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First published in 1995, *Insurance Day* has become the favourite publication for the London market, which relies on its mix of news, analysis and data to keep in touch with this fast-moving and vitally important sector. Its experienced and highly skilled insurance writers are well known and respected in the market and their insight is both compelling and valuable.

Insurance Day also produces a number of must-attend annual events to complement its daily output, including the *Insurance Day* London Market Awards, which recognise and celebrate the very best in the industry.

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New LMG taskforce to work with government on Brexit trade deal

Strong arguments for EU to agree to mutual access, Aubert says

Michael Faulkner
Editor

The London Market Group (LMG) is creating a taskforce to work with the government in securing a trade deal for the insurance industry once the UK exits the EU, *Insurance Day* can reveal.

The group has been asked by the Department for Exiting the EU and HM Treasury to create a taskforce to help the government "find a way forward" once the negotiations with the EU begin.

LMG chief executive, Chris Beazley, told *Insurance Day* the group had made recommendations to the government on what a "mutually beneficial" trade deal could contain. The next step was "how to engage with the EU27".

The working group's participants had yet to be decided, Beazley added.

Last week the London Market Group set out its recommendations to the UK government to secure the London market's access to European business following Brexit.

In a comprehensive set of recommendations, the group called for a guarantee the London insurance market would be considered to have regulatory equivalence with the EU.

In addition, it said a new trade deal with the EU was needed that gave both UK and EU insurers, reinsurers and brokers continued rights to undertake cross-border activity, the LMG said.

It also called for an early agreement on an implementation period to avoid a "cliff edge" on the day the UK leaves the EU.

Brexit: the LMG has created a taskforce to work with the government to get a trade deal for the insurance industry once the UK leaves the EU

LMG chairman, Nicolas Aubert, said there were strong arguments for European negotiators to agree to a trade deal, as the EU achieved "significant" benefits from access to the London insurance market.

More than £6bn ($7.3bn) of international business is written in London by firms with a parent company or principal base located elsewhere in the EU.

"London is a centre of excellence. There is no incentive for the EU to see that move to Hong Kong or Dubai. It would have social and economic implications for the EU," Aubert told *Insurance Day*.

The publication of the LMG's report comes as insurance giant AIG revealed it plans to set up a subsidiary company in Luxembourg to write business in the European Economic Area and Switzerland from 2019.

Aubert said it was expected companies would "have to make a call" on their Brexit contingency plans.

But companies may choose not to execute them if it later become clear access to European business will be maintained for UK insurers, he said.

Losses widen as ERS cuts profit forecasts following Ogden change

Lloyd's insurer ERS has dramatically cut its profit forecast for its syndicate 218 following the recent changes made to the Ogden rate, *writes Rebecca Hancock*.

The syndicate said forecast profits for 2015 year of account would now be 7.1 percentage points worse than previously anticipated. It now expects profit to be in the range of -9.9% to 0.1% of capacity.

Profit for the 2014 year of account has deteriorated 1.2 percentage points to a 4.7% loss on its capacity.

At this stage there are currently no forecasts for 2016.

The UK Ministry of Justice surprised the insurance industry by announcing a significant decrease of the discount rate used to calculate lump sum awards in UK bodily injury cases, known as the Ogden rate, from 2.5% to -0.75%.

This change affects the most serious claims that are exposed to the syndicate's reinsurance programme, although the net position is a deterioration of 3.7% of capacity owing to this issue.

Part of the change to the 2015 year of account was also attributed to claims inflation, some of which is attributed to the rising cost of damage claims following the fall in the value of sterling.

NEWS

Hannover Re CEO: UK motor reinsurers to drive up rates 50% following Ogden

Limited market for excess-of-loss cover will enable underwriters to achieve 'significant' rates hikes

Michael Faulkner
Editor

UK motor excess-of-loss reinsurance could rise by 50% as a result of the cut in the Ogden rate used to calculate personal injury damages, Hannover Re's chief executive has said.

Ulrich Wallin said the limited market for this cover meant reinsurers would be able to achieve "significant rate increases".

"If the price deficiency due to the Ogden rates on UK motor is 10%, I think a 50% increase on the motor excess-of-loss is a very good guess, I would say," he told analysts following the publication of the company's results.

Many motor reinsurance contracts renew on January 1, but some are due to renew on April 1. For these contracts, the uncertainty about the impact of the lower rate on claims costs would contribute to higher rates, Wallin said.

"Until we've really looked at the individual claims, which we are currently doing, there's uncertainty on the impact," he said. "And if an underwriter is uncertain and the market for UK motor excess-of-loss is not that large because of the unlimited nature – there are many reinsurers that wouldn't even write that business – therefore I think we will be able to sell significantly higher prices there."

