partnership could have helped to absorb the initial shock, reducing the multiplier effects of lost jobs and panicked markets whilst providing the government with indispensable fiscal space to manoeuvre.

The second ingredient is broad, consistent, relevant protection. Pool Re's cover includes chemical, biological, radioactive and nuclear risk (CBRN) and is continually evolving to match and anticipate the terrorism threat, ensuring that the cover member insurers are able to offer continues to complement businesses' risk profile and transfer requirements.

Since 2018, Pool Re has integrated non-damage business interruption and limited cyber into its proposition, the first of the world's pools to do so. This wide cover dovetails back to back with insurers' general cover, whilst the mutual structure promotes transparency and clarity of coverage, trigger and process at every stage of the chain.

The third necessity is for coverage to be widely available to both insurers who wish to offer it and businesses who wish to purchase it. Membership of Pool Re is open to any authorised insurer, and if the general property cover is acceptable to the insurer, terrorism terms must be offered upon request. Cover and terms are not restricted by geographic area or risk profile, and is accessible through any of Pool Re's members, who together constitute the vast majority of property insurers in the UK market.

The importance of relevant, affordable, available insurance for catastrophic, potentially systemic risk over the next decade is difficult to overstate. The key, however, to effective public-private partnerships in the future will be creating models which both serve the national interest and are profitable for the insurance industry. Pool Re may provide an example for how to achieve this equilibrium. Supported by the guarantee, the pool can incubate terrorism risk, placing a clear upper ceiling on the terrorism losses carriers can suffer both individually and in the aggregate. The traditional tenets of diversification and portfolio management continue to underpin insurers' operations, since they hold only the level of terrorism risk they feel confident retaining.

The pool, however, invests a small portion of annual premium income (less than 2%) to fund the research, partnerships and modelling development required to gradually raise this comfort threshold and transfer a growing portion of attritional terrorism liabilities to the private sector. Since 2015 alone, insurers' skin in the game has doubled to an annual retention of over £400m, and £250m per event; meanwhile, the standalone market in the UK is estimated to have more than doubled in that time. These encouraging signs of growing capacity and confidence are crucial for developing a healthy, competitive, innovative terrorism market able to meet the needs of policyholders and respond to a dynamic risk as it evolves.

Firmly integrating the insurance industry into the national resilience and disaster preparedness architecture would scale the opportunities for further alignment of social and free market objectives beyond terrorism. No sector understands risk like insurance, and our industry is the natural steward to confidently guide an uncertain society through an uncertain decade.

TAKING THE INNOVATION INITIATIVE

Lloyd's has moved fast to offer customers greater protection against the fallout from the COVID-19 pandemic – and future systemic risks, CEO **John Neal** writes

COVID-19 has resulted in a humanitarian and economic crisis on a scale the world was underprepared for. It's also challenged the global re/insurance industry's reputation by exposing the limitations of existing risk transfer structures for systemic risks of this dimension. Lloyd's is committed to working with the market to provide short, medium and long-term solutions to the challenges its customers face as they begin to recover and re-open.

The global re/insurance industry is playing its part to help society cope with and recover from the impacts of COVID-19 by paying claims, donating funds to support business and society, and offering flexible terms and conditions. Lloyd's has estimated that the market will pay claims in the range of $3bn to $4.3bn to its global customers.

Lloyd's has also donated £15m to a number of charities concerned with healthcare, wellbeing and innovation and our market has already started creating new policies to support the immediate health response as well as the longer-term exit strategy, including the search for diagnostics, treatments and vaccinations. One syndicate alone is insuring more than 100 individual clinical trials taking place around the world investigating all stages of COVID-19. I'm pleased to say we recently announced the creation of 'Syndicate 1796' which will insure the storage and transportation of a COVID-19 vaccine, once developed, to emerging economies.

However, the magnitude of the pandemic's financial and social impacts has exposed the shortcomings of society's preparedness for, and resilience to, systemic risks of this scale and nature, including the ability of some risk transfer products and structures to provide protection.

The last few months have shown systemic risks, such as pandemics, that cause large economic and societal losses are unlikely to be covered in their entirety by the global insurance industry as the total economic loss would exceed its financial resources. Where cover is available, premiums can be significant for what many customers have previously regarded as remote threats. This means the insurance industry must develop new products and structures in those areas where protection gaps exist today to support business recovery over the short term, together with providing greater resilience over the medium to longer term.

At the same time, as economies are opening up, there is also an understandable demand for protection against a second wave of the pandemic and for longer-term protection from future systemic risks.

Responding to the COVID-19 challenge

The global insurance and reinsurance industry is responding, but COVID-19 has taught us that there is much more that we can do to support our customers by providing protection for the evolving risks they face.

To inform the industry's response to our customers' changing needs, Lloyd's interviewed executives and experts from key industries around the world and published its "Supporting global recovery and resilience for customers and economies" report in July, which set out several solutions that could help businesses protect themselves in the short, medium and long term.

Over the short term, customers told us they wanted business resilience to a second wave of the pandemic, safeguarding employees on their return to work and a safe environment for customers to return. Crucially, customers want clarity of insurance cover. In the medium term they were worried about holding more flexible insurance cover for a more volatile business environment, ways to increase the resilience of global supply chains, in-depth assessment and protection from cyber risk exposures and protection from digital economy liabilities. Over the long term, they said they needed risk prevention and mitigation support and also advice on preparing for the next systemic risk.

Solutions to short-term needs

A great deal of the work we have done so far is in connecting with our customers to understand what they need from us. Our research shows businesses are concerned; many industries have suffered significantly since the onset of the COVID-19 pandemic, and their recovery will be challenging and heavily dependent on cashflow.

Our aim is to stimulate innovation and accelerate development by proposing new solutions that could be developed and adopted by the global insurance industry. Following conversations with leading experts in travel, hospitality, healthcare and pharmaceuticals, retail, automotive, supply chain and transportation, energy, and construction, we have been able to lay out three open source framework ideas. These frameworks could be applied in different territories around the world with an aim to offer a pathway to recovery, build greater resilience and protect the future.

In the next few weeks and months, we can support our clients and policyholders through several methods. Firstly, some of these customer needs can be catered for using existing or modified products and services; others specifically impacted by COVID-19, such as business interruption and trade credit risk, require new approaches.

A short-term approach would be our framework called ReStart. It's a commercial structure for pooling risk between insurers to support the return to work. The solution would give certainty of business interruption coverage for a potential second wave of COVID-19 where alternatives are few and far between, and work on the basis of regional and industry diversification of the risk.

ReStart would also contribute directly to customers and their recovery from the pandemic, in turn strengthening relationships and trust in our industry over time. Our sector will undoubtedly face increased scrutiny from now on and the work we do to address this will be important. Furthermore, the ability to manage customer affordability and insurers' exposure through risk pooling, variable limits and industry and geographical diversification could benefit many customers from a smaller SME base.

> "The insurance industry must develop new products and structures in those areas where protection gaps exist today to support business recovery over the short term, together with providing greater resilience over the medium to longer term"

Supporting recovery in the medium term

We are exploring ways to enhance the re/insurance industry's understanding of systemic risk. Lloyd's is developing a centre of excellence to build the industry's resource and capability to better protect customers against systemic risks, including pandemics but also against other catastrophic events such as global supply chain disruption, or widespread interruption of critical infrastructure or utilities.

We are also working with the Lloyd's Product Innovation Facility to speed up product development and meet customers' changing needs. The Product Innovation Facility is initially focusing on innovating products to respond to the accelerated shift towards intangibles-driven business models in response to COVID-19, through a series of product development sprints that are aimed at testing, learning and potentially scaling successful initiatives.

Alongside this work, the Lloyd's Lab has built a strong reputation for bringing the best InsurTechs in the world to our market: this is something I am particularly proud of. Our fifth cohort will have a focus on COVID-19 products and solutions to help fast-track these innovative solutions to market. They will include: new types of insurance to support the COVID-19 response; helping the Lloyd's market to assess COVID-19 risks; and helping Lloyd's customers to adapt to a changing workplace.

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Protecting our long-term future

As society recovers from the impacts of COVID-19, it must do so in a way that makes it more resilient to future systemic risks. While the global re/insurance industry does not have the capacity to absorb systemic catastrophic events on its own, it can work with governments to establish national or regional structures that could provide protection.

To this end we have proposed an open source framework, Black Swan Re, which could be implemented in any territory or region around the world. If implemented Black Swan Re could provide coverage for future systemic risks through re/insurance industry-pooled capital, and a guarantee from government to pay out if ever the pool had insufficient funds.

This government reinsurance framework would benefit customers during non-damage business interruption events and would give policyholders certainty of cover and quicker pay-outs.

Recover Re, our "after the event" proposal, would also require support from government. This framework could act as an efficient way of getting commercial and government funds into the economy, providing relief to customers with limited borrowing capacity. In this case, governments would need to guarantee policyholders' future premiums to mitigate the risk of them defaulting on their payments. While this idea would offer immediate benefits to customers, it would require long-term government guarantees of future premium flows to make the product affordable for customers.

By working collectively and with governments, the global re/insurance industry can help to develop structures that ensure that protection against systemic risks is paid for by the customers that benefit so that price reflects risk and drives mitigating behaviour, is modelled and understood, and provides a layer of commercial capital to support customers before the risk falls on government. These partnerships will be critical in protecting businesses and people in the future.

Fast-tracking industry's response

Delivering these initiatives at the pace and scale needed to help our customers and wider society will require close collaboration between insurers, reinsurers, governments, customers, and, in some cases, the capital markets and NGO sector.

Lloyd's will provide seed funding of up to £15m to support this process and will use its marketplace to act as a convenor and incubator to develop some of these initiatives. Over the coming weeks and months, we will co-design and pilot initiatives in the London market and across the UK, with the support of our London and Global Advisory Committee members.

We often pride ourselves as a sector on our inherent social purpose – that is to help businesses and communities reduce the risks they face, enable them to recover quickly from disasters by paying claims, and to provide the security that allows them to innovate, develop and drive economic growth. COVID-19 has demonstrated that there is much more we can do in this role and, on behalf of our customers, we should carry out this work as quickly as possible.

"We all have a role to play in offering short, medium and long-term support to our customers. By working together, our global industry can develop and implement these proposals around the world at a pace and scale that cannot be achieved by individual firms. The pandemic has provided us with an opportunity to come together to share risk and create a braver, more resilient world – and we must seize it"

We all have a role to play in offering short, medium and long-term support to our customers. By working together, our global industry can develop and implement these proposals around the world at a pace and scale that cannot be achieved by individual firms. The pandemic has provided us with an opportunity to come together to share risk and create a braver, more resilient world – and we must seize it.

Reactions

North America Re/Insurance Week

Webinar Series: September 23-25, 2020

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STRONGER WORKING TOGETHER

The insurance value chain stood up well to COVID-19 and the lessons learned will help take the industry to an even higher level, according to **Marc Grandisson**, CEO of Arch Capital Group

Like many other companies, Arch has devoted a significant amount of time in recent months to considering where we go from here. How do we, as a company and as an industry, respond to the fallout across our businesses from COVID-19 and help our clients as they figure out their own paths forward?

Even before the pandemic, our clients' exposures to economic losses were becoming larger and more complex. Ransomware attacks and cyberwars between states are surging, while changing weather patterns and the rise of litigation finance as an investment vehicle continue to demonstrate that the insurance cycle is still with us.

It is becoming clearer by the day that now, more than ever, it is crucial that we use our risk management expertise to not only recover, but also deliver on our promise of assessing and mitigating risk for our clients and insureds as we all seek to rebuild from the impacts of COVID-19.

A history of resilience

Each decade has brought new challenges that have threatened to bankrupt large swathes of our industry. We have proven both resilient and adaptable when facing these crises: in the 1970s, insurers dealt with stagflation, while the 1980s brought a deluge of jury verdicts from asbestos and unprecedented medical and product liability awards. In 1992, Hurricane Andrew led us to reconsider our approach to wind and flooding and then in 1994, the Northridge earthquake further highlighted the risk of concentrated exposure to natural catastrophes.

Similarly, in 2001, the 9/11 terror events required insurers to determine how to manage the sheer magnitude of losses that could be inflicted on urban geographies across so many different policy coverages. (Re)insurers retooled with more than $11bn of fresh capital flowing into Bermuda — creating the "Class of 2001" that helped provide the necessary capacity to rebuild, and through the development of some of the most sophisticated catastrophe models, established Bermuda as the cat risk capital of the world.

In each of these worst-case realities, our industry experienced significant losses. However, we've proven our resilience by learning, adjusting and creating new product offerings and approaches to underwriting to mitigate future events. Whether revising our catastrophe modeling, developing cat bonds and insurance-linked securities to better manage risk accumulations or investing significant resources into data analytics, we have always found creative ways to evolve and improve our business. In 2020, the pandemic is introducing yet another disaster that will most certainly reshape our world and our industry. Once again, our field will have to call upon its expertise, ingenuity and people to move forward and provide durable solutions to its clients.

Catalyst for innovation

COVID-19's total impact is still being tallied, but most agree industrywide losses are likely to surpass those of 9/11. Estimates have projected insured losses ranging from $50bn to $120bn even as uninsured losses are likely a multiple of that. The retail, travel and oil sectors have already suffered tremendously, and economists are projecting historic waves of bankruptcies and defaults over the next 18 months. An estimated 1.85 million U.S.

businesses closed their doors or temporarily suspended operations in the second quarter, and total bankruptcies are expected to challenge the record set the year after the 2008 economic crisis.

As it becomes clear that a post-COVID-19 world will be fundamentally changed, insurers will need to be leaders in helping businesses rebuild. I believe our challenge is, first and foremost, to retool our capabilities to support our clients and serve as a catalyst for innovation and growth. Historically, catastrophic events have required us to develop new data analytics and I believe the recent growth in technology has brought us to a critical stage in our collective development. More than ever before, our ability to utilise big data in managing insurance portfolios will not only drive our assessment of individual risks, but also be a valuable offering to help our clients better understand and manage their own risk.

Actionable data analytics

The past decade has seen an increase in spending on technology and data analytics teams that are critical to the long-term success of our business. However, we should ask ourselves: is it possible that we spent too much time thinking about our own models and too little using our information and insights to enable possibility for our clients?

There is so much we can offer our partners beyond paying claims. For those retaining some insurance risk, our advanced data analytics help them better understand and ultimately mitigate that risk. If we actively seek opportunities to share our tools and conclusions with our clients, we can build deeper relationships, reduce losses for all parties and become better business partners.

Working with our MGAs and cedents, we can supplement their internal data with external data and predictive analytics to find areas for rapid, profitable growth. Similarly, our insureds' risk managers already have good visibility into the claims within their own organisations; however, by bringing better data analytics capabilities, we can work more closely with clients to quickly identify emerging trends and address seemingly benign claims before they become headline issues.

Broker servicing challenges

An additional opportunity for our industry is to make our brokers' jobs easier. The global pandemic and a hardening P&C market present new challenges for our brokers servicing their customers. As carriers, we can use our data to improve our service, especially for lines with a high volume of transactions. In some areas, Arch has been able to use external data to start underwriting prospective accounts before we've even received a submission, leaving our partners more satisfied with service times and freeing our underwriting teams to provide additional value by focusing on high-touch business.