Insurers were caught off guard last month by the UK Ministry of Justice's surprise decision to slash the discount rate used to calculate lump sum awards in UK bodily injury cases from 2.5% to -0.75%. The new rate will be effective from March 20, 2017.

Motor re/insurers are expected to bear the brunt of the impact. According to analysis by Willis Towers Watson, the reduction will cost the insurance industry a material one-off reserve charge of approximately £5.8bn ($7.19bn).

Wallin said Hannover Re was currently assessing the implications of the lower discount rate on the company's reserves. Current reserves "would probably be sufficient", although the company may add some additional reserves following the review, he said.

Hannover Re writes approximately £50m of UK motor excess-of-loss business, participating only in higher layers with a minimum attachment point of €5m ($5.3m) and an average of attachment of between €7.5m and €8m.

"We have pretty good transparency on the claims that have the potential to hit our layers," Wallin said, "so on the single person losses, even with the new Ogden tables, many of them will not be able to reach us there."

Hannover Re cuts exposure to marine and aviation

Aviation reinsurance rates no longer cover the cost of capital, Hannover Re chief executive has said, *writes Michael Faulkner*.

Ulrich Wallin said the firm had cut its exposure to this class at the January 1 renewals and bought "quite a lot" of retrocession cover "to safeguard the results".

"It's clearly a soft market portfolio now, like we had before 9/11," Wallin told analysts.

Despite the continued decline in rates, Wallin said aviation was the line of business "where we have the highest percentage of redundant loss reserves".

Wallin also said the company would continue to scale back its marine reinsurance book on the back of continued soft rates. "It will be a smaller, profitable book," he said.

Hannover Re generated group net income of €1.17bn ($1.23bn) in 2016. Gross premium volume was down 4.2% to €16.4bn, while operating profit was €1.7bn.

Ogden revision spoils UK results for 2016

UK insurers avoided severe damage over the winter months but the government's February announcement of a change to the Ogden rate governing the discount rate applicable to lump sum bodily injury awards has had the kind of impact normally associated with a catastrophic loss, *writes Graham Village*.

Insurers have been scrambling to recalculate figures for both current and prior years in line with the discount rate change, from 2.5% to -0.75%, as of March 20. Companies are already reporting a hefty impact to their results because of the change and reinsurers of UK motor liability business are expected to be preparing to react as soon as contract terms allow.

Large premium increases for insureds are likely to follow, although it remains to be seen how successful insurers are in bumping up what are already high rating levels for private motor cover.

PwC said the average cost of a car policy would increase by between £50 ($60.85) and £75 but certain groups would be hit particularly hard, notably younger drivers and those over 65.

Table: Ogden discount rate revision, impact on selected companies

Company	Impact
Admiral	£150m ultimate net cost, £105.4m hit to 2016 pre-tax profit
Aviva	£475m pre-tax, £380m after-tax hit, 5.9 points on combined ratio
Axis	$50m pre-tax Recognition in Q1 2017. UK motor non-proportional generates $40m in annual premium or 1% of total book
Direct Line	£217.3m hit to pre-tax profit, 5.9 points on combined ratio
esure	£1m additional impact as company had already factored in reduction of Ogden rate to 0%
Hastings	£20m, 4 points to combined ratio
Novae	£35.4m hit to pre-tax profit, 5.3 points on combined ratio
Saga	£4m pre-tax hit to profit for year ended January 31, 2017
XL	$75m pre-tax. Recognition in Q1 2017. Mostly affects reinsurance of UK motor BI, employers' liability and public liability

Willis Towers Watson estimated the market would suffer a one-off reserving charge of £5.8bn plus an increase of about £868m a year in the cost of providing motor insurance in future.

The biggest damage in financial terms came at Aviva, which took a £475m hit to 2016 pre-tax profit, equating to a 5.9 percentage point increase to the combined ratio.

The government has promised to look again at the methodology for setting the discount rate. Aviva said that could lead to volatility in the rate over the next couple of years so the insurer has decided to treat the Ogden adjustment as an exceptional item in its 2016 financials.

Direct Line similarly suffered a 5.9-point increase in combined ratio because of Ogden and was forced to tap into its reserves. Before Ogden, reserve releases were up 13.4% to £430m. After Ogden, they fell to £267m.

UK insurers have been relying heavily on reserve releases to shore up weak accident-year performances for several years but the Ogden change will see companies exhaust a large chunk of their reserve cushion, according to Fitch.