We should also continue to push to use more of the dynamic, risk-based pricing that our friends in personal auto have applied for years. Arch introduced risk-based pricing in our mortgage insurance operation years before it was adopted by the rest of the industry. By replacing the standard rate card that essentially used two factors with a model that considers over 15 different variables, we were able to dramatically improve our risk selection while providing better pricing. Similar to the example of using external data to proactively underwrite accounts, more dynamic pricing can benefit both our clients and internal underwriting teams.

A recent example of finding opportunity in this crisis was in the first week after COVID-19 forced us to close our offices and send employees around the world home to work. As we got settled, we realised we had no idea how our partners would adjust to the new normal. Were we ahead of or behind the curve? What could we do to get visibility into how our partners were handling the transition? Working rapidly, our data analytics team built a tool to provide real-time insights into submission flow. We were able to quickly identify spots where a partner might be having difficulty.

Empowering employees

New ways of using data and analytics are empowering our employees with the information and insights they need to do their jobs, and our partners have been very receptive to the intelligence we've been able to provide. A hallmark of our industry's resilience is the partnership between insurers, brokers and clients. We're stronger working together.

One silver lining of the past several months has been more time to ponder big issues and challenge our thinking. With so much time spent in the fast lane, we seldom pause and consider the direction of our businesses and what ultimately makes us successful. Insurers have been evolving for over 300 years, since Lloyd's of London was founded. These times feel like another opportunity for us to rethink how we engage with our partners and clients. The pandemic has changed the world we once knew. By leveraging our capabilities to help our partners rebuild, we have the ability to create a better tomorrow. Let's not miss this opportunity.

A BRIGHTER FUTURE BECKONS BEYOND COVID-19

There will be opportunities as well as challenges after COVID-19, according to **Andy Marcell**, CEO at Aon Reinsurance Solutions, and InsurTech partnerships will play a big role

The COVID-19 pandemic has been a game-changer for most industries – not least the re/insurance sector. Whilst the past few months have been a difficult and, for some, distressing period, when eventually viewed through an historical lens, such adversity will evidence resilience and innovation that not only reduced the likelihood of future events having such a serious impact, but provided an opportunity to pause and realign society to people's evolving needs and expectations.

Take remote working as just one example. Large, global companies such as Aon had already long embraced the technology that would allow their employees to work effectively outside the office, but the pandemic has provided a rare opportunity to stress test these capabilities at scale. This has helped to evaluate both the efficacy of the technology and systems themselves when used as the primary way of working, and whether teams can operate in a cohesive and effective manner in a continuous virtual environment.

Over the past few months, along with many of our trading partners, we have fine-tuned remote operations so high levels of client service could continue unabated, and in many cases, even improve as colleagues began to increasingly adapt to a new way of working. What we are now seeing is that, rather than hindering business productivity, these proven remote infrastructures are actually opening up new possibilities for growth. This situation will only be amplified as we further embrace what has been termed the "new normal" – a phrase which has negative connotations when interpreted as a compromise, but could in fact represent a much-needed evolution with long-lasting benefits.

Pulled into a new future

The pandemic has significantly accelerated customers' adoption of remote services – particularly in banking and retail. For some, such as the elderly and vulnerable, this will have proved to be a lifeline. In our own industry, we are seeing a similar seismic shift: the move to online placement platforms is gaining momentum as a result of the pandemic, and despite the shorter-term challenges faced in terms of potential losses and continued provision of comprehensive cover, we may actually find that COVID-19 has helped save what was – as we all knew – an industry that desperately needed to modernise.

We have been pulled into a new future, one which is proving itself to work effectively, and one which will have benefits beyond the need to maintain business continuity in difficult times. Indeed, our InsurTech partnerships now seem even more relevant, as prevailing conditions serve to align us on a similar vision for the advancement of our industry.

For all the long term benefits this period may bring, we need to remain mindful of the near- to medium term

impact of COVID-19 on our sector and our clients. No one needs reminding of the devastating effect of the pandemic on the global economy, precipitating what seems likely to be the worst recession since the 1930s.

According to forecasts from both the International Monetary Fund (IMF) and the World Bank, global gross domestic product (GDP) is set to decrease by around 5% in 2020. Global stock markets quickly lost around a third of their value by the end of March and, while an unprecedented policy response by major economies resulted in the stabilisation and partial recovery of stock markets in the second quarter, valuations in the insurance and reinsurance sectors have been lagging, seemingly due to the persisting uncertainty around the evolving nature of COVID-19 related losses.

Challenging market conditions

And I want to emphasise the word “seemingly”, because given that so much negative news flow on our sector focuses on the pandemic, it would be easy to forget that market conditions were challenging even before COVID-19 took a ubiquitous hold. Back in January, our analysts were already forecasting a modest tightening of reinsurance capacity in 2020, driven by below par results over the past few years, generally lower capital adequacy, concerns around the adequacy of casualty reserves and the prospective impact of lower interest rates. Furthermore, losses and trapped collateral in the alternative capital sector were impacting the availability and cost of retrocession capacity.

Most of these negative factors have been amplified by COVID-19; earnings and solvency have been impacted, and significant uncertainty remains around the ultimate extent and distribution of associated claims. Demand for reinsurance is generally increasing as cedants look to de-risk, while reinsurers have simultaneously become more discerning when it comes to the deployment of their capacity. Consequently, the mid-year renewals have shown pricing increasing on a broadening front.

Importantly, the prospect of improved returns has enticed new capital into our sector. New equity issuance exceeds $8bn over the past few months and more capital is likely to follow, given the numerous press reports of expansion plans and potential new start-ups. The property catastrophe bond market has also been a bright spot, as the liquidity of the product and the peril-specific nature of the coverage continues to attract strong interest. Around $6.5bn of limit was placed in the first half of 2020 – exceeding the amount placed in the whole of 2019. In addition, we’ve seen significant activity in the industry loss warranty market, given the more limited availability of UNL (ultimate net loss) coverage.

> “Our InsurTech partnerships now seem even more relevant, as prevailing conditions serve to align us on a similar vision for the advancement of our industry”

Change for the better

As we head towards the important 1 January renewals season, many of the existing pressures will remain in play. Globally, all markets will have their own dynamics, but the direction of travel will be the same. As an industry, we need to take stock of the past six months, re-evaluate our positions and exposures, and invest in solutions that will help our clients to find success in these testing times. We should remember that we are the world experts in risk, with the resources and talent to help companies, governments and communities navigate through this unprecedented period.

We should also remember that now is the time to build the future world we want to see; to change what needed to be changed, and to move towards a more robust and sustainable environment. We have been given an opportunity to better position ourselves to help those that need our assistance, and in so doing ensure that COVID-19 leaves as positive a legacy as possible.

LOOK EAST FOR OPPORTUNITY

Although the COVID-19 pandemic will continue to take its toll in Asia, insurers and reinsurers should not overlook growth opportunities that will persist in the region, says Peak Re CEO **Franz Josef Hahn**

In emerging Asia, the world insurance markets' growth engine of the past 10 years, penetration in non-life insurance is still only half the global average – partly due to the region's expanding middle class. Natural catastrophe risks remain widely underinsured, while climate change further aggravates exposures. However, alternative capital is expected to generate further capacity that will contribute to closing the current gap.

In June, the International Monetary Fund (IMF) projected global GDP growth of -4.9% for 2020. The recovery will be more protracted than previously forecasted with global growth forecast at 5.4% for 2021. Overall, the IMF concludes, COVID-19 will leave 2021 with GDP some 6.5 percentage points lower than initially assumed in January 2020, prior to the outbreak of the pandemic.

Against this backdrop, the contribution of the emerging growth markets, particularly emerging Asia, will be of vital importance for the overall recovery. Both advanced (-8%) as well as emerging and developing economies (-3%) are seeing a steep downturn. For the first time in recent memory, Asia's economy is expected to contract. Only a few economies in the region may grow this year, including China by 1.0%, while India, by contrast, is expected to decline by 4.5%.

Governments and central banks have implemented unprecedented measures to soften the downturn. Global fiscal support now amounts to over $10trn. In addition, central banks have provided substantial additional stimulus such as interest rate cuts, liquidity injections or asset purchases. As for Asia, fiscal and monetary policy support has been unprecedented, especially in

the region's mature markets, while in emerging markets support has been mainly in the form of guarantees, loans or quasi-fiscal activities. However, emerging Asia is expected to recover faster than most other markets. The IMF projects that Asia will grow by 6.6% in 2021, with China recovering at 8.2%.[1]

Emerging Asia's key opportunity

Insurance will remain an important facilitator of economic growth in emerging Asia. In the past 10 years the premium volume in the region's largest markets, China and India, expanded at about 15% annually respectively. Similarly, Indonesia, Vietnam, Singapore and South Korea also registered double digit growth over the past decade. However, penetration is still lagging far behind the advanced economies. While the world's average penetration rate stands at just over 7% for both life and non-life, China's penetration is still only 4.3% for both life and non-life. India's insurance penetration is lower at 3.8% for both life and non-life, with an even more pronounced under-penetration in non-life, where the subcontinent registers a penetration rate of less than 1%, compared with 3.9% for the global average. With the exception of Thailand and Malaysia, the penetration of all other emerging Asian markets is still lower than India's.

Despite the current crisis, we therefore expect emerging Asia to remain the growth engine of the global insurance markets. Although the region's GDP growth will moderate somewhat due to COVID-19, we still predict that 60% of the additional premium volume of roughly $3trn that global insurance markets are expected to grow over the next 10 years (from $4trn in 2018 to $7trn in 2029) will originate in emerging Asia.

While China's market share of global insurance premiums is set to double over the next 10 years from 11% to more than 20%, Asia-Pacific as a whole is expected to account for more than 40% of global premiums by 2029.

One of the key growth drivers is emerging Asia's natural catastrophe exposure. China and India face the highest frequency of natural catastrophe losses in the world. Located along the Ring of Fire of the North-Western Pacific Ocean, the region experiences about 90% of the world's earthquakes and one-third of all natural catastrophe events.

In 2019 Asia had to digest 45% of the economic losses that natural catastrophe events caused worldwide. However, due to the continent's low insurance penetration, its share of insured losses only amounted to 30%. With typhoons Hagibis and Faxai, the region was hit by the two largest loss events in 2019 with insured losses of $8bn and $7bn, respectively.

Climate change risks grow

The frequency and severity of these catastrophic events is exacerbated by climate change and also the rapid urbanisation taking place along coastal areas of the region, which are located at the fault lines for natural catastrophes. While Asia's population has doubled over the past 60 years, more than half of its population today lives in urban areas. Besides, with its extensive coastlines, low-lying territories, and many islands, Asia's geography is highly susceptible to climate change risk. That might translate into heatwaves, floods, and droughts affecting every aspect of life, from nutrition and health, to safety and income.

In a recent report, the UN warned that growing disaster risks may exceed Asia-Pacific's capacity to

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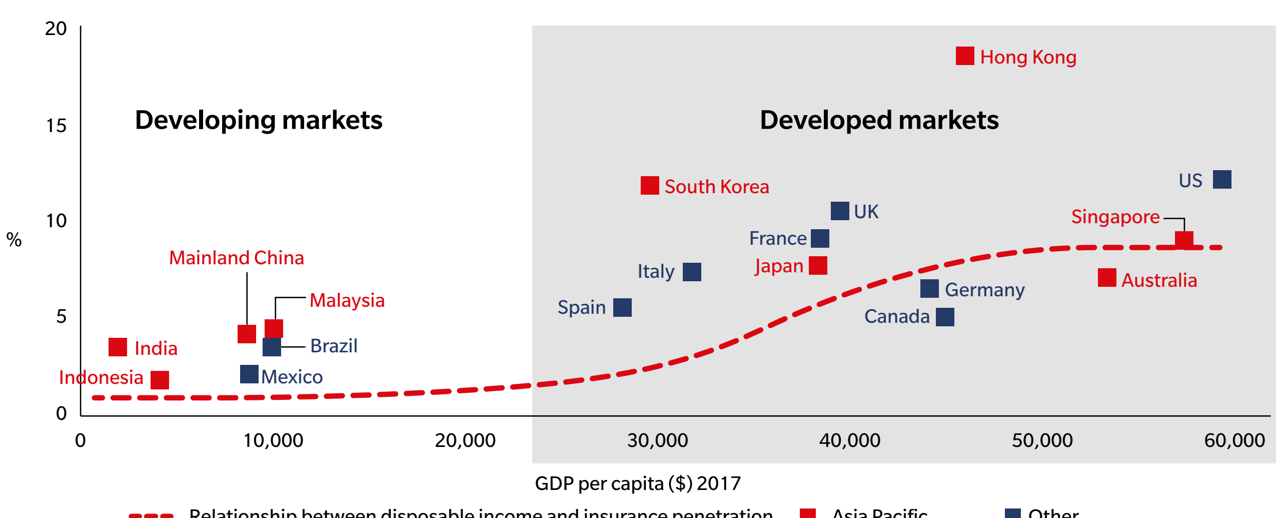
Low insurance penetration in Asia Pacific's developing markets signals pent-up demand

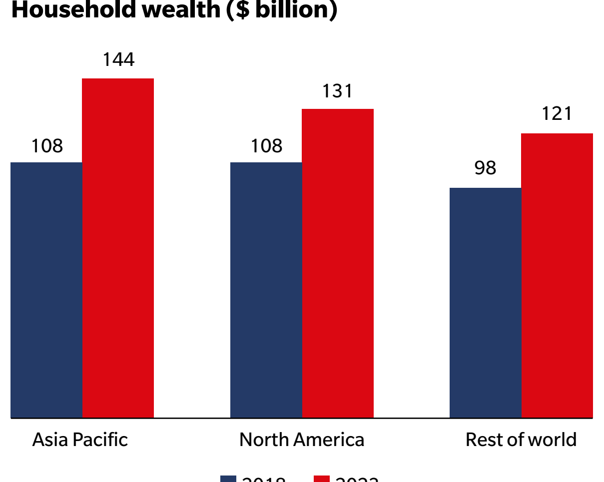
Total insurance penetration (gross written premiums/GDP), 2017



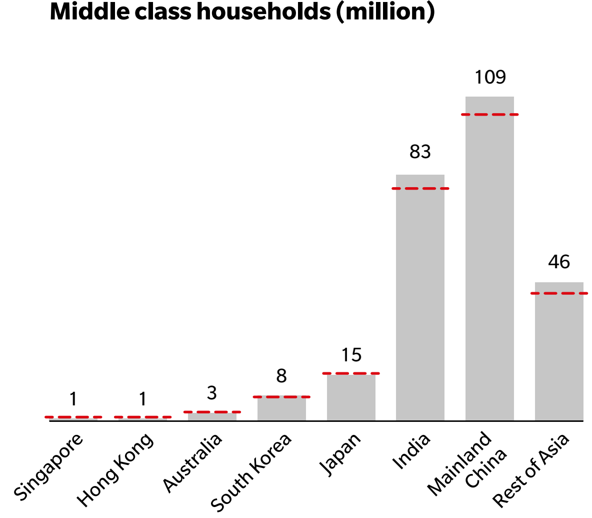
Notes: Total insurance includes five segments (life, pension, nonlife, personal accident and health, and reinsurance); GDP and GDP per capitata are at current USD conversions; all countries are gross written premiums except for Brazil, France, Italy and Malaysia (direct written premiums) and the UK (net written premiums)
Sources: GlobalData Global Life/Non-Life Insurance Database; World Bank World Development Indicators

Expanding middle class in emerging Asia – expanding household wealth

Household wealth ($ billion)



Middle class households (million)



Note: Rest of Asia include Indonesia, Malaysia, Philippines, Thailand and Vietnam
Sources: Credit Suisse Research Institute, *Global Wealth Report 2018*; Euromonitor; Bain analysis

respond. The sequence of natural disasters in Asia and the Pacific over the past two years is a sign of things to come in the new climate reality. Recent disasters, especially those triggered by climate change and environmental degradation, have deviated from their usual tracks and are growing in intensity, frequency and complexity.

In addition, the region is also exposed to slow-onset disasters, notably drought events. Their impact on agriculture has resulted in a sharp increase of annual economic losses and disproportionately affect the rural poor.

Middle-class expansion

The rapid expansion of Asia's middle class is a further driver of the region's growth momentum and a key reason for its low insurance penetration hovering at around 0.9% (India) to 2.0% (China) in non-life insurance. Globally, the number of people living in the middle and upper classes is expected to grow from 3.5 billion in 2017 to 5.6 billion by 2030.

Of the total, 87% of the next billion middle-class entrants will be from Asia. In fact, 150 million people are entering the middle class in emerging Asia on a yearly basis and that progression continues to exceed the region's premium growth.

However, Peak Re predicts that insurance penetration will steadily rise as the region addresses its protection gap – namely in natural catastrophes where coverage will have to improve. When in 2012 Hurricane Sandy hit the U.S. coast, insurance payouts were close to 90% of the economic loss. When a few years later in 2017 Typhoon Hato made landfall in South China, near Hong Kong and Macao, insurance payouts were just 10% of the loss. Given this gap, natural catastrophe protection will increase substantially.

Capacity will also enter from the alternative capital markets with both Singapore and Hong Kong establishing the necessary capabilities to house insurance linked security structures. Both centres have seen the first arrival of dedicated ILS funds. We expect that capital that is seeking to diversify its risk, from China, Japan and South Korea, will enter the marketplace and will either invest in existing structures or fund new ones.

Endnotes

1 IMF, Tao Thang, Greater Bay Area Chief Economist Forum Speech on the Global and Asia Economic Outlook, July 10, 2020

"One of the key growth drivers is emerging Asia's natural catastrophe exposure. China and India face the highest frequency of natural catastrophe losses in the world. Located along the Ring of Fire of the North-Western Pacific Ocean, the region experiences about 90% of the world's earthquakes and one-third of all natural catastrophe events"

MAKING MARKETS FUTURE-PROOF

The current crisis is a wake-up call for policymakers to re-think their approach to systemic market risk, says **Bertrand Wollner**, CEO of SI Re

The COVID-19 pandemic has hit the global economy at a sensitive moment. The crisis will cause an unprecedented economic downturn, challenges the health systems and will cause major capital market uncertainty over the long term.

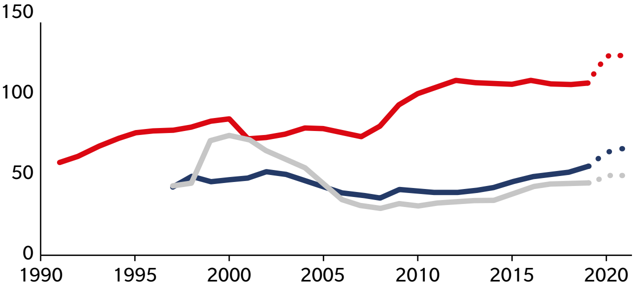
Within 10 years since the last upheaval, the global economy now faces its third cross-regional and even global crisis since the turn of the millennium, following the severe economic turmoil triggered by the terror attacks in September 2001 and the 2008 financial crisis.

However, the lasting impact of COVID-19 on growth distinguishes it from the previous crises. In January 2020, the IMF predicted global growth of 1.9% for 2020. It has since revised that prediction to a -4.9% downturn, which is set to impact the developed economies in particular.

The response of the central banks and politics to these events has consistently been to loosen financial and monetary policy for the benefit of the economy and society. The current pandemic is no different, as the markets have again been promised "whatever it takes" to cushion the shock of a sudden economic downturn.

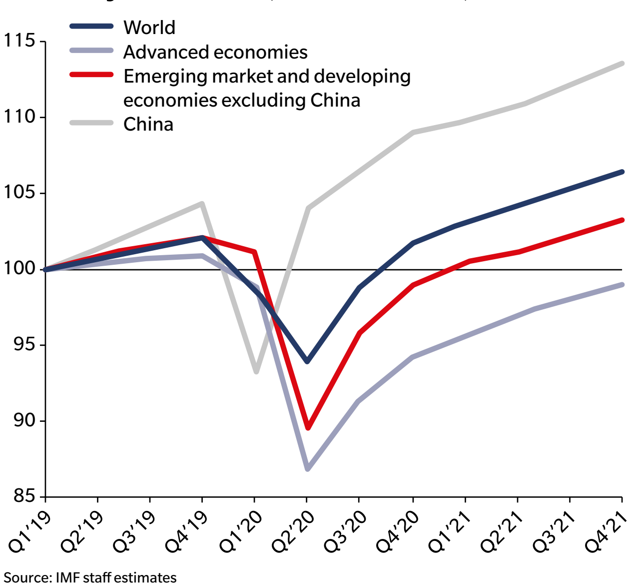
The U.S. alone has pledged around $2,800bn in financial aid. The EU will prepare a €750bn recovery fund for its member states and a seven-year budget of €1,074bn. At the same time, France and Germany will provide €500bn and €1,000bn respectively in subsidies, loans and tax relief to their own economies. The central bank measures offer additional support.

Moreover, there is widespread consensus that these measures are necessary to prevent an even more severe recession. Nonetheless, global developed market debt has increased from 70% of the Gross National Product (GNP) to over 105% in the past 10 years. The IMF believes the current measures for economic aid will



Source: IMF Data Mapper, red: advanced economies, grey: low-income developing economies, blue: emerging market and average-income economies

Quarterly world GDP (2019: Q1 = 100)



Source: IMF staff estimates

increase this figure to a steady 122% in the developed world by the end of 2020.

Short-lived remedies

Notwithstanding the scale of the support, we are not convinced as to its effectiveness. The political position seems to be that the cost of national debt is negligible. That is diametrically opposed to the economic viewpoint. As demonstrated by the U.S. economists Carmen Reinhart and Kenneth Rogoff in their famous 2010 paper Growth in a Time of Debt, debt incurred to stimulate flagging income and production weighs on future demand. This structurally weakens growth, as the measures don't quite provide the increase in income necessary to service the debt and promote investment.

It would make more sense to apply the funds where they would bring more than a short-lived feel-good factor since the growing debt detracts from the relative benefit derived from always resorting to the same measures, which simply make the global economy more vulnerable in the event of future crises.

After the lockdown, the developed economies could find themselves in a deflationary phase, possibly of Japanese proportions. The massive excess capacity in some economic sectors such as aviation, tourism or entertainment needs to be balanced out. The corporate

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world will adapt its marketing to the new reality, thereby expanding their online presence and investing more in process digitalisation and cyber security. Unsettled by the high drop in corporate revenues, growing insolvencies and rising unemployment, which may well average out at just under 10% in the eurozone, private households will consume less, but save more. However, if the political response to the crisis is to increase borrowing, this will simply dampen future growth.

SI Re expects an initial short-term recovery in the eurozone in 2020 and the start of 2021. Following that, we envisage a stagnation or possibly a slight economic downturn. We thus share the view of the World Bank that the economy will not, as previously predicted, return to pre-crisis levels by the end of 2021.

Solvency ratios dip

The consequences of COVID-19 for the insurance markets remain quantifiable for now. Ideally, a well-diversified insurance sector displays a low correlation to the various asset classes. That is one important factor underpinning the security provided by insurance policies.

The turbulence that impacted the insurance sector in the first quarter of 2020, thus initially manifested itself in the investment side of the business. From the end of January, equity funds broadly collapsed by about 30%. On the bond front, the corrections mainly affected specific COVID-19-sensitive loans. Hidden reserves, accumulated during the previous year, were erased and transformed into unrealised losses. Depreciation in value totalled 30% of investments.

As a result, the solvency ratios of insurers in Switzerland dropped by 30 percentage points on average. In the meantime, the capital markets recovered as news of the seemingly limitless bail-outs emerged in the second quarter. As such, solvency ratios are just below pre-crisis levels.

The insurance industry was able to withstand the turmoil during the first half of 2020 due to its good capitalisation, as the solvency test includes pandemic scenarios in its solvency quotient calculation on an annual basis. Fortunately, the pandemic scenarios accurately reflected the consequences of COVID-19.

The rating agency Fitch forecasts a rise in the reinsurance industry's combined ratio from 101.1% to 103.5% for 2020. Non-life reinsurers are therefore likely to post an underwriting loss for the fourth consecutive year. Willis Re concurs with a forecast of pre-tax losses in the region of $30bn for the global reinsurance capital base. While equity capital in the reinsurance sector will thus fall by around 5%, the return on equity will fall from 9.6% in 2019 to a mere 0.6% for 2020.

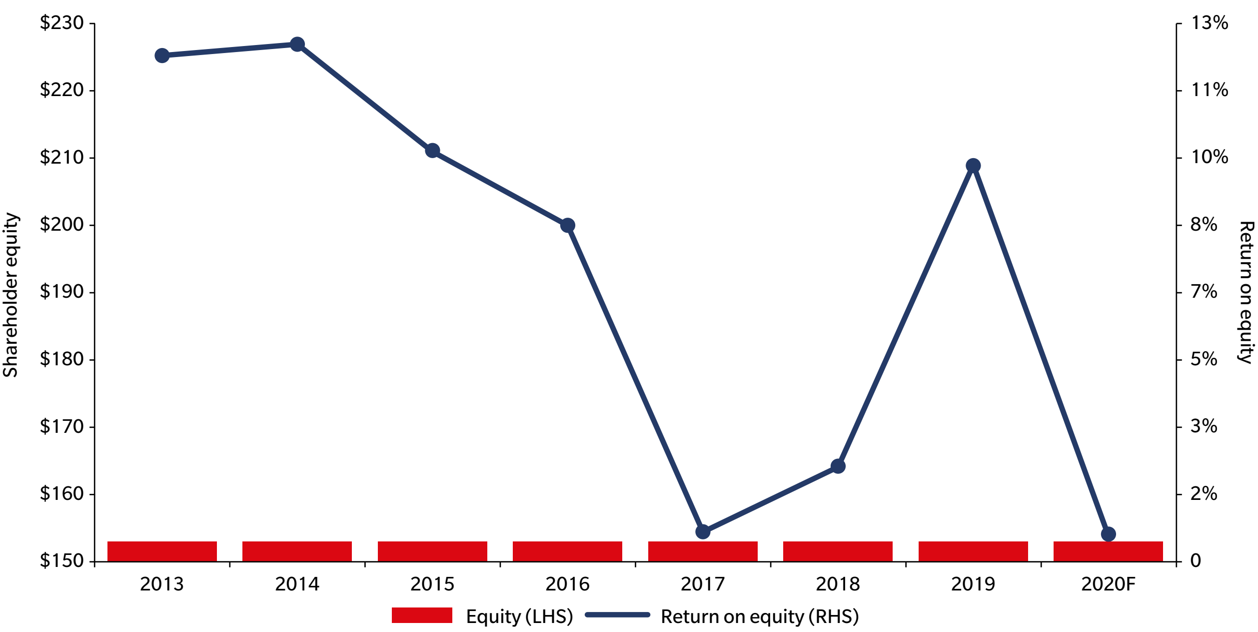
COVID-19 claims impact

There is considerable uncertainty over the volume of claims resulting from the pandemic. Insurers and reinsurers have reported $20.5bn in claims to date. In its top-down approach based on industry exposure, Willis Re sees losses amounting to $30bn–$80bn, depending on the claims scenario.

From an insurance perspective, insured losses are comparable to those of natural catastrophes, i.e. $67bn a year on average over 10 years (2009–2019).

In Europe, the main claims burden in the non-life business stems from policies covering the cancellation of cultural and sporting events.

Coronavirus will limit return on equity in 2020



Note: Data represents peer group of reinsurers monitored by Fitch, excludes Berkshire Hathaway
Source: Fitch Ratings

There were also business interruption claims under fire insurance policies, as some insurers provide epidemic cover for business closures due to infection. The distinction between epidemic and pandemic was not clearly defined in the majority of the cases, and the industry is paying for that lack of clarity now: contract wordings need to be adapted to make that distinction.

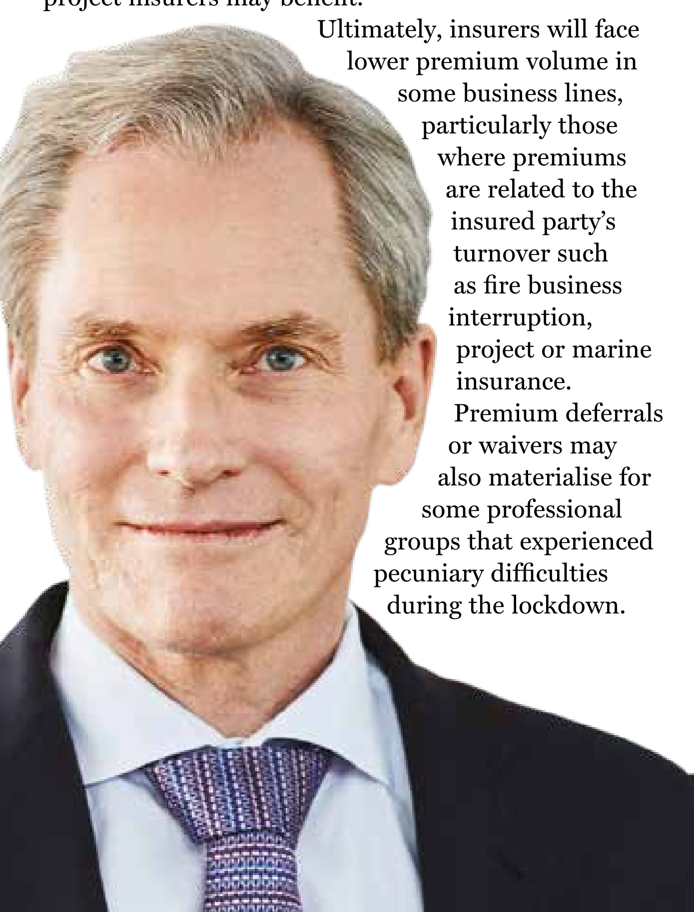
Furthermore, travel and legal protection insurance, export and credit insurance as well as public liability are all affected, both in Europe and worldwide.

There are also signs, alike during the financial crisis, that COVID-19 will lead to defaults in mortgage-indemnity business (insurance against the risk of non-payment of mortgage loans). In the U.S. especially, mortgage-indemnity providers have been posting rising losses as growing unemployment due to the lockdown means more private households have been unable to keep up with their loan payment obligations. Consequential claims will be likely to occur, since insurers cede most of their risk to the alternative capital market or reinsurers through excess-of-loss policies.

On the other hand, some claims burdens were reduced due to the lockdown as a result of business and social activities being restricted to an unprecedented extent. As a result, motor insurers and, in some cases, project insurers may benefit.

"The insurance market does not have sufficient capacity in itself to bear the risk of an accumulation of insured events, capital market collapse and recession caused by a pandemic"

Ultimately, insurers will face lower premium volume in some business lines, particularly those where premiums are related to the insured party's turnover such as fire business interruption, project or marine insurance. Premium deferrals or waivers may also materialise for some professional groups that experienced pecuniary difficulties during the lockdown.