The rating agency said smaller motor sector players, particularly those heavily backed by reinsurance, could find the market extremely difficult as Ogden will intensify pricing competition, pressure reserves and increase the cost of reinsurance. Acquisitions could follow.

Fitch last week revised its outlook sector for the UK non-life industry to negative from stable, mostly because of Ogden. Positive benefits that should flow once proposed whiplash reforms come into force are not expected to take effect until October 2018 and the Ogden increase plus the rise in Insurance Premium Tax to 12% this June will offset any future gain, the rating agency said.

The companies shown in the table have disclosed total charges of about £1bn in reaction to the Ogden change, suggesting there is plenty more to come. For the larger UK players, the change added about four to six percentage points to the year's combined ratio.

The discount rate spoiled the underwriting performance for the UK's largest domestic insurers but the industry will be thankful 2016 proved a good year in most respects. Although highly unwelcome, at least the discount change has come after a period of low major weather-related and catastrophic loss activity. The big companies were able to absorb the Ogden revision and the Flood Re levy to maintain profitability in 2016.

Tomorrow's Companies House looks further at the results of the larger UK players and brings a further round of 2016 reporting from the global insurance and reinsurance sector.

FOCUS/ CAPITAL MANAGEMENT

Capital returns

Billions of dollars are being returned to investors as the major reinsurers in Bermuda and Europe unveil significant share buyback programmes. Yet at the other end of the spectrum, smaller insurers are turning to debt issuance to raise capital

Antony Ireland
Journalist

Whether operating under Solvency II or an equivalent regime, efficient capital management has never been of greater importance for reinsurance companies. For some this may mean raising capital to meet regulatory requirements or fund expansion. For more, it means finding the most cost-effective way to redistribute surplus cash among shareholders.

Underwriting rates may be under pressure, but after several years of relatively benign losses, reinsurers find themselves in a position of strong risk-adjusted capitalisation. However, opportunities to profitably deploy this capital have diminished against the backdrop of an increasingly difficult underwriting environment and low interest rates.

Many major payers have turned to share repurchasing. So far in 2017 alone, Swiss Re, Scor and XL have announced major share buybacks and there are more in the pipeline, including potentially Munich Re for the third successive year.

"In recent results announcements, a large number of companies shared plans to return capital to investors through share buybacks, bemoaning the lack of underwriting opportunities," Catherine Thomas, analytics director at AM Best, says.

"In the absence of a sharp upward turn in market conditions this is expected to continue through 2017," she adds. "However, more active capital management will be constrained by concerns regarding the ability to access additional capital if necessary in an uncertain economic environment."

Soft market

Share repurchase activity continues apace in Bermuda. According to Quentin McMillan, director of equity research, property/casualty insurance at investment bank and broker Keefe, Bruyette & Woods (KBW), the declining pricing environment is a key reason why underwriters in Bermuda have focused their capital deployment on share repurchases and returning capital to shareholders in recent times.

While some, such as RenaissanceRe and Axis Capital, have indicated they would return 100% of operating earnings to shareholders, others, such as Everest Re, do not give specific capital management guidance. "Everest Re does not set specific targets but plans to repurchase shares opportunistically at attractive valuations when it sees shares pull back," McMillan says.

Bermudian re/insurers are buying back high single-digit percentages of their shares, making them a meaningful volume of the overall stock in some circumstances, according to McMillan. "This gives investors decent downside protection as they know there is a buyer in there repurchasing shares if management believes valuation is too low," he says.

Valuations in the US have moved up fairly meaningfully, which changes the dynamics of share repurchase, McMillan says. "In the 2010 to 2012 timeframe, most Bermudian reinsurers were trading at a discounted book value, but in 2017 the average Bermudian reinsurer is probably trading between 1.1 and 1.2 of book."

"Unfortunately pricing isn't getting better, so repurchasing is going to continue unless individual companies announce any large M&A [merger and acquisition] transactions, which would suck up some of the capital that would otherwise be used to buy back shares."

Indeed, McMillan adds with many companies seeking to use surplus capital, acquisition activity is likely to continue steadily. "We have seen some companies making small and even large acquisitions around the fringe of the market," he says, pointing to Validus's recent acquisition of ADM's crop insurance business Crop Risk Services as a good example.

This, McMillan argues, was a good decision. "They believed the returns in crop insurance were attractive, brought diversification to the portfolio, and probably provided a better return to shareholders than just repurchasing shares or giving a dividend," he says.

"Others in the space are considering similar options – though they have to be disciplined not to chase prospects when valuations have run away a little," he adds.