More resilient economy needed

The COVID-19 pandemic confirms that, following the preceding two crises – the terror attack of 9/11 and the financial crisis – the global economic system can provide enormous sums to cushion the effect of a sudden economic downturn.

However, these funds are unlikely to trigger the dynamics required to ward off deflation. This may result in government debt becoming unmanageable, thus limiting the scope to counter future crises effectively. A rethinking of macroeconomics is absolutely necessary.

During the crisis, insurers showed that their investment strategies account for the requirements of their insurance obligations. Insurers who pursue a very cautious investment strategy, as SI Re does, emerged practically unscathed from the volatility of recent months.

The general economy needs to become more resilient and robust to be prepared for future crises. The corporate sector won't always be able to rely on their federal governments for intervention to the extent seen during the COVID-19 crisis. Businesses need to put more effort into making their own provisions. However, the state can contribute through tax incentives so companies can use profits to accumulate reserves.

The re/insurance industry in particular, with its long-term balance sheet liabilities, should be enabled to form extra volatility reserves for investments before taxes. It would then be better equipped to withstand extreme market fluctuations. Hand on heart, there is no real substance behind the current stock market highs and they will have to be corrected to a realistic level in the not too distant future.

Public-private partnership

In view of the extent and systemic nature of pandemic risk, additional measures are necessary to provide the required cover. The insurance market does not have sufficient capacity in itself to bear the risk of an accumulation of insured events, capital market collapse and recession caused by a pandemic.

A public-private partnership, however, could improve insurability and mitigate the risk. One solution could be to form risk pools as already exist for the coverage of terrorism or natural catastrophe risks. Insurers join together for those events and cover risk up to a certain level. When losses exceed a predefined threshold, the respective federal government contributes or assumes liability. That is how, for example, Extremus Insurance in Germany or Pool Re in the UK are organised, both of which cover terrorism risks.

REDEFINING HUMAN RESOURCES

It's time to reassess talent spotting and the way we work, according to **Nick Cook**, CEO, BMS Group

The insurance industry has adapted, shifted working patterns and restructured operating models in the face of COVID-19; in a few short months it has become a very different industry to work in. That difference gives us an opportunity to think creatively about how we recruit.

As one of the few countercyclical sectors in the economy, we have an opportunity and a responsibility to help sustain the recovery – and we can do that as we grow, by providing stable, well-paid jobs in culturally progressive companies. In a macro environment where new jobs are hard to come by, we have the chance to attract a diversity of talent that will build a sustainable future for insurance and the economy.

The insurance industry has, more than once, proven disaster resilient. A decade ago, carriers and brokers bore the consequences of a significant macroeconomic downturn and emerged in strong financial shape. We expect the same to be the case for most businesses in our industry in the aftermath of this crisis. Banks and regulators are set to require increases in insurance coverage in the coming months and years and opportunities are opening for flexible insurers and brokers to expand their product offerings. Insurance distribution in particular will benefit from a careful analysis of premium spend in both the SME and large corporate sector.

As the outlook for our industry improves, we should consider how to attract the right talent to drive sustainability. Bringing in the very best of the next generation is a challenge for all of us. I do not, however, share some of my colleagues' gloom about the attractiveness of our industry. To succeed in promoting our industry to fresh talent, we need to demonstrate a culture that is welcoming, open and full of opportunity. Now that we've learned how well we can operate even while locked out of our offices, we can add flexible to a list of attributes that will open our industry not only to young talent, but to people with broader experience and knowledge to offer.

Breaking talent into two groups, those at the start of their careers and those already with some experience, we have much to offer and much to gain.

Graduate appeal

For those at the start of a career, we traditionally focus on attracting graduates who can demonstrate academic achievement and a rounded education, and that will always be valid. Graduates applying to join a business want to sense the difference in culture, where everyone works together towards the common good. They want to feel our youth and vitality, and see that everyone has a voice and an opportunity. They want a collegiate team environment and it has to infuse everything we do. It engenders production, profitability, and growth.

But we should focus on attracting a broader talent base than university graduates. While it's a reflection of our resilience that more graduates have, since the financial crisis, expanded their career search to include insurance, now is the time to diversify and expand our intake.

We are still not doing enough to attract non-graduates, despite the significant growth of apprenticeships in the past decade, particularly in the London market. Some countries, notably Germany, have built a sustainable further education (FE) sector oriented towards providing a viable alternative to higher education.

In London, however, apprenticeships have not yet reached the critical mass needed to be perceived as an equally valid way to begin your career. Many school leavers are choosing, for a variety of reasons, not to go to university and apprenticeships offer the opportunity to mould the next generation of workers early. A broker or carrier can train new employees in the skills that present real, tangible value to the business and its customers and we'd be losing potentially valuable new recruits if we did not expand our apprenticeship programmes.

New directions

Turning to the recruitment of those already working but seeking a different direction, there are a number of practical reasons we should look not just for insurance experience. Fundamental recent changes in how the insurance industry operates, with much more analytical and actuarial expertise included in-house, means the type of talent we need to attract has broadened.

Remuneration models have improved significantly in recent years as involvement, usually through investment, from the private equity and pension sector has brought best practices from outside insurance. More flexible, more generous remuneration structures have been introduced that can now compete with other parts of the City of London and financial services globally.

Among the vast numbers of the workforce on furlough or newly unemployed, there are many who would enrich the insurance world. Everyone's perspective is unique, everyone brings to the table work and life experiences that can prove valuable. Valuable perspectives can also be gained from experienced, skilled workers from other industries. Recruitment from outside insurance, enabled by the increasingly generous pay schemes implemented in recent years, has become a viable and necessary source of fresh talent.

Carriers, for example, have for decades hired engineers to underwriting roles, and M&A and tax brokers often have a legal background. As compliance and risk functions have grown in importance across the industry, we can augment our business with new skills by bringing in individuals with experience in the accountancy or consultancy sector. Company secretariats have done so with great success. Strategy, information and operations functions can all benefit from the additional knowledge.

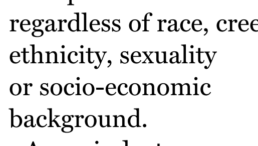
Flexible, diverse working models

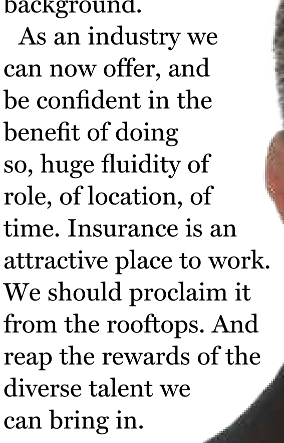
The new operating models we have developed provide city-based firms new and potentially broad talent pools. Flexible working patterns and remote access mean there is no longer any need for employees to be chained to their desks. We can provide a better environment for people in need of childcare arrangements and we can cut time spent commuting. Teams can avoid the rush hour or work from home more often.

We therefore now have the chance to access talent and expertise that might have been unavailable previously - and those of us in EC3 are no longer limited to London and its environs when recruiting. An employee can be equally productive from Devon while juggling childcare demands as someone in an office in the City.

Whether we're looking at first jobbers, or at attracting experience, our sector has not, historically, been sufficiently diverse. We have a responsibility to engage positively and fully with inclusion initiatives as part and parcel of our efforts to build a diverse, open and entrepreneurial workforce, regardless of race, creed, ethnicity, sexuality or socio-economic background.

As an industry we can now offer, and be confident in the benefit of doing so, huge fluidity of role, of location, of time. Insurance is an attractive place to work. We should proclaim it from the rooftops. And reap the rewards of the diverse talent we can bring in.





A MARKET SOLUTION FOR NOVEL RISK

The search is on for a sustainable pandemic risk transfer solution – but it won't be easy, says Third Point Re CEO **Dan Malloy**

The reinsurance industry has always responded with innovation after a big shock event, which has often led to a significant change to the status quo.

ACE and XL Group were born out of the mid-1980s liability crisis and helped jumpstart the alternative Bermuda market; in 1992 Hurricane Andrew sparked a new breed of offshore reinsurers on the island which looked to take advantage of the country's enlightened regulatory regime, speed to market, and friendly tax regime. After 9/11, there was the [start-up reinsurer] class of 2001, followed by the class of 2005, which came in the wake of Hurricanes Katrina, Rita and Wilma.

The dislocation caused by COVID-19 would usually spark the kind of innovation and change that gives birth to a new chapter in the story of the industry. However, unlike a hurricane whose life is measured in hours or days, we are eight months into COVID-19 and the world is still experiencing the chaos and uncertainty generated by the pandemic. Right now, there are more questions than answers – and more problems than solutions.

The underlying reason is that the aggregation facing insurers is unprecedented. Take, for example, a single line of business such as property business interruption (BI) cover, and the impact that a global pandemic can have. The sheer volume of COVID-19 BI losses is huge in both quantum and in the number of losses. In the U.S., the Insurance Information Institute estimates that due to COVID-19, between $1trn and $1.5trn of revenue is being lost every month. Take that number and multiply it by every other country affected (which in this instance, is every country in the world) and you start to get a sense of the problem. The global insurance and reinsurance markets do not have the capacity to cover these sorts of exposures from a single event.

Of course, any impact on our businesses and the market is secondary to the very real impact the virus has had on so many human lives. But today we are talking about how the lessons learned from COVID-19 could lead to some positive change in the reinsurance industry.

Pandemics versus nat cat losses

Coronavirus will make it onto the top 10 list of largest economic losses in history. In reinsurance terms, we often look at events such as Hurricane Katrina or Hurricane Andrew – which resulted in $250bn and $26.5bn of economic losses respectively – as benchmarks for industry-changing events. However, recent pandemics have also generated significant economic losses that often do not show on the reinsurance market's radar. For example, SARS and the H1N1 flu pandemics caused an estimated $56bn and $80bn in economic losses respectively.

The reinsurance industry is used to dealing with a shock event such as a hurricane or an earthquake. With today's technology, loss estimates and claims management begin almost immediately. In the case of the coronavirus, however, we still can't calculate the costs associated with the pandemic and we will be dealing with the fallout for months, if not years.

The world has endured other major infectious disease outbreaks that have killed hundreds and thousands of people without shutting down the economy – for example, the Asian Flu in 1957 and 1958 and the Hong Kong Flu pandemic between 1968 and1970. However, in this case, we are witnessing the shutdown of society and the economy, which makes this an unprecedented test for the industry. The government-mandated business closures and global lockdowns have been the real Black Swan event, not the coronavirus itself.

Clamour for cover

Prior to COVID-19, standalone pandemic insurance was available, but there were few buyers willing to pay the price for coverage – and businesses were left exposed if they did not wish to pay the premium. Now, many buyers who have been left unprotected and are losing money hand over fist are seeking cover for future events.

The industry is faced with an enormous challenge. Insurance that works is insurance that addresses a pressing need. How do we write future pandemic cover that fulfils the buyers' needs and our own underwriting criteria?

This is where it gets complicated. As everyone knows, pandemics have no respect for borders, therefore commercial carriers are writing for one single global aggregate irrespective of territory. This means that any loss from covering COVID-19 or the next global pandemic is additive. How do we intelligently or creatively provide coverage that we know will aggregate with further losses?

There is also evidence that some underwriters are woefully out of their depth when considering and writing pandemic risk. The market's stance on providing insurance for COVID-19 right now is to avoid it where possible This was evidenced in many of the contracts in the June and July renewals, which had all sorts of exclusionary language.

However, exclusionary wordings may not always be as tight as many think. In many cases underwriters are relying on a pandemic exclusion to protect them from exposure, but this only works as long as COVID-19 is a declared pandemic. At some point, COVID-19 will be downgraded to an epidemic or even to a straightforward communicable disease.

At this stage, underwriters who were relying on a pandemic exclusion may find themselves covering active COVID-19. As it took the World Health Organization (WHO) nearly three months to declare the pandemic in the first instance, it seems highly likely that, in the event of a second, third or fourth wave, there would be a similar delay – during which period many treaties would be providing coverage.

The situation is further complicated with the application of judicial review clauses in some contracts which can serve to invalidate any exclusionary language and where, again, it seems there is a lack of awareness of how these clauses could lead to underwriters writing active COVID-19.

At the moment, underwriters are struggling to grasp the true nature of pandemic exposure and the vast majority of brokers (with a few notable exceptions) are relying on others to find a solution. Most underwriters have been told by executive order to exclude communicable disease altogether. That is stifling innovation. But nobody wants to put their head above the parapet – yet.

We are the solution

I continue to hear market participants talk about the reinsurance market in the third person – "the reinsurance market needs to ..." It's as if they were trying to deliberately detach themselves from the problems we need to address.

A "Pandemic Re" is not the solution. The risk is too complex and too global for individual government-backed initiatives. Let's remember that the need for cover is not because of the effect of the pandemic – at least not this time. The need for cover is due to the effect of the restrictions on people and businesses to go about their normal day-to-day activities. Governments have learned a great deal from COVID-19, including that many responded too late. In the future, it is highly likely that they will instead institute restrictions in advance of a declaration of a global pandemic, and by responding early and decisively, potentially prevent the pandemic from happening. In this situation, any backstop that only responded to a pandemic would be useless.

> "The reinsurance industry is used to dealing with a shock event such as a hurricane or an earthquake. With today's technology, loss estimates and claims management begin almost immediately. In the case of the coronavirus, however, we still can't calculate the costs associated with the pandemic and we will be dealing with the fallout for months, if not years"

Once governments and buyers realise that coverage needs to go beyond a pandemic response, then other more fundamental problems present themselves. In the U.S., 99% of businesses are classified as "small" i.e. employing less than 500 people. In 2017, there were approximately 32 million small businesses. If each of those businesses were offered coverage for BI arising out of a government-mandated lockdown due to communicable disease, and 50% of them took up this opportunity, then the industry and/or government would be faced with a portfolio of around 16 million insureds – all of whom in the event of a future lockdown are likely to present a claim at the same time. Even the largest companies out there would struggle with the volume of losses that would need to be assessed and handled in a very short time period.

The fact is, we are the market. We can create change, we can inspire and embrace innovation, design new structures, establish new companies, and seal new deals.

We are working on finding solutions, and so are others in the market. The problems are not insurmountable, and we are starting to see some of the innovators and thinkers in our industry come up with some preliminary outlines of potential solutions. Watch this space.

It was recently announced that Third Point Re is to merge with Sirius International Insurance Group and that following the closing Dan Malloy will remain a senior underwriting executive of SiriusPoint.

BRIGHT FUTURE FOR INDEPENDENT BROKERS

Broker consolidation will benefit resourceful independents, says Beach CEO **Jason Howard**

The working world will look different post COVID-19 and the insurance industry, as with every other industry, has to navigate its way through the changes. What lockdown proved was that our "modus operandi" has evolved. We do not need to be physically in the office to get placements completed. The industry has successfully demonstrated that it can work more flexibly.

However, we need to make sure there's a balance. One of the benefits of gathering people together in a central space is to encourage and facilitate entrepreneurial thinking, to discuss and devise new products and to share in a common culture. I don't believe we have yet been able to replicate this as well remotely. There is still a need to bring people together regularly to spark ideas, debate and learning. It is critical for the younger generation where so much of our job, particularly the ability and encouragement to think creatively, is learnt through osmosis; by sitting at the shoulder of experience. And if the ability to think creatively gives independent brokers an edge, we must nurture that ability.

For independents to compete with the world's largest brokers we must use our intellect, our agility and an entrepreneurial zeal. And by applying thought and energy to product design and programme structuring we will always be able to add value to our customers.

Dislocation benefits

Consolidation among the larger players is not always beneficial for the industry or for clients, but it does lead to market dislocation from which independent brokers like Beach can benefit. If the proposed Aon and Willis Towers Watson deal completes then between 80% and 90% of the brokered reinsurance market would be controlled by two entities. Clients, markets and talent want choice and a duopoly of distribution behemoths stifles choice, particularly when those two have dominant positions right along the transaction chain.

By far the largest proportion of Lloyd's business, and a very significant proportion of the company market, rely on brokers for distribution and these marketplaces want both choice and diversity of channel to reach their customers.

The independents, often specialists or with market leading expertise focused in a limited number of arenas, offer far less potential for conflict of interest and are trusted to provide advice based solely on achieving the best outcomes for their clients.

Equally, in the aftermath of a merger frenzy, there are a number of smart, talented individuals who find themselves working for an organisation very different from the one they joined and in an environment that no longer appeals. Huge organisations can offer excellent prospects and varied career paths, but they're not for everyone. Along with other independent brokers we have been hiring world class talent looking for a different work experience, where creativity, entrepreneurialism and independence are watchwords.

Data and analytics

But although consolidation and COVID-19 are currently dominating headlines, our industry needs to continue to focus on a number of areas that are shaping our future: the impact of technology, the implementation of analytics and the use of data.

Historically the London market has been slow to adopt electronic trading but the lockdown has changed that. It has forced people to trade electronically and we've seen that it can work and that it can be beneficial. The number of risks being placed through PPL and other digital platforms has skyrocketed – which is revolutionary given that Lloyd's felt the need to mandate the use of electronic trading two years after it was introduced in 2016.

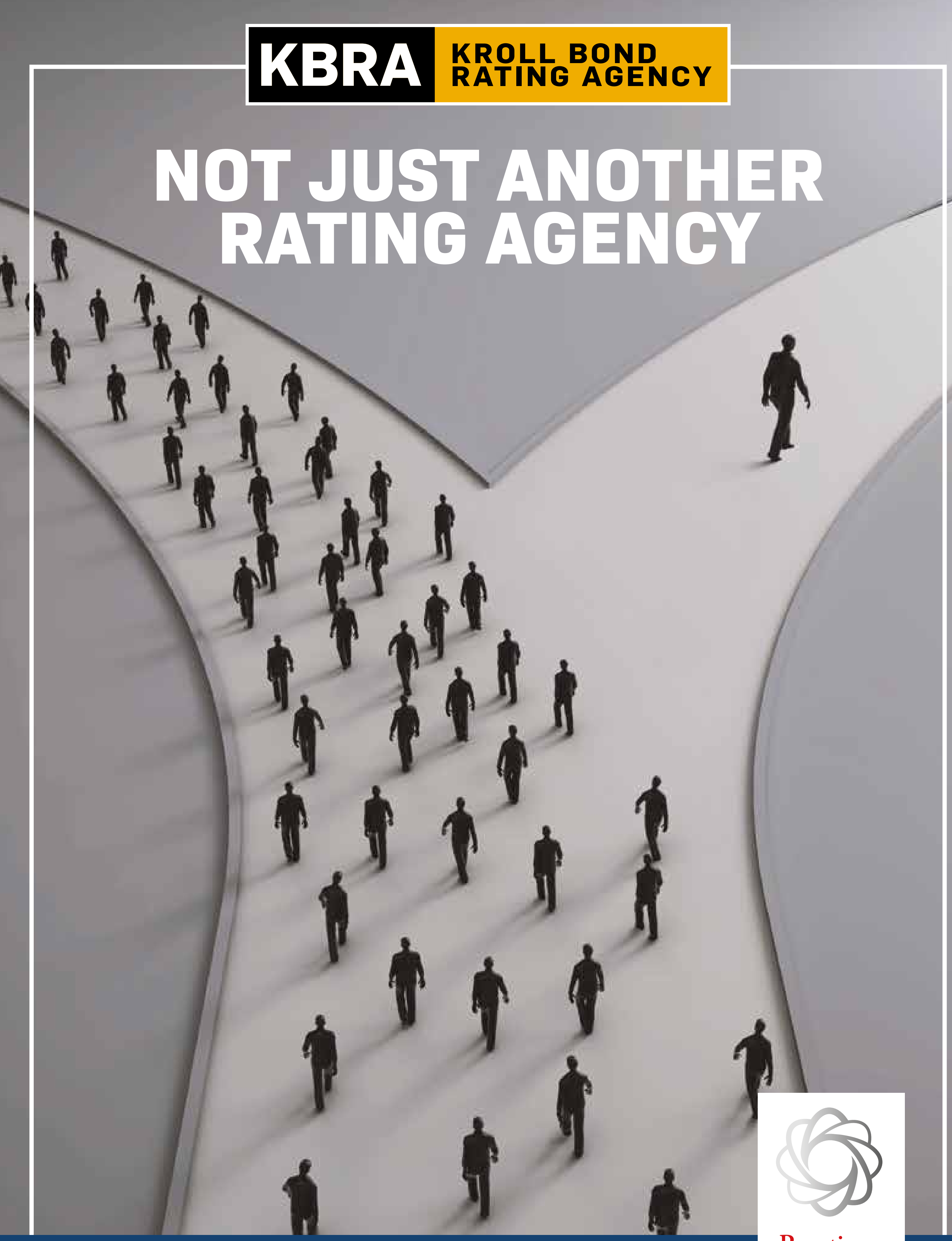
Digital advancement and electronic trading is the future and by adopting it wholeheartedly we will be able to increase efficiency and reduce cost to the benefit of our customers and our markets.

Reinsurance has been heavily analytical for some years and that requires specialist expertise and a certain scale. We were an early adopter of analytical and data focused talent and have built Beach's expertise in that area remorselessly since the 1990s. And other markets are moving in the same direction, so when we launched our wholesale division in 2018, we put analytics at its heart.

Embrace the future

We are living and working in fascinating times and the way our industry behaves over the next six months will have a lasting impact on its reputation, its relevance and its future. But this gives us as an industry a great opportunity to demonstrate our value.

Longer term, the industry is moving towards highly bespoke, analytically sophisticated, capital efficient products and solutions for clients. Those who have invested in world class talent and analytics, who embrace the efficiencies that technology can bring, and who truly put clients first will not just survive, but thrive in this environment.



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Your non-core business is our core business

By Alex Roth, Group Chief Strategy Officer, DARAG Group.

The legacy sector has matured. No longer an undertaker of unprofitable portfolios, we have developed a comprehensive toolkit to become a true partner to and indispensable part of the insurance market. We see ourselves as a service provider: simplifying your operations, enabling your strategy and freeing up capital for your core business. Whether it's operational efficiency, capital relief or portfolio management solutions that your business needs, DARAG as a legacy-as-a-service operator will have a range of solutions on offer. Decades invested in developing and designing a regulatory and legal framework for legacy transactions has borne fruit and we are able to design effective packages in most territories and jurisdictions.

A legacy deal could be good for your business

Operational efficiency has become one of the leading drivers of legacy deals, notably in continental Europe. Insurers are streamlining where particular portfolios cause inefficiencies in either the use of human resources, management time or lumber an insurer with legacy data and IT systems. What an insurer sees as their core business varies from company to company and can of course change – the insurance marketplace depends on the value of that differentiation. A carrier will invest significant capital and time to generate value in their core lines. When a portfolio is either no longer seen as core or was never core in the first place, but perhaps previously seen as a necessary part of the offering, management and core function time as well as other valuable resources are spent inefficiently.

These portfolios are typically discontinued, often originate in the distant past and come with sometimes non-negligible risk. They are sometimes highly complex and occupy valuable financial and human capital. The guiding principle of DARAG is to continuously develop new legacy solutions, tailor-made to the needs of our clients and to enable them to reduce their organizational complexity, drive their core business forward and to support them in achieving their strategic goals while maintaining the original insurers promise to clients and therefore their reputation.

The sheer cost in maintaining legacy IT systems, for example, can be a significant drain on a carrier's resources. Market studies estimate that, on average, around 70% of a company's total IT budget is spent on storing data in outdated databases or inefficient IT platforms. DARAG have the experience and tools to transfer these portfolios into modern IT structures, at once simplifying the vendor's business and improving the efficacy of claims handling. Reducing the complexity of discontinued portfolios benefits the carrier and the policyholders and is therefore a key advantage of a legacy deal for all stakeholders.

> "The guiding principle of DARAG is to continuously develop new legacy solutions, tailor-made to the needs of our clients and to enable them to reduce their organizational complexity, drive their core business forward and to support them in achieving their strategic goals while maintaining the original insurers promise to clients and therefore their reputation"

In the low interest rate environment, insurers are also under pressure to seek adequate returns on their capital deployed. Historically low central bank rates have hardly budged in a decade, with the ECB baseline hovering around zero since 2011. Capital restraints, including the regulatory capital burdens under Solvency II or equivalent regulation, are putting the historic business model of insurance under pressure in several territories.

Focusing on lines where the insurer has developed a specialism or is expecting to outperform is part of effective portfolio management. Therefore, unlocking capital trapped to cover liabilities for non-core or no longer live portfolios can lead to increased profits and an improved overall performance of the business. The capital relief solutions offered by DARAG are therefore an important tool for management looking to drive bottom-line growth by optimising capital allocation and improving capital efficiency.

Which legacy solution is right for you?

DARAG offers finality solutions for non-life portfolios. Compared to life insurance, claims can be handled effectively as a consolidated operation, without the need for the frequent ongoing face-to-face interaction that is expected in the case of expiring life coverage.

The solutions we can offer vary and each have their respective advantages and disadvantages. A **portfolio transfer** involves DARAG taking over all policies as well as outstanding and expected claims. DARAG as a legacy-as-a-service operator receives all technical insurance provisions, including incurred-but-not-reported (IBNR) reserves and any assets set aside to cover those liabilities and takes over all the expense of administering the business. A legal framework exists to facilitate this type of transaction, which guarantees legal and economic finality but requires approval by the appropriate regulator. A typical portfolio transfer can take as little as one or two months until a transaction is signed.

A **company sale**, in turn, takes place when an entire legal entity is bought by DARAG, with all the liabilities, reserves and assets automatically transferred to DARAG. The complete legal and economic finality provided to the seller makes this route attractive, but it is subject to change of control regulatory approval which might take additional time. Usually, we would expect a deal of this type to be signed in three to four months.

Reinsurance, whether via a loss portfolio transfer (LPT) or adverse development cover (ADC), is a familiar tool for many in the market and historically frequently used by North American and Bermudian carriers, including licensed excess and surplus insurers. A LPT is, in effect, a reinsurance transaction which approximates a portfolio transfer through a reinsurance purchase in which reserves are retrospectively reinsured in full.

In an ADC, all risks in excess of the booked reserves are covered by the reinsurance contract. The reinsured is therefore safe in the knowledge that loss deterioration would be neutralised. Reinsurance transactions have fewer regulatory requirements but grant only economic finality and the original insurer retains a (negligible, but nonetheless non-zero) default risk of the reinsurer. DARAG does offer operational finality with its reinsurance solutions by taking over the claims and administrative handling of the portfolio. For both an LPT and an ADC, we would expect one to two months to complete as no regulatory approval is required in most jurisdictions.

Structured solutions, which have recently increased in popularity as DARAG tackle ever more complex vendor needs, need to be individually assessed in terms of potential regulatory requirements and how they provide finality. These usually involve a combination of the above offerings.

What to consider when conducting a legacy deal

To efficiently conduct a legacy transaction, potential challenges can be assessed and addressed in advance. On the vendor side, the process of moving towards a legacy deal usually involves identifying non-core portfolios by appropriately first calculating their profitability, then appraising how many management and integration resources are bound up in the book potentially up for sale. In recent years, improved analytical tools have also enabled insurers to pinpoint unprofitable portfolios subsidised by more lucrative business. These often haven't received executive attention for many years. A carrier will also calculate the capital cost of migrating business in its strategic assessment of resource allocation.

If, at the end of this review, the portfolio is allocated for sale, the ball passes to DARAG. Our due diligence will assess the reserves, costs involved in completing the transaction, whether it will fit the risk appetite and whether there might be some diversification capital bonus.

We maintain an exceptionally close collaboration with the vendor at this point. We call this "eye-level collaboration" to emphasise how due diligence is conducted as a conscious, joint effort by DARAG and the original risk carrier. The deal should benefit both and it is in both parties' respective interest to be transparent and effective at the due diligence stage. DARAG have outstanding actuarial, claims and transaction management teams that will be able to conduct this process quickly, efficiently and thoroughly – indeed, we decline a substantial number of business at this point.

> "A legacy deal is a symbiotic transaction, both parties rely on the other to simplify their operating model. The recent growth of the legacy market is testament to the quality of the solutions developed – we are an expert market that works to support your businesses"

The reputation of the vendor is reliant on DARAG maintaining the promise to the insureds; therefore, DARAG must take great care to only take over portfolios they believe can produce an adequate return and maintain DARAG's sustainability. The legacy market has built an outstanding reputation and that reputation cannot be put at risk by acquiring unviable business. At DARAG, the thoroughness of our due diligence has been recognised by our regulators, and that in turn means that we have built a 100% approval rate for our transactions.

At its core, legacy is a tool for risk carriers to streamline and optimise their resource allocation. Whether operational or capital efficiency is what you seek, DARAG will be able to provide, at the appropriate price and to mutual benefit. A legacy deal is a symbiotic transaction, both parties rely on the other to simplify their operating model. The recent growth of the legacy market is testament to the quality of the solutions developed – we are an expert market that works to support your businesses.

Reactions Legal Survey 2020

What's the No. 1 concern among legal experts this year?

When the first headlines appeared about a new coronavirus emerging in China, few would have expected it to have the impact it has had on the world. But fast forward just a few months and COVID-19 has changed the world forever – and the re/insurance market is no different.

That is why it comes as no surprise that the *Reactions* 2020 Legal Survey has pandemic-related risks right at the top of the legal issues facing re/insurers.

In fact, the top issue globally with our survey respondents is the uncertainty surrounding business interruption claims arising from COVID-19 and the various restrictions and lockdown measures put in place by governments across the world.

In the UK, the Financial Conduct Authority (FCA) has taken a test case to the high court to determine whether or not insurers' policy wordings provide cover for pandemic risks, and the result of the hearing is expected to be announced by mid-September.

The regulator hopes that the results of the case will provide some much needed clarity around whether or not businesses are covered for losses arising from the pandemic, but one respondent to our survey said the truth is this is far from over.

Win or lose, insurers are expected to be facing additional litigation and legal challenges, and respondents to our survey said that the denial of claims and subsequent legal test case will only have the effect of diverting litigation rather than stopping it.

In the U.S. and Bermuda, meanwhile, legal action against insurers is taking a much less holistic approach, and this will lead to fragmentation in the market.

Different policy wordings across the various insurers and states have led to differing approaches as to how the litigation proceedings are started, as well as how the courts react to them.

In some states, courts have responded favourably to requests for class action suits to be dismissed, for example, whereas in others these requests have been denied.

Policy Scope

But while approaches to handling the business interruption crisis may vary, the problem facing insurers and regulators across the globe are very similar – and the respondents to our survey said the main issue is one of scope.

Business interruption policies and event cancellation cover were never intended to protect against pandemic risks, but in many cases they also did not explicitly exclude them.