Different structure

While share buybacks look set to continue in both Europe and Bermuda, driven primarily by the same market forces, McMillan points out that the investors bases in the two markets vary significantly, meaning the structure of these buybacks may look different from across the Atlantic.

"US-based investors tend to be focused on total return – they care less if it comes from dividends, share repurchase or organic growth. European investors are much more focused on getting a reasonable dividend yield relative to share price," he says.

> **'US-based investors tend to be focused on total return – they care less if it comes from dividends, share repurchase or organic growth. European investors are much more focused on getting a reasonable dividend yield relative to share price'**
>
> **Quentin McMillan**
> **Keefe, Bruyette & Woods**

While some companies are finding ways to offload surplus capital, others are taking advantage of suppressed yields to raise capital and/or rebalance their capital bases by issuing debt.

A key advantage to debt issuance is that it provides a tax-efficient alternative to equity without diluting existing shareholders. "The cost of debt is cheaper than the cost of equity, and lower hurdle rates can lead to improved returns on risk-adjusted capital," Thomas says.

Over the past few years in particular, the terms on offer have been favourable and refinancing has helped companies lower their debt service costs, she adds.

With interest rates still at very low levels, insurers remain keen to issue long-dated, highly subordinated debt to lock in favourable rates. Such instruments have the additional benefit of being likely to receive regulatory and rating agency capital credit.

Thomas says key considerations for European insurers looking to issue Solvency II-compliant debt include restrictions on the early redemption of tier 1 and 2 instruments, the trigger events for principal loss absorbency mechanisms, limitations on incentives to redeem and mandatory deferral features.

According to John Butler, managing partner of Twelve Capital, an investment manager specialising in insurance debt and insurance-linked securities, Solvency II has driven a steady interest in debt issuance among the biggest re/insurers in Europe over the last couple of years. "The cycle of issuance of public debt from larger insurance groups is very much in line with expectations" he says.

"In Europe, we've been through a stage where the Solvency I instruments that do not qualify under the Solvency II regime, absent grandfathering, have been replaced by instruments qualifying under Solvency II, which caused increased refinancing activity," Butler says. "The large insurance groups now appear adept at interpreting what they can issue and how it must be structured under Solvency II."

Issuance growth

While public debt issuance may be exclusively the realm of the largest corporations, Butler notes a significant recent uptick in strategic private debt issuance from smaller European insurers.

According to Butler, around half of the insurers his teams speak to that are looking to raise capital in this way are doing so to facilitate growth or corporate development, while the other half needs capital to rectify a shortage caused by poor results or to satisfy negative regulatory issues. "Twelve only has an interest in companies with positive reasons to borrow, rather than distressed debt – that's not suitable for the appetite of our investors," he points out.

"There is plenty of M&A activity, growth and development in the smaller re/insurance company sector, and these firms are now willing to consider issuing private debt to raise capital, but they have needed to be re-educated that this option is available to them. Until recently, the product had not been available for some time," Butler says. "Now a broader market is being established and the pipeline is picking up strongly."

In Bermuda, the story is starkly different. There, the debt issuance pipeline is barely moving. Most Bermudian reinsurers have a surplus of cash and have no need to raise capital in this way, McMillan says. "All of them are to varying degrees overcapitalised, which is why they are returning 100% of their operating earnings in repurchases and dividends," he says.

"Reinsurers are also very cognisant of their credit ratings and don't want to lever up too much. If their ratings were to slip below A-, questions would be raised about their long-term viability to write the portfolios they want, but they wouldn't even tread close to that line as it could be disastrous."

The only scenarios in which Bermudian firms are likely to consider debt issuance any time soon, McMillan argues, are if share prices become extremely attractive or if capital needs to be raised for a specific deal – such as when Arch Capital issued debt to help facilitate the December purchase of AIG's mortgage guarantee unit.

"In this case, Arch Capital tapped all parts of its capital structure – it issued some debt and also some preferred shares to get the deal done at what we thought was an attractive price," McMillan says.

Another reason debt issuance may be slow in Bermuda is the relative infancy of Bermuda's Solvency II equivalent regulatory regime. However, uncertainty over the treatment of debt issuance under the jurisdiction's laws looks to be dissipating; Twelve Capital recently completed its first Bermuda private debt transaction under the local regime (a $20m Tier 2 capital transaction for R&Q Re), and is now working on a second transaction in the territory.

"We feel there is now sufficient clarity in the application of the revised regime in Bermuda to structure debt instruments, but had waited until there was sufficient development before entering the territory," Butler says.