In the U.S. and Bermuda market, many of the legal issues facing re/insurers regarding the scope of a policy relate to whether or not COVID-19

constitutes property damage. In the UK, the issue is more one of geographical limitations, and whether or not the fact that the very nature of a pandemic is that it occurs everywhere means that geographical restrictions make the policy not liable for paying out.

Workers' compensation claims in the U.S. are also facing legal questions regarding the extent of cover, and whether or not re/insurers should be liable for COVID-19-related illnesses under a workers' comp policy.

One respondent to *Reactions*' survey highlighted that a lot of legislation regarding workers' compensation presumptively concludes that should a worker contract COVID-19, then it must have occurred in the workplace – meaning that a workers' comp policy should pay out.

For first responders and healthcare workers, that is likely to be a fair assumption in most cases. But when considering professions for which diseases aren't typically a workplace risk, it is less clear. Therefore, questions remain as to whether COVID-19 should be classified as a work-related injury that falls under the remit of a standard workers' compensation policy.

At the individual level this is not likely to be a major issue for workers or their employers, but workers' compensation re/insurers could soon be facing millions of claims – as well as all the legal uncertainty that follows.

The effects of the coronavirus pandemic are much wider-reaching than the direct implications for claims, however – and the biggest of those effects, according to respondents to our survey, is the increased cyber risk arising from re/insurers being forced to work remotely as a result of the lockdown restrictions implemented across many regions of the world.

Not only does remote working increase the risk of data and confidential information being lost through misuse or carelessness, the risk of hacking and malicious damage or theft also increases. Home networks are much less secure than those usually used in an office environment and hackers are aware of this, making targeted attacks much more likely.

One respondent said re/insurers needed to up their game in response to this increased exposure, and must make sure they adhere to the same policies and processes regarding data safety as they would do in an office location.

Economic Pressures

The global economic landscape has created a low-yield environment that is most damaging to re/insurers covering long-tail risks, whether that be traditional providers who underwrite the risks, or those specialists who acquire legacy books to run off. This has forced those re/insurers handling such risks to take on increased levels of investment risk to improve their yields and supplement the profitability of their portfolios.

This means the underlying investments for some long-tail risks are a lot riskier than the economic assumptions used when underwriting the risks or acquiring them for runoff.

Legal Risks

Global	
1	COVID-19 business interruption claims
2	Unintended coverage
3	Cyber risks
4	Low investment yields
5	Under-insurance
6	Third-party capital
7	Workers' compensation
8	U.S. 2020 elections
9	Brexit
10	Lack of claims precedents on new products
UK/Europe	
1	COVID-19 business interruption claims
2	Unintended coverage
3	Cyber risks
4	Low investment yields
5	Brexit
US/Bermuda	
1	COVID-19 business interruption claims
2	Unintended coverage
3	Cyber risks
4	Workers' compensation
5	Low investment yields

This will increase pressure on those re/insurers underwriting long-tailed risks. One respondent to our survey said the ongoing persistence of low interest rates will only be exacerbated by the continuation of existing fiscal policies both in Europe and the U.S.

This increased pressure, along with a surge in underinsurance in many sectors, means that re/insurers will be looking to design new policies and risk-transfer mechanisms, and this will create a set of new exposures.

Re/insurers run the risk of creating policy wordings that are either too broad or too narrow, potentially creating unintended coverage issues, and regulators will also be taking a closer look at third-party capital being brought in to support these new risk-transfer mechanisms.

Uncertainty Remains

Looking to the future, our survey shows that re/insurers are already highlighting a number of exposures looming on the horizon.

Brexit, while having been going on for years, is still not concluded – and the COVID-19 outbreak has only served to delay negotiations and preparations, increasing the likelihood of a messy divorce.

One survey respondent pointed to the uncertainty surrounding Solvency II and financial reporting as a major concern for re/insurers, while the wider economic impact on businesses and their supply chains is also likely to cause issues for risk carriers and their insureds.

In the U.S., meanwhile, re/insurers are already looking at policy wordings for their public unrest and civil authority policies in anticipation of further flashpoints surrounding this year's presidential elections as well as the ongoing fallout from the death of George Floyd and subsequent rise in popularity of the Black Lives Matter movement.

Matt Scott (freelancematt1987@gmail.com) is a freelance contributor to Reactions.

Suspicious minds – US regulators adopt principles for trustworthy AI

By Mary Jane Wilson-Bilik and John S. Pruitt, Partners at Eversheds Sutherland (US) LLP

On August 14, 2020, the National Association of Insurance Commissioners (NAIC) adopted a set of Artificial Intelligence (AI) principles that will guide the work of insurers and entities, including data providers, that play an active role in the lifecycle of AI systems used in insurance. The principles set out expectations that AI systems and AI actors be fair and ethical, proactively avoid proxy discrimination against protected classes, be accountable, compliant with the law, transparent and have secure, safe and robust outputs.

Work on the NAIC's AI principles began a little over a year ago at the NAIC Artificial Intelligence (EX) Working Group meeting during the 2019 Summer Meeting. At that meeting, the AI Working Group, chaired by Commissioner Godfread (ND), decided to use as its model the AI principles adopted by the Organization for Economic Cooperation and Development (OECD) in May 2019. The OECD's AI principles have now been adopted by 42 countries, including the United States. In adopting its AI principles, the NAIC joins the EU, other governments and big tech companies (IBM, Google, Microsoft, among others) in aiming to foster innovation and trust in AI by promoting the responsible stewardship of trustworthy AI and by proactively pursuing beneficial outcomes for consumers while avoiding the possible harms of AI, such as proxy discrimination against protected classes.

The NAIC document includes five general principles that insurers should strive to meet in developing and adopting AI: (i) fair and ethical, (ii) accountable, (iii) compliant, (iv) transparent and (v) secure, safe and robust. Each of these five principles is then further defined as part of the guidance document. During their discussions at AI Working Group meetings, regulators made clear that the scope of the principles is intended to include not only insurers, but also third parties such as rating

and advisory organizations and data providers. Consistent with the principle of accountability, regulators expect insurers to be responsible for any use of AI by their third-party service providers.

Regulators also noted that disclosures regarding the functionality and use of AI should be different for consumers and regulators, with regulators having access to much more information than what will be useful or desired by consumers. And disclosures should include revealing the kind of data being used, the purpose for using the data and the consequences for all stakeholders. Regulators made clear they believe consumers have a right to know what information is used and where that information is coming from. How such disclosures will interact with disclosures required by existing (or new) privacy and other laws and regulations was not addressed.

The "fair and ethical" principle was the focus of significant debate among regulators, consumer representatives and industry groups on whether responsible stewardship of AI requires AI actors to proactively avoid proxy discrimination against protected classes. The discussion focused on the meaning of the term "proxy discrimination" and the practicality of avoiding proxy discrimination against protected classes in a risk-based insurance system. But the NAIC leadership, including NAIC President Ray Farmer (SC), recognized the importance of addressing proxy discrimination in AI as a part of the NAIC's broader effort to address racial inequality in insurance. The concept of avoiding "proxy discrimination against protected classes" remained in the AI principles that were adopted unanimously by the full NAIC membership during the August 2020 National Meeting.

Recently, the National Institute of Standards and Technology (NIST) in the US Department of Commerce began a series of workshops involving both the public and privacy sectors to discuss the building blocks of trustworthy AI and the associated measurements, methods, standards and tools needed to implement those building blocks when developing, using and overseeing AI systems. On August 18, 2020, NIST held a workshop aimed at facilitating the development of a shared understanding of bias in AI, what it is, and how to measure it. The workshop focused on the bias inherent in the data sets used by AI, including where, how and when bias starts to play a role. It also focused on algorithmic bias – the measurement and management of bias beyond the data and how bias can affect the modeling and algorithmic decisions and outcomes. It also explored whether algorithms can be used to mitigate data bias and what role human oversight of AI systems can play in controlling bias. The insurance-specific AI applications" and, on that basis, are intended to serve as guiding principles for new regulations and enforcement of existing ones. They nonetheless reflect regulators' recognition that regulation should not stifle technological innovation, stating the principles should be "interpreted and applied in a manner that accommodates the nature and pace of change in the use of AI by the insurance industry [to] promote innovation, while protecting the consumer."

> "AI is rapidly changing our world and has the potential to impact nearly every aspect of our society. In insurance, AI is a powerful, dynamic tool that can be used to identify hidden correlations and relationships among factors in massive data sets"

NIST expects to continue holding workshops and writing reports on the building blocks of trustworthy AI, including bias in AI, which may prove to be valuable resources for AI actors in the insurance sector.

AI is rapidly changing our world and has the potential to impact nearly every aspect of our society. In insurance, AI is a powerful, dynamic tool that can be used to identify hidden correlations and relationships among factors in massive data sets. AI-based applications currently underwrite and price insurance policies, assist in processing claims and fraud avoidance and identify populations of consumers for targeted advertising, among other uses. AI is a strong growth area whose "deep learning" capabilities, without accountability and transparency, could, and, some allege has, lead to unfair outcomes. However, if a data set or an algorithm used in AI is biased, insurance regulators at the NAIC AI Working Group stressed that the algorithm must be avoided. AI actors will be expected to anticipate this possibility and not, in the words of one regulator, "cut the machine loose" and claim they were not aware of the risks of bias.

The NAIC AI principles are intended to be an aspirational document that acts as guidance and "do not carry the weight of law or impose any legal liability." They nonetheless constitute a statement of regulatory policy and "should be used to assist regulators and NAIC committees addressing

To deal with the power and potential of AI, the NAIC principles call on AI actors to implement mechanisms and safeguards to foresee potential adverse consequences and address these risks comprehensively. The NAIC principles recognize the need for improving public confidence in AI by providing stakeholders with a way to inquire about, review and seek recourse for AI-driven insurance decisions. The principles also call on AI actors to ensure a reasonable level of traceability of AI datasets, processes and decisions made during the lifecycle of an AI system. To that end, the principles provide that AI actors should enable transparent analyses of their AI systems, consistent with best practices and legal requirements. Finally, the principles provide that AI actors should apply a systemic and continuous risk management approach to each phase of the AI system's lifecycle, and focus on outputs in the areas of privacy, data security and unfair discrimination.

During the NAIC meetings, many regulators remarked that their duty is to ensure that the industry innovates responsibly by using AI systems that are well thought out with no unintended consequences. Insurance regulators and industry representatives recognize that adopting these AI principles is only the beginning. The far more difficult task will be putting these principles into practice and operationalizing them in law and/or regulation as necessary.

Rough seas

The COVID-19 pandemic takes its toll on a line of business that had already been seeing its share of choppy waters.

By Marc Jones, Associate Editor

When the COVID-19 pandemic took hold this year, many industries were hit with varying degrees of impact – and the marine industry was affected in myriad ways.

Cruise liners were quarantined, and those vessels eventually were all but mothballed; container ships have had to deal with a host of issues surrounding crews and other personnel. And marine insurers have had to deal with not only a slew of losses but also the challenges of working and settling claims remotely.

The pandemic hit ports right from the start of the crisis, according to Martin Cook, Divisional Director, Marine for Ed Broking. Cook pointed out that confidence in international trade has taken a blow, and Ed anticipates that the ramifications will be medium- to long-term. With many ports closing and/or refusing to allow cargoes to load or unload, Ed has seen an increase in requests for legal contract advice. In some cases, backlogs of 50 days or more of cargoes have accumulated and will take time to clear, and the contractual implications and negotiations will take much longer.

"Port closures, the lack of

demand for consumer goods and raw materials, and of course the collapse of the cruise industry have all had a marked impact on the flow of shipping," Cook tells *Reactions*. "With the stockpiling of goods and the crash in oil prices, we are effectively seeing tankers being used as floating storage units." This, he adds, will continue until the price of oil recovers sufficiently.

Ship owners, he continues, have responded to the downturn in use of tonnage by mostly laying up vessels. One option is a "cold" lay-up, in which most of the crew are taken off duty after unloading the cargo to cut costs with a reduced insurance premium. "This requires relatively prompt reaction by the owner to bring vessels back to running order once countries begin to ease lockdown restrictions, especially since cold lay-up can often require a reactivation survey," Cook explains.

The alternative "warm" option, whereby owners allow their ships to sit idle with a full crew on board, ready to begin trading as soon as the crisis ends, has obvious cost ramifications against an as-yet-undetermined end to the global pandemic.

No pleasure cruise

Cook pointed out that the cruise industry will face the greatest challenge to recover. The initial hopes of larger operators trading again by the summer of 2020 are fading fast, and many have confirmed their offerings are cancelled at least until next autumn. Even then, enforcing social distancing on cruise ships carrying 5,000 passengers and crew will be a challenge, and the confidence in the safety of cruise holidays is at an all-time low.

The news is somewhat more optimistic on the shipping side. "There are positive signs as countries around the world are beginning to ease lockdown restrictions," adds Cook. "As we continue to find new ways to live and work, demand for goods will rise and some sectors of international society will seek ways to re-establish connections with commerce and leisure."

William Moore, Global Loss Prevention Director at the American Club, points out that the maritime industry has always adapted to challenges – and maintains that COVID-19 is no exception. Moore explained that these challenges are wide in scope, including compliance with local, national and international requirements while remaining commercially viable. The NGOs representing their interests, including the International Group of P&I Clubs, have responded effectively and are working diligently on their behalf.

"To date, passenger ships have taken the brunt of the COVID-19 pandemic but in recent months we've seen a number of outbreaks on commercial ships," says Moore. "However, ship owners have done an exceptional job in controlling the number of outbreaks aboard ships worldwide by following proactive industry guidance as well as working well together with their P&I clubs in managing these cases."

Moore notes that the COVID-19 pandemic has created an underlying sense of anxiety for seafarers whose contracts have expired while on board and are looking to return home. Ship owners in general have reacted well to industry guidance from ICS, WHO and other government and non-government organsations' guidelines, best practices and guidelines particularly in the use of personal protective equipment (PPE), procedures to prevent and manage COVID-19 outbreaks and bunkering.

The American Club, for example, has offered life-saving advice to seafarers in protecting themselves and their fellow shipmates in the short video "Weathering the Storm," highlighting the importance of wearing PPE.

The mental aspect

"The industry has expressed its concerns regarding challenges in making crew changes around the globe and are working diligently with governments and industry NGOs to solve this problem," says Moore. "They have also pressed the issue of their concerns regarding increase of long-term fatigue on those seafarers who are due for relief but have been unable to leave their ship. To date, we have heard of seafarers still on-board ship for as long as 17

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months. This truly exacerbates the situation for seafarers and ship owners alike from an overall ship safety as well as individual physical and mental health perspective."

The last part is a valid concern: Moore said that to date, the industry has experienced nine confirmed suicides since the coronavirus struck.

Cook agrees that this is a very important issue. As the outbreak took hold, he explains, there was an immediate increase in the number of requests on individual P&I clubs for guidance relating to many issues, with crew issues and port closure procedures being most prevalent. The clubs, he adds, responded extremely well.

Crew rotation, he notes, has been an extremely pressing issue. Periods of employment aboard vessels vary, but a three- or six-month rotation can be common – and the COVID-19 impact has produced estimates of as many as 150,000 crew members being forced to overstay their rotation. Even in instances where the vessel owner has made arrangements for crew to be rotated, the restrictions put in place by national governments and ports have often frustrated these plans.

Concerns for mental health and crew well-being have been widespread, and is an area in which clubs have stepped forward to offer support. North Mind Call, an extension of the North P&I Club's Mymindmatters, is an example of a confidential helpline (backed by a club online resource) to assist with mental health support and advice.