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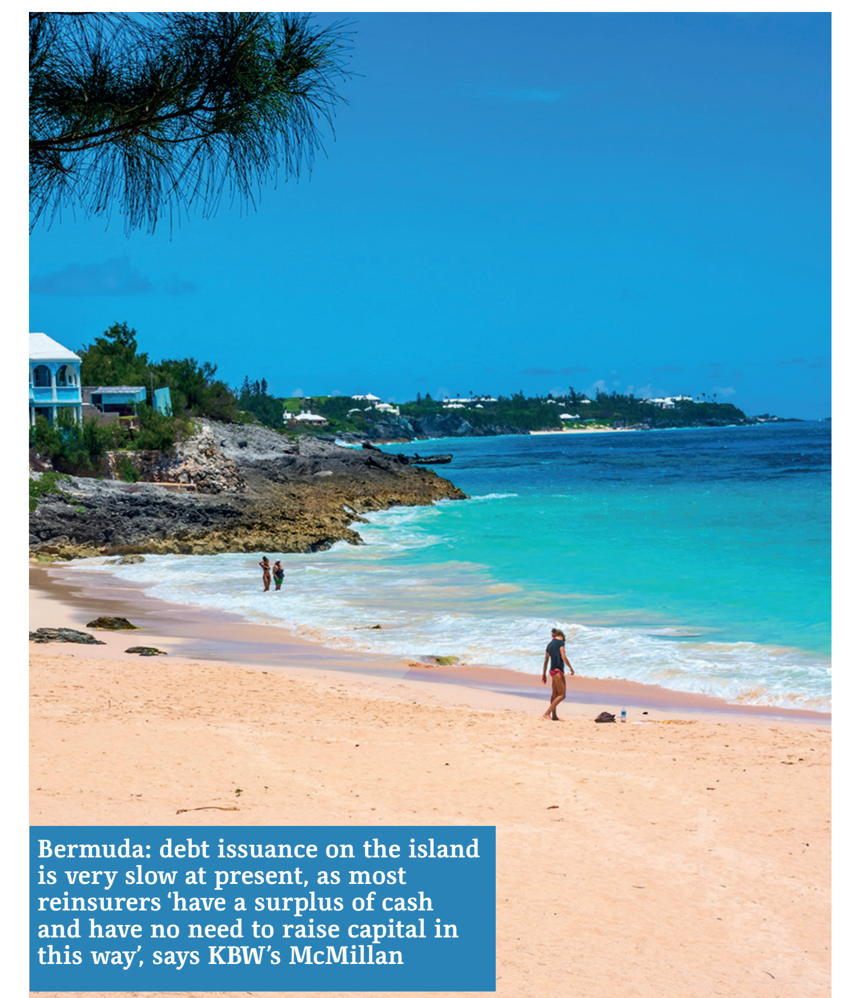
> **John Butler**
> **Twelve Capital**

Whether private debt will catch on among Bermuda's smaller reinsurers remains to be seen, but it looks unlikely the public debt markets will be awash with big-name reinsurance paper any time soon.

While both debt issuance and share repurchase look set to continue in Europe for the foreseeable future, M&A activity may well shape the extent to which both trends pan out in Bermuda – either as a potential stimulus for capital raising or a potentially lucrative alternative to buybacks if book values continue to rise. ■



Bermuda: debt issuance on the island is very slow at present, as most reinsurers 'have a surplus of cash and have no need to raise capital in this way', says KBW's McMillan

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FOCUS/ CAPITAL MANAGEMENT

Efficient capital structures and the underwriting cycle

What should an efficient capital structure for a London market specialty lines company look like in the current market environment?

With the implementation of Solvency II, re/insurers are under pressure to squeeze inefficiencies out of their capital structures and to manage their expense base more tightly. Here, a group of sector experts consider the roles of a company's own balance sheet, reinsurance and third-party capital in the make-up of an efficient capital structure.

»With the cost of reinsurance continuing to be lower than most other forms of capital, particularly debt and equity finance, what are the opportunities for those cedants who are looking to increase their use of reinsurance to write more business and support their earnings growth?

Pervez Rizvi, group chief financial officer, International General Insurance (IGI)

"As the effects of the soft market continues, transfer via reinsurance has emerged as a cheaper and more efficient form of contingent capital compared to debt and equity finance. This has further helped insurance carriers to use this opportunity to be better protected and use reinsurance more strategically.

"We are optimistic that by taking advantage of this, ceding companies can support new growth initiatives and pursue profitable business which would consequently help them to sustain the existing challenging operating environment. Carefully re-examining the strategic reinsurance purchases will not only support earning protection but would also reinforce the value creation for both cedant and reinsurers."

David Flandro, global head of analytics, JLT Re

"There is currently a great opportunity for cedants to optimise capital structures and lower costs of capital with the cost of reinsurance being where it is. As the reserving picture changes, adverse development and stop loss cover is an incredibly efficient way to protect against rises in inflation and changes in discount rates. With cat cover at such low rates-on-line, it is important to take advantage now before industry loss experience changes."

Catherine Thomas, senior director, analytics, AM Best

"Increasingly, reinsurance purchasing decisions are made at group level with the board taking into account strategic goals, formal risk appetite statements and overall capital management. In a deteriorating pricing environment, insurers are looking to relatively cheap reinsurance as a means to maintain, or even grow, premium volumes and client relationships, without breaching their profitability hurdles.

"Building strategic relationships with reinsurers, whose support they can rely on over the longer-term, is an important consideration. Using reinsurance in the place of equity or debt capital to support the writing of business can also have the advantage of reducing earnings volatility and protecting franchise value. Reinsurers can also benefit from strategic relationships that support the capital management of their cedants, as they gain a client that takes a long-term view, rather than one focused primarily on the current cost of cover."

»What are the strategic considerations for both the cedant and the reinsurer in an arrangement where cedants are looking to increase their use of reinsurance to write more business?

David Flandro, JLT Re

"Some of the strategic considerations for the cedant are outlined in my comments earlier. Reinsurers, by contrast, have comparative advantages and different levels of capitalisation and expected returns in certain lines and can carry the risk more efficiently in terms of economic and rating capital, for example."

Mike Van Slooten, head of international market analysis, Aon Benfield

"We believe the economics of reinsurance purchasing have improved to the point where properly structured products can deliver compelling advantages to insurance companies looking to manage economic capital, support business growth and reduce earnings volatility. Re/insurers are under intense pressure to minimise expenses and maximise the efficiency of their capital structures. However, the main driver is the need to keep shareholders and rating agencies happy, rather than the regulators. Improved risk management and greater transparency brought about by Solvency II should ultimately be reflected in a lower cost of capital."

»How are debt and equity finance best mobilised within a re/insurer's capital structure in the current market environment?

David Flandro, JLT Re

"This is where strong economic capital modelling and capital optimisation are required. It will vary company by company, of course, and we at JLT Re have been looking across the entire capital structure and helping clients to find the optimal mix."

Brandan Holmes, vice-president and senior analyst, Moody's

"Quality and permanence of capital is a key consideration for cedants deciding how much to rely on reinsurance versus debt and equity capital. In terms of quality, the counterparty risk introduced through reinsurance will lead to some deterioration in capital quality.

"However, the more important consideration is permanence of capital – while there is currently ample reinsurance capacity and pricing is low, there is no certainty as to how long this will continue. A sharp hardening in reinsurance pricing and reduction in available capacity could have a detrimental effect on the franchise value of cedants that have placed too much reliance on reinsurance to enable them to pursue more business."

»Transferring portfolios of legacy business to third-party run-off specialist service and investment companies is increasingly cited as an example of efficient capital management, particularly within the context of Solvency II. But how accessible and effective is this as a capital management solution for specialty lines re/insurers?

Mike Van Slooten, Aon Benfield

"The legacy market is robust and seeing heightened deal flow as re/insurers look to offload non-core, capital-intensive business that is not meeting return thresholds. This is more driven by market dynamics than by Solvency II."

Catherine Thomas, AM Best

"There is an active market for legacy solutions and there have been a number of such deals completed over the past year. In general, insurers are looking to redeploy capital from the run-off of long-tailed reserves to activities that potentially add more value, such as writing new business.

"For insurers with low-risk investment portfolios, the return on assets supporting legacy reserves will have reduced as interest rates have fallen to historic lows. Also, as concern regarding the industry's reserve adequacy grows, there is likely to be more interest in reinsurance solutions, such as adverse development covers (ADCs).

"Factors that can determine the level of capital relief such transactions provide include the attachment points and limits of ADCs, the credit quality of the reinsurer and the presence of commutation clauses."

Ivor Edwards, European head, corporate insurance group, Clyde & Co

"The run-off market is healthy and is a seller's market, with willing buyers across lines of business. This means insurers can make good money from their legacy books.

"However, there are many other factors that might inform a run-off strategy above and beyond capital management. Legacy books can take up valuable management time that could be used elsewhere, running off business can be a way of reducing headcount and associated costs, and, perhaps most importantly, there is the overarching strategic decision to extricate oneself from a difficult line of business that is potentially costly and cumbersome to manage. These factors will often come before any capital management considerations."