The long-term view

There is also concern that the impact of COVID-19 will be felt in the long term among seafarers. Cook said that the effect of the pandemic on crew well-being may well be felt beyond the end of the crisis as sailors may be reluctant to return to rotation amid concerns of a possible second wave of the pandemic.

"It is well known and has been widely (and accurately) reported that the marine insurance market is already going through a recovery phase after nearly two decades of reducing premiums and increasing claims costs. We anticipate that COVID-19 will not ease these pressures, and will likely increase them"

Martin Cook, Divisional Director, Marine, Ed Broking

"Generally, we have seen increased collaboration between the clubs, with the shared goal of supporting the wider shipping industry," he adds. "While this move was already well underway, the pandemic accelerated the clubs' efforts."

A good example of P&I clubs working closely together to make a positive impact on the industry is the International Group of P&I Clubs' digital dashboard. Launched in April, the platform delivers up-to-date information on infection and death rates as well as whether a port is open and whether crews can be changed. This information has been vital in helping ship owners, charterers, operators and others in the maritime sector make the best decisions. This tool has, for example, been instrumental in assisting crew managers to work together to charter flights in and out of safe ports to change crew who may otherwise have been stuck.

Paul Jennings, Chairman of the International Group, said that increased collaboration between the P&I Clubs can achieve far more for the shipping industry in a shorter time, as opposed to Clubs focusing on a single individual Club advantage. The development and launch of the COVID-19 information dashboard tool were only made possible through the collaboration of all the P&I Clubs, including North, and their willingness to share their intellectual property and bespoke information. This has been quite a profound change for the Clubs, and Jennings expects we shall see more of this in the future as the industry starts to think beyond the current pandemic.

And then there is the impact of the crisis on the marine insurance market itself. Cook says the rapid rise in remote working throughout the insurance industry has been a major challenge, but one that the industry has tackled head-on.

"Although not perfect, the speed at which the industry has responded has been impressive," he says. "While certain roles might fit the 'new normal' way of working, many brokers, ship owners and underwriters will still find value in face-to-face meetings. They will undoubtedly wish to resume in-person meetings when they can, but it remains unclear as to what may ultimately be possible."

Marine COVID-19 related claims are not as prevalent as they are in, say, the Property, Event Cancellation or Aviation markets, Cook says, but the impact of one is likely to feed in to the other – "and so we can anticipate pressure on pricing, particularly from insurers who are multi-class."

"It is well known and has been widely (and accurately) reported that the marine insurance market is already going through a recovery phase after nearly two decades of reducing premiums and increasing claims costs. We anticipate that COVID-19 will not ease these pressures, and will likely increase them."

Staying strong

Hong Kong to remain competitive as an international marine insurance and financial hub.

Hong Kong has developed into one of the most important maritime hubs in Asia over the years due to its geographic advantage amidst China's robust economic growth. In recent years however, its prominent position has increasingly been challenged by other Asian cities.

In the 2020 Xinhua-Baltic International Shipping Centre Development (ISCD) Index, Hong Kong fell out of the top three international maritime centers for the first time, whilst Singapore and Shanghai took first and third places, respectively. A key question today amongst industry observers is if Hong Kong can remain competitive and retain its position as an international maritime hub.

Hong Kong's capital and insurance markets, which form the basis of the Special Administrative Region (SAR)'s financial position, have remained strong. The Hang Seng Composite Index rose 9% in 2019, and in the first half of 2020, Hong Kong hosted 54 IPOs with proceeds amounting to $11.18bn, up 23% compared to the same period in 2019.

Within the insurance sector, general insurance gross premiums grew by nearly 4% in 2019, followed by a further 10% annualized increase in the first quarter of 2020.

Building economic resilience through insurance

A thriving insurance industry is important to support businesses during times of crises. To allow the insurance and marine sectors weather the prolonged COVID-19 pandemic-induced economic recession, the Hong Kong SAR government recently unveiled a number of tax incentives.

On 15 July 2020, the Legislative Council passed a bill to reduce corporate tax rate by 50% for all general reinsurance business of direct insurers and certain insurance brokerages. This new tax concession is expected to be effective by the end of 2020 or early 2021, and aims to facilitate the development of the marine and specialty risk insurance businesses of Hong Kong.

This would foster the insurance industry's competitiveness in benefitting from major geographic industry trends, including those from the Belt and Road Initiative ("BRI") and the Greater Bay Area in Southern China.

BRIEF Broadens Its Talent Pool and Network

In the past decade, China's marine insurance market has expanded to become one of the world's largest markets for cargo and marine hull insurance.

The opportunities brought by BRI and the Greater Bay Area development initiatives have driven international insurers to set up offices in Hong Kong to expand their presence in the Greater Bay Area encompassing both Hong Kong and China.

During COVID-19, the Belt and Road Insurance Exchange Facilitation (BRIEF) launched by the Hong Kong Insurance Authority ("IA") continued to pull together key industry players to co-ordinate and partner together to capture business opportunities from BRI.

To date, 42 members have joined the platform with the International Union of Marine Insurance (IUMI) Asia Hub becoming a member this May. The knowledge and network brought by IUMI will facilitate the growth of local talents in the region.

BRIEF has also grown its capability to bring new collaboration opportunities for insurers across different cities in China. Currently, a large part of this sizeable premium growth is coming from the domestic seaborn trading segment, including inland water shipping. In May, IA signed a Memorandum of Understanding (MOU) with the Chengdu Municipal Financial Regulatory Bureau.

As the capital city of the Sichuan province, Chengdu is also a central hub for freight traffic between China and Europe. Through the MOU, foreign insurers can tap into the growing opportunities in inland waterway transport, logistics and infrastructure, and rail freight risk management. Furthermore, insurers can look to gain from BRI developments in China's largest inland port city Chongqing, another neighbouring provincial city that is also strategically located on the new Silk Road and the economic belt of the Yangtze River.

Capturing Growth Opportunities

To pursue growth opportunities, Markel earlier this year strengthened its marine specialty team in Hong Kong to offer a full range of marine coverage including hull and war, marine liability, cargo, energy, and terrorism risks.

Looking back to the 1970s, Hong Kong has successfully weathered numerous challenges to become the pre-eminent international finance hub it is today.

Despite the current economic uncertainties, Hong Kong's well-established financial and legal systems built over decades, as well as the diverse talent pool, give it a strong foundation to weather and recover from recent changes.

Buoyed by the rising tide of BRI and Greater Bay Area development, industry practitioners are confident that Hong Kong will again like before regain its footing and global competitiveness as an international maritime center.

Danielle Yu is Marine Underwriter, Hong Kong for Markel International Asia.

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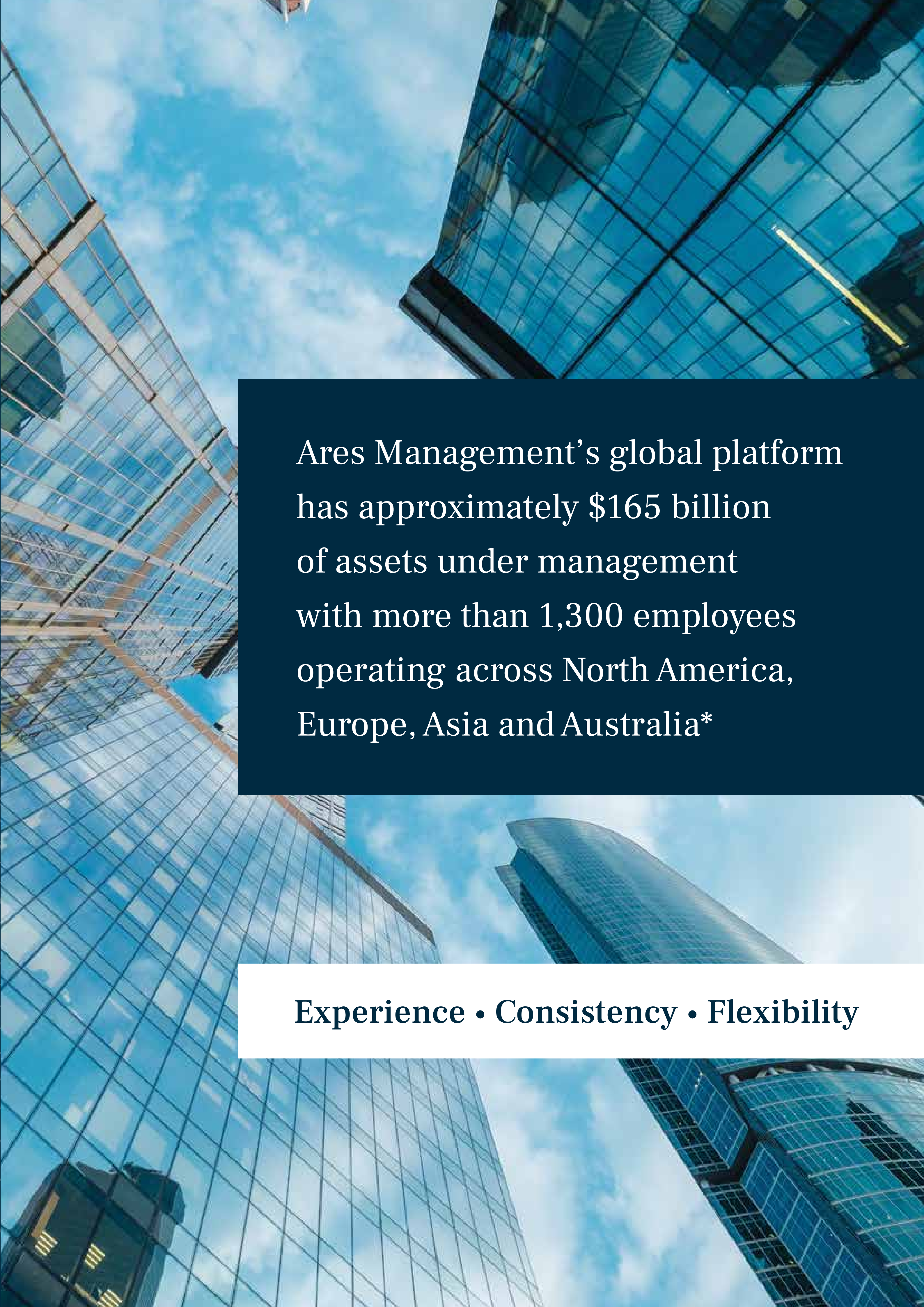
Ares Management's global platform has approximately $165 billion of assets under management with more than 1,300 employees operating across North America, Europe, Asia and Australia*
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Guy Carpenter has appointed **Peter Askew** President and CEO of its Canadian business.

He replaces **Donald Callahan**, who is stepping down from the role after 20 years. Callahan will remain with Guy Carpenter in Canada, and support Askew as he enters the role.

Askew was most recently Managing Director, Guy Carpenter & Company Ltd. in Canada. Prior to joining Guy Carpenter, he was Director of Canada, QBE Services Inc. (Canada).

Lloyd's has appointed **Pavlos Spyropoulos** Country Manager, Singapore and CEO of Lloyd's Asia.

Spyropoulos has worked in a number of senior roles at Lloyd's following his completion of the Lloyd's graduate scheme in 2008.

In 2014 he relocated to Singapore to assume responsibility for Lloyd's Asia's Market Development function and lead several strategic initiatives in Asia Pacific before becoming Head of Market Development for Lloyd's in Asia Pacific in 2019.

In his new role he will report to Iain Ferguson, Regional Director, APAC and President of Lloyd's Japan.

Canopius has named **Stephen Pike** Head of its Credit & Political Risk (CPR) team, part of the Credit, Political & Crisis (CPC) division.

Pike joined Canopius as an Underwriter in CPR in 2017 from ED&F Man Capital Markets.

He began his career at Merrill Lynch, focussing on M&A and then leveraged finance.

Pike reports to Bernie de Haldevang, who oversees CPR as the overall Head of CPC at Canopius.

Grant Maxwell has been appointed Global Head of Alternative Risk Transfer (ART) at Allianz Global Corporate & Specialty (AGCS).

Maxwell reports directly to AGCS Board Member and Chief Underwriting Officer Corporate Tony Buckle. He has led the global ART team on an interim basis since February.

ART Head of Underwriting & Portfolio Management since May 2019, Maxwell originally joined AGCS in March 2008 and was Regional Head of ART for AGCS' Regional Unit London and also Head of ART Deal Management since February 2010. Prior to his time with AGCS, he held senior underwriting roles at XL Capital, Gerling and St Paul Re. Prior to that he was an actuarial consultant at Tillinghast, a unit of Willis Towers Watson.

The Brit-launched, algorithm-driven, follow-only Lloyd's syndicate Ki has appointed **Dan Hearsum** Managing Director.

Hearsum will lead Ki's commercial strategy, deliver its underwriting plan and drive Ki's relationships with key trading partners. He will report to Mark Allan, CEO of Ki. He joins Ki from Marsh-JLT Specialty, having previously led the UK Specialty digital strategy.

Prior to Marsh, Hearsum was at Willis and started his career at C.E. Heath.

Aon has appointed **Andrew Tunnicliffe** UK Chairman, Global & Specialty, part of its Commercial Risk Solutions, Health Solutions and Affinity business.

Tunnicliffe previously served as UK CEO of Commercial Risk Solutions, Health Solutions and Affinity, before stepping down in May 2017 and has since taken some time out of the market. Prior to that, he was Chief Operating Officer for Commercial Risk Solutions, Health Solutions and Affinity in EMEA.

Guy Carpenter has appointed **Henry Lawrence** Managing Director, GC Fac UK.

Lawrence will be responsible for the U.S. region at GC Fac UK. This is a new position that forms part of a wider realignment process currently being implemented across the division. Based in London, Lawrence will report to Dominic Samengo-Turner, Guy Carpenter's Global Head of Facultative.

Lawrence has nearly 30 years of experience in the facultative market with a particular focus on North American property. He joins Guy Carpenter from Willis Towers Watson, where he was Managing Director and Global Head of Broking, Facultative, having spent his entire career to date at the company.

Atradius has appointed **James Burgess** Head of UK Commercial.

Burgess has been with Atradius since February 2014 and joins the UK & Ireland Commercial Management Team under the leadership of recently appointed Regional Director Stuart Ramsden.

In his new role Burgess will assume overall responsibility for account teams and sales for both corporate and SME segments, while Richard Reynolds, who also joins the UK management team, will continue to

lead the strategic account segment. Based at Atradius' City of London office, Burgess previously led the London & South East Commercial team.

AIG-owned Talbot Underwriting has appointed **Catherine Barton** Chief Financial Officer.

Barton will take up the role from 28 September 2020 and will also join the Talbot Board, subject to regulatory approval.

She succeeds **Nigel Wachman**, who retires from Talbot this month after 20 years' service.

Most recently, she was Commercial and Finance Director of the UK Bupa business from 2015 to 2017 and General Manager for Bupa Dental Care in 2018. Since 2017 she has also been a Non-Executive Director and chair of the Audit Committee of Sabre Insurance Group.

Willis Re has appointed **James Moss** co-head of Willis Re Specialty's Casualty practice.

In his role, Moss will work in tandem with **Chirag Shah** to lead Willis Re Specialty's Casualty strategy in London.

Moss joins from Lockton Re, where he was a partner and head of International P&C reinsurance.

Before joining Lockton in 2012, Moss was a senior vice president in Guy Carpenter's London market Casualty team and began his career at R K Carvill & Co. Ltd. He is based in London and will report to Andy Law, managing director and head of Specialty P&C.

QIC Global has named **Alexander Craggs** acting CEO and **Jim Lye** acting Active Underwriter, at Antares Syndicate 1274. Craggs will report to Michael van der Straaten, CEO at QIC Global and Lye will report to Craggs.

Craggs had been active underwriter of Antares Syndicate 1274 since May 2019. He first joined Antares in 2010 as class underwriter for property treaty and agriculture and between 2017 and 2019 was head of reinsurance at the syndicate. He started his career at AHJ in 1994.

Lye was previously head of terrorism and energy at Antares. He joined the business in 2012 as an energy underwriter, having been an underwriting and claims manager at Infrassure since February 2010.

Amanda Blanc has been appointed the new CEO of Aviva.

Blanc had been an Independent Non-Executive Director at Aviva. Since being appointed in January 2020, she has chaired the Customer, Conduct and Reputation Board Committee.

Blanc previously served as CEO, EMEA & Global Banking Partnerships at Zurich Insurance Group. Before that, she was Group CEO, AXA UK, PPP and Ireland and has served as Chair of the Association of British Insurers and President of the Chartered Insurance Institute.

Maurice Tulloch, who was appointed CEO in March 2019, stepped down from the role for family health reasons.

Additionally, he has retired from his position on the Aviva Board.

Oneglobal Broking has appointed **Vanessa Macdonald-Smith** Executive Director, responsible for Direct and Facultative.

She will join the Group Executive Committee and will report to Oneglobal's CEO, Mike Reynolds.

Macdonald-Smith has more than 30 years' international experience and was latterly CEO of JLT Facultative. Previous roles have included senior leadership positions at Willis Towers Watson and Benfield Corporate Risks.

HDI Global Specialty SE has added to its Management Liability & Financial Institutions team with the hiring of **Louise Parker** and **Charles Boorman** (pictured). Both join the specialty lines insurer's London office from Neon Syndicate 2468.

Parker, who joins as Senior Underwriter Management Liability & Financial Institutions, specialises in non-U.S. domiciled financial institutions and commercial management liability business. Prior to Neon, Parker spent 10 years at Arch and four years at Goldman Sachs as a Financial Analyst.

Boorman joins HDI Global Specialty SE as Head of Management Liability & Financial Institutions, having held the same role at Neon where he oversaw the running of its commercial and financial institutions book from 2017. Previously he held similar roles at Probitas Syndicate 1492 and QBE Europe, as well as senior broking roles at Aon.

New fronting insurance holding company Obsidian Insurance Holdings has added to its senior management team with the appointment of **Stacy Armstrong** as Chief Client Officer. Her role will include responsibility for managing client and reinsurer relationships.

Armstrong most recently served as Executive Vice President, Underwriting, M&A, TPA Management at Cranmore, an advisory and consulting service unit of Enstar Group.

Prior to Cranmore, she served in various underwriting and marketing leadership positions for 20 years with Maiden Re and its predecessor organisation, GMAC Re, most recently as Executive Vice President of Broker Treaty & New Products.

Insurance services provider Charles Taylor has appointed **Rob Brown** its Group CEO.

Brown was previously CEO of AXA Global Corporate Solutions, and prior to that spent 15 years at Aon in a variety of senior leadership roles in the UK and EMEA, including a four-year period as CEO of Aon UK.

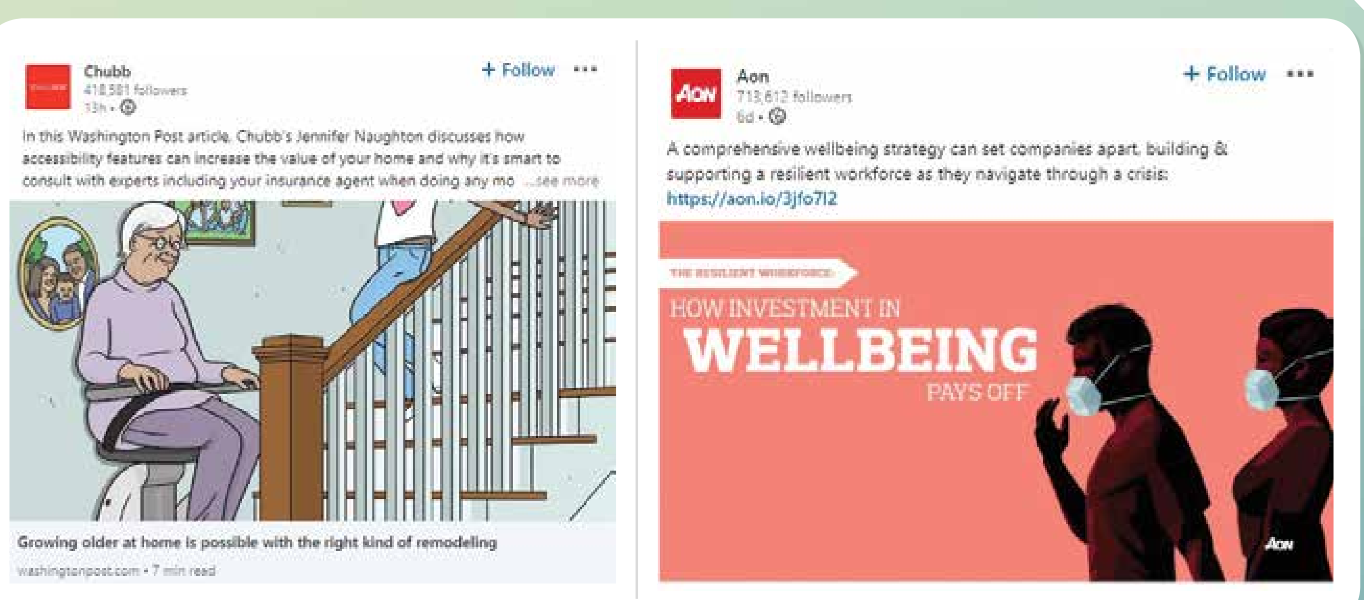
He takes over from David Marock, who left in April.

Marsh has appointed **Joanne Silberberg** Canadian Renewable Energy Leader.

Since joining Marsh through the graduate programme in 2004, Silberberg has worked in a number of specialist roles within Australia. In January, she relocated to Calgary to be part of the Energy & Power team. In this newly created role, she will report to Richard Doherty, Head of Marsh JLT Specialty, Canada and Amy Barnes, Energy & Power Practice Leader, U.S. and Canada.

Dan Gumsley also joins Marsh as an Account Manager in the Renewable Energy team and will focus on the growing offshore wind market in the UK. He joins the business from one of Europe's leading offshore wind developers. Based in London, Gumsley will report to Hamish Roberts, Power Leader.

Re/insurance companies spread their message on social media



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Life without insurance can be ruff, ruff, ruff.

Happy International Dog Day to all of you dog lovers out there!

+ Follow

"People listen to every word you say, so be careful that you don't sent an inadvertent message." Great advice from @MonicaACaldas, CIO of @LibertyMutual's Global Retail Markets: http://spr.ly/6048Go3fw #Liber ...see more

Monica Caldas of Liberty Mutual Insurance: People listen to every word you say, so be careful that...

medium.com • 10 min read

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This month is the 100th anniversary of the 19th Amendment, which guarantees and protects women's constitutional right to vote in the United States. To celebrate the 19th Amendment's centennial, the Markel Women's Network (MWN) is ...see more

CleanTech startup fighting #ClimateChange? Don't miss your chance to take part in the exclusive #MunichRe and ERGO Group AG Side Call in the Climate-KIC Accelerator Programme! Grant + coaching + more. #noequity. Deadline ...see more

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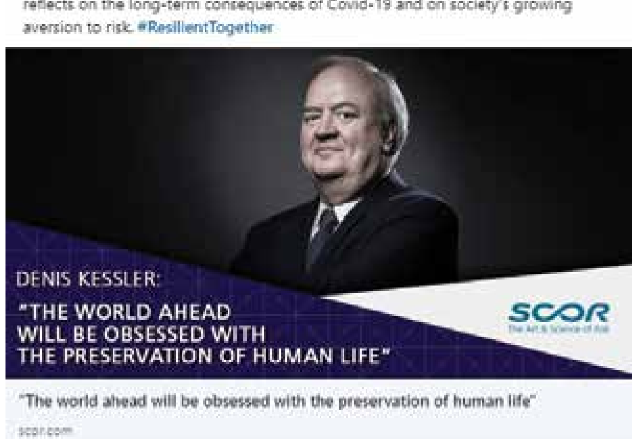
In an interview with l'Express magazine, Denis Kessler, Chairman & CEO of SCOR, reflects on the long-term consequences of Covid-19 and on society's growing aversion to risk. #ResilientTogether



"The world ahead will be obsessed with the preservation of human life"

scor.com

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The #insurance industry has been heavily impacted by the #coronavirus pandemic, especially the life health sector. Listen in to AM Best speak with Chris Behling, Chief Underwriter, Life & Health Americas Swiss Re on finding ways of maintaining the positive momentum to responsibly underwrite life insurance. http://ow.ly/s65k50BeLqR #BuildingSocietalResilience #COVID19

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- Create and engage in discussions
- Network with other industry professionals
- Receive important updates and event information

Play the Song, Pass It On.

It's a beautiful way to make a difference. Download **"The New Frontier (Say Their Names)"** by Siedah Garrett here: **li.sten.to/NewFrontier**. All proceeds benefit Black Lives Matter.

To kick off the Americas events for Dive In 2020, RMS CEO Karen White will host a fireside chat with Grammy Award-winning and twice Oscar nominated singer-songwriter Siedah Garrett, who will perform her signature composition, "Man in the Mirror," share her perspectives as an African American artist, and also perform her new single about racial injustice, "The New Frontier (Say Their Names)."

At RMS, we're not just pioneers in risk management. We know talent when we see it, and we'll never stop working to make our industry better in every way.

Join us at the Dive In Festival Americas kickoff on September 22.

www.diveinfestival.com
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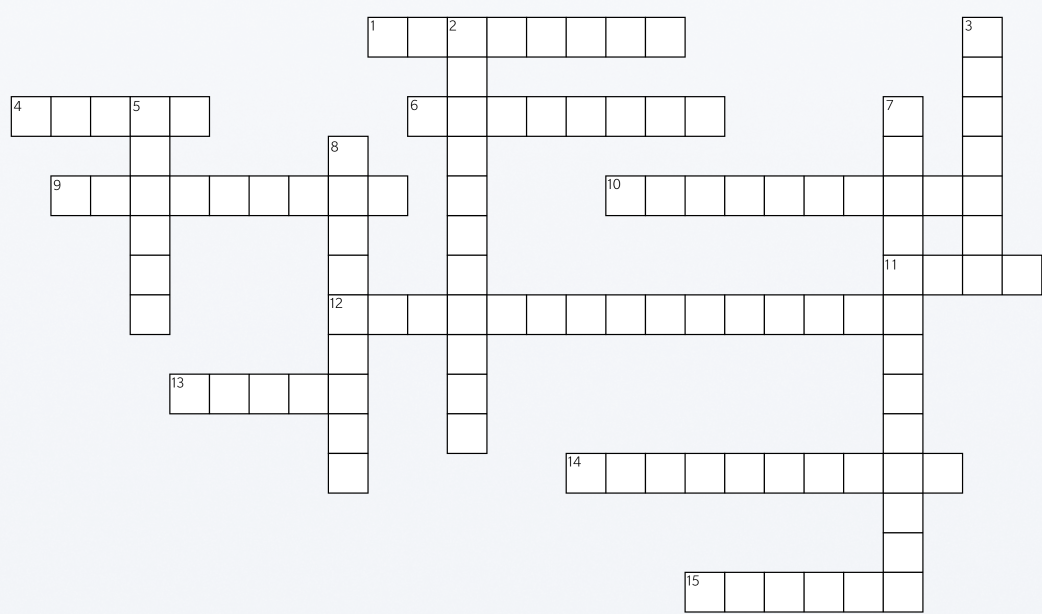
Reactions

CROSSWORD



Across

1 Hiscox CEO speaking in the opening panel of *Reactions* Latin America Re/Insurance Week on 8 September: Bronek ___.

4 Malta-based legacy start-up that launched in August with €500m of committed capital.

6 Leigh-on-Sea-based Thames Underwriting has been acquired by this consolidator broker.

9 This 1920s silent movie star is thought to have purchased the first ever policy insuring a body part

10 Editor-in-Chief Shawn Moynihan opened *Reactions'* London Market Awards with a unique rendition of this classic Oasis song.

11 What does the "L" stand for in the acronym for Bermudian insurance body BILTIR?

12 A large amount of this chemical compound is what exploded in Beirut, causing at least 181 deaths.

13 UK personal lines broker Hastings has agreed to be acquired by Rand Merchant Investment Holdings and which Finnish insurer?

14 In August, Aon assisted this U.S. mortgage guarantor to close its third Multifamily Credit Insurance Pool.

15 Hurricane which battered the U.S. East Coast from 30 July to 5 August.

Down

2 The name given to the new company formed through the merger of Third Point Re and Sirius.

3 Andrew Carrier has been named CUO of this insurer.

5 Peter Askew has been named Guy Carpenter's President and CEO of this country.

7 Winner of the 2020 Lifetime Achievement Award at the *Reactions* London Market Awards.

8 The annual November SIRC conference, cancelled this year, is held in ___.

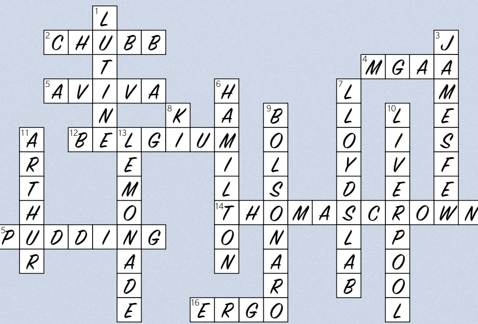
Reactions Summer crossword solution

Across

2. *U.S. carrier that has revealed Q2 COVID-19 losses of close to $1.4bn.*
4. *Peter Staddon is stepping down as Managing Director of this insurance trade body.*
5. *Amanda Blanc has taken over as CEO at this UK insurer.*
12. *Howden was in June granted permission to expand into this European country.*
14. *1968 film in which Faye Dunaway plays an insurance investigator, "The__ Affair."*
15. *The Great Fire of London is thought to have started on _ Lane.*
16. *Name of Munich Re's primary insurance business.*

Down

1. *This ceremonial bell was rung to signal the temporary closing of the Lloyd's underwriting room due to COVID-19.*
3. *TigerRisk UK CEO delivering a keynote at the Reactions London Market Re/Insurance Week Webinar Series.*
6. *Bermuda-headquartered insurance company that shares its name with an award-winning musical.*
7. *Name of the Lloyd's InsurTech incubation programme.*
8. *Name of the new Brit-owned follow-only syndicate set to launch in Q4 this year.*
9. *Name of the Brazilian President revealed to have contracted COVID-19, Jair _.*
10. *Football team sponsored by AXA, crowned Premier League champions.*
11. *The first named storm to strike in the 2020 Atlantic Hurricane Season.*
13. *U.S. InsurTech launching an IPO valued at $1.6bn.*



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I wish I had deployed my capital using a parametric trigger. Now I am trapped in here with my collateral…WOW!!

I just talked to Timmy the Turtle, you're going to be trapped in there for at least two more years.

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