»There is a move towards a greater use of third-party capital by re/insurers, with some industry figures calling on companies to develop new structures to better accommodate such capital. But what are the key considerations for companies who grow their top line in this way and then channel the greater proportion of that 'additional' revenue to its capital partners, but earning fees and profit commissions in the process? The benefits appear obvious, but what are the challenges?

Catherine Thomas, AM Best

"A key advantage of partnering with third-party capital is that it allows re/insurers to offer more meaningful capacity and increase their relevance to clients.

"To date, this capital has primarily supported risks that can be easily modelled, such as catastrophe business in peak areas such as the US. However it has been more difficult to attract and structure third-party participation in the casualty market, principally due to the extended period between a policy being underwritten and a claim being paid. The ability to partner with third-party capital providers that are able and willing to offer solutions that replicate traditional re/insurance structures can also be challenging.

"Relying on third-party capital to support strategic plans can be risky owing to uncertainty as to the long-term commitment of capital that is more likely to exit the market in response to changes in investment conditions, as well as insurance-specific factors, such as out of appetite losses or price deterioration."

Pervez Rizvi, International General Insurance (IGI)

"Alternative capital is expanding at a faster pace than traditional reinsurance capital. However, there is a continuous challenge in accelerating slowdown in reinsurance growth amid excessive reinsurance capacity."

»Could there be a situation where the use of third-party capacity by a reinsurer exceeds the reinsurers' own capacity or will the reinsurer always need to have more 'skin in the game' than the third-party capital or capacity provider?

Brandan Holmes, Moody's

"The ability to manage conflicts of interest is one of the key challenges as companies look to channel a portion of their business to alternative capital structures, such as sidecars.

"Insurers will need to demonstrate to third-party investors they are not retaining the best business on the insurance balance sheet, but channelling less attractive business to the third-party capital vehicle. Reputational risk, and constructive obligation to support a sponsored alternative capital vehicle are additional considerations.

"While reinsurers may not have a contractual obligation to support a sponsored alternative capital vehicle through distress, there will likely be compelling reasons, including client relationships, to provide support."

Mike Van Slooten, Aon Benfield

"The use of third-party capital is evolving as re/insurers seek to match risk with investor appetite.

"We expect further expansion over the next two to three years, as re/insurers look to broaden their capital market relationships; strengthen their offerings to clients and lower their overall cost of capital.

"In so doing, they must typically retain some 'skin in the game' to avoid the perception of conflicts of interest."

»And how crucial are such third-party capital structures likely to be in terms of reinsurers sustaining or broadening their offering to their clients over the next two to three years?

Brandan Holmes, Moody's

"Our view is that it is increasingly important that reinsurers are able to engage with alternative capital, both in their own capital structures and as an offering to clients.

"As primary insurers become more familiar with alternative capital and seek to deploy it in their own capital structures, those reinsurers that are able to offer alternative capital solutions to their primary insurance clients are likely to be more secure in their position on the primary insurers' reinsurance panel.

"In addition, strategic use of alternative capital helps reinsurers to lower their own blended cost of capital, supporting profitability in the soft reinsurance pricing environment."

»Many traditional reinsurers are incorporating alternative capital into their underwriting structures to improve their offering to primary insurers, but how far away are we from a vision of the reinsurer's role being one where it matches the right risk with the right capital, whether that be traditional capital or alternative capital in all its forms? How attractive or feasible is this vision, which sees the reinsurer play more and more of an intermediary-type role in the distribution chain?

Brandan Holmes, Moody's

"We think reinsurers' own balance sheets will remain the primary venue for risk absorption for the foreseeable future, with alternative capital as a supplement that enables it to offer larger line sizes to cedants. Further, we expect reinsurers will continue to play a key role in providing risk absorbing capacity to primary insurers (as opposed to being an intermediary), particularly due to the technical expertise that accompanies reinsurance and the value cedants place on the relationships and flexibility they have with reinsurers.

"Some reinsurers are very active in matching risk to various capital platforms, including their own balance sheets, sidecars and collateralised reinsurance facilities. What is less apparent, is the way in which some reinsurers increasingly deploy a range of instruments in its own balance sheet, including third-party capital and retrocession to lower their blended cost of capital, and to – in a less direct manner – match sources of capital with risks underwritten."

»Finally, what should an efficient or optimal capital structure look like for a London market specialty lines re/insurance company in the current market environment?

Pervez Rizvi, International General Insurance

"The peaks and troughs of an underwriting cycle have been a core feature of the reinsurance market and efficient or optimum capital structure needs to be aligned accordingly.

"The London insurance market is currently grappling with the impact of Brexit – many are fearful of the implications of the UK leaving the European single market and losing crucial passporting rights to sell services to EU firms.

In this case, the right mix of: a) judicious use of a company's own balance sheet to serve retained risks; b) cost-effective use of reinsurance at a competitive cost; and c) viable use of alternative capital, can only address the volatility of exposures reflected in insurance books." ■

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M&A fallout 'driving majority of MGA growth'

Underwriters look to MGAs to control their own destiny

Scott Vincent
Editor, news services

The spate of merger and acquisition (M&A) activity in recent years is continuing to drive interest in MGA formation as an increasing number of underwriters seek to be in control of their own destiny.

Amid projections of another busy year for MGA formation, Asta Underwriting Management's John Holm told *Insurance Day* the interest he was seeing was predominantly coming from underwriters looking for new opportunities.

"It may be in the fallout from M&A or maybe they have decided to walk away from their companies. I'd estimate around 75% of what we are seeing at the moment is in the fallout from M&A," he said.

"Experienced underwriters may decide they want to set up on their own and don't want to continue working for a large company or syndicate. An established team that doesn't feel rewarded or respected in a bigger company may want to be in charge of their own destiny," Holm added.

Forming an MGA was an attractive model for underwriters looking to set up their own business, he continued.

London: continuing M&A activity is fuelling the surge in MGA formation, according to Asta's John Holm

"The target of most, if not all, MGAs that set up is to build the business to a scale where it is attractive for someone to buy. At the sale of the business, the owners cash in and can make a lot of money.

"And as more people do it, something of a herd instinct can be seen. When someone sees their peers do something, they believe they can do it too."

As well as benefiting from simpler reporting requirements than syndicates, Holm said MGAs were an ideal model to embrace new technologies and represented a cost-effective route to market. They benefit from the lack of legacy IT systems, which makes them suited for an insurtech-style start-up.

"They are lean operations with a low cost base and can embrace new technology far more easily than an established company burdened by legacy IT systems," he said.

MGAs have emerged as an effective route to market at a time when other business models, both on the underwriting and broking side, have become more costly.

"At Asta, we were seeing individuals with syndicate business plans that were too small. If you come along for a business plan now for a syndicate with a capacity stamp of £30m [$36.5m] to £40m, it's not going to happen," Holm said.

"But by setting up an MGA instead, you can grow the business to a point where it becomes viable to develop."

Another alternative when an MGA grows successfully is for it to be bought by the carrier or carriers providing capacity. "Rather than continue to pay significant profit commissions, they may decide to buy the MGA and take it in-house," he said.

For an MGA to be successful, Holm believes it has to have a niche and offer non-standard business.

"Carriers tend to be quite happy to back MGAs with capacity as they can use it as a test bed for additional classes – if it works well, they can take it in-house," he said.

"If they are to succeed, it is important they are entrepreneurial and have a business-life approach. When starting up a business, all the things that are done for you as part of a big company you need to do yourself. This includes IT, travel, pensions, office space – as an MGA, you need to organise all of this.

"Many underwriters think they have that mindset – it's my job to decide whether they really do and often they do not.

"An experienced underwriter will have worked in a company environment for a considerable period of time and this type of atmosphere does not engender much in terms of running your own business – you become used to having things done for you.

"So many do not have the skill set to start their own business – they haven't been trained that way. But you do find there are some individuals – a minority – who still have that spark and nous."

Thomas Miller Specialty marine and energy business goes live

Thomas Miller Specialty has begun binding business in its recently formed offshore marine and energy division, *writes Rebecca Hancock*.

The division at the managing general agency (MGA) is being led by former Dual executive Bernt Hellman and is the latest addition to the MGA's growing product range of marine, space, cyber and corporate kidnap and ransom.

Speaking to *Insurance Day* Guy Pierpoint, chief executive of marine at Thomas Miller Specialty, said despite the prevailing challenging conditions in the marine and energy sector, the company intends to carve itself a position in the market by focusing on strong service.

Pierpoint said to differentiate itself from other players in a market marred by overcapacity and abundant capital, Thomas Miller Specialty would focus not only on highly specialised lines but also claims services, which he called "the cornerstone" of the MGA's offering.

"We don't consider ourselves your average MGA," he added.

With the continued entrance of new players to the marine insurance market, coupled with established players bolstering their positions, Hellman said the key to winning business was to target specific areas.

"There's no point in underwriting the same as existing carriers – you have to go specific. You can only add value to your client when the product you offer is specific," he said.

This can mean bringing together existing products "that work for the client and meets their needs", Pierpoint said.

Insurance Day reported in December Talanx subsidiary HDI is to be the exclusive capital provider for the offshore marine and energy business